

**Alcon, Inc.**  
**Q3 2021 Results - Earnings Call**  
**November 9, 2021**

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**Presenters**

**David Endicott – Chief Executive Officer**

**Tim Stonesifer – Chief Financial Officer**

**Karen King – Senior Vice President, Head of Global Corporate Affairs and IR**

**Q&A Participants**

**Ryan Zimmerman – BTIG**

**Julien Dormois – BNP Paribas**

**Scott Bardo – Berenberg**

**Veronika Dubajova – Goldman Sachs**

**Larry Biegelsen – Wells Fargo**

**Daniel Vouchda – ZKV**

**Cecilia Furlong – Morgan Stanley**

**Jeffrey Johnson – Baird**

**Operator**

Greetings, welcome to Alcon's Third Quarter 2021 earnings call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation.

If anyone should require operator assistance during the conference, please press “\*”, “0” on your telephone keypad. Please note this conference is being recorded.

I will now turn the conference over to your host, Karen King, Senior Vice President, Head of Global Corporate Affairs and IR. You may begin.

**Karen King**

Welcome to Alcon's Third Quarter 2021, earnings conference call. Yesterday, we issued a press release and interim financial report and posted a supplemental slide presentation on our website to enhance today's call. You can find all of these documents in the Investor Relations section of our website at [Investor.Alcon.com](http://Investor.Alcon.com).

Joining me on today's call are David Endicott, our Chief Executive Officer, and Tim Stonesifer, our Chief Financial Officer.

Our press release, presentation and discussion will include forward-looking statements. We expressly disclaim any obligation to update forward-looking statements, as a result of new information or future developments, except as required by law.

Our actual results may vary, materially, from those expressed or implied in our forward-looking statements. Accordingly, you should not place undue reliance on any forward-looking statements.

Important factors that could cause our actual results to differ, materially, from those in our forward-looking statements are included in Alcon's Form 20-F and our earnings press release and interim financial report, on file with the Securities and Exchange Commission and available on the SEC's website at [sec.gov](http://sec.gov).

Non-IFRS financial measures used by the company may be calculated differently from and therefore, may not be comparable to similarly titled measures used in other companies. These non IFRS financial measures should be considered along with, but not as alternatives to, the operating performance measures, as prescribed for IFRS.

Please see our reconciliation between our non-IFRS measures with directly comparable measures presented in accordance with IFRS in our third quarter earnings presentation, which can be found on the Investor Relations website.

As a reminder, for discussion purposes, we are providing comparisons of 2021 versus 2019, unless otherwise noted, as we believe this is more operationally meaningful, since our results were impacted by the pandemic in 2020. We will continue this practice through the end of the year.

You will find a summary of results comparing 2021, 2020, and 2019 in our slide presentation, and a comparison of 2021 versus 2020 in our press release and interim financials.

As usual, our comments on growth are expressed in constant currency. And with that, I'll now turn the call over to David.

**David Endicott**

Welcome to Alcon's third quarter 2021, earnings call. I'll begin by providing a brief update on our third quarter, overall market dynamics, and our new innovative products. After my comments, Tim will discuss our third quarter performance and our outlook for the full year. Then I will wrap up with some closing remarks and we'll open it up for our Q&A.

And we're pleased to announce we had another strong quarter, despite markets that are still recovering.

Similar to the second quarter, this was driven, primarily, by demand for new product innovation, solid commercial execution, and strong market recovery in the United States.

Recovery in our international markets remains mixed, although we're encouraged to see signs of recovery in select European markets late in the quarter. Other countries like Japan, which is our second largest market, continue to be impacted by the pandemic.

Third quarter sales of \$2.1 billion were up 13 % versus 2019, with increases across all sales categories in Surgical and Vision Care. Core operating margin was 17.7% and core diluted earnings per share was \$0.54.

Customer interest and need for our new products are driving above-market growth. And in surgical, our portfolio of advanced technology intraocular lenses is driving increased penetration rates of AT-IOLs, and we continue to see strong demand for cataract refractive equipment.

In Vision Care, our new contact lenses are winning in the market and our sustained brand family is posting strong double-digit growth in all regions.

Now moving to our end markets by franchise.

In Surgical, the global cataract surgery market was relatively consistent with last quarter. Excluding India, the global market was down mid-single digits versus 2019.

While the U.S. showed solid mid-single digit growth over 2019, the international markets remained down high-single digits, primarily due to emerging markets in Japan, which continue to be suppressed. Against this backdrop, our Implantables business continued to outpace the market driven by our strong AT-IOL performance.

In Vision Care, the contact lens market was flat to slightly up versus the third quarter of 2019.

Similar to Surgical, the U.S. market has returned to growth, while international markets are approaching 2019 levels. Our contact lens business grew significantly faster than the market, driven by the strong performance of PRECISION1.

Now moving to innovation in Surgical, we maintained our strong market share in PC-IOL, solidifying our position as the market leader.

This is driven by strong demand for our new innovative products, PanOptix and Vivity, despite new market entrants. We continue to see AT-IOL penetration rates increasing, sequentially, as existing surgeons increase their use of advanced technologies and as surgeons who traditionally preferred Monofocals and Torics, are now implanting Vivity.

Vivity is the first and only PC-IOL with wave front-shaping technology and a clinically proven exceptionally low rate of visual disturbances. Surgeons appreciate the consistency of patient outcome, without the worry of halos and glare.

In our equipment business, our products and innovations remain a favorite of surgeons; including our market-leading phaco equipment are ACTIVE SENTRY hand-piece, the LuxOr Revalia Microscope, and the ARGOS Biometer.

Earlier this week, we unveiled the latest evolution of cataract connectivity with Smart Cataract. Designed specifically for ophthalmology, this new cloud-based application delivers planning, connectivity, and analysis to improve cataract surgery efficiency, reliability, and accuracy.

This is the next step in the evolution of our equipment ecosystem and further enhances the value of our new innovations.

Installations of our first application, SMART Cataract, are under way with select customers in the United States.

In Vision Care, we're expanding our contact lens offerings to the premium and middle market segments by launching a steady stream of new Silicone Hydrogel daily and reusable products. In the premium segment, we're building out our total brand with a complete portfolio of design options.

In addition to our existing DAILIES TOTAL1 sphere and multi-focal lenses, we're now adding DAILIES TOTAL1 for astigmatism to capture the premium Toric market. And also TOTAL30, to capture the premium reusable market. DAILIES TOTAL1 for astigmatism has been eagerly anticipated by eye care professionals for years.

This lens provides a significant opportunity in a fast-growing segment where only one in four astigmatic patients are wearing Toric lenses.

Select customers in the U.S. are already fitting the lens, early feedback has been very positive, and we're excited for the broader commercial launch early next year.

The TOTAL30 addresses the large \$4 billion reusable market, which hasn't seen any significant innovation in years. TOTAL30 is now available to wearers in the U.S. and Europe, and early reception has been strong.

This lens brings the water gradient feature of DAILIES TOTAL1 into a monthly lens, creating a comfortable lens, which feels like nothing on day one and on day 30.

Now moving to the middle market segment, the strong performance of PRECISION1 and PRECISION1 for astigmatism continues to drive our above-market growth in the total DAILIES market.

Both the sphere and Toric designs are currently available in the U.S. and Europe, and PRECISION1 sphere is available in Japan. As more international markets recover, we believe we are well-positioned to drive steady growth with PRECISION1.

Finally, at Ocular Health, we're building out our eye-drop portfolio. Sustained sales continue to grow globally, reinforcing our leadership in artificial tears.

If you recall, about 25 % of the fast-growing U.S. market for artificial tears is the preservative-free category, compared to over 50 % in some international markets. Our multi-dose preservative-free formulations of SYSTANE Ultra and Hydration are now available in Europe and the U.S., where we're seeing a favorable customer response.

We also continue to see strong demand for Pataday Family of Allergy products, which has been aided by our recent launch of Pataday Extra Strength, earlier this year. And finally, this is the first full quarter where we've added Simbrinza to our growing portfolio of eyedrops.

Now, before I pass the call to Tim, I wanted to touch on our recent announcement regarding our intention to acquire Ivantis.

We're very excited for the opportunity to expand our glaucoma portfolio in this large \$500 million market, growing in the low to mid-teens. Glaucoma is the second largest cause of blindness after cataracts and impacts more than 75 million people globally.

Ivantis' flagship product is the Hydrus MicroStent, a minimally Invasive glaucoma surgery device. Importantly, the Hydrus is unique as the only MIGS device with safety and efficacy data out to five years.

The 5-year horizon clinical study of Hydrus is the longest continuous follow-up of a MIGS device. It demonstrated that 65 % of Hydrus patients remained medication-free at five years. Hydrus has a combination cataract indication in the U.S., which means the device is implanted during cataract surgery, and both combo cataract and standalone indications in five international markets.

And we intend to leverage our global commercial footprint and our development capabilities to create even greater value for existing and future Ivantis products. In a few minutes, Tim will walk you through some of the financial aspects of that deal.

Our third quarter performance demonstrates the resilience of our business, the strength of our innovation engine, and the expertise of our commercial organization.

We are executing on our new product launches and growing faster than the markets around the world, even as they continue to recover. For surgical, we're expanding our leadership and equipment by developing an equipment ecosystem to improve efficiency and accuracy, while we're expanding our implantables business in surgical glaucoma.

And for Vision Care, we're using our water gradient technology to create differentiated new Silicone Hydrogel contact lenses for both, daily and monthly use.

And with that, let me pass it to Tim, who will take you through our financial results.

**Tim Stonesifer**

Thanks, David. We're pleased to report third quarter sales of \$2.1 billion. Up 13 % versus 2019, driven by 14 % growth in Surgical and 12 % growth in Vision Care. Year-to-date sales were up 10% versus the first nine months of 2019, with Surgical up 12 % and Vision Care up 9 %.

Implantable sales were \$375 million in the third quarter, an increase of 32 % versus 2019.

As David mentioned, we remain market leaders with our PC-IOL portfolio, and we continue to see adoption, driving encouraging penetration rates above historical levels. On a year-to-date basis, implantable sales were up 28 % versus the first 9nine months of 2019.

Consumable sales of \$594 million in the third quarter increased by 3 % versus 2019, with sales growth across all 3 categories of Cataract, VITREC, and Refractive.

On a year-to-date basis, consumable sales were up 1 % versus the first nine months of 2019.

Equipment and other sales were a \$192 million in the quarter, up 20 % versus 2019. About 8 points of the growth was due to the refractive sales with continued demand for LASIK procedures. The remaining growth was primarily due to strong demand in cataract and new equipment.

On a year-to-date basis, equipment and other sales were up 21 % versus the first nine months of 2019.

Now turning to Vision Care, third quarter sales of \$923 million grew 12 % versus 2019. Contact lens sales were \$562 million in the quarter, up 7 % versus 2019. This was driven by strong demand for PRECISION1 and PRECISION1 for astigmatism, as well as continued growth from DAILIES TOTAL1.

As David mentioned, we're also rolling out TOTAL30 in the United States and Europe, where customer feedback has been extremely favorable. Based on the strong performance of our contact lens portfolio, we continue to add new manufacturing lines and assess the need for additional capacity to support product flow of our new products, especially, PRECISION1 for astigmatism.

On a year-to-date basis, contact lens sales were up 5 % versus the first nine months of 2019.

Now, moving to Ocular Health, where sales of \$361 million in the quarter increased by 20 % versus 2019. About a half of the growth is attributed to SYSTANE, which grew double digits in all regions, underpinned by a growing artificial tear market.

This was aided by our new Multi-Dose Preservative-Free launches in Europe and the U.S. The other half of the growth is primarily due to new additions to our portfolio, including Pataday and Simbrinza, which had no comparable sales in 2019.

On a year-to-date basis, our Ocular Health sales were up 16 % versus the first nine months of 2019.

Now moving down the income statement, third quarter core gross margin was 63.7%, broadly in line with 2019. We continue to see inflationary headwinds related to raw materials, freight, and labor, despite our best efforts to mitigate these pressures through active management of supply and selective price increases.

Core operating margin was 17.7% in the quarter, driven by operating leverage is higher sales outpaced increases in SG&A. As we mentioned on our last call, we do expect to see incremental margin pressure in Q4, primarily due to product mix and timing of spend as we continue to invest in our commercial activities and sales force, as markets recover.

Third quarter interest expense was \$31 million, down from \$35 million in 2019.



While we've taken on incremental debt, we've benefited from lower variable interest rates and lower debt in affiliates.

The core effective tax rate was 17.5% in the quarter, compared to 18.2% in the third quarter of 2019. The current rate benefited from a buildup of inventory in certain international markets that had a favorable product mix and a favorable mix of pre-tax income and loss, across tax jurisdictions. For the first nine months of the year, the core effective tax rate was 19.1%.

Core diluted earnings per share in the third quarter of 2021 were \$0.54, up \$0.08 versus the third quarter of 2019, driven primarily by operating leverage.

Next, I'll touch on a couple of cash flow and balance sheet items. Free cash flow, year-to-date, was \$578 million, compared to \$260 million for the same period in 2019.

Higher core operating income and lower separation spend were partially offset by increases in capital expenditures and inventory to support new product launches and expected upcoming demand.

CapEx was \$380 million for the first nine months of the year, with the increase driven by our contact lens manufacturing expansion.

As a reminder, historically, CapEx spend has been heavily weighted in the fourth quarter, and we expect that trend to continue, this year.

Transformation costs were \$14 million for the third quarter and a \$141 million, life-to-date.

Turning now to business development. As David mentioned, we announced our intention to acquire Ivantis for \$475 million in cash, plus potential future payments contingent upon the achievement of certain development and commercial milestones.

Ivantis offers attractive sales, and earnings growth potential in a fast-growing category, where we currently do not participate. We estimate Ivantis will have sales of approximately \$60 million for the full year 2021.

In 2022, we estimate that Ivantis will be broadly neutral to core operating income with some pressure on the core operating margin rate. We expect the acquisition to be accretive to core operating income in 2023.

We anticipate to close the transaction in the first quarter of next year, subject to customary closing conditions, including regulatory review.

As we discussed earlier in the call, we continue to see broader macroeconomic burdens, such as inflation and tightness in the supply chain.

We have been, proactively, working to manage these challenges. But we've seen pressure, to date, and expect that to continue, going forward.

In addition, the U.S. dollar has appreciated, significantly, since the first half of the year. If the U.S. dollar remains at current rates, we would expect to see FX headwinds in 2022, as compared to 2021. Despite that backdrop and based on the strong performance year-to-date, we expect to come in around the higher-end of our 2021 guidance.

This outlook continues to assume that global markets return to 2019 levels, by the end of the year, U.S. markets continue to grow above 2019 for the remainder of the year and on an aggregated basis, international markets reach 2019 levels early next year, with emerging markets and countries like Japan remaining subdued.

Now, I will turn it back to David for some closing remarks.

**David Endicott**

Thanks, Tim. To briefly wrap up, we're pleased with the strong results we saw this quarter with sales up in every category, exemplifying the resilience of our business, the strength of our innovation engine, and the expertise of our commercial organization. Our new product launches are gaining momentum and taking share as markets around the world will continue to recover.

We're pleased to be expanding our surgical portfolio both through our smart solution ecosystem and through our intended acquisition of Ivantis. And in Vision Care, a robust pipeline of innovative products are bringing new options for doctors and patients in contact lenses, dry eye, allergy, and glaucoma drops.

We're pleased with our ability to deliver growth and outpace the market, and we are well-positioned to capture an outsized benefit, as the global markets recover, delivering long-term value to our shareholders.

And with that, let's open up the line for Q&A.

**Operator**

Thank you. At this time, we will be conducting a question-and-answer session. If you would like to ask a question, please press “\*”, “1” on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press “\*”, “2” if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset, before pressing the star keys.

One moment, please while we pull for questions. And our first question comes from the line of Brian Zimmerman with BTIG. Please proceed with your questions.

**Ryan Zimmerman**

Great. Thank you for taking the questions and congrats on the quarter. Tim and Dave, when I think about your markets, last year, in the height of COVID, ophthalmic markets really took a pause. And yet, now they're proving far more resilient. And so, I'm wondering if you could just speak to that dynamic as to why that is.

And we've heard from many of your peers about staffing challenges into next year. Are you anticipating that or not, particularly in the U.S. market where, again, it sounding to be--it's proving to be more resilient? I'd love to hear some comments on that.

**David Endicott**

Yeah, Ryan, we have seen a lot of strength in the markets, and I think it probably speaks to the underlying fundamentals-the core.

You kind of think about getting through this, not everybody--I think we weren't a 100 % sure how it was going to happen. First of all, as you recall, we were a little bit off on the early guidance, but I think what we really believe is that these cataracts aren't going away and that they are coming back.

But we know, again, even through this point in time, I think if you look and then we've used 2019 as comparative, so that you can kind have divided by two and see if it's still there. And I think through couple of years, we still think the market is not yet back to full growth.

So, I think in the U.S. it was 4 % procedures, over 2019. So if you do that by two, you're still not quite what the normal growth would be.

We would have expected normal growth to have been about 3 %. So yeah, it's been solid coming back. And again, although it paused last year, a lot of the underlying things in Vision Care, for example, were better than we expected.

So I think Vision Care, we don't see necessarily, for example, the visits back to where we'd like to see them, but we are seeing revenue come back, and that seems to be a phenomenon of some renewal remotely for prescriptions, and also larger purchase, per patient.

So, we're seeing some of that happen, as well. So I think there has been some unique circumstances, but I think, more importantly, the underlying fundamentals on eye care lead you to believe that these are relatively resilient markets.

And so, I do think they are going to--as we said, come back, largely, by the first part of next year all in. We think this year, the U.S. is growing now, as I said, but international is going to take a while. It's going to take a little longer, and some markets may drag into the middle part of the year.

But I think in aggregate, international should be back sometime early, next. So, we'll get there, but I think it's likely to be a slow steady climb from here. Maybe slightly above historical numbers, as opposed to any kind of quick bounce back that looks a little bit more steep.

I think it's much more likely to be a gradual climb that's just slightly warmer than historical growth rates.

**Ryan Zimmerman**

Okay.

**David Endicott**

On staffing, yeah, I'm sorry, thanks. On staffing, yeah, we still see that. I will tell you that staffing in optometry, in particular, I think is difficult, right now. The surgical centers, I think, are generally pretty good, but it is difficult for them to kind of go way beyond what they were doing and I think this is kind of--early on, we had hoped that there would be a steeper bounce back, perhaps.

I don't really see that, partly because, frankly, it's hard to get more through put out of the current capacity that we have and there are staffing issues in Vision Care similarly, I think if you were seeing 20 patients a week, or sorry--20 patients a day in '19, you're probably seeing 16 or so, right now.

And it is tough without additional staff to get back up to that 20. So, again, I think that will climb slowly, but I think over the long haul, you're going to see that these markets are kind of roughly returning as we would expect, next year, and kind of back to kind of historical growth rates.

**Ryan Zimmerman**

Okay. And then just on cataract, obviously, there's been some product introductions in the market, competitively. And so, what are your expectations for when you could or could not see that impacted? It seems like your PanOptix and Vivity are doing well despite that, those introductions.

And so, I would imagine, though, that you're baking in some expectation, there. If you can speak to that a little bit, I'd appreciate it.

**David Endicott**

Sure.

**Ryan Zimmerman**

Thank you for taking my question.

**David Endicott**

Yeah--no, look--we've seen this market--products in the market around the world, for a while. So really, the only new market here is the U.S. And I think we expected to--we had a very high share up in the 80s. Certainly, that's going to come down. It's

just a matter of is it more or less than we planned? And I think, we're seeing pretty much what we expected.

I think people will try the lens. It's a good product, but I think they're going to find that, particularly Vivity, has no halos and glare really to speak of. And I think it's very similar to a monofocal, when you really cut all through it, but it's giving you intermediate and near vision.

So, this lens has turned out to be a much better alternative for a lot of folks, than trying some of the newer lenses, I think, that have a lot more of the visual disturbances.

So, I think somewhere between PanOptix, if you really want near vision, 100 % pretty much guaranteed near vision, that's going to be a PanOptix patient. But you can get a lot out of this Vivity product, and we are seeing a lot of benefit from that.

And remember that again, even with the share dynamic, what we're really trying to do now is move more to the penetration side of this thing. And so, we've been talking a lot about how do we get more people involved in AT-IOLs? How do we get more patients through the end of these practices?

And I think that will be the dynamic that's probably more important, over the long haul. As I think we said in the past, as you know, there's probably, for every 100 basis points of penetration, we can pick up a \$100 million.

So, we're very interested in, right now, the penetration rates because our shares are pretty solid. And I feel really good about the competitiveness of our current position.

**Ryan Zimmerman**

Thank you.

**Operator**

And our next question comes from the line of Julien Dormois with BNP Paribas. Please proceed with your question.

**Julien Dormois**

Yeah, hi. Good morning, Dave, and team, thanks for taking my questions. I have two. The first one relates to Vision Care, and most precisely, the launch of TOTAL30. If I'm right, you currently have a share in the mid-teens in that category of premium reusable.

How do you think what's the reasonable share objective that you have for this specific segment, and how long do you think it could take to get you there?

And my second question is on Surgical, and I know you have already had the question on other calls, but I've just been very puzzled by the very different growth patterns that we still see between consumables on the one hand, and implantable and equipment on the other hand.

And that obviously, compares to 2019. So, is it just a function of implantable and equipment growing above their historical trends, or do you still expect to see a catch-up effect at some point in consumables, for example, in 2022?

**David Endicott**

Sure, Julien. Let me start with the first one, we're very excited about T30. I mean, TOTAL30 is a unique product that I think adds water gradient to a material that is durable for 30 days. And so, you're getting the two best elements of what we want, which is durable material that will last 30 days.

And yet at the same time, feels like nearly nothing on day one and actually out at day 30, very similar to the first day you had it in your eyes. So that's a big change from what the kind of products that are available, right now. And we're excited about the reception we see to that, right now.

So, I think that, notwithstanding, the beautiful thing about the contact lens market is it takes a while to move share.

And so, on the one hand, you'd like to see it--the aggressive part of this is you'd like to see it run up. But what you're really doing is turning a small part of the market, every year.

So remember, if you're happy in your lenses, you're likely to stay in your lenses, and that's probably 70 % of the patients walking through the door. They're going to end up basically in the lens they walked in with.

If you're unhappy or you're having a trouble or it's not as comfortable, that's a switch or a new patient, and you need to think about those as really about a third or less of the total market that churns.

And so, that's the available opportunity, every year, to move some share. And so, that takes several years. And medications, DT1, for example, we've had out nearly 10 years. It's still growing share. And we will see a long rise of these products.

They're not super steep, they're relatively stable when you get them on a share trajectory, they tend to grow every year a little bit. And that's really the outlook. In a lot of ways, that's a very helpful financial trajectory because you've got a pretty good pattern. And it's got long-term sustainable growth. So, we're excited about what it could be.

Again, I wouldn't forecast a share objective, per se, for this product right now, but we're excited about what we see, early days.

On the Surgical side, there isn't really--the way to think about implantables and equipment are different, but you start with the market growth. And again, historically, the market growth in procedures, you can pretty much approximate with unit growth in implantables. And again, typically, it's been kind of in that three--somewhere between three and four, globally.

It's been hotter than that occasionally, but somewhere in there is usually the procedural growth. The unit for implantables is going to grow very close to that procedure rate, because of course, one surgery usually means one implantable.

Consumables, similarly, should grow roughly, in other words, one pack or one unit of used idea will come along with that same surgical piece.

What you're seeing in implantables is a trade-up in volume or value. So you're trading a unit that was a dollar or it was \$1.00, was in essence, \$100, let's just say for a monofocal, now trading at \$600 to \$800 to \$900 in some places. And that's what's driving the value difference between those numbers.



Equipment is slightly different. Equipment has just been unusually robust, and we would normally say that equipment should run just slightly in advance of procedural growth.

So, if you figure the market has enough equipment to service the equipment, there's some changeover, every year.

So, that's usually, let's call it somewhere between 10% and 20 % of the market should be retiring equipment and buying new equipment. And then you've basically got growth on the market that is procedural growth.

And so, that is how we think about that growth. It's usually again, typically slightly warmer than the procedural growth, depending on the price of the equipment, and then if you're upgrading on a price, then again, the value grows a little bit faster.

So, that's probably the way to think about it. But I don't think there's a ton of catch-up here for consumables because whatever procedures grow, I think is where you're going to see the consumables rate grow, generally. And so, that's kind of where we are.

And part of the difference you're seeing, is some of our markets is that weak index more heavily to markets that, right now, have recovered versus the global markets. In many cases, we exclude India because it really hasn't recovered, is a monster number of procedures, but we're not benefiting from those, right now.

### **Julien Dormois**

Helpful. Thank you very much.

### **Operator**

Our next question comes from the line of Scott Bardo with Berenberg. Please proceed with your question.

### **Scott Bardo**

Yeah, thanks, guys, for taking the question, so two questions. I'll start with the first, please. Just on guidance. The obvious question would be, why didn't you include any comments on guidance in your release? I think that confused quite a bit of the capital markets this morning, and I thought that we've seen it before.

I appreciate, Tim, also you highlighting comments about inflation and logistic cost, and so forth. What I'm trying to understand is, are they significant enough to drive the 16% margin in Q4 implied by your guidance? And do you still hold your 20% margin, by 2023, despite this acquisition? That's the first question. Thanks.

**Tim Stonesifer**

There are a few questions in that question. To be honest with you, I was a little surprised with the reaction to the no guidance in the press release. Our philosophy has typically been that we don't update the guidance, unless there's a change to the guidance. Obviously, we've provided a little bit more color on the script that we think will be at the high-end of the guidance.

But there were--there were no changes, overall. From a 16% perspective, there are a couple of things in there. I mean, Q4, historically, from a seasonality perspective, is typically lower than Q3. That's primarily driven by Vision Care and a couple of other elements. We also had, as we mentioned, some timing of spend.

So, we've got some spend that we thought we would spend in Q3, that has now shifted to Q4. So, I think, as you think about how material are things going to be, as you project out into 2020, I would just provide the following color. I think first of all, I would take the high end of our guide.

So, as an example, if you start with revenue, take the \$8.2 billion. And then we've said in the past that we're going to grow mid-single digits. I would just take into account that we have a lot of momentum exiting 2021, from a revenue perspective. So, if you think about implantables, to David's earlier comments, really strong performance in Vivity, we're going to continue to launch that in new geographies, next year. So, that momentum will continue.

If you look at contact lenses as an example, we have a lot of momentum in P1. We've got two new lenses coming out, P30 DT1 for astigmatism.

So, again, I would expect to see more growth there, and then Dry Eye, we're very well-positioned with our SYSTANE family. So, I would take that into account from a revenue perspective--the one caveat I would add is the comment around equipment.

I don't think equipment is going to run as hot, next year, as it did this year. Because I don't think refractive stays at those levels. So, but nonetheless, that's how I think about--how I think about revenue, now.

When you go to gross margin in my inflation comments, I do expect to see some gross margin pressure, year-over-year, next year.

We, like everybody else, we continue to see pressure in raw materials if you think about resins, if you think about electronic chips, that continues. I think freight pressures continue, labor wages are continued to be pressured.

So, we would expect to see some gross margin pressure, next year, year-over-year. If you think about R&D, just to keep going through the P&L, we said 7% to 9%. We've been running at the high end of that range.

I think next year now that we've, I don't want to say caught up, but just given the profile of our innovation pipeline, I would expect that to be more at the midpoint of that 7% to 9%. And then SG&A, as we've continued to say, I would expect to continue to get some nice operating leverage.

### **Tim Stonesifer**

I mean, if you look particularly on, if you look at the G&A side of the house, I mean, there are going to be modest increases in that, given all the transformation work we've done and then, obviously, we'll invest behind the markets that are growing. So, that's how I would key it up.

And then the only thing I would say, on top of that, is looking at FX. If you just look at the rates as of last Friday and compare that to take the average rates for September year-to-date, I mean, all the currencies are moving, and you've got--the dollar has shrunk couple of percent versus the euro. It's roughly 2% or 3% versus the pound, it's 4% versus the yen.

So, assuming rates stay at those levels, we would expect to see that type of pressure going forward into 2022. And as far as 2023, we feel very comfortable with the guidance that we gave a Capital Markets Day in reaching the commitments in both '23 and '25.

### **Scott Bardo**

That's a very comprehensive answer. Thank you. And maybe if I can just sneak in a quick one. David, I'd love to hear your thoughts about Ivantis in the acquisition, here. I'm just curious to understand why you decided to buy this business when you could have, arguably, acquired the market-leader with four times the revenue. Just share with us what it is about this business that particularly appeals.

**David Endicott**

Well, look, I mean, this is--one of the things we've thought a lot about is--because we've been in this space a number of times, is where is the market need. And I think this particular product, I mean, the Ivantis folks have done a terrific job with the data that they've created, with the safety of this product and importantly, this is a uniquely effective product.

And we've always thought--I've always thought that the space that needs to get filled here is something that is effective, over a long haul. And when you think about the data that they're showing, which is 65 % of patients medication free at five years. This has got a demonstrable efficacy that we think is very powerful.

And I think if we put our muscle behind that, put some more data behind that, given that the commercial footprint that we have, we think that this has got a lot of runway. And so, I think the opportunity here is per dollar paid, if you will. I think there's just a better value.

**Scott Bardo**

Okay. Thank you.

**Operator**

Our next question comes from the line of Veronika Dubajova from Goldman Sachs. Please proceed with your question.

**Veronika Dubajova**

Good morning, guys. And thanks for taking my questions-two, please. One, just on the IOL or PC-IOL momentum. David, I was hoping you could talk about to what extent the growth that we saw in the quarter is being driven by Vivity versus PanOptix?

And maybe just give us a little bit of flavor for the type of market share that you've seen with Vivity in Europe and kind of how--how you think that informs your views, going forward.

And if I can sort of interpret your comments on continued higher penetration and uptake of IOLs--I think I ask you this question every quarter--but just your degree of confidence that that continues as we move into next year--has it increased or decreased? And then my second question is a bit of a financial one for Tim.

Tim, just thinking about the bridge from the '21 margin to the 2023 margin, and would love to get your thoughts to what extent do you think that margin progression is '22 versus 2023 weighted? Is this an even keel or should we be thinking about some element of phasing, especially, in the context of the Ivantis deal, as well? Thanks.

**David Endicott**

Hey, Veronika. Good to hear from you. Listen, on the PC-IOLs, look, the Vivity product on a growth rate basis is growing really well and, obviously, it's growing faster than PanOptix because it's wrapping around on a really tiny number. PanOptix is still growing, nicely--to be fair, double-digits.

But I think what we're seeing really is what we said before, which was you're going to see as PanOptix peaks and comes over and starts wrapping around on all the launches that it's had, that it settles down and then Vivity becomes really that next booster, if you will, for us. So, we're excited about what we see with Vivity.

We're excited about the utility that we see with Vivity. There's a lot of surgeons doing a lot of--kind of important things, I think, and able to treat patients without this halo and glare that is bringing patients, for example, from a monofocal Toric to a multi-focal Toric, and that's a big move, right?

Because if we can upgrade our Toric business to multi-focal Toric, really pretty risk-free, I think that's a really nice opportunity. That seems to be a big part of the Vivity growth for us, right now.

But I would say that our share growth in, around the world, has been mostly, at this point, is being driven mostly by Vivity. PanOptix, pretty stable slight growth. There are several markets yet to launch Vivity.

So again, I think what we saw in PanOptix for about 12, 18 months is what we'll probably see with Vivity for about 12 or 18 months, which is, as it wraps around on its prior year, we'll get steady launches, around the world.

We still got to get it into Japan—we've still got China to go, and we got a couple other markets. We haven't got the Toric out yet in a couple of markets. So we're--we've got more, I think, share to have--to be had, but my point on penetration has been, look, there's going to be competitors to us. We've got a very high share right now, so, we don't expect that that's the main driver of growth, going forward.

So, your second question makes tons of sense, which is we are excited about what we see, right now. With Vivity in particular, we think there is some additional patients coming into the PC-IOL business, and that's a little bit what I said before with monofocal and monofocal Torics converting into patients now that are interested in doing this because of the lack of halos and glare, or at least, the very similar profile it has to a monofocal. I think that's really what it is.

Now, the confidence I have around it is a little bit tough because I feel good about that it's definitely, driving greater penetration, right now. But I would be careful with it because, again, right now, the penetration rate has a denominator that lacks a lot of monofocals in it.

So, if you look around the world, we're still recovering, internationally, in particular. So, there's millions of procedures that were not done.

Let's just pick India, Brazil, Russia, a bunch of other kind of developing countries, where when you add back all of those units to the denominator, I think the current penetration rate, which is pretty high, would probably come down a little bit. So I--we're waiting to see the market stabilize.

But I think what's fair to say, because we see it with individual surgeons is, year on prior-year, inside of Individual surgeons markets, we see their, their individual penetration is growing, and we know we're not losing surgeons that direction. So, I think we feel confident that it's growing.

The durability of it, we'll have to see, and the size of it again, I think, is still jury is still out on. But again, we're of the mind that this is the right thing to be thinking about and tracking.

**Tim Stonesifer**

Hey, Veronika. And on the margin profile, I'd say our story is still the same. It's--that margin improvement is really roughly 80% driven by operating leverage and call it 20 % driven by gross margin improvement. So, I think, from an operating leverage perspective, it should be relatively linear because again, revenue is really going to drive that improvement.

So, as we continue to grow at mid-single digits and keep our cost base at inflationary-type levels, that should go over--that should move in sort of a linear perspective.

On the gross margin perspective, I think the view is there's probably been a little bit more improvement in '23, as compared to '22. And that's really driven by two things. I'm not sure how long this inflationary pressure is going to last. I'm not sure we'll see as much pressure in '23 as '22 or '21.

We'll have more time, obviously, to put in mitigating actions and what have you see how the market responds. And then, you have less pressure on the P1 line installations in '23, as compared to '22 and '21. So, that's how I would see that progression.

And then as far as Ivantis, if you recall, Capital Markets Day, the guidance we gave did not include any acquisition, so, we feel very good about the '23 and '25 commitments. Ivantis isn't really material enough to impact those, when you think about the longer-term, anyway.

**Veronika Dubajova**

Fabulous. Thank you, guys.

**Operator**

Our next question comes from the line of Larry Biegelsen with Wells Fargo. Please proceed with your question.

**Larry Biegelsen**

Good morning. Thanks for taking the question. So, David, just one on Ivantis. Do you, guys--it sounds like you guys think you can grow the product from here, from the \$60 million, despite the reimbursement change. Can you grow that product in 2022, and beyond?

And any color on the U.S., OUS breakdown of sales? And Tim, could you just help us quantify the FX headwind, the Ivantis headwind and inflation in 2022? Thanks for taking the questions.

**David Endicott**

Yeah, Larry, on the Ivantis, yeah. We believe we can grow the product, long term. I think, it's--we were very--we were very aware of a number of situations that we wanted to see resolved, before we got into an acquisitive mode with Ivantis. The CMS ruling was one of them, and as you know, that settled, out last week.

It was very improved from the very difficult price they gave us at the beginning. But again, it is going to have some downward effect on what it was, I think, a low-to-mid-teens growth rate on the market.

That said, again, we think the market continues to grow, and we think this product, in particular, can gain share.

So, as we see it, the market is a fast-growing market where, with the right amount of energy on this product and the right amount of messaging and, frankly, the great amount of data that the team at Ivantis has pulled together for us, we're excited about what we can do with it. And we'll see how that adds into. And you know, this is right in our wheelhouse, right?

I mean, we're in surgery every day with these surgeons doing this procedure. This is--it's an easy and important kind of add to our service to the surgeons.

And on the OUS U.S. sales, the way to think about it, it's predominantly U.S. sales, right now. There's not a significant amount of OUS, right now. We look forward to try to change that.

But we'll work principally on reimbursement first, before we get very far out, getting a bunch a sales folks out there. We're going to work through that. And again, I think



they are in five countries, right now. As you know, we're thinking about a lot of other markets than that.

**Tim Stonesifer**

Yeah. And as far as, some of quantifications, Larry, I'll start with F., I rattled off some of the currencies that have been increasing. If you were to take the entire bucket or the currencies that really matter, it could be two or three points. And, but again, that's as of rates, as of last week, and we're just going to continue to monitor those, as we progress through and before we give guidance, next year.

On the inflation front is--I'm a little bit hesitant to say because again, we have--we have pricing actions out there. We have our manufacturing guys driving a bunch of productivity initiatives that we're still shaping up. So, that's one we're going to continue to monitor. I would expect to see some pressure, but we'll give you some more color when we give our guide, next year.

And as far as Ivantis, it'll put some slight margin rate pressure. I mean, I would think, about take the \$60 million in sales and grow that at whatever you think as appropriate, next year. And there won't be a lot of core operating income with that. So, that will give you some rate pressure.

**Larry Biegelsen**

Thank you, guys.

**Operator**

Our next question comes from the line of Daniel Vouchda (PH) with ZKV. Please proceed with your question.

**Daniel Vouchda**

Thank you so much, gentlemen, for taking my two questions. The first one maybe on the Vision Care margin and then it was pretty nice to see that Vision Care had a relatively good margin in the Q3. Obviously, we are all aware of the capacity additions you have on the drafting a closing on operating margins, here. But can we really see Q3 like the turning point, here?

So that going into 2022, Vision Care should really--should turn the tide and show rising margins?

And then the second question on the one-offs. You had this one in the amount of \$178 million, and can you clarify a little bit more what this was related to? And also you have \$50 million legal expenses; what does that cover and what are the risks, here? Could there be bigger burdens to come still on the legal side? Thank you very much.

**Tim Stonesifer**

Sure. Thanks for the question, Danny. As far as Vision Care margins, we were pleased with Q3. We continue to make progress. I would caveat that though that Q3 is impacted, by seasonality.

So, we had a very strong revenue performance, and some of that is driven by--if you think about allergies, allergy season as an example, we have a heavier revenue mix in Q3, as compared to Q4.

If you look at the back-to-school programs that we run, particularly in the U.S., that gives you a stronger Q3, as compared to Q4. So, operating leverage is driving a significant amount of that improvement. But nonetheless, we're very pleased with how the Vision Care business is performing. From an impairment perspective, yes, we did impair. We had a surgical asset that we had purchased in 2017.

And as you know, given the portfolio that we have, we manage all of our assets, all of our investments on a continuous basis. And given some of the successes we've had in other pieces of the surgical business, which is where this asset was, we decided to suspend our R&D in any potential commercialization. So, we did take an impairment that was a \$178 million.

That is a one-time non-cash item. And then lastly, on the legal provision, we don't really comment on outstanding legal cases. So, what I would say every quarter, we look at the legal landscape, and we look at the Balance Sheet and we provide provisions to make sure that we are adequately covered, and we feel like we're adequately covered in Q3.

**Daniel Vouchda**

There's no bigger issue you are technically being worried about on the legal side.

**Tim Stonesifer**

I'm sorry. What was that?

**David Endicott**

He was asking about--no, look, we're again on the legal stuff. We look at it every quarter. We've aggregated and then look at our risks and we make an appropriate provision. So, that's what we've done.

**Daniel Vouchda**

Okay, thanks very much, very clear.

**Operator**

Our next question comes from the line of Cecilia Furlong with Morgan Stanley. Please proceed with your question.

**Cecilia Furlong**

Thank you for taking the question. Two questions, and I'll ask them both, upfront. But just in terms of new fits, I'm curious if you talk a bit more about what you saw in OUS markets during the quarter, as well as your outlook going forward from a recovery standpoint.

And then also, just between TOTAL30 and ramping DT1 Toric, can you talk a bit more about just how you're thinking about balancing those two in your comments on ramping manufacturing lines into '22, and thank you.

**David Endicott**

Yeah, so new fits, right now, are going quite well for us. I would say in the U.S., we continue to make a lot of progress, particularly in the DAILIES, that T30 's brand new. So, we don't have a lot of data to give you on that one. But PRECISION1 has done very well, DT1 is also--continues to do well for us.

Outside the U.S., it's a bit slower, and I would say that what we've seen is that the markets really have new fits coming into the office have been down and remain down, particularly Japan, which is our second largest market. Europe has gotten a little bit better. Slowly working its way back.

But as you, as I think you're correctly pointing out, you need to be in a situation where new patients are coming into the office and/or patients are having trouble with their current lenses are coming in and looking for some alternative.

And so, as the market comes back in those areas, and I think we believe that the Vision Care international business will, largely, be back to the 2019 levels in the beginning of the year.

Again, I think that's really positive for the new fits for new products, but I do think that we've been trailing our trajectory in the U.S. because the new fits really aren't there, yet. But we'll get there, and I think what we see, which is encouraging, is that when we get these products into the hands of patients and optometrists, they are really performing well.

And so people really like our PRECISION1 one for astigmatism. They really like the PRECISION1 sphere.

Our DT1 for astigmatism has got great reviews in the U.S. Same thing with T30, both in Europe and in the U.S. And so, we are working through all of those, and obviously, we look forward to a more normal market, next year, where we can get a little bit more share outside the U.S.

I would say on the ramp up of manufacturing, we are in a good place. We did--we've had a greater-than-expected demand for PRECISION1.

And so, we were a little bit off guard with how well PRECISION1 astigmatism did. And we did sporadic back orders around the U.S. And we've had to delay some roll-outs because of that but it just took off on us. And so, the good news is we're getting a great reception and we've had some nice moving on that product.

But what we do need to do is really look at now, what do we expect from these products, and do we need more line time, and do we need more machines? What are we going to do about it?

So, I think we're working through that. now. Again, I don't anticipate any major changes per se, but we may want to invest a little bit more manufacturing for next year. So, we'll see.

**Cecilia Furlong**

Thank you for taking the questions.

**Operator**

And ladies and gentlemen, as we reached the top of the hour, we have time for one more question, which leads us to the line of Jeff Johnson from Baird. Please proceed with your question.

**Jeffrey Johnson**

Thank you. Good morning, guys. Thanks for squeezing me in. David, just on that contact one point. I'd be interested to hear, primarily, your expectations, what you're seeing for trade-ups versus trade downs from DT1 to trade downs, trade-ups from DACP and some of the other older focus products, number one.

And number two, let's say you grow a couple of points above market in the contact lens market, over the next couple of years. Do you think that will, primarily, be driven by net kind of trade up benefits within your own portfolio, or do you expect that you'd also be taking unit or patient share on eye share, however you want to think about it, relative to competition?

**David Endicott**

Yeah, a little bit of both, Jeff. I think, let's start with the cannibalization question. We expected to have some cannibalization with P1 of DACP, in particular. In truth, I think the DHCP has been a little bit more stable than we expected. And DT1 was probably a little bit more than we expected but, directionally, the all-in value change was pretty much as expected.

So, I would say the mix might have been a little bit different than we expected. But we are also working hard to make sure that people really understand what these products are and their proposition, and I think, as we get DT1--one of the reasons we pushed DT1 Toric out a little bit sooner than maybe we had wanted to was because P1 Toric took off on us, and that put some pressure on DT1 because the TOTAL1 product, obviously great product, but we didn't have a Toric for it.

So, we were seeing a little bit of P1 eat into DT1. So, now we've got the Toric out there. Again, that stabilizes our premium product, now we've got both the P1 and P1 Toric out there. So, we've got a middle-market product and again that line--that lineup seems to be doing quite well for us, going forward.

Over time, look, I think there is a lot of trade-up going on between reusables and DAILIES.

It's gone on for years, and I think one of the really great things about the Vision Care market is it isn't fast-moving, or it isn't--it's steady and strong.

And so, you're seeing a very fundamental shift from reusables to DAILIES, which is going to continue. And I think that drives value growth even in a market where EQ growth would be 1%- ish, maybe 2% on a good day.

So, I think that we expect to see some competitive share for sure, but we don't have to go steal share from everybody in this space to grow nicely in the mid-single-digits, or higher.

So, I think that's the beauty of what we're doing, right now. The other piece of this, of course, is that our reusable business is under--under-represented in our share position is one of the earlier questions came to us.

So, as we think about that, we actually think we can gain share in the reusable space pretty easily, particularly, with this technology. And that margin profile is a good margin profile for us, right? That's a much better margin than the DAILIES margin, albeit, a lower growth at market.

So, we can gain share, improve margin there, and then gain revenue and maybe a less attractive margin, but still positive.

We've got a good mix going, and I think that's how we see moving forward. Remember too, that when we go to the specialty lenses, Torics in particular, that's the sweet spot of this market, right now. Growing very quickly in the silicon hydrogel space and at a premium price to the sphere.

So, again, I think we are well-positioned to grow for a good bit of time, here.

### **Jeffrey Johnson**

Understood. And a quick follow-up. It's been a little quiet here, recently. Maybe that's a good thing, but I haven't heard any updates recently on VBP in China. Any timing update there? Any kind of way to look at public versus private mix within your business? Just how to think about exposure.

And if there is a timeline to think about when that exposure might have to be factored into models. Thanks.

**David Endicott**

Yeah, I think China has, obviously, gone down this path for some time. The IOL was implemented on a provincial level in most of the provinces, at this point. In October, there was probably only one VBP tender. I think it was a joint tender for two provinces.

But in previous IOL - VBPs, the ATL, some of them included AT-IOL, but mostly they were having price impacts on our monofocal--on the monofocal business, and we are I would say, underrepresented in the public monofocal business, generally.

So, where we're kind of over represented in China, it tends to be in the private AT-IOL business. So, again, I don't really have a split for you, but I will just tell you that directionally, most of our money is kind of in the private sector AT-IOL business.

Now, but there's some crossover impacts here that we're watching very carefully. But again, I think directionally, we probably have less exposure than some.

**Jeffrey Johnson**

Thank you.

**Operator**

And we have reached the end of the question-and-answer session. And this also concludes today's conference. You may disconnect your lines at this time. Thank you for your participation.