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ASX Announcement

17 August 2017

COCHLEAR FINANCIAL RESULTS FOR YEAR ENDED JUNE 2017

Cochlear's market leadership position has strengthened with market growth and market share improvements throughout the year

- **Net profit of $223.6m, up 18% in Australian dollars**
- **Sales revenue up 7% in Australian dollars (12% in constant currency[1]) to $1.2 billion, with 15% CC sales revenue growth in the second half**
- **Cochlear implant units up 8% to 32,554 (up 14% excluding Chinese Central Government tender units)**
- **Strong uplift in operating cash flows supporting the 17% increase in the final dividend**
- **FY18 net profit guidance of $240-250 million, based on an AUD/USD of 80 cents**

A$m	**FY17**	**FY16**	**Change % (reported)**	**Change % (CC)**
Cochlear implant units	32,554	30,172	⬆ 8%	
Sales revenue	1,239.7	1,158.1	⬆ 7%	⬆ 12%
Earnings before interest & tax (EBIT)	315.6	262.6	⬆ 20%	⬆ 15%
Net profit	223.6	188.9	⬆ 18%	⬆ 11%
Basic earnings per share	$3.90	$3.31	⬆ 18%	
Final dividend per share	$1.40	$1.20	⬆ 17%	
Total dividends per share	$2.70	$2.30	⬆ 17%	
Franking %	100%	100%		
Payout ratio %	69%	70%		

[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.

OVERVIEW

FY17 operational highlights

Cochlear's Chief Executive Officer, Chris Smith said, "The positive momentum we have experienced over the past few years has continued throughout FY17 with strong growth in sales revenue and units delivered across all regions, with reported net profit growing by 18%.

"Cochlear's market leadership position has strengthened with market growth and market share improvements throughout the year underpinned by successful new product launches, growing investment in direct-to-consumer marketing and sales force expansion.

"The core cochlear implant business grew strongly with CC revenue growth of 10% and unit growth of 8%.

"Developed market unit growth was particularly strong, increasing by 12%, with highlights including continued strong performances from the US and Western Europe.

"Emerging market units grew by around 20% (adjusted for the impact of lower Chinese Central Government tender units), with continuing strong growth in India and solid improvements in Latin America and Central & Eastern Europe.

"During the year, the Kanso® Sound Processor, our first off-the-ear sound processor, and the Nucleus® Profile Slim Modiolar (CI532) electrode, the world's slimmest electrode, were launched, with both products experiencing strong uptake.

"In July 2017, we introduced the Nucleus 7 Sound Processor, the world's first Made for iPhone cochlear implant sound processor, which will allow users to stream sound from an iPhone®, iPad® and iPod touch® directly to their sound processor, offering greater accessibility, connectivity and wireless solutions. The Nucleus 7 Sound Processor has received FDA and CE mark approval and will commence full commercial rollout in September.

"Cochlear continues to demonstrate its commitment to being the technology leader in our industry with ongoing investment in research and development (R&D). During the year we invested $152 million, 12% of sales revenue, in R&D with a pipeline of new products expected to be launched over the coming years.

"The Services business, which includes sound processor upgrades and accessories, delivered CC revenue growth of 10% driven by continuing demand for the Nucleus 6 Sound Processor and the popularity of the Kanso Sound Processor. Second half momentum was particularly strong with 17% CC sales growth, with upgrade penetration reaching around 40% across the developed markets.

"The Acoustics business had a strong year with sales growth of 26% in CC. Strong growth in both new system sales and upgrades was driven by the popularity of the Baha® 5 range of sound processors."

Strong financial position

Mr Smith said, "Cochlear has continued to invest to drive growth, delivering a strong profit result with net profit up 18% to $224 million (11% in CC). Operating cash flow increased by 40% to $260 million, funding acquisitions and dividend payments with only a minimal increase in net debt."

Solid progress made against business priorities

"Cochlear's priorities are focused on the customer with initiatives aimed at maintaining technology leadership and accelerating market growth through global expansion of awareness and increased market access initiatives. With a growing recipient base, now numbering over 450,000, we are actively strengthening our servicing capability to provide products, programs and digital services to support the lifetime relationship with our recipients.

"We made progress against our business priorities which are focused on growing the core, building a service business, shaping the organisation and value creation. The key areas of focus have been on continuing to expand the sales force across major developed and emerging markets, expanding our direct-to-consumer programs in the US, Australia, Germany, UK and India and building greater engagement with our recipient base," said Mr Smith.

FY18 financial outlook

For FY18, Cochlear expects reported net profit to increase to $240-250 million, with currency headwinds expected to moderate strong underlying business growth.

Cochlear's President, Dig Howitt said, "Positive momentum continues across the business with the significant investments made in product development and market growth initiatives over the previous few years expected to underpin growth in FY18. In particular, we expect the launch of the Nucleus 7 Sound Processor, which commences its full market release from September, to contribute to both implant growth and upgrade demand over the coming years. The stronger Australian dollar will however have an impact on earnings, and is likely to reduce underlying net profit growth by a few percentage points in FY18.

"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 FY18:

- expect solid momentum in unit growth to continue, which will be supported by further investment in market access and market growth activities;
- expect net profit to be weighted to the second half given the timing of the Nucleus 7 Sound Processor launch;
- expect R&D expenditure to be $160-170 million; and
- forecasting a weighted average AUD/USD exchange rate of 80 cents for FY18 versus 75 cents in FY17.

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PRODUCT & SERVICE HIGHLIGHTS

	FY17	FY16	Change % (reported)	Change % (CC)
Cochlear implants (units)	32,554	30,172	⬆ 8%	
Sales revenue *(A$m)*				
Cochlear implants	767.8	729.2	⬆ 5%	⬆ 10%
Services (sound processor upgrades & accessories)	305.6	289.4	⬆ 6%	⬆ 10%
Acoustics (bone conduction & acoustic implants)	166.3	139.5	⬆ 19%	⬆ 26%
Total sales revenue	**1,239.7**	**1,158.1**	⬆ **7**%	⬆ **12**%

Cochlear implants – 62% of sales revenue

Cochlear implant revenue grew 5% in Australian dollars (10% in CC) with unit growth of 8% (14% excluding the benefit of Chinese Central Government tender units). Globally, the average selling price declined modestly driven by currency, regional mix and some minor pricing reductions.

Developed markets grew units by 12% with highlights including continued strong performances from the US and Western Europe. Emerging markets units grew by around 20% (adjusted for Chinese Central Government tender units) with continuing strong growth in India with solid improvements in Latin America and Central & Eastern Europe.

Cochlear's first off-the-ear sound processor, Kanso, was released during the first half. Uptake has exceeded expectations and contributed to market share gains during the year. The electrode portfolio was expanded with the full market release of the new Slim Modiolar electrode in Europe, the US and Canada with a strong uptake of the electrode since launch.

The increase in sales revenue also reflects continued investments in market growth initiatives including direct-to-consumer activities and field expansion of over 100 people. These initiatives help build awareness of implantable hearing solutions and support further penetration into the adult segment.

Services (sound processor upgrades and accessories) – 25% of sales revenue

Services sales revenue increased by 6% in Australian dollars (an increase of 10% in CC) driven by the continuing uptake of the Nucleus 6 Sound Processor and the popularity of the Kanso Sound Processor. Second half momentum was particularly strong with 17% CC sales growth.

Upgrade penetration since the release of the Nucleus 6 Sound Processor has been strong with close to 40% of recipients in developed markets upgrading their processors since it was first launched in September 2013, with penetration rates exceeding 50% in a number of key markets including Australia and the UK.

As part of the commitment to increase recipient engagement and provide recipients with a great customer experience, the business continued to rollout a number of service-oriented programs. Cochlear's recipient membership program, Cochlear Family, is growing rapidly, with membership growing by over 150%, to around 60,000 recipients, this year. Recruitment continues to be a priority with Cochlear Family members upgrading their sound processors at a significantly higher rate than that of non-members.

Acoustics (bone conduction and acoustic implants) – 13% of sales revenue
Acoustics, which includes bone conduction and acoustic implant sales revenue, grew 19% in Australian dollars (26% in CC) with solid performances across all regions. Strong growth in both new system sales and upgrades was driven by the popularity of the Baha 5 range of sound processors.

REGIONAL REVIEW

Sales revenue *(A$m)*	**FY17**	**FY16**	**Change % (reported)**	**Change % (CC)**
Americas	595.0	519.7	⬆ 14%	⬆ 18%
EMEA (Europe, Middle East & Africa)	428.5	427.9	0%	⬆ 7%
Asia Pacific	216.2	210.5	⬆ 3%	⬆ 4%
Total sales revenue	**1,239.7**	**1,158.1**	⬆ **7%**	⬆ **12%**

Americas (US, Canada & Latin America) – 48% of sales revenue
Sales revenue increased by 14% in Australian dollars (18% in CC). The highlight was the growth in the US with cochlear implant unit growth of over 15%. Growth overall has been driven by new product introductions and the success of awareness building initiatives which continue to drive overall market growth rates. Services revenue grew strongly, supported by the success of the Kanso Sound Processor.

The expanded field sales organisation, direct-to-consumer marketing and improvements in sales force effectiveness have also supported strong market growth rates.

Overall Latin American unit growth and sales revenue have recovered well after declining in FY16.

EMEA (Europe, Middle East and Africa) – 35% of sales revenue
Sales revenue was flat in Australian dollars (increasing by 7% in CC). Western Europe unit growth was over 10% with consistent rates of growth delivered across most countries. Investments in market growth initiatives and the positive reception to the Kanso Sound Processor, the Slim Modiolar electrode and the Baha 5 range of sound processors drove market share across many markets.

Central & Eastern Europe also performed well with the region benefiting from Cochlear's expanding presence, while units declined in a number of emerging markets, a result of the timing of tenders.

Asia Pacific (Australasia & Asia) – 17% of sales revenue
Sales revenue increased by 3% in Australian dollars (4% in CC). Strong growth was experienced across India, Korea and several South East Asian markets driven by the expansion of the field force, growing clinic numbers and improvements in reimbursement. Growth at the regional level was however moderated by the impact of tender units. In particular, the result includes around 1,900 Chinese Central Government tender units, which compares to over 3,300 units in FY16.

FINANCIAL REVIEW

Profit & loss

A$m	FY17	FY16	Change % (reported)	Change % (CC)[1]
Sales revenue	**1,239.7**	**1,158.1**	**7%**	**12%**
Cost of goods sold	358.4	333.6	7%	10%
% of sales revenue	*29%*	*29%*		
Selling, marketing and general expenses	348.9	324.1	8%	13%
Administration expenses	83.5	79.3	5%	6%
Research and development expenses	151.9	145.1	5%	7%
% of sales revenue	*12%*	*13%*		
Total expenses	**942.7**	**882.1**	**7%**	**10%**
Other income	4.5	14.1		
FX contract gains / (losses)	14.1	(27.5)		
EBIT	**315.6**	**262.6**	**20%**	**15%**
% of sales revenue	*25%*	*23%*		
Net finance costs	6.8	8.3	(19%)	
Taxation expense	85.2	65.4	30%	
% effective tax rate	*28%*	*26%*		
Net profit	**223.6**	**188.9**	**18%**	**11%**

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

Sales revenue increased by 7% (12% in CC) to $1,239.7 million while total expenses increased by 7% (10% in CC) to $942.7 million. As a result, the business generated an EBIT increase of 20% (15% in CC) to $315.6 million with the EBIT margin increasing by two points to 25%.

Key points of note:

- Cost of goods sold (COGS) increased by 7% (10% in CC) to $358.4 million, primarily as a result of growing volumes. COGS as a percentage of sales revenue remained steady at 29%;
- Selling, marketing and general expenses increased by 8% (13% in CC) to $348.9 million. The increase reflects the continued investment in the sales force and expanded marketing activities;
- Investment in R&D increased 5% (7% in CC) to $151.9 million, representing 12% of sales revenue;
- Other income of $4.5 million includes $0.4 million in foreign exchange (FX) gains on translation of certain balance sheet assets, primarily working capital. This compares to $8.7 million in FX gains in FY16, an $8.3 million reduction;

- Reported net profit includes $20.0 million of FX translation impacts, a result of the rising Australian dollar. The most significant impacts were from the increase in the weighted average AUD/USD (from around 73 cents to over 75 cents), AUD/GBP (from around 49 cents to 59 cents) and AUD/EUR (from 66 cents to 69 cents) in FY17;
- FX contract gains on hedged sales were $14.1 million, reflecting the impact of the AUD appreciation against many of the major currencies compared to FY16 rates. This compared to FX contract losses on hedged sales of $27.6 million in FY16 as unfavourable FX contracts rolled off;
- Net finance costs reduced by 19% to $6.8 million, reflecting lower average net debt levels for the year, more favourable facility terms and improved interest income; and
- During the first half, the Australian Government reduced the R&D tax concession rate from 40.0% to 38.5%, effective from 30 June 2016. In FY16, Cochlear had approximately $100 million in qualifying R&D investments which delivered a full year benefit to net profit of around $10 million. The change in legislation reduced the tax benefit to around $8.5 million, a $1.5 million reduction in FY17 compared to FY16. Cochlear's effective tax rate increased from 26% to 28%, reflecting the reduced R&D concession rate.

Cash flow

A$m	**FY17**	**FY16**	**Change $**
EBIT	315.6	262.6	53.0
Depreciation and amortisation	31.2	33.5	(2.3)
Change in working capital and other	(0.6)	(20.0)	19.4
Net interest paid	(7.9)	(10.3)	2.4
Income taxes paid	(78.5)	(80.7)	2.2
Operating cash flow	**259.8**	**185.1**	**74.7**
Capital expenditure	(26.0)	(28.9)	2.9
Acquisition of Lane Cove property	(27.6)	-	(27.6)
Acquisition of subsidiary (Sycle)	(63.7)	-	(63.7)
Other investments	(18.3)	(21.2)	2.9
Free cash flow	**124.2**	**135.0**	**(10.8)**

The business generated strong cash flows with operating cash flow increasing by $74.7 million, up 40%, to $259.8 million, primarily driven by increased earnings. Free cash flow declined by $10.8 million, reflecting acquisitions made during the year.

Key points of note:

- Cochlear acquired its long-term manufacturing facility at Lane Cove in Sydney for $27.6 million; and
- In May 2017, Cochlear acquired practice management software company, Sycle, for an estimated US$78 million. Net $63.7 million was paid in FY17 with the balance to be paid over three years as the acquisition is finalised and based on business performance.

Capital employed

A$m	Jun17	Jun16	Change $
Trade receivables	275.4	268.5	6.9
Inventories	160.0	154.1	5.9
Less: Trade and other payables	(130.9)	(110.3)	(20.6)
Working capital	304.5	312.3	(7.8)
Debtor days	*79*	*85*	*(6)*
Inventory days	*164*	*169*	*(5)*
Property, plant and equipment	120.1	86.9	33.2
Intangible assets	340.0	224.3	115.7
Other net liabilities	(91.6)	(57.1)	(34.5)
Capital employed	**673.0**	**566.4**	**106.6**

Capital employed increased by $106.6 million to $673.0 million since June 2016, primarily as a result of an increase in intangible assets.

Key points of note:

- Trade and other payables increased by $20.6 million, reflecting current payables relating to the Sycle acquisition and the gearing up of the supply chain for production of the Nucleus 7 Sound Processor;
- Property, plant and equipment increased by $33.2 million, primarily reflecting the $27.6 million acquisition of the Lane Cove manufacturing facility;
- Intangible assets increased by $115.7 million to $340.0 million, with $101.5 million of the increase comprising goodwill for the acquisition of Sycle in May 2017;
- All intangible assets are tested for impairment on an annual basis. There were no impairments or write-downs of intangible assets in FY17; and
- Other net liabilities increased by $34.5 million, largely reflecting the deferred consideration, and expected earn-out, for Sycle, which is to be paid over the next three years based on business performance.

Net debt

A$m	Jun17	Jun16	Change $
Loans and borrowings			
Current	84.7	4.0	80.7
Non-current	134.2	189.3	(55.1)
Total debt	218.9	193.3	25.6
Cash and cash equivalents	(89.5)	(75.4)	(14.1)
Net debt	**129.4**	**117.9**	**11.5**

Average net debt levels were lower in FY17, resulting in lower net finance costs compared to FY16. The $11.5 million increase in net debt to $129.4 million since June 2016 reflects:

- Net $63.7 million in cash paid for Sycle acquisition in May 2017;
- $27.6 million in cash paid for the Lane Cove manufacturing facility; which was almost entirely offset by
- Strong cash flow from operations.

Dividends

	FY17	FY16	Change %
Interim ordinary dividend ($/share)	$1.30	$1.10	18%
Final ordinary dividend ($/share)	$1.40	$1.20	17%
Total ordinary dividends ($/share)	$2.70	$2.30	17%
Payout ratio %	*69%*	*70%*	
Franking %	*100%*	*100%*	

Strong free cash flow and the continued strength of the balance sheet have supported the payment of a final dividend of $1.40 per share, franked at 100%. Total fully franked dividends of $2.70 per share were declared for the year, an increase of 17% on dividends paid last year, representing a payout of 69% of net profit.

The record date for determining dividend entitlements is 20 September 2017 and the final dividend will be paid on 11 October 2017.

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 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 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

	FY17	FY16	Change %
Net profit (reported)	**223.6**	**188.9**	**18%**
FX contract gains/(losses)		41.6	
Spot exchange rate effect to sales and expenses[1]		(20.0)	
Balance sheet revaluation[1]		(8.3)	
Net profit (CC)	**223.6**	**202.2**	**11%**

[1] FY17 actual v FY16 at FY17 rates

Total currency translation and transaction impact on reported net profit

	FY17	FY16
FX contract gains/(losses)	14.1	(27.5)
Spot exchange rate effect to sales and expenses[1]	(20.0)	48.8
Balance sheet revaluation[1]	(8.3)	7.5
Total currency impact to net profit (reported)	**(14.2)**	**28.8**

[1] reporting year actual v prior year at reporting year rates

Hedging position for key exposures

Cochlear utilises currency hedging to provide some certainty around near-term cash flow. Over 90% of revenue and around 50% of costs are denominated in foreign currency. Most of the cash that is generated is repatriated to Australia to fund operating and investing activities, including R&D and dividends. In order to provide some certainty around near-term cash flow, expected cash flows are hedged back to Australian dollars.

The following table includes FX contract cover and rates as at 30 June 2017:

Total FX hedges expressed in foreign currency (local currency - millions)	USD 275.2	EUR 174.5	JPY 2,066.0	Total
FX hedges expressed in $Am	374.9	270.0	25.9	
% of total cover	*56%*	*40%*	*4%*	*100%*
3 year weighted average rates				
- FX contracts 30/6/17	0.73	0.65	79.8	
- FX contracts 30/6/16	0.74	0.64	83.8	
FY18 weighted average rates				
FX contracts at 30/6/17	0.73	0.65	81.1	
Cover for FY18 ($Am)	258.8	154.9	15.3	429.0
% covered	89%	92%	97%	

Summary of relevant FX rates

	FY17	**FY16**	**Change %**
Average rates (used for translating P&L)			
USD	0.75	0.73	*3%*
Euro	0.69	0.66	*5%*
JPY	82.0	85.1	*(4%)*
GBP	0.59	0.49	*20%*
Average contract rates (used to repatriate FX to Australia)			
USD	0.75	0.80	*(6%)*
Euro	0.65	0.67	*(3%)*
JPY	84.1	88.7	*(5%)*
	Jun17	**Jun16**	
Period end rates (used for translating balance sheet)			
USD	0.76	0.74	*3%*
Euro	0.67	0.67	-
JPY	85.4	75.4	*13%*
GBP	0.59	0.56	*5%*