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HOLX.OQ - Q1 2025 Hologic Inc Earnings Call

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OVERVIEW:

Company Summary

CORPORATE PARTICIPANTS

Mike Watts *Hologic Inc - Corporate Vice President, Investor Relations*

Stephen Macmillan *Hologic Inc - Chairman of the Board, President, Chief Executive Officer*

Essex Mitchell *Hologic Inc - Chief Operating Officer*

Karleen Oberton *Hologic Inc - Chief Financial Officer*

CONFERENCE CALL PARTICIPANTS

Patrick Donnelly *Citi - Analyst*

Anthony Petrone *Mizuho Securities - Analyst*

Doug Schenkel *Wolfe Research - Analyst*

Vijay Kumar *Evercore ISI - Analyst*

Tycho Peterson *Jeffries. - Analyst*

Casey Woodring *JPMorgan Chase & Co - Analyst*

Tejas Savant *Morgan Stanley & Co. LLC - Analyst*

Ryan Zimmerman *BTIG - Analyst*

Jack Meehan *Nephron Research LLC - Analyst*

Puneet Souda *Leerink Partners LLC - Analyst*

Andrew Cooper *Raymond James & Associates, Inc. - Analyst*

PRESENTATION

Operator

Good afternoon and welcome to the Hologic's first quarter fiscal 2025 earnings conference call. My name is Lisa and I'm your operator for today's call. Today's conference is being recorded. All lines have been placed on mute.

I would now like to introduce Mike Watts, Corporate Vice President, Investor Relations, to begin the call. Please go ahead, sir.

Mike Watts - *Hologic Inc - Corporate Vice President, Investor Relations*

Thank you, Lisa. Good afternoon and thank you for joining Hologic's first quarter fiscal 2025 earnings call. With me today is Steve MacMillan, the company's Chairman, President and Chief Executive Officer; Essex Mitchell, our Chief Operating Officer; and Karleen Oberton, our Chief Financial Officer.

Our first quarter press release is available now on the investors section of our website. We will also post our prepared remarks to our website shortly after we deliver them. And a replay of this call will be available on our website for the next 30 days.

Before we begin, we'd like to inform you that certain statements we make today will be forward-looking. These statements involve known and unknown risks and uncertainties that may cause actual results to differ materially from those expressed or implied. Such factors include those referenced in the safe harbor statement that's included in our earnings release and SEC filings.

Also, during this call, we will discuss certain non-GAAP financial measures. A reconciliation to GAAP can be found in our earnings release. Two of these non-GAAP measures are organic revenue, which we define as revenue excluding divested businesses and revenue from acquired businesses owned by Hologic for less than one year.

Also, organic revenue excluding COVID-19, which further excludes COVID-19 assay revenue, other revenue related to COVID-19, and sales from discontinued products and diagnostics. Finally, any percentage changes we discussed will be on a year over year basis, and revenue growth rates will be in constant currency unless otherwise noted.

Now, I'd like to turn the call over to Steve MacMillan, Hologic's CEO.

Stephen Macmillan - *Hologic Inc - Chairman of the Board, President, Chief Executive Officer*

Good afternoon, everyone. I'd like to begin today by welcoming Mike back to the Hologic team. We're all excited to have him back. And now, we are pleased to discuss our financial results for the first quarter of fiscal 2025.

As we pre-announced last month, total revenue for the quarter was $1.022 billion, an increase of 1% on a constant currency basis. This was in line with our guidance as the stronger dollar subtracted about $9 million from reported revenue since we guided in early November.

Non-GAAP earnings per share were $1.03 at the high end of our guidance range and an increase of 5%. This reflected strong improvement in non-GAAP operating margins of 90 basis points, as well as share buybacks and the benefits of our foreign exchange hedging program.

In my remarks today, I'd like to revisit some of the themes from our presentation at the JPMorgan conference last month. In that discussion, we reflected back on Hologic's strong financial performance since 2014. Our main point, however, was not about the past. It was that we believe we can continue to grow revenue and earnings at similar rates in the future.

Why do we believe that? Because of our market leading products and the strong organizational capabilities we have steadily built around them. To be more specific, from 2014 through 2024, Hologic grew revenue from about $2.5 billion to more than $4 billion. This represented a compound annual growth rate of 4.8%, including all our acquisitions and divestitures along the way.

Over the same period, non-GAAP earnings per share increased from $1.46 to $4.08 representing a CAGR of 10.8%, more than double the rate of sales growth. At JPMorgan, our primary message was that we believe we can continue to grow earnings at a double-digit rate into the future.

While some years, like this one may be below this level, we are confident in our future and still believe this is an appropriate long-term goal.

The financial algorithm that will get us there includes a continuation of mid single-digit growth on the topline, modest expansion of our already best-in-class operating margin, and a healthy mix of acquisitions and share buybacks to increase both our revenue and EPS growth rates.

The foundation for this expected performance, of course, lies in our market leading brands, which generate a tremendous amount of reliable cash flow.

From Panther, Aptima, and ThinPrep in diagnostics to Genius in breast health, to MyoSure and NovaSure in surgical, we enjoy leading market shares that have proven durable over time. Much of our growth comes from building around these brands and using the cash they generate to drive future innovation.

For example, we now have more than 20 assays on our Panther and Panther Fusion platforms. We have built a reliable service business in breast health that is now larger than our capital sales, which can be more volatile. And we are adding products to our surgical division, both organically and inorganically to leverage our excellent sales channel.

Best in class products don't just happen. Instead, they are the result of several organizational capabilities that we have very deliberately built and nurtured over time. And these capabilities give us confidence in our ability to hit our financial targets in the future. For example, our 7,000 employees around the world are motivated by a passion for women's health.

They have demonstrated an ability to create and expand markets for the benefit of patients and customers and to redefine clinical standards of care. Examples include transitioning traditional Pap testing to liquid Pap. And now adding digital capabilities to catch more cancers and improve workflow.

And more recently we have partnered with our customers to literally create a market for high throughput vaginitis testing, which has fueled our second largest molecular diagnostics test on the Panther system. Many of these successes originated in the United States, but we have now built the capabilities to grow internationally on a consistent basis.

We continue to go direct in more geographies and businesses, most recently in our surgical division, while strengthening our market access capabilities around the globe. Similarly, we have learned from past mistakes and improved our business development capabilities. We have strengthened our talent and processes for conducting due diligence on new targets, cultivating relationships with them and integrating acquired assets more effectively.

This internal maturation has been reflected in the solid performance of some of our more recent acquisitions. For example, Biotheranostics, Endomagnetics, and Gynesonics should all boost our revenue growth rate.

These organizational capabilities give us confidence in the future, especially our ability to be a consistent double-digit earnings compounder and deliver value to shareholders reliably over time.

Now, I will turn the call over to Essex.

Essex Mitchell - *Hologic Inc - Chief Operating Officer*

Thank you, Steve, and good afternoon everyone. In my remarks today, I will first review our divisional revenue performance in the first quarter. Then I'll provide a little color on Gynesonics, a tuck-in acquisition we recently closed in our surgical business that we are excited about.

As Steve said, we met our revenue guidance on a constant currency basis in the first quarter, growing 1%. At the highest level, we outperformed in diagnostics but lagged in breast health. Surgical and skeletal were roughly in line with our expectations.

Our diagnostics business continues to be one of the best performing diversified assets in the space, in Q1 was another strong quarter. Revenue of $470.6 million grew 5.2% and 9.1% organically excluding COVID. Growth for the division continues to be led by molecular diagnostics, which grew 6.7% or 11% excluding COVID.

Within molecular, our Biotheranostics lab testing business continued to grow at a healthy double-digit rate and our BV CV/TV also had another outstanding quarter of strong double-digit growth. We believe we are only in the middle innings of realizing the total opportunity for this test.

For example, we have just begun using our physicians sales force to expand the vaginitis testing market in the US, leveraging the same playbook we have used to grow our legacy women's health test. Our core women's health assays that run on our automated Panther platform also had a strong performance in the quarter.

We often get investor questions about competition diagnostics. So I want to be clear that these assays have held leading market positions for some time, and our sales force continues to win new business and grow that share despite an always competitive environment.

Although, respiratory testing is a relatively small piece of our business, it is seasonal and can vary significantly based on flu prevalence. This quarter, the respiratory season started slowly but worsened in late December. As a result, non-COVID respiratory sales finished close to our expectations for the quarter.

These respiratory tests as well as many of the other assays we have in development, run on our Panther Fusion sidecar. For our customers, having a Panther Fusion is the key to unlocking our full menu. We have been pleased to see our sales force grow the attachment rate of the Panther Fusion in recent quarters. Nearly 40% of our US customers now have a Fusion system.

In our cytology and perinatal business within diagnostics, we saw higher than average growth of 4.7% for the quarter. As a reminder, sales in the prior year quarter were slightly depressed, resulting in an easier comp for the current period.

Moving to breast health. Total first quarter revenue of $369.1 million was disappointing. Sales declined 2.1% or 5.8% organically when excluding SSI and Edomagnetics. The decline versus prior year was primarily driven by lower sales of capital equipment.

However, we continue to see strong growth in service revenue, which tends to be more steady than gantry sales, reflecting our long-term strategy to diversify revenue in this business, service accountant for more than 40% of sales in Q1.

As we've analyzed the breast health market recently, we have concluded that 2025 will be a softer year for gantry placements than we initially expected. This is for a few reasons. As we recovered from the chip shortage, we saw multiple quarters of sustained double-digit growth in mammography sales.

This clouded our picture of what a normal gantry market would look like entering 2025 and has made for tough comps. Now that we have upgraded most 2D units in the United States to our 3D standard of care, our challenge is to drive 3D-to-3D conversions.

In this context, we are seeing customers lengthen their replacement cycles, especially those who are considering our new Envision platform which we expect to launch commercially next year. On the bright side, our competitive position remains strong. And we have received very positive feedback on Envision since we introduced it at RSNA which gives us long-term confidence.

Customers are excited about the system's better image quality, patient experience and workflow. Outside of the United States, we are also seeing pressure on capital investments as many private and government hospital customers struggle with local budgetary constraints.

Turning to our interventional breast business, we are pleased with the integration and performance of Endomagnetics, which we acquired in the fourth quarter of fiscal 2024 and is well positioned for a strong year. We are excited about Endomag's innovative on-market products, but also its R&D capabilities which will provide opportunities to further broaden our interventional breast portfolio.

In surgical, first quarter revenue of $166.3 million increased 2.5%. Q1 was another strong quarter for our international surgical business with growth of nearly 20%. In the US, results were in line with our expectations considering the temporary headwind of the IV fluid shortage that we discussed on our Q4 earnings call.

Most of our customers saw their IV fluid constraints resolved as we exited the quarter. So we do not expect this to have a significant impact going forward. Finally, in our skeletal business, first quarter revenue of $15.8 million decreased 37.4%. As shipping for some of our Horizon DXA units resumed later in the quarter than originally anticipated. We expect the manufacturing of these units to progressively ramp up to full capacity before returning to normal in the third quarter.

Before I hand the call over to Karleen, I wanted to highlight the Gynesonics acquisition that we completed in January. We're excited to introduce their Sonata system into our surgical portfolio. Sonata is a minimally invasive radio frequency ablation tool used to treat uterine fibroids that are less accessible by MyoSure or Acessa.

So it's highly complimentary to our current portfolio and fits nicely into our sales bags of the largest commercial channel we have. Gynesonics had about $28 million of revenue in its most recent fiscal year, including a healthy mix of international sales. We expect sales to grow at a healthy double-digit rate in the hands of our large GYN sales force.

Gynesonics' gross margin is solid, although plan investments will make the acquisition slightly dilutive to non-GAAP EPS this year. As Steve mentioned, strengthening our business development capabilities has been a key focus for the organization in recent years. In each division and at the corporate level, we now have teams in place that bring a deep understanding of the respective in the market and significant experience and diligence and integration.

The success of recent deals like Biotheranostics, Endomagnetics, and our good start with Gynesonics give us confidence in our ability to identify and integrate future deals. As we've said many times, accessing high growth adjacent markets through successful M&A will be key to our growth strategy moving forward.

With that, I'll hand the call over to Karleen.

Karleen Oberton - *Hologic Inc - Chief Financial Officer*

Thank you, Essex and good afternoon, everyone. In my comments today, I will stop by walking through the rest of our non-GAAP income statement, then touch on several key financial metrics and finish with our guidance for fiscal Q2 and the full year.

Let me begin by saying we are pleased to grow non-GAAP earnings per share by 5% this quarter when revenue only grew 1%. Although, we clearly want revenue to grow faster and we believe it will, this demonstrates the substantial operating leverage we can generate and gives us confidence that we can grow earnings at a double-digit rate over time.

So how did we do that in the first quarter? To start, non-GAAP gross margin of 61.6% increased 80 basis points. This margin expansion was primarily the result of favorable product mix and operating efficiencies.

Moving down the P&L, first quarter operating expenses of $329 million increased approximately 0.5%. As a reminder, Q1 usually represents our highest level of operating expense for the year due to several large commercial initiative. Despite this, the year-over-year increase was driven by the addition of Endomagnetics. Excluding Endomag, operating expenses would have decreased 2.3%.

First quarter operating margin finished at 29.4%, representing an increase of 90 basis points. This operating margin expansion came primarily from drop through of a higher gross margin and good expense control. As Steve said, leveraging the P&L to drive modest margin expansion from already best in class levels and strong EPS growth remained the key focus.

Below operating income, other income net was a loss in our fiscal first quarter by slightly more than $4 million. This result was better than expected due to the benefit of our foreign exchange hedging program. As a reminder, this hedging program seeks to minimize the negative or positive bottom-line impact of currency fluctuations.

Finally, our tax rate in Q1 was 19.5% as expected. Altogether, net margin for the quarter was 23.4%, approximately flat to the prior year and very strong relative to our diagnostics and medtech peers. Because we have tremendous confidence in our long-term future, we continue to bet on ourselves and use our balance sheet to enhance a shareholder value.

In the first quarter, we repurchased 6.8 million shares for a total of $517 million. Including the completion of the $250 million ASR announced on our Q4 earnings call. As a result, we brought our weighted average diluted share count down to 232 million, a decrease of 8 million shares compared to the prior year. All this led to non-GAAP earnings per share of $1.03 which we were pleased to deliver at the high end of our guidance range.

With strong operating cash flow of $189 million in the first quarter and $2 billion in cash and investments on our balance sheet at the end of the quarter, we are well positioned to continue to execute our capital deployment strategy to drive both top and bottom-line growth.

Now let's move on to our updated non-GAAP financial guidance for the full fiscal year and for the second quarter. I'd like to start by acknowledging the dramatic shift in the geopolitical and macro environment since we first provided guidance in early November.

As everyone knows, we are seeing an immediate impact from the new administration in the US, both in terms of policy changes and a strengthening US dollar. Entering the new calendar year, we also have greater visibility on our end market landscape for 2025. Combining these pieces together, we're using this opportunity to reset our financial expectations for the year.

For the full year we are lowering our revenue guidance range by $100 million, [to $4.05 billion to $4.10 billion]. But we are maintaining our non-GAAP EPS guidance of $4.25 to $4.35. Our diagnostics and surgical businesses are performing well, and we are adding roughly $25 million of Gynesonics revenue to our reported results.

However, these positive developments are being offset by three factors. First, like everyone else, we have experienced a significant strengthening of the US dollar since early November. We now expect FX to represent a headwind of $30 million for the full year. This represents a swing of more than $60 million from our original expectations, which we are baking into our reduced guidance today.

Second, we are expecting lower sales of our breast health capital equipment for the year. As Essex detailed, we didn't have a clear picture of the gantry market, which led to two aggressive forecasts for 2025. Especially considering that, our next generation gantry is still a ways off.

Third, two potential policy changes in the new US administration are introducing uncertainty in our business. First, the freeze on foreign aid has affected our main partner for HIV testing in developing countries.The President's Emergency Plan for AIDS Relief, or PEPFAR. Although, PETFAR has been granted an exemption based on the lifesaving work they do, activities on the ground have still been disrupted. This disruption could affect our revenue by as much as $30 million for the balance of our fiscal year.

Second, contract manufacturers in Mexico make our skeletal and Gynesonics products. So we could be subject to tariffs that lower our gross margins as we import them into the United States. Although these are relatively small pieces of our businesses and the tariffs could have -- the tariffs have been delayed for now, we believe it is appropriate to risk adjust our forecast for the potential impact.

Despite these headwinds, we are maintaining our full year EPS guidance of $4.25 to $4.35. The strong financial discipline and capabilities we've established as an organization are enabling us to mitigate the bottom line impact of these issues.

For the second quarter, we are expecting total revenues in the range of $995 million to $1.005 billion, including a $10 million FX headwind and non-GAAP EPS in the range of $1 to $1.03.

Now, let me provide some additional details that underpin our guidance. In terms of quarterly pacing, we expect our revenue growth rate to improve in the third quarter and further in Q4. So we should exit the year above our long-term mid single-digit target on quarterly basis.

In terms of the divisions, we expect diagnostics to grow mid-single digits for the year, excluding the impact of declining COVID-19 sales. We continue to forecast that growth will be driven by strength in our molecular women's health assays in Biotheranostics lab testing.

For COVID revenue, we expect assay sales to be about $9 million in the second quarter and approximately $35 million for the full year. COVID-related items are expected to be about $25 million in the second quarter and approximately $100 million for the year.

Finally, in diagnostics, we expect blood screening revenue of about $5 million in Q2 and about $20 million for the full year. As both COVID-related sales and blood screening revenue are backed out of our organic growth calculations.

Within breast health, as mentioned, we are lowering our expectations for the full year based on softer capital equipment sales. We now expect the business to decline in the low single-digits for the full year, including Endomagnetics. We do, however, expect revenue growth to build in the second half with good year over year growth in Q4 as we exit our fiscal year.

Lastly, in surgical, we expect high single-digit growth for the year with the inclusion of Gynesonics in our results for the three quarters. In our core surgical business, we expect growth to be powered by international with contributions in the US from MyoSure and Fluent.

Moving to the rest of the P&L, we expect gross margin in the low-60s for the full year. We anticipate gross margins to step up in the second half with higher sales, the elimination of redundant manufacturing facilities and then breast health, and direct sales and Endomagnetics.

For operating margin, we're expecting to be in the low-30s for the full year, with steady margin expansion as we move through the year. Below operating income, we estimate other income net to be an expense of $10 million to $15 million in Q2 and an expense between $40 million and $45 million for the full fiscal year.

Our effective tax rate of approximately 19.5% for the full year remains unchanged from our prior guidance. To reflect the share repurchase activity we completed in Q1, diluted shares outstanding are expected to be approximately $230 million for the full year.

To conclude, our financial discipline and strength have us in a position to meet our EPS commitments even in a year where we're seeing pressures on the topline. We believe these pressures are largely transitory in nature, and we expect topline growth to be healthy as we exit the year.

We feel great about the long-term outlook for each of our divisions driven by our ability to retain and grow our market leading positions while continue to add new growth drivers through internal innovation and business development.

With that, we ask the operator to open the call for questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instruction) Patrick Donnelly, Citi.

Patrick Donnelly - *Citi - Analyst*

Hey, guys. Thank you for taking the questions. Steve, maybe starting on the gantry side, not surprisingly, you've obviously lived through a lot of different CapEx cycles on the hospital side, maybe just take us through what you're seeing there.

How much of it is, again, maybe a little bit of a pause before the product launch. Just the right way to think about that piece, is that number came down a little bit? Just want to talk through that.

Stephen Macmillan - *Hologic Inc - Chairman of the Board, President, Chief Executive Officer*

Yeah. Patrick. Great one. Let me try to put it in the context. I think where we really frankly missed the boat a little bit was when we had three quarters in a row of 27%-plus breast health growth, growth in the late '23 and in the early '24 period.

That was really a bolus that made the market bigger during that time period than what the long-term trend is. It's a little bit like even surgical had a couple of great quarters coming out of COVID and breast health had the same thing coming out of chips.

So we had that year, '23, we grew at 17%-plus for the full year, grew another 6% on top of that last year. And I think instead of really going back and looking at the longer-term trend of the market, we were just building on top of that. So the long-term trend of the market is clearly below what it was in 2023.

Now, I think what we're seeing this particular year is the total market, therefore, is probably going to be down a little bit just as we saw in some of the other businesses kind of post COVID, we'll see the same for chips combined with the fact that we've got a new gantry on deck.

So I think the positive as we look at it is probably going to be a down market this year for the overall market globally. But we've got something on the horizon that I think will both reaccelerate the market in '26 as well as re accelerate our business.

So that hopefully frames it in some good context. I think it's more cyclical clearly and you know that we've got a long track record of being able to call out either cyclical or structural issues usually with pretty good accuracy. So I think this one is very clearly a little cyclical.

Patrick Donnelly - *Citi - Analyst*

Okay. That's helpful. And then maybe one on the diagnostic side, helpful to have some more color in the script there on just what you're seeing on the competitive side. We get some questions there clearly, you do as well. Any changes there, whether it's BV/CV/TV or other parts of the portfolio that the competitive landscape has changed at all.

And then just curious when you think about the growth outlook there, the key things in the pipeline, we should be focusing on that could supplement the growth as we move forward here. Thanks.

Stephen Macmillan - *Hologic Inc - Chairman of the Board, President, Chief Executive Officer*

Good job, Patrick, working several questions into your one follow up. So kudos to you. So high level, I can't tell you how excited we are about our diagnostics business. And what we said when we went in COVID by placing all the Panthers around the world. And even as we saw the ups and downs, as (inaudible) Delta, everything else was hitting, we just systematically got stronger in terms of our Panther placements and then rolling out the menu of particularly BV/CV, where we've rolled out a new assay and then we've created the market and we're still, as Essex mentioned, we're still in the mid-innings at most as it relates to the BV/CV opportunity.

And I think when you look at our molecular business, then you add in Biotheranostics. I don't think I've ever been more excited about where this diagnostics business is going, particularly in a world where there's a lot of noise as you well know in the diagnostic space right now.

And the way we try to look at it is that core molecular lab channel, are we winning or losing? And we feel really good about our position as we build out from there. And then we still got the international opportunities on top of it all and still a lot of growth in Biotheranostics as well.

Karleen Oberton - *Hologic Inc - Chief Financial Officer*

Yeah. I would just add on to that as far as -- but I'll call our special sauce in our molecular diagnostics that physician sales force where we really partner with our lab customers to promote guidelines. And I think as we said in our prepared remarks, we're just starting now with BV/CV. So that's what gives us confidence that there's still runway for growth for that newer assay.

Operator

Anthony Petrone, Mizuho Group.

Anthony Petrone - *Mizuho Securities - Analyst*

Thanks and welcome back, Mike. Nice to hear your voice. Maybe a high level one, just for the long term -- medium-term financial outlook. I mean Steve and or Essex. When you think about that mid single-digit sort of profile, I think -- and we look at the last time that range was out there was 5% to 7%, and we're trending here, obviously, in the low single digits right now.

We're in a low point of a cyclical gantry cycle here. What sort of gets you back to 5% to 7%? How long do you think that will take? What amount of that will come organically versus inorganically? And then quickly, just on the second one, diagnostics. Late last year, you had H5N1 bird flu development CBC. It sounds like that actually could be an assay this year. Is that something we should expect? Thanks again.

Stephen Macmillan - *Hologic Inc - Chairman of the Board, President, Chief Executive Officer*

Great, Anthony. Yeah, I think the highest level -- I laugh a little bit in that as you recall, we put out the 5% to 7% for a three-year window, the '23, '24, '25 window. In our very first year, we probably delivered about 17% organic in that year and everybody was challenging us to raise that number.

And effectively, what we're really saying is we're mid single digits, and this year, frankly, just for a few quarters, we think we're below it, not for the full year to be below that. But just as it was way above, we said we weren't that good. We're also not as bad in a cyclical period where we're recovering from the -- frankly, a lot of those big comps.

So what gives us excitement going forward really is each franchise, right? The surgical business keeps strengthening and the addition of Gynesonics, the international expansion there is looking great. Our diagnostics business, as we've said, is great. By the way, we'd love to view that H1N1 is going to be anything. I probably put this one in my world, kind of like the Zika virus.

We're always there for the government and for the CDC to be one of the quickest to develop any of these. And even as we did in COVID right at the beginning, we didn't know it would amount to anything. Obviously, that would have amounted to something very big.

I wouldn't assume a lot for H1N1, if that came, that would be upside to our business. And then the breast health business, as we continue to build out the disposable side of the business, the interventional side with things like Endomagnetics. And then as the new gantry kicks in next year, I think that gets us back very solidly into our longer-term consistent trajectory in that mid-single range of topline growth.

Operator

Doug Schenkel, Wolfe Research.

Doug Schenkel - *Wolfe Research - Analyst*

Hey, good afternoon, everybody. And thank you for taking my questions. Two, that I'd like to touch on. One is it's just a little bit unclear to me how much of the change in your assumption that you've embedded into guidance for breast health as a function of market conditions versus a reassessment of the impact of market stalling in advance of the new gantry launch.

If it's more stalling, that might lead to a big acceleration in revenue growth down the line. If it's the market, that's something else. So could you just provide a little more color there?

And then the second topic is really M&A in your prepared remarks, you talked about the importance of M&A is part of the long-term strategy. Can you just provide any updated thoughts on one, the environment given the new administration and two, what parameters you're using and assessing potential targets, revenue growth margins, accretion, ROIC? Thank you.

Essex Mitchell - *Hologic Inc - Chief Operating Officer*

Great. I'll start with the breast comments here. So I do think we tried to outline that it is a blend of both market conditions and given our high market share, our new launch slowing the market down. But if you had to wait, I would say market conditions are the bigger impact.

And so, that does give us confidence about our future moving forward and do expect this business to accelerate as we exit the year moving forward. The big thing I would say is that if you think about coming out of the chip shortage with a significant amount of pinned up demand, we got through a ton of that. I would say over the '23 and '24 time period.

In addition to that, as we've seen other areas of acceleration, those were driven by large innovation, advances, primarily driven by us. So when you saw going from the 2D to the 3D market, that was a huge catalyst, not only in a technological advance, but also with regards to reimbursement and a number of factors that helped physicians and caregivers.

So as we look at a technological event coming up here, I would say from us early in '26, we do believe that it has an impact but largely I think the chip shortage rebound is playing a bigger impact on the slower year this year with the breast business. So I still would say it's both. But if I had to lien one way or another, I would tell you that it's a bigger impact on the market.

And I'll probably start with the M&A and then kick it to Karleen. And I would say our capital allocation strategy is M&A first and obviously anything we can do to help the bottom line if needed. We have the luxury of being able to do both.

I think if you look at our most recent acquisitions of Endomagnetics and Gynesonics, that's right in the wheelhouse of what we would like to continue to do. Nice size, on market products that we can grow at a topline at a creative rate to our core growth rate is exactly the place we'd like to be.

Karleen Oberton - *Hologic Inc - Chief Financial Officer*

Yeah. And just to build off of that, when we look at financial metrics, it clearly starts with the revenue. We were looking at assets that are accreted to the growth rate. We're looking at things that hopefully have a gross margin that is at the corporate average or maybe accreted.

And like we've seen with the Gynesonics, sometimes they're going to be dilutive on the bottom line, but I think we've got the flexibility to manage that. And then I think over the longer term we look for a double digit ROIC within a reasonable time frame in terms of return on that investment. And I think if you look at both Endomagnetics and Gynesonics, they played nicely within that framework.

Operator

Vijay Kumar, Evercore ISI.

Vijay Kumar - *Evercore ISI - Analyst*

Hi, guys. Thanks for taking my question, Steve. A couple of guidance related questions here. One in breast. I think breast health, the guidance here is the organic for the segment assuming down mid singles as I thought I heard you say the year on year declines includes the acquisitions. So I guess the organic implied is down med singles. Is that right? And I guess looking at Q1, why wouldn't trends improve from Q1?

Karleen Oberton - *Hologic Inc - Chief Financial Officer*

Yeah. So you are right that the organic would be closer to a mid digit decline year-over-year. And I think as we think about sequentially Q1 to Q2, you are looking at a similar performance, Q1 to Q2 in terms of absolute dollars. I think we're looking for improvement into Q3 and into Q4, and I think we specifically said Q4 would have a nice growth rate as we exited the year.

Vijay Kumar - *Evercore ISI - Analyst*

Understood. And Karleen, maybe a follow-up on a similar question on the surgical franchise. I think the high singles includes Gynesonics, excluding the acquisition I think it points to low singles growth. I guess Q1 was impacted by flu shortage, right? Shouldn't that go in numbers if GYN was up low singles, shouldn't that be mid- to high singles in the back half?

Karleen Oberton - *Hologic Inc - Chief Financial Officer*

So what I would say is as we did see the impact of the IV fluid shortage in Q1 result as we exit the quarter. As we think about Q2, think about Q2 as always a step back from Q1, given the reset of deductibles and then we'll have improving growth rates in the back half of the year and certainly as we add Gynesonics into that equation. But I think we've provided the guidance on with Gynesonics for what we expect for growth.

Operator

Tycho Peterson, Jefferies.

Tycho Peterson - *Jeffries. - Analyst*

Hey, good afternoon. Steve, so just curious given your exposure across the portfolio to screening, breast diagnostic, skeletal, just thoughts on us [USTF], given the Braidwood case what should we be thinking about here? What have you kind of factored in as you think about the guidance for the year?

Stephen Macmillan - *Hologic Inc - Chairman of the Board, President, Chief Executive Officer*

Yeah. We don't expect a big impact from that. At the end of the day, we feel really good about the products that we're providing are meaningful for both patients and frankly ones that insurers will want to continue to take care of. So I think of all the stuff we have going on we're not worried about that and feel very good about where we'll be.

Tycho Peterson - *Jeffries. - Analyst*

All right. And then follow up on Panther utilization. I guess, how should we be thinking about utilization growth in the next, call it, five years. Can you kind of double utilization while holding the install base flat and what should we be thinking about for the next leg of growth beyond STIs which have been putting up great growth. But how do we think about kind of further menu expansion?

Stephen Macmillan - *Hologic Inc - Chairman of the Board, President, Chief Executive Officer*

Yeah. I think that the part that we feel great about both for Panthers is whether it would double on the existing base that might be a little aggressive, but there's significant opportunity without needing to place them, which is a capital replacement.

And similarly, frankly, our capacity to manufacture because of all the expansions we did during COVID, our need for CapEx and things like that are very low. So on the margin, the ability to expand as we bring more menu. And really that menu is going to largely be as we expand the Panther Fusion sidecar.

And I think Fusion is not getting as much attention probably as it deserves because that's really opens up the dramatic opportunity for our PCR assays which are cheaper to produce or cheaper to bring the market faster and things like our GI and other things that will be coming down the road will be on that.

So the magic is we've got this incredible installed base that we really can't build on through both Fusion and the additional menu. So I think, we've got multiple, multiple years of opportunities ahead of us here.

Operator

Casey Woodring, JPMorgan.

Casey Woodring - *JPMorgan Chase & Co - Analyst*

Great. Thank you for taking my questions. So on breast, can you break out performance in the quarter between US and international customers? You mentioned the international opportunity as a growth driver in the past.

But today, you kind of talked about some budget constraints from customers abroad. So wondering how much of an impact you're seeing from that dynamic and the visibility into that improving over the course of the year and I have one follow up.

Karleen Oberton - *Hologic Inc - Chief Financial Officer*

Yeah. Sure. So we look at the performance of the breast business, we had declined both in the US and international and both were in the mid single digits, probably a little higher decline internationally.

Stephen Macmillan - *Hologic Inc - Chairman of the Board, President, Chief Executive Officer*

Yeah. I think it's the same issue of just much slower market right now.

Casey Woodring - *JPMorgan Chase & Co - Analyst*

Got it. Okay. That's helpful. And then at our conference, you mentioned that part of the reason you're launching the new gantry in 2026 instead of earlier is that you're consolidating manufacturing to one facility in breast. Just curious on timing there and the potential margin benefit once the consolidation is finished and the next gantry is launched and ramped. Thank you.

Karleen Oberton - *Hologic Inc - Chief Financial Officer*

Yeah. So I think we're on track with the facility with the consolidation. So expect that the facility will not be a hold up as we get into '26. I think in terms of margin while we will have benefit from consolidation of the facility and probably a little higher ASP on the new gantry, we do have actually higher costs if you think about one of the components of that new gantry is that the ability for the arm to move forward. So I wouldn't expect a dramatic change in the margin profile. I think they all kind of net out at the end of the day.

Operator

Tejas Savant, Morgan Stanley.

Tejas Savant - *Morgan Stanley & Co. LLC - Analyst*

Hey guys, good evening. Just a couple of clean ups on the gantry side of things, Steve. So I know you've talked about an upgrade pathway on existing gantry sales. Can you just provide some context and the degree to which that's unlocking some conversations for you or is it really not sort of making much of a dent pending the new gantry launch?

And then given the leadership changes and compensation sort of adjustments that you've made on breast health performance, how should we think about the lessons to be learned here? I mean, obviously you talked about perhaps assuming a greater quantum of growth. But beyond that, operationally, are there any other lessons that you take away from the lowering of the growth forecast here on the gantry side of things?

Stephen Macmillan - *Hologic Inc - Chairman of the Board, President, Chief Executive Officer*

Yeah. I think the discussions for Envision, I think from our leading customers, there's a lot of excitement. So I think we feel great about -- we've been the innovators in this space. We've been the pioneers been on the leading edge, continue to feel very good about being in that continued position.

I think we did -- we probably just got a little over eager about the market growth rates and didn't look back hard enough to realize what we actually had was a bullish in '23 and beginning of '24 as opposed to a long term trend. We were way above that long term trend, more gantries were placed in those quarters than our typical.

And I think we had some questions, I remember Karleen actually challenging the team a little bit. I think we were just a little too optimistic in that division of thinking about it. You know what, I probably didn't go as deep as I should have in completely challenging the underlying assumption of the market growth rate.

So it's a quick lesson learned, a little bit of a misstep there and we're right back on track. And I will tell you feel really, really good about the new leadership that Essex has put into that business. A new division President, new head of sales and I think a deeper level of rigor analytics and fire than what we had probably coming out of the chip shortage.

Tejas Savant - *Morgan Stanley & Co. LLC - Analyst*

That's helpful. And then maybe one for you, Karleen, just to clean up on the tariff side of things, appreciate the color on Mexico as it relates to Gynesonics and skeletal. But at a high level, given the shifting headlines from one day to the next, how much of cologix OUS revenue is made in the US and how much of US revenue is dependent on manufacturing overseas at the level at the portfolio level.

Obviously, you've talked about Canada and Mexico exposure as being pretty minimal. You don't sell much in China. So just any color at the portfolio level would be great.

Karleen Oberton - *Hologic Inc - Chief Financial Officer*

Yeah. Sure. Our biggest exposure would be related to our manufacturing Costa Rica. We manufacture all of our surgical products except for Gynesonics in Costa Rica and substantially all of our disposable breast health products are in Costa Rica.

So if there was a tariff imposed there that would be the most significant challenge to us. I think the tariffs that have been talked about right now, Mexico is the one that would -- it was enacted would impact us but not terribly significantly. But we did want to call it out.

Stephen Macmillan - *Hologic Inc - Chairman of the Board, President, Chief Executive Officer*

And overall, I think we're in a really good position in so many ways and that effectively all of our gantries and most of our molecular diagnostics are made in the United States. So we resisted a lot of those moves to go overseas through the years. And I think that's going to benefit us here well for the next few years at least.

Operator

Ryan Zimmerman. BTIG.

Ryan Zimmerman - *BTIG - Analyst*

Thanks for taking the questions. Two for me. One on breast and I know we've talked a lot about this evening. But as we think about 2026 when you do launch the new gantry, arguably that would carry a price increase with it and given where we're assuming kind of growth is today, are you suggesting or implied in that would be a declining unit? Just in terms of unit volume, which is offset by potential price increase. And just taken in the context of Essex comments that you're selling 3D to 3D now going forward.

Stephen Macmillan - *Hologic Inc - Chairman of the Board, President, Chief Executive Officer*

Yeah. I think what you'll start to see in '26 is units will start to improve again as the new launch and we will have a combination of both units as well as additional price from a mix standpoint. So it's why we feel really good about where we're going to head.

We're not going to guide to '26 at this stage. But you know, it's very nice to be sitting where we're sitting and feeling like we've got line of sight that we know a couple of down quarters here and then we come roaring back.

Ryan Zimmerman - *BTIG - Analyst*

Okay. And then on Gynesonics, heard you guys call out -- I think I heard and correct me if I'm wrong, Karleen or Essex is $28 million in sales. You're guiding to $25 million incrementally for this year.

I just want to understand -- I think that was $28 million training 12 month basis. [$25 million] is that three quarters worth of sales or is there some disruption assumed there? I just want to be clear.

Karleen Oberton - *Hologic Inc - Chief Financial Officer*

The he prepared remarks is $25 million for the balance of the year, which is the three quarters.

Operator

Jack Meehan, Nephron Research.

Jack Meehan - *Nephron Research LLC - Analyst*

Thank you. Good afternoon. Karleen, I had a couple of guidance related questions for you. The first wouldp you talked about some of the policy uncertainty as it relates to the HIV testing. I just wanted to clarify, did you build in -- you talked about disruption up to $30 million of sales. Is that in the guidance? Or did you put in a risk-adjusted number in the guidance? Or just how did you handle that?

Karleen Oberton - *Hologic Inc - Chief Financial Officer*

It's substantially in the guidance. Even there has been a waiver there is clearly disruption in the ground. And so they could the supply chain significantly. So that's why we decided to include it.

Jack Meehan - *Nephron Research LLC - Analyst*

Got it. And just to make sure I understand from a reporting perspective, this would show up in the molecular line for the virology testing? Or is it something else?

Karleen Oberton - *Hologic Inc - Chief Financial Officer*

Virology and molecular, yes, that's correct.

Jack Meehan - *Nephron Research LLC - Analyst*

Got it. Okay. And then just was wondering if I heard the commentary around margin for the year, and it sounds like there's a little bit of a second half step-up. Just any color around where we should be landing 2Q for gross margins and op margins would be helpful. Thank you.

Karleen Oberton - *Hologic Inc - Chief Financial Officer*

Yeah. I would say op margins for Q2, you might have a little sequential improvement, but clearly, more improvement in the back half as we see improvement in revenue as well as we talked about Q1 and even Q2 to some extent are our largest operating expense quarters.

Q1 is with some of our larger commercial meetings and then some of the variable comp structure is weighted to expense in the first two quarters versus the last two quarters.

Operator

Puneet Souda, Leerink Partners.

Puneet Souda - *Leerink Partners LLC - Analyst*

Yeah. Hi, Steve. Thanks for taking the questions. If you don't mind, I want to go back to breast again. It appears to me, obviously, three issues here. There's the assessment of breast that you also had some changes in the incentive comp and sales reps, and then there's the market issue with the hospital CapEx. I mean, if I look at the sales side, can you elaborate a little bit on the incentive comp changes and the sales rep changes in the field?

And then on the hospital side, if the CapEx pressures that are on today, if they were to get worse, how would it -- how can a hospital continue to purchase new equipment if they have to stress their dollars longer? Just thinking about the sort of the pressures that the hospitals are seeing? And then maybe potential pressures that could arise from those or other efforts focusing on the hospitals?

Stephen Macmillan - *Hologic Inc - Chairman of the Board, President, Chief Executive Officer*

Yeah. I think as we think about the hospital CapEx to come at that I think we still feel good, right? And again, I can always go back on the '08, '09 downturn where we saw the incredible pressures. Given where mammography sits which is a few hundred thousand dollars a unit and how critically important women's health and mammography screenings are for hospitals.

I think we feel really good that those markets are going to continue to be fine and be there. And then from -- it's back to overall standpoint, the market a little down. Our sales force evolution is one of these things. We go through it from time to time in each of our businesses, and we're shifting a little bit more to making sure we're really driving those gantry sales going forward.

I think we took our foot off -- our eye off the ball a little bit during chip shortage because candidly, we couldn't deliver. And so, now so getting back to that focus on delivering the gantries.

Mike Watts - *Hologic Inc - Corporate Vice President, Investor Relations*

Operator, I think we have time for one more question.

Operator

Andrew Cooper, Raymond James.

Andrew Cooper - *Raymond James & Associates, Inc. - Analyst*

Hey, everybody. Thanks for the questions here. A lot to ask, but maybe just one on kind of the pace of Panther Fusion adoption. Is there any reason that 40% has a cap and can't get to [100%] down the road. How do you think about kind of the uptick there as exiting customers look to potentially layer in that additional menu? And what does it take from a new menu build-out perspective to maybe push some of those folks who haven't done it yet to start looking at Fusion?

Stephen Macmillan - *Hologic Inc - Chairman of the Board, President, Chief Executive Officer*

Yeah. I think we feel really good. Ultimately, it probably could get close to 100%. And it's just kind of a steady improvement as we just win customers one at a time. The molecular diagnostics business, I think some people don't always understand how much effort it takes to change over a customer from one assay to another.

And I think what we feel great about is as the lab techs are using Panthers, they just want to keep adding more. And then it's, okay, we'll add a Fusion, we'll qualify a new assay. And so, we keep bringing these things out. It's really kind of multiple years of growth ahead as opposed to any one-year massive step up. So I think that's what gives us the underlying confidence that it just grows over time. Thanks, Andrew.

Andrew Cooper - *Raymond James & Associates, Inc. - Analyst*

Perfect. And if I can sneak one more in just on the margins. Just want to make sure I understand the guide. If we go past quarter, it was near 30% in 1Q, climbing 50 to 100 basis points. The language was just a little different this quarter in terms of that low-30s for the year and getting better each quarter.

Is the exit rate fairly similar? How do we think kind of the landing spot as we move through the course of the year knowing that the slightly lower revenue is certainly a drag on top of maybe some dilution from the M&A?

Karleen Oberton - *Hologic Inc - Chief Financial Officer*

Yeah. We'll certainly exit the year at a higher operating margin than where we're at here in Q1 and Q2. But I would just caution that that's really -- you're jumping off point for '26. Again, we have some seasonality to our operating expenses as well as highest operating expenses in Q1 and actually typically lowest revenue in Q2. So we will see that improvement that would not be a jumping off point for '26.

Stephen Macmillan - *Hologic Inc - Chairman of the Board, President, Chief Executive Officer*

Yeah. I think as a reminder, we always do see our operating margin improves over the course of the year, as Karleen said, because of the way our expenses flow. And then too often, I think people look at the fourth quarter rate as a launching off point. We think about it as each quarter year-over-year. So first quarter relative to last first quarter.

If you look we just had 80 basis points of gross margin improvement in the current quarter, 90 points of op margin improvement in Q1. We just keep thinking about those rates as opposed to -- and then ultimately, averaging it over the course of the year, but feeling that we'll post better margins this year than last year, and they were already pretty good last year. So thank you.

Operator

This concludes our question-and-answer session. We will now conclude today's conference call. Thank you for your participation. You may now disconnect and have a great day.