Hear now. And always

Cochlear®

ASX Announcement

18 February 2020

COCHLEAR FINANCIAL RESULTS
FOR THE SIX MONTHS ENDED DECEMBER 2019

Cochlear delivered a 9% increase in sales revenue for the half

- **Reported sales revenue up 9% (5% in constant currency[1]) to $777.6m, with Cochlear implant revenue up 14%, Services up 9% and Acoustics revenue down 9%**
- **Cochlear implant units up 13% to 18,894, with developed markets up 7% and emerging market volumes up over 20%**
- **Reported net profit increased by 23% to $157.7m and includes $25.0m in non-cash after-tax gains from the revaluation of innovation fund investments**
- **Underlying net profit[2] of $132.7m was in line with HY19, with operating profit growth offset by foreign currency contract losses**
- **Interim dividend to increase 3% to $1.60 per share**
- **FY20 net profit guidance[2] of $270-290m, a 2-9% increase on underlying net profit for FY19, with strong cochlear implant growth to be partly offset by the impact of the coronavirus on sales in Greater China**

$m	**HY20**	HY19	Change % (reported)	Change % (CC)
Cochlear implant units	**18,894**	16,740	⬆ 13%	
Sales revenue	**777.6**	711.9	⬆ 9%	⬆ 5%
Earnings before interest & tax (EBIT)[2]	**183.7**	180.5	⬆ 2%	⬆ 2%
Net profit (reported)	**157.7**	128.6	⬆ 23%	⬆ 22%
Net profit (underlying)[2]	**132.7**	132.1	0%	0%
% net profit margin[2]	**17%**	19%		
Basic earnings per share	**$2.73**	$2.23	⬆ 22%	
Interim dividend per share	**$1.60**	$1.55	⬆ 3%	
% franking	**100%**	100%		
% payout ratio[2]	**70%**	68%		

[1] Constant currency (CC) removes the impact of foreign exchange (FX) rate movements and FX contract gains/(losses) to facilitate comparability. See end note for further detail.

[2] Excluding revaluation of innovation fund

HY20 OPERATIONAL HIGHLIGHTS

Strong growth in cochlear implant revenue

	HY20 $m	HY19 $m	Change % (reported)	Change % (CC)
Cochlear implants (units)	18,894	16,740	⬆ 13%	
Sales revenue				
Cochlear implants	469.9	413.9	⬆ 14%	⬆ 9%
Services (sound processor upgrades and other)	225.5	207.2	⬆ 9%	⬆ 5%
Acoustics (bone conduction and acoustic implants)	82.2	90.8	⬇ 9%	⬇ 13%
Total sales revenue	**777.6**	**711.9**	⬆ **9%**	⬆ 5%

Cochlear's CEO & President, Dig Howitt said, "The business delivered a 9% increase in sales revenue (5% in CC) with underlying net profit in line with HY19. The highlight was the strong growth in cochlear implant revenue with lower than expected Acoustics sales."

Cochlear implant revenue grew by 14% (up 9% in CC) with units growing 13%. Mr Howitt said, "The Nucleus Profile™ Plus Series cochlear implant has been well-received by the market since its launch late in FY19 with developed market units growing by 7%. The US rebounded strongly, growing units by over 10%, with improvements in market share since the launch. Western Europe also experienced an improvement in momentum with availability of the new implant expanding across the half. Units increased by 5% with growth weighted to the second quarter."

While market share is growing in Western Europe, market growth continues to be challenging with many countries limited by funding caps or restrictive indications, which will take many years to change. Mr Howitt said, "We continue to build our market access capability to assist in removing barriers to growth. Over the past few years there has been an expansion of clinical indications and reimbursement for cochlear implants across many countries including Japan (Oct17), the UK (Mar19) and Belgium (Aug19), more than doubling the total addressable market for implants in each market. While these changes take time to flow through to referral behaviour, we are experiencing a strong lift in demand in Japan."

Emerging market units increased by over 20%, with growth delivered across many regions including the Middle East and China. Mr Howitt said, "Emerging markets provide a long-term growth opportunity as awareness of and affordability for cochlear implants expands. The result reflects the benefits of investments made over many years to strengthen Cochlear's presence across all regions."

Services revenue grew by 9% (5% in CC), with sound processor upgrade revenue increasing by 5% in CC. Mr Howitt said, "Services continues to benefit from the uptake of the Nucleus® 7 Sound Processor albeit at a slower rate as penetration rates reach high levels across the developed markets. The business also had a very strong HY19 result in which revenue grew 21% in CC."

Acoustics revenue declined by 9% (13% in CC) with some loss of market share from competitor product launches. The market also slowed more than expected in anticipation of the launch of the next generation bone conduction implant, the Cochlear™ Osia® 2 System.

Underlying profits flat with operating profit growth offset by foreign currency contract losses

Cochlear delivered underlying net profit of $132.7 million, which was in line with HY19 (flat in CC). Reported net profit did not benefit from the lower Australian dollar due to currency hedging, with foreign exchange contract losses of $21.9 million in the half. As a result, profit growth was the same in both reported and constant currency. The Board has declared an interim dividend of $1.60, an increase of 3%, representing a payout of 70% of underlying net profit.

Mr Howitt said, "We have continued to invest in product development and market growth initiatives to drive long-term market growth. The balance sheet is strong with cash flow generation sufficient to fund investing activities, capital expenditure and growing dividends to shareholders whilst maintaining conservative gearing levels."

Reported profits benefit from revaluation of the innovation fund

Cochlear's innovation fund has made several small investments in companies with novel technologies that may, over the longer term, enhance or leverage Cochlear's core technology. The innovation fund includes investments in Saluda, Nyxoah and EpiMinder.

On 13 February, Cochlear agreed to invest an additional €8.0 million (A$13.0 million) in Nyxoah as part of a €25.0 million private financing round from new and existing investors. As a result, Cochlear's original €13.0 million investment was revalued to €35.5 million, resulting in a pre-tax gain of €22.5 million (A$25.0 million after-tax), which has been recognised in reported net profit as a revaluation of the innovation fund.

Update to dividend policy

The Board has updated the dividend policy from a target payout of around 70% of net profit to around 70% of underlying net profit. Underlying net profit excludes after-tax gains or losses from innovation fund investments.

Launch of the Cochlear™ Osia® 2 System

In November 2019, Cochlear received FDA clearance for the Osia 2 System. Mr Howitt said, "The Osia 2 System expands our Acoustics portfolio into the next generation of bone conduction hearing solutions. It is the world's first active osseointegrated steady-state implant, using digital piezoelectric stimulation to bypass damaged areas of the natural hearing system, sending sound vibrations directly to the cochlea. Pre-market trials have demonstrated significant improvements in outcomes for patients[3] over traditional bone conduction hearing solutions, creating high demand for the new implant ahead of its launch."

Anticipation of the launch of the new implant contributed to a decline in Acoustics sales in the first half across both North America and Western Europe as surgeons held back Baha surgeries for patients that may benefit from the new implant. The US commenced commercial rollout of the Osia 2 System in early 2020. CE mark will, however, take longer than originally expected as it will be assessed under the new European Medical Device Regulations, with approval not expected until mid to late 2021.

Mr Howitt said, "We believe the Osia 2 System is the right product to drive category growth and deepen penetration of bone conduction implants over time. The new implant represents a significant improvement in performance, aesthetics and quality of life for bone conduction patients with an enthusiastic response from surgeons and patients over the past few months. Over the coming years there is still a lot of work to do to broaden reimbursement and access. We anticipate Acoustics sales will continue to be impacted in Europe until regulatory approval has been achieved."

Launch of the Cochlear™ Nucleus® Profile™ Plus with Slim 20 Electrode (CI624)

On 14 February, Cochlear received FDA approval for the Cochlear™ Nucleus® Profile™ Plus with Slim 20 Electrode (CI624). The Slim 20 Electrode expands Cochlear's portfolio which consists the slimmest atraumatic electrodes on the market, providing an option for surgeons who prefer an insertion depth of up to 20mm with a lateral wall electrode. Mr Howitt said, "The addition of the Slim 20 Electrode further strengthens Cochlear's market leading portfolio of electrodes designed for structural preservation, hearing performance, and surgeon preference."

Cochlear will commence the commercial rollout of the Slim 20 Electrode in the US during 2020.

---

[3] ClinicalTrials.gov [Internet]. Bethesda (MD): National Library of Medicine (US); 2017 March 22. Identifier NCT03086135. Clinical Performance of a New Implant System for Bone Conduction Hearing; 2019 January 31 [cited 2019 June 20]; [4 screens]. Available from: https://clinicaltrials.gov/ct2/show/NCT03086135

FY20 financial outlook

For FY20, Cochlear expects to deliver underlying net profit of $270-290 million, a 2-9% increase on underlying net profit for FY19. The guidance outlook was reduced from $290-300 million on 11 February due to an expected impact from the novel coronavirus (COVID-19). Mr Howitt said, "While we are delivering strong results from the cochlear implant business, profit growth will be lower than our original expectations due to the impact of the coronavirus on sales in Greater China."

For the second half, Cochlear expects strong growth in cochlear implant units to continue across the developed markets, driven by growing uptake of the Nucleus Profile Plus Series cochlear implant and the continued investment in market awareness and access activities.

Services revenue is expected to grow for the full year although at a lower rate than previous years as penetration rates of the Nucleus 7 Sound Processor reach high levels across the developed markets and the business cycles a strong FY19 result.

Acoustics revenue is expected to decline for the full year following a decline in the first half. While the second half will benefit from the launch of the Osia 2 System in the US, the European launch is now not expected during FY20.

Cochlear expects an impact to sales from the coronavirus in Greater China in the second half with hospitals currently deferring surgeries, including cochlear implants, to limit the risk of infection from the virus. While Cochlear cannot predict how long surgeries will be delayed, the low end of guidance factors in a significant decline in sales for Greater China for the second half. Cochlear is confident that many of the delayed surgeries will progress once hospitals resume normal operations.

Mr Howitt said, "As the global leader in implantable hearing solutions, we continue to be excited by the long-term opportunity to grow the hearing implant market. While we face some near-term challenges with the coronavirus and with delays to the approval for the Osia 2 System in Europe, our view to the longer-term opportunity to grow our markets remains unchanged.

"Our strategy to retain market leadership and grow the hearing implant market has clear priorities that drive investment decisions and capital allocation. And we have a strong financial position that enables the business to fund its growth activities while rewarding shareholders along the way with a growing dividend stream.

"We expect to continue to deliver growth in revenue and earnings in the coming years, underpinned by the investments made in product development and market growth initiatives. The balance sheet and free cash flow generation remain strong and we target a dividend payout ratio of around 70% of underlying net profit."

Additional considerations for FY20:

- Emerging market growth rates over time continue to be strong, however, annual growth rates can be variable driven by the timing of tender based activity, macro-economic conditions and political instability;
- Expecting foreign exchange contract losses for the second half to be around $10 million lower than the first half;
- Includes an estimated $1.0-1.5 million decline in net profit from the introduction of the new Australian leasing accounting standard (AASB16);
- Capital expenditure and investments to increase to around $180 million, including the continued development of the China manufacturing facility, fitout of the new, larger Denver office as well as investment in IT platforms. Capital expenditure is expected to drop to around $100 million in FY21;
- Underlying net profit excludes after-tax gains or losses from innovation fund investments. As the Nyxoah transaction increases Cochlear's ownership of Nyxoah above 20%, the investment will be equity-accounted from the second half of FY20; and
- Forecasting a weighted average AUD/USD exchange rate of 68 cents for FY20 (72 cents in FY19) and AUD/EUR of 0.62 EUR (0.63 EUR in FY19).

AMF patent dispute

Cochlear continues to expect a decision on the AMF appeal in 2020. Please refer to page 9 of the Directors Report for further details on the patent dispute.

For further information, please contact:

Analysts

Kristina Devon
Head of Investor Relations
Email: kdevon@cochlear.com
Ph: + 61 2 9611 6691

Media

Jennifer Stevenson
Head of Corporate Communications
Email: jstevenson@cochlear.com
Ph: +61 2 9611 6959

Authorised for lodgement by the Board of directors of Cochlear Limited

REGIONAL REVIEW

Sales revenue	HY20 $m	HY19 $m	Change % (reported)	Change % (CC)
Americas	381.9	350.5	⬆ 9%	⬆ 3%
EMEA (Europe, Middle East and Africa)	262.4	248.4	⬆ 6%	⬆ 3%
Asia Pacific	133.3	113.0	⬆ 18%	⬆ 13%
Total sales revenue	**777.6**	**711.9**	**⬆ 9%**	**⬆ 5%**

Americas (US, Canada & Latin America) – 49% of sales revenue

Sales revenue increased by 9% (up 3% in CC) with strong cochlear implant revenue growth moderated by low growth in Services revenue and a decline in Acoustics revenue. The US recorded an uplift of over 10% in cochlear implant units. The launch of the Nucleus Profile Plus Series cochlear implant in late June has been well-received by the market, driving an uplift in market share since launch.

Services revenue in the US was flat as the business cycled very strong sales in HY19, with penetration rates now reaching high levels. Acoustics sales declined with some loss of share from competitor product launches and a slowdown in surgeries in anticipation of the launch of the Osia 2 System.

The business continues to invest in expanding direct-to-consumer marketing in the US with a growing emphasis on working with the hearing aid channel to grow referrals. The Cochlear Provider Network continues to expand and is building education of the indications and benefits of cochlear implants to hearing aid audiologists and is starting to provide a referral pathway to cochlear implant surgeons.

The highlight in Latin America was solid growth in Services revenue driven by improved funding.

EMEA (Europe, Middle East and Africa) – 34% of sales revenue

Sales revenue increased by 6% (3% in CC) with strong cochlear implant revenue growth moderated by low growth in Services revenue and a decline in Acoustics revenue. Western Europe experienced an improvement in momentum with availability of the new implant expanding across the half. Units increased by 5% with growth weighted to the second quarter.

In August, Riziv, the Belgian Medicines Verification Organisation, announced the expansion of reimbursement criteria for cochlear implants to also include candidates with a severe hearing loss, a major milestone that is expected to support growth in Belgium over the coming years.

Like the US, Services revenue growth slowed as the business cycled very strong sales in HY19, with penetration rates now reaching high levels and Acoustics revenue declined.

Units and sales revenue across EMEA's emerging markets grew as a result of the timing of a number of tenders and is underpinned by investments in the organisation in recent years.

Asia Pacific (Australasia & Asia) – 17% of sales revenue

Sales revenue increased by 18% (13% in CC). Japan and Korea experienced strong growth across both cochlear implant units and sound processor upgrades. China recorded strong growth in sales revenue, benefitting from increased investment in sales and marketing capability over the past few years.

FINANCIAL REVIEW

Profit & loss

	HY20 $m	HY19 $m	Change % (reported)	Change % (CC)
Sales revenue	**777.6**	**711.9**	**9%**	**5%**
Cost of sales	192.2	179.5	7%	4%
% gross margin	*75%*	*75%*	*0 pts*	*0 pts*
Selling, marketing and general expenses	243.5	216.1	13%	9%
Research and development expenses	94.4	88.2	7%	6%
% of sales revenue	*12%*	*12%*		
Administration expenses	47.9	47.5	1%	0%
Total expenses	**578.0**	**531.3**	**9%**	**6%**
Other net income	6.0	8.0		
FX contract losses	(21.9)	(8.1)		
Earnings before interest and tax (EBIT)*	**183.7**	**180.5**	**2%**	**2%**
% of sales revenue	*24%*	*25%*		
Net finance expense	4.8	2.7	78%	
Income tax expense	46.2	45.7	1%	
% effective tax rate	*26%*	*26%*		
Net profit (underlying)*	**132.7**	**132.1**	**0%**	**0%**
*% net profit margin**	*17%*	*19%*		
Revaluation of innovation fund (after-tax)	25.0	(3.5)		
Net profit (reported)	**157.7**	**128.6**	**23%**	**22%**

* Excluding revaluation of innovation fund

Sales revenue increased by 9% (5% in CC) to $777.6 million. Reported net profit increased by 23% (22% in CC) to $157.7 million and includes $25.0 million in non-cash gains after-tax from the revaluation of innovation fund investments. Underlying net profit, which excludes the revaluation, was in line with HY19 (flat in CC), with the net profit margin declining by 2 percentage points to 17%.

Key points of note:

- Cost of sales increased by 7% (4% in CC) to $192.2 million, reflecting growing sales. The gross margin remained stable at 75% with a higher mix of lower margin sales from emerging markets offset by benefits from lower warranty costs, the result of improved sound processor manufacturing and design that has resulted in lower warranty repairs;
- Selling, marketing and general expenses increased by 13% (9% in CC) to $243.5 million. The increase reflects the continued investment in the sales force and direct-to-consumer marketing, with a growing investment in longer-term market growth activities including standard of care and market access initiatives. It also includes one-off costs associated with Brexit preparations;
- Investment in R&D increased 7% (6% in CC) to $94.4 million, representing 12% of sales revenue;
- Other net income of $6.0 million includes $6.9 million relating to a release in the contingent consideration value of Sycle ($5.3 million in HY19);
- FX contract losses increased by $13.8 million to $21.9 million;
- The $25.0 million after-tax revaluation of innovation fund investments reflects non-cash gains from the revaluation of the Nyxoah shareholding; and
- Net finance expenses increased by 78% and includes $2.8 million in interest expense resulting from the adoption of new leasing accounting standard AASB16 (see separate AASB16 note on page 8). Net finance expenses (excluding the lease-related expense) declined by 26% to $2.0 million with the business benefitting from lower interest rates.

Impact to income statement of adoption of AASB16

From FY20, Cochlear's accounts include the impact of the new lease accounting standard, AASB16, which changes the way that companies account for leased assets. For HY20, AASB16 has reduced Cochlear's net profit after tax by $0.5 million when compared to the prior accounting standard, AASB117. For FY20, Cochlear estimates a $1.0-1.5 million post-tax earnings impact from the introduction of AASB16. The following table summarises the impact to Cochlear's income statement of AASB16 for HY20 by highlighting lease expenses based on AASB16 versus the impact using the prior accounting standard, AASB117.

	HY20 (AASB16) $m	HY20 (AASB117) $m	Variance $m
Operating lease expenses	-	(15.0)	15.0
Depreciation and amortisation (lease-related)	(12.9)	-	(12.9)
EBIT	**(12.9)**	**(15.0)**	**2.1**
Interest expense (lease-related)	(2.8)	-	(2.8)
Net profit before tax	**(15.7)**	**(15.0)**	**(0.7)**
Income tax expense (lease-related)	4.7	4.5	0.2
Net impact of leases to income statement	**(11.0)**	**(10.5)**	**(0.5)**

Cash flow

	HY20 $m	HY19 $m	Change $m
EBIT (excluding revaluation of innovation fund)	183.7	180.5	3.2
Depreciation and amortisation (excl AASB16 impact)*	21.3	17.5	3.8
Changes in working capital and other	(15.1)	15.5	(30.6)
Net interest paid	(4.8)	(2.7)	(2.1)
Income taxes paid	(58.3)	(46.7)	(11.6)
Operating cash flow	**126.8**	**164.1**	**(37.3)**
Capital expenditure	(49.8)	(36.0)	(13.8)
Acquisition of other intangible assets	(10.8)	(8.7)	(2.1)
Other net investments	-	(20.9)	20.9
Free cash flow	**66.2**	**98.5**	**(32.3)**

* Depreciation and amortisation excludes the impact of the adoption of AASB16 to provide a like for like comparison to HY19

Operating cash flow decreased by $37.3 million to $126.8 million, with free cash flow reducing by $32.3 million to $66.2 million driven by increases in working capital and capital expenditure.

Key points of note:

- Changes in working capital and other decreased by $30.6 million due to an increase in inventory to support business growth, a reduction in trade payables, an increase in insurance prepayments and an increase in payments related to short-term incentives due to a change in policy from biannual to annual payments; and
- Capital expenditure (capex) increased by $13.8 million to $49.8 million, reflecting stay in business capex, the continued development of the China manufacturing facility, fitout of the new, larger Denver office and IT platform development.

Capital employed

	Dec19 $m	Jun19 $m	Change $m
Trade receivables	295.6	299.5	(3.9)
Inventories	204.0	195.4	8.6
Less: Trade payables	(147.4)	(160.8)	13.4
Working capital	352.2	334.1	18.1
*Working capital / sales revenue**	*23%*	*23%*	
Property, plant and equipment	190.9	166.5	24.4
Intangible assets	428.2	424.4	3.8
Investments	83.0	47.8	35.2
Other net liabilities	(104.0)	(143.9)	39.9
Capital employed	**950.3**	**828.9**	**121.4**

* Based on doubling HY20 sales revenue

Capital employed increased by $121.4 million to $950.3 million since June 2019 reflecting an increase in working capital, property, plant & equipment, investments and a reduction in other net liabilities.

Key points of note:

- Working capital increased by $18.1 million due to an increase in inventory to support business growth, including safety stock carried in case of a hard Brexit, and a reduction in trade payables;
- Property, plant and equipment increased by $24.4 million and includes the partly-constructed China manufacturing facility and fitout of the new Denver office;
- The increase in investments includes a $35.8 million pre-tax increase in the value of Cochlear's investment in Nyxoah;
- Other net liabilities reduced by $39.9 million to $104.0 million reflecting movements across a number of net liabilities including a $20.3 million net reduction in the value of forward foreign exchange contracts, resulting from the $21.9 million loss on foreign exchange contracts in the income statement; the establishment of a net lease liability of $19.9 million from the introduction of AASB16; a reduction in the Sycle earn out provision; a reduction in tax liabilities and a reduction in the warranty provision reflecting improved sound processor manufacturing and design that has resulted in lower warranty repairs.

Net debt

	Dec19 $m	Jun19 $m	Change $m
Loans and borrowings:			
Current	3.3	3.3	-
Non-current	230.4	178.3	52.1
Total loans and borrowings	233.7	181.6	52.1
Less: Cash and cash equivalents	(89.4)	(78.6)	(10.8)
Net debt	**144.3**	**103.0**	**41.3**

Net debt increased by $41.3 million to $144.3 million since June 2019, driven by increased working capital and capital investment.

Dividends

	HY20	HY19	Change %
Interim ordinary dividend (per share)	$1.60	$1.55	3%
% payout ratio (excluding revaluation of innovation fund investments)	70%	68%	
% franking	100%	100%	

An interim dividend of $1.60 per share has been declared, an increase of 3%, franked at 100%. The interim dividend is franked at 100% and represents a payout of 70% of underlying net profit.

The record date for determining dividend entitlements is 25 March 2020 and the interim dividend will be paid on 17 April 2020.

NOTES

Forward-looking statements

Cochlear advises that this document contains forward-looking statements which may be subject to significant uncertainties outside of Cochlear's control. No representation is made as to the accuracy or reliability of forward-looking statements or the assumptions on which they are based. Actual future events may vary from these forward-looking statements and it is cautioned that undue reliance not be placed on any forward-looking statement.

Non-IFRS financial measures

Given the significance of foreign exchange rate movements, the directors believe the presentation of the non-IFRS financial measure, constant currency, is useful for the users of this document as it reflects the underlying financial performance of the business. This non-IFRS financial measure has not been subject to review or audit. However, KPMG has separately undertaken a set of procedures to agree the non-IFRS financial measures disclosed to the books and records of the group.

Constant currency

Constant currency removes the impact of foreign exchange rate movements to facilitate comparability of operational performance for Cochlear. This is done by converting the prior comparable period net profit of entities in the group that use currencies other than Australian dollars at the rates that were applicable to the current period (translation currency effect) and by adjusting for current year foreign currency gains and losses (foreign currency effect). The sum of the translation currency effect and foreign currency effect is the amount by which reported EBIT and net profit is adjusted to calculate the result at constant currency.

Reconciliation of constant currency net profit

	HY20 $m	HY19 $m	Change %
Net profit (underlying)	**132.7**	**132.1**	**0%**
FX contract movement		(13.8)	
Spot exchange rate effect to sales revenue and expenses*		17.1	
Balance sheet revaluation*		(2.9)	
Net profit (underlying) (CC)	**132.7**	**132.5**	**0%**
Revaluation of innovation fund (after-tax)	25.0	(3.5)	
Net profit (reported) (CC)	**157.7**	**129.0**	**22%**

* HY20 actual v HY19 at HY20 rates