

## ASX Announcement

14 August 2018

### COCHLEAR FINANCIAL RESULTS FOR THE YEAR ENDED JUNE 2018

**Cochlear's market leadership position has strengthened with growth delivered across both developed and emerging markets in FY18**

- **Reported sales revenue up 9% (9% in constant currency<sup>1</sup>) to \$1,351.4m**
- **Cochlear implant units up 8% to 35,260 (units up 11% excluding Chinese Central Government tender units)**
- **Reported net profit of \$245.8m, up 10% (up 10% in CC)**
- **Solid cash flow generation supports the 14% increase in the final dividend, with full year dividends up 11%**
- **FY19 net profit guidance of \$265-275 million, an 8-12% increase on FY18**

<i>A\$m</i>	<b>FY18</b>	<b>FY17</b>	<b>Change % (reported)</b>	<b>Change % (CC)</b>
Cochlear implant units	<b>35,260</b>	32,554	↑ 8%	
Sales revenue	<b>1,351.4</b>	1,239.7	↑ 9%	↑ 9%
Earnings before interest & tax (EBIT)	<b>348.4</b>	315.6	↑ 10%	↑ 11%
Net profit	<b>245.8</b>	223.6	↑ 10%	↑ 10%
Basic earnings per share	<b>\$4.27</b>	\$3.90	↑ 10%	
Final dividend per share	<b>\$1.60</b>	\$1.40	↑ 14%	
Total dividends per share	<b>\$3.00</b>	\$2.70	↑ 11%	
Franking %	<b>100%</b>	100%		
Payout ratio %	<b>70%</b>	69%		

<sup>1</sup> 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.

## OVERVIEW

### FY18 operational highlights

Cochlear's CEO & President, Dig Howitt said, "The growth we have experienced over the past few years has continued in FY18. The business delivered strong growth in cochlear implant units and sales revenue, with net profit growing by 10% (10% in CC).

"We continued to execute on our strategy of investing to retain market leadership and drive market growth. Our market leadership position was enhanced by new product launches and improvements in the service offering to our customers. Market growth continued as awareness, indications and funding grew. And the expansion of direct-to-consumer marketing and focus on sales force expansion and effectiveness continued to support overall growth.

"The cochlear implant business grew strongly with CC revenue growth of 8% and unit growth of 8% (up 11% excluding Chinese Central Government tender units).

"Developed markets continued to perform well with unit growth increasing by 9%. Highlights include strong performances from the US and UK and solid unit growth across much of Western Europe, Australia and Japan. Emerging market units grew by over 15% (adjusted for the impact of lower Chinese Central Government tender units), with strong growth in the Middle East and the China private pay market.

"The Nucleus® 7 Sound Processor, the world's first Made for iPhone cochlear implant sound processor, was launched during the second quarter across key markets including the US, Western Europe and Australia, performing well in its first nine months. In June, the Nucleus Smart App for Android™ smartphone users was released, allowing recipients with a compatible Android device to control their hearing with the Nucleus Smart App. And the Baha® SoundArc was launched, providing a non-surgical bone conduction solution that works with all of Cochlear's Baha 5 sound processors.

"The Services business performed strongly, delivering CC revenue growth of 15% driven by the release of the Nucleus 7 Sound Processor and the first full year of Sycle revenue. Sound processor upgrade revenue increased by 12% in CC and Cochlear Family membership exceeded 100,000 members.

"The Acoustics business delivered CC sales in line with last year, following 26% CC growth last year, with demand continuing for the Baha 5 sound processor range."

### Over 500,000 implants sold

Mr Howitt said, "We reached a major milestone early in FY18, selling our 500,000<sup>th</sup> implant. We have now provided more than 550,000 of our cochlear implants, bone conduction implants and acoustic implants, helping a growing number of people hear with one – or two – of our implantable devices.

"While a wonderful milestone for the Company, it is also a reminder of the challenge, and opportunity, for Cochlear with fewer than 5% of the people who could benefit from an implantable hearing solution currently being treated."

### Strategic priorities focused on building awareness and market access, particularly for seniors

Mr Howitt said, "Cochlear's priorities are centred on the customer, with activities aimed at growing awareness and access to the industry for implant candidates. And with a growing recipient base, the Company is actively strengthening its servicing capability to provide products, programs and services to support the lifetime relationship with recipients.

“Cochlear has prioritised three market segments – adults and seniors in developed markets; children in developed markets; and children in emerging markets – with strategies to improve awareness and access tailored by segment.

“The adults and seniors in the developed markets provide the biggest opportunity for Cochlear given the large, and growing, market size as the population ages. The segment is however challenging to penetrate as most candidates suffer from a progressive hearing loss and, together with their care providers, either do not know about cochlear and bone conduction implants, or do not understand the indications for them.

“While penetration rates are currently very low, at around 3%, the seniors segment has been the fastest growing segment for Cochlear over the past few years as awareness increases.

“Cochlear has an important role to play in supporting cochlear implants becoming the standard of care for adults and seniors with severe to profound hearing loss. We have been increasing our investment in health economics, our market access capability and the collaborative partnerships we have with the medical research community to build on the clinical evidence that demonstrates the effectiveness of our products, particularly for seniors.

“Over the past 12 months, Cochlear has pledged funds to the Johns Hopkins Bloomberg School of Public Health to establish the ‘Cochlear Center for Hearing and Public Health’. The Center will be a first of its kind at any academic institution focused on addressing hearing loss as a global public health priority. We also announced the establishment of the co-funded Cochlear Chair in Hearing and Healthy Ageing at Macquarie University which aims to develop a leading platform for further impactful research in hearing in Australia.

“We will continue to invest in driving referrals via our successful direct-to-consumer marketing activities as well as through the hearing aid channel. And there continue to be opportunities to expand indications and reimbursement in many markets.”

### **Strong financial position**

Cochlear delivered net profit of \$245.8 million, an increase of 10% on FY17 (10% in CC), which was within the guidance range of \$240-250 million. Mr Howitt said, “Cochlear continues to deliver on its objective of delivering consistent revenue and earnings growth over time.

“Our investment in sales and marketing activities is building awareness of and access to implantable solutions and driving market growth. The investment in R&D continues to strengthen our leadership position through the development of market-leading technology. And by delivering a world-class customer experience, we empower our recipients to connect with others and live a full life.

“In FY18, the business delivered manufacturing efficiencies from improvements in its warranty and repair functions. These gains were reinvested into our market growth activities with the net profit margin maintained.

“We have a strong balance sheet and delivered operating cash flows in excess of net profit, enabling the business to fund capital investment, reduce debt and increase dividends to shareholders.”

## **FY19 financial outlook**

For FY19, Cochlear expects to deliver reported net profit of \$265-275 million, an 8-12% increase on FY18.

Mr Howitt said, "Growth is expected to continue across the business in FY19, underpinned by the significant investments made in product development and market growth initiatives over the previous few years.

"We will continue to invest operating cash flows in activities aimed at building awareness and market access, with the objective of delivering consistent revenue and earnings growth over the long-term. Through disciplined investment, we are targeting to maintain the net profit margin, reinvesting any efficiency gains, currency or tax benefits into market growth activities.

"Over the next few years, we have a number of large long-term investment projects including the development of our China manufacturing facility, with the construction phase expected to be complete by the end of FY20, and investments in IT platforms to strengthen our connected health, digital and cyber security capabilities. These projects are expected to increase capital expenditure levels to \$80-100 million per annum over the next few years.

"The balance sheet and free cash flow generation remain strong and we continue to target a dividend payout ratio of around 70% of net profit."

Key guidance considerations for FY19:

- Expect growth across the developed markets, which represent around 80% of cochlear implant revenue, to continue;
- 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 and macro-economic conditions;
- Continued investment to retain market leadership and drive long-term market growth with the target of maintaining the net profit margin; and
- Forecasting a weighted average AUD/USD exchange rate of 75 cents for FY19 (77 cents in FY18) and AUD/EUR of 0.63 EUR (0.65 EUR in FY18).

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## PRODUCT & SERVICE HIGHLIGHTS

	FY18 \$m	FY17 \$m	Change % (reported)	Change % (CC) <sup>1</sup>
Cochlear implants (units)	35,260	32,554	↑ 8%	
<i>Sales revenue</i>				
Cochlear implants	831.0	767.8	↑ 8%	↑ 8%
Services (sound processor upgrades and other)	355.2	305.6	↑ 16%	↑ 15%
Acoustics (bone conduction and acoustic implants)	165.2	166.3	↓ 1%	0%
<b>Total sales revenue</b>	<b>1,351.4</b>	<b>1,239.7</b>	<b>↑ 9%</b>	<b>↑ 9%</b>

### Cochlear implants – 62% of sales revenue

Cochlear implant revenue grew 8% (8% in CC) with unit growth of 8% (up 11% excluding the impact of Chinese Central Government tender units). Reported average selling prices were stable in constant currency driven by country mix. However, there was continued downward pressure in prices in some markets, particularly Western Europe.

Across the developed world, the cochlear implant market continues to experience robust growth, with improving awareness and growing uptake in the adults and seniors segment. Cochlear's developed markets business, which represents around 80% of revenue, grew units by 9%, with highlights including continued strong performances from the US and UK.

The Nucleus 7 Sound Processor, the world's first Made for iPhone cochlear implant sound processor, was launched across key markets during the second quarter and has performed strongly, driving market share gains for Cochlear.

The increase in sales revenue also reflects continued investments in market growth initiatives including direct-to-consumer activities and sales force expansion. These initiatives help build awareness of implantable hearing solutions and support further penetration into the adult segment.

Emerging markets units grew by over 15% (adjusted for the impact of lower Chinese Central Government tender units), with highlights including strong unit growth in the Middle East and the China private pay market. The FY18 result included around 1,100 Chinese Central Government tender units compared to around 1,900 in FY17.

### Services (sound processor upgrades and other) – 26% of sales revenue

Reported Services sales revenue increased by 16% (15% in CC) driven by the release of the Nucleus 7 Sound Processor during the second quarter and first full year of revenue from Sycle, the audiology practice management software business acquired in May 2017.

Sound processor upgrade revenue increased by 12% in CC, with the Nucleus 7 Sound Processor available as an upgrade in key markets from October. Cochlear continues to invest to provide its growing customer base with a world-class customer experience with increased connectivity and engagement. Cochlear's recipient membership program, Cochlear Family, continues to grow rapidly, with membership growing by 70% this year to now exceed 100,000 members.

### Acoustics (bone conduction and acoustic implants) – 12% of sales revenue

Reported Acoustics revenue declined by 1% (0% in CC), following 26% growth in CC in FY17, with solid demand continuing for the Baha 5 sound processor range.

## REGIONAL REVIEW

Sales revenue	FY18 \$m	FY17 \$m	Change % (reported)	Change % (CC)
Americas	648.5	595.0	↑ 9%	↑ 11%
EMEA (Europe, Middle East and Africa)	478.9	428.5	↑ 12%	↑ 7%
Asia Pacific	224.0	216.2	↑ 4%	↑ 5%
<b>Total sales revenue</b>	<b>1,351.4</b>	<b>1,239.7</b>	<b>↑ 9%</b>	<b>↑ 9%</b>

### Americas (US, Canada & Latin America) – 48% of sales revenue

Reported sales revenue increased by 9% (11% in CC). The highlight was the growth in the US with cochlear implant unit growth of around 15%, the result of market growth as well as market share gains. Growth has been driven by new product introductions and the success of awareness building initiatives which continue to drive overall market growth rates, particularly in the seniors segment.

The expanded field sales organisation, direct-to-consumer marketing, increased referrals from hearing aid retailers and improvements in sales force effectiveness have continued to contribute to growth in the US.

### EMEA (Europe, Middle East and Africa) – 35% of sales revenue

Reported sales revenue increased by 12% (7% in CC). Unit growth in the UK was the highlight, with solid growth across many countries in Western Europe. Like the US, Western Europe is benefiting from the expanded field sales organisation and direct-to-consumer marketing which are building awareness of cochlear implants and driving demand at clinics.

Expansion of indications and funding for cochlear implantation in Western Europe continues to be a key opportunity and focus area, with much of the region restricting access and funding to candidates with a profound hearing loss.

After a soft start to the year, units and sales revenue across EMEA's emerging markets, including Central & Eastern Europe and the Middle East & Africa, grew strongly primarily as a result of the timing of a number of tenders.

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

Reported sales revenue increased by 4% (5% in CC). Australia and Japan experienced solid unit growth, with private pay and non-tender business in Greater China growing strongly. Solid unit growth was delivered across a number of smaller countries in the region driven by a combination of tender activity, expanded indications and Cochlear's growing presence.

Overall sales revenue at the regional level was impacted by Chinese Central Government tender units. The FY18 result includes around 1,100 Chinese Central Government tender units compared to around 1,900 in FY17.

## FINANCIAL REVIEW

### Profit & loss

	FY18 \$m	FY17 \$m	Change % (reported)	Change % (CC) <sup>1</sup>
<b>Sales revenue</b>	<b>1,351.4</b>	<b>1,239.7</b>	<b>9%</b>	<b>9%</b>
Cost of goods sold	361.2	358.4	1%	1%
<i>% gross margin</i>	73%	71%		
Selling, marketing and general expenses	397.0	347.2	14%	14%
Administration expenses	97.4	85.2	14%	14%
Research and development expenses	167.7	151.9	10%	9%
<i>% of sales revenue</i>	12%	12%		
<b>Total expenses</b>	<b>1,023.3</b>	<b>942.7</b>	<b>9%</b>	<b>8%</b>
Other net income	8.0	4.5		
FX contract gains	12.3	14.1		
<b>Earnings before interest and tax (EBIT)</b>	<b>348.4</b>	<b>315.6</b>	<b>10%</b>	<b>11%</b>
<i>% of sales revenue</i>	26%	25%		
Net finance expense	7.9	6.8	16%	
Income tax expense	94.7	85.2	11%	
<i>% effective tax rate</i>	28%	28%		
<b>Net profit</b>	<b>245.8</b>	<b>223.6</b>	<b>10%</b>	<b>10%</b>

Reported sales revenue increased by 9% (9% in CC) to \$1,351.4 million while total expenses increased by 9% (8% in CC) to \$1,023.3 million. As a result, the business generated an EBIT increase of 10% (11% in CC) to \$348.4 million, with the EBIT margin increasing by one percentage point to 26%.

#### Key points of note:

- Reported cost of goods sold increased by 1% (1% in CC) to \$361.2 million, reflecting manufacturing efficiencies, lower warranty costs and lower repair expenses resulting from the centralisation of repairs. As a result, gross margin increased by two percentage points to 73%;
- Selling, marketing and general expenses increased by 14% (14% in CC) to \$397.0 million. The increase reflects the continued investment in the sales force and expanded marketing activities and the first full year inclusion of expenses related to Sycle, which was acquired in May 2017;
- Administration expenses increased by 14% (14% in CC) to \$97.4 million with additional corporate investment required to support business growth;
- Investment in R&D increased 10% (9% in CC) to \$167.7 million, and was in line with FY17 at 12% of sales revenue;
- Other net income of \$8.0 million includes \$5.3 million relating to a reduction in the contingent consideration value of Sycle; and
- Income tax expense includes a \$4.6 million net impact resulting from the change to the US federal corporate tax rate (see next note for details).



### Impact of changes to US tax legislation

The US Government passed the Tax Cuts and Jobs Act which contained significant tax reform measures. The major change in legislation to affect Cochlear is from the reduction in the US federal corporate tax rate from 35% to 21%, effective 1 January 2018.

As a consequence of the reduction in corporate tax rates, Cochlear was required to revalue its US deferred tax assets as at 31 December 2017, resulting in a reduction in the value of the asset. The first half result included a one-time non-cash expense of \$5.5 million, reflecting the revaluation of the deferred tax assets. There was a further \$0.8 million adjustment in the second half, taking the FY18 impact to \$6.3 million.

From 1 January 2018, Cochlear generated an ongoing annual cash tax benefit from the lower corporate tax rate and this amounted to \$1.7 million in the second half.

### Cash flow

	FY18 \$m	FY17 \$m	Change \$m
EBIT	348.4	315.6	32.8
Depreciation and amortisation	34.2	31.2	3.0
Changes in working capital and other	(15.3)	(0.6)	(14.7)
Net interest paid	(7.9)	(7.9)	-
Income taxes paid	(101.3)	(78.5)	(22.8)
<b>Operating cash flow</b>	<b>258.1</b>	<b>259.8</b>	<b>(1.7)</b>
Capital expenditure	(42.0)	(35.3)	(6.7)
Acquisition of land & buildings	(2.6)	(27.5)	24.9
Acquisition of subsidiary (Sycle)	-	(63.7)	63.7
Acquisition of other intangible assets	(5.1)	(8.2)	3.1
Other net investments	(5.7)	(0.9)	(4.8)
<b>Free cash flow</b>	<b>202.7</b>	<b>124.2</b>	<b>78.5</b>

The business generated \$258.1 million in operating cash flow, with free cash flow increasing by \$78.5 million to \$202.7 million.

#### Key points of note:

- EBIT increased by \$32.8 million driven by the 9% increase in sales revenue;
- Income taxes paid increased by \$22.8 million to \$101.3 million, reflecting higher earnings and the impact of the timing of cash tax payments;
- Capital expenditure increased by \$6.7 million to \$42.0 million, primarily driven by additional investment in plant and equipment and IT systems; and
- Other net investments of \$5.7 million includes investments made in Sensorion, a French biotech company pioneering novel treatments for inner ear diseases, and Epi-Minder, a new Australian venture launched to develop a breakthrough monitoring device aiming to improve treatment of patients suffering with epileptic seizures and related conditions.



## Capital employed

	FY18 \$m	FY17 \$m	Change \$m
Trade receivables	299.1	275.4	23.7
Inventories	167.4	160.0	7.4
Less: Trade and other payables	(140.5)	(130.9)	(9.6)
<b>Working capital</b>	<b>326.0</b>	<b>304.5</b>	<b>21.5</b>
<i>Working capital / sales revenue</i>	<i>24%</i>	<i>25%</i>	
<i>Debtor days</i>	<i>69</i>	<i>74</i>	<i>(5)</i>
<i>Inventory days</i>	<i>171</i>	<i>164</i>	<i>7</i>
Property, plant and equipment	128.4	120.1	8.3
Intangible assets	345.3	340.0	5.3
Other net liabilities	(102.7)	(91.6)	(11.1)
<b>Capital employed</b>	<b>697.0</b>	<b>673.0</b>	<b>24.0</b>

Capital employed increased by \$24.0 million to \$697.0 million since June 2017, primarily as a result of an increase in working capital.

Key points of note:

- Working capital increased by \$21.5 million, reflecting increased sales revenue. Working capital as a percentage of sales revenue declined by one percentage point to 24%, with debtor days reducing by 5 days to 69 days; and
- Other net liabilities increased by \$11.1 million to \$102.7 million. Other net liabilities include a reduction of \$6.3 million in the value of US deferred tax assets. The reduction was a consequence of the legislated reduction in US corporate tax rates, which required a revaluation of US deferred tax assets as at 31 December 2017.

## Net debt

	FY18 \$m	FY17 \$m	Change \$m
Loans and borrowings:			
Current	3.7	84.7	(81.0)
Non-current	144.0	134.2	9.8
<b>Total debt</b>	<b>147.7</b>	<b>218.9</b>	<b>(71.2)</b>
Less: Cash and cash equivalents	(61.5)	(89.5)	28.0
<b>Net debt</b>	<b>86.2</b>	<b>129.4</b>	<b>(43.2)</b>

Net debt decreased by \$43.2 million to \$86.2 million, driven by improved earnings and initiatives to improve cash management.

## Dividends

	FY18	FY17	Change %
Interim ordinary dividend (per share)	\$1.40	\$1.30	8%
Final ordinary dividend (per share)	\$1.60	\$1.40	14%
Total ordinary dividends (per share)	\$3.00	\$2.70	11%
Payout ratio %	70%	69%	
Franking %	100%	100%	

Strong free cash flow and the continued strength of the balance sheet have supported the declaration of a final dividend of \$1.60 per share, an increase of 14%. Full year dividends increased by 11% to \$3.00 per share, franked at 100% and representing a payout of 70% of net profit.

The record date for determining dividend entitlements is 18 September 2018 and the final dividend will be paid on 10 October 2018.

## 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 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 to reported net profit

	FY18 \$m	FY17 \$m	Change %
<b>Net profit (reported)</b>	<b>245.8</b>	<b>223.6</b>	<b>10%</b>
FX contract gains		(1.8)	
Spot exchange rate effect to sales and expenses*		1.4	
Balance sheet revaluation*		(0.3)	
<b>Net profit (CC)</b>	<b>245.8</b>	<b>222.9</b>	<b>10%</b>

\* FY18 actual v FY17 at FY18 rates.