



## FY19 Result Presentation

16 August 2019

**Dig Howitt** CEO & President

**Brent Cubis** CFO

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## FY19 highlights



FY19 result

### Strong growth in sound processor upgrades

- Upgrade revenue increased by 17% in CC\* with strong uptake of the Nucleus® 7 Sound Processor
- Growing recipient base driving Services to 30% of sales revenue

### Slower year for implants with uplift in sales since launch of new product

- Developed market units flat driven by loss of market share with a return to growth following the launch of Nucleus Profile™ Plus Series cochlear implant in late Q4
- Continued strong growth in Japan following an expansion of indications in 2017
- Emerging markets units decline with ~700 fewer China tender units

### Investing to grow on track

- Growing investment in R&D to advance the long-term technology development pipeline
- Expansion of direct-to-consumer marketing and hearing aid channel referral programs
- Investment in activities to support cochlear implants becoming the standard of care for adults and seniors
- Expanded market access capabilities globally
- Positive clinical results<sup>1</sup> showing significant quality of life improvements with cochlear implants over hearing aids

### Strong financial position

- Underlying net profit up 7% (6% in CC), delivered within guidance range
- Strong cash flow generation supports 10% increase in dividends

\* constant currency (CC)

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# Improved sales since new product launch in late Q4



## Cochlear implants

58% of sales revenue

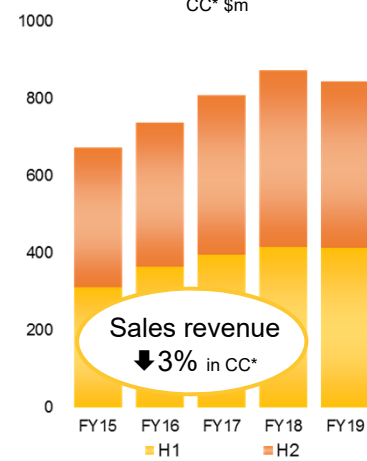
### Developed market units flat

- Improved sales from mid May19 in Western Europe and late June in the US following the Nucleus® Profile™ Plus Series cochlear implant launch
- Japan momentum continues following the expansion of indications in 2017
- UK announced expanded indications in March

### Lower emerging market units

- ~700 fewer China tender units in FY19, with very significant declines in Turkey and Argentina
- Strong growth in the Middle East and Eastern Europe
- Expanded direct presence

### Cochlear implant Sales revenue



\* constant currency (CC)

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# Increasing engagement with growing recipient base



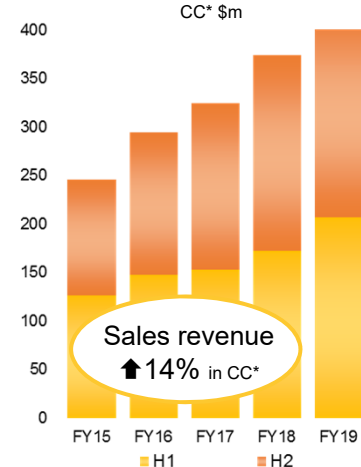
## Services

30% of sales revenue

### Sales revenue up 14% in CC\*

- Importance of growing recipient base to revenue growth – now 30% of sales revenue
- Sound processor upgrade revenue up 17% in CC with strong demand for the Nucleus 7 Sound Processor
- Expanded global focus on recipient engagement with Cochlear Family membership up ~40% over the past 12 months to exceed 140,000 members

### Services Sales revenue



\* constant currency (CC)

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# Retained market leadership

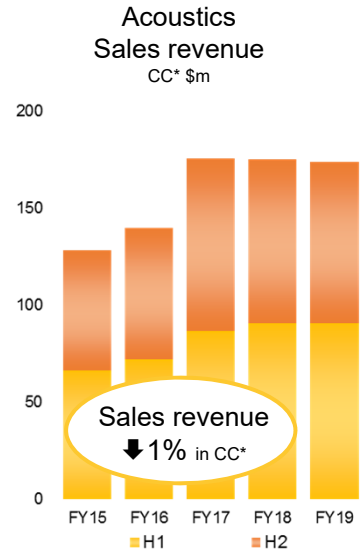


## Acoustics

12% of sales revenue

### Sales revenue down 1% in CC\*

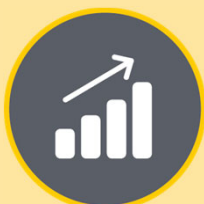
- Lower upgrades sales
- Expect to release the new OSIA product later in FY20 to extend the Acoustics product portfolio
- Longer-term opportunity for market expansion and new products



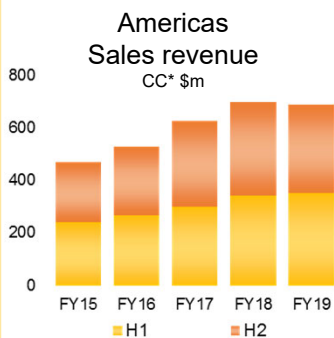
\* constant currency (CC)

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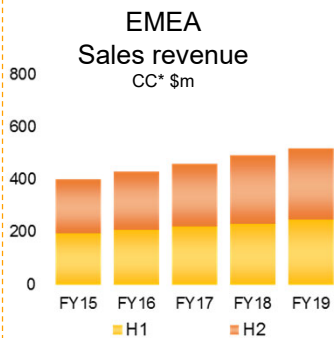
# Regional review



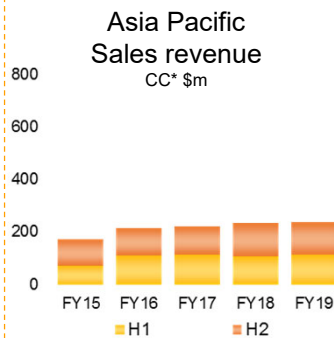
## FY19 result



- Sales revenue down 1% in CC
- Uplift in sales in the US following the launch of Nucleus Profile Plus in late June
  - Latin American declines driven by significant declines in Argentina



- Sales revenue up 6% in CC
- Sales return to growth in Germany since the launch of Nucleus Profile Plus in mid May
  - Strong Services growth



- Sales revenue up 2% in CC
- Strong unit growth in Japan and Services growth in Australia
  - ~700 fewer China tender units

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Brent Cubis

CFO

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## Financial highlights



FY19 result

Delivering continued revenue and earnings growth

### Continued investment to drive market growth

- Strong upgrade cycle, operational efficiencies and lower US tax rates fund investment in market growth activities
- Continued investment in longer-term initiatives – market access, standard of care, CPN, clinical trials

### Strong balance sheet and cash flow generation fund investment

- Operating cash flows > net profit
- Strong operating cash flow generation funds market growth activities, increased capex and increased dividends with only a small increase in debt

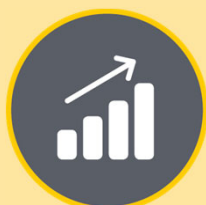
### Delivering consistent earnings growth

- Underlying net profit of \$265.9m, up 7% (up 6% in CC), within guidance range
- Net profit margin maintained at 18%, in line with target

### Revaluation of innovation fund

- Reported net profit includes \$10.8m in non-cash net gains from the revaluation of innovation fund investments

## Profit & loss



FY19 result

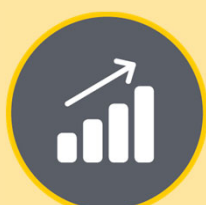
Re-investing gains from operating efficiencies into market growth activities

Strong upgrade cycle, operational efficiencies and lower US tax rates fund investment in market growth activities

\$m	FY19	FY18	Change (reported)	Change (CC)
Sales revenue	1,446.1	1,351.4	7%	2%
% GM	76%	73%	3 pts	2 pts
Selling, marketing and general expenses	450.9	397.0	14%	9%
R&D expenses	184.4	167.7	10%	9%
% of sales revenue	13%	12%		
Administration expenses	94.8	97.4	(3%)	(3%)
Other income	13.8	10.2		
Other income - revaluation of innovation fund	10.8	(2.2)		
FX contract gains / (losses)	(19.4)	12.3		
<b>EBIT</b>	<b>370.1</b>	<b>348.4</b>	<b>6%</b>	<b>5%</b>
EBIT / sales revenue	26%	26%		
Net finance costs	4.5	7.9	(43%)	
Taxation expense	88.9	94.7	(6%)	
% effective tax rate	24%	28%	4 pts	4 pts
<b>Net profit (reported)</b>	<b>276.7</b>	<b>245.8</b>	<b>13%</b>	<b>11%</b>
<b>Net profit (excl revaluation of innovation fund)</b>	<b>265.9</b>	<b>248.0</b>	<b>7%</b>	<b>6%</b>
% net profit margin (excl revaluation of innovation fund)	18%	18%		

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## Cash flow



FY19 result

Strong cash flow generation funds growth activities

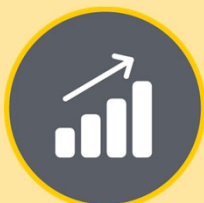
Strong cash realisation with operating cash flows > net profit. Higher capex to fund IT platforms and China manufacturing facility

\$m	FY19	FY18	\$ change
EBIT	370.1	348.4	21.7
Depreciation and amortisation	38.5	34.2	4.3
Change in working capital and other	(17.4)	(15.3)	(2.1)
Net interest paid	(4.5)	(7.9)	3.4
Income taxes paid	(90.7)	(101.3)	10.6
<b>Operating cash flow</b>	<b>296.0</b>	<b>258.1</b>	<b>37.9</b>
Capital expenditure	(86.6)	(44.6)	(42.0)
Acquisition of other intangible assets	(28.0)	(5.1)	(22.9)
Other net investments	(23.2)	(5.7)	(17.5)
<b>Free cash flow</b>	<b>158.2</b>	<b>202.7</b>	<b>(44.5)</b>

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## Capital employed



FY19 result

Investing activity drives growth in capital employed

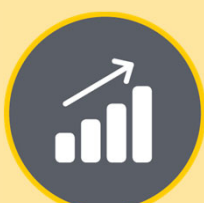
Inventory build ahead of new product launch with increase in capital employed driven by investments in China manufacturing facility, IT platform development, GN collaboration, Nyxoah and acquisition of emerging market distributors

\$m	FY19	FY18	\$ change
Trade receivables	299.5	299.1	0.4
Inventories	195.4	167.4	28.0
Less: Trade and other payables	(160.8)	(140.5)	(20.3)
Working capital	334.1	326.0	8.1
Working capital / sales revenue	23%	24%	
Property, plant and equipment	166.5	128.4	38.1
Intangible assets	424.4	345.3	79.1
Investments	47.8	15.8	32.0
Other net liabilities	(143.9)	(118.5)	(25.4)
<b>Capital employed</b>	<b>828.9</b>	<b>697.0</b>	<b>131.9</b>

USD 70c @ 30/6/19    USD 74c @ 30/6/18

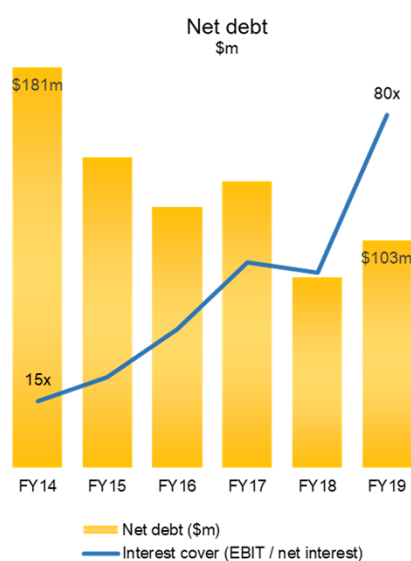
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## Net debt



FY19 result

Maintaining conservative debt levels while increasing investing activity



- Strong operating cash flow generation funds market growth activities, increased capex and dividends with only a small increase in debt
- Net debt has reduced ~\$80m over the last 5 years despite >\$400m in capex and other investments over that time

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# Dividends

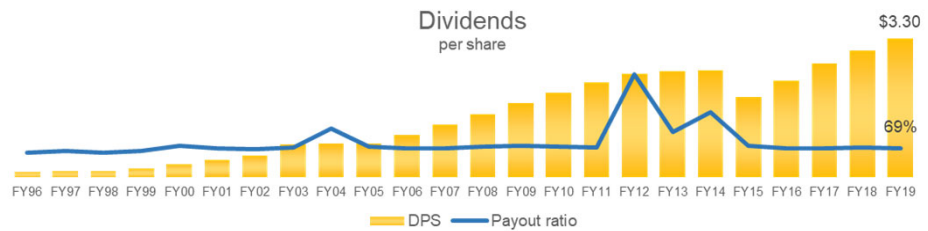


FY19 result

Growing dividends with a payout of ~70% (or above) of net profit since FY00

Full year dividends increased by 10%, fully franked, with the payout on target at ~70%

\$m	FY19	FY18	% change
Interim ordinary dividend (per share)	\$1.55	\$1.40	11%
Final ordinary dividend (per share)	\$1.75	\$1.60	9%
Total ordinary dividends (per share)	\$3.30	\$3.00	10%
Payout ratio %	69%	70%	
Franking %	100%	100%	



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# Strategic priorities



## Retain market leadership

Market-leading technology | World-class customer experience



## Grow the hearing implant market

Awareness | Market access | Clinical evidence



## Deliver consistent revenue and earnings growth

Invest to grow | Operational improvement | Strong financial position

# Market-leading product portfolio



Retain market leadership

## Cochlear implants (88% of revenue)



Cochlear™ Nucleus® Profile™ Plus with Slim Modiolar Electrode (CI632)



Cochlear™ Nucleus® Kanso® Sound Processor (CP950)



Cochlear™ Nucleus® 7 Sound Processor (CP1000)



Cochlear™ Nucleus® Smart App

## Bone conduction implants

## Acoustics (12% of revenue)



Cochlear™ Baha® 5, Baha 5 Power and Baha 5 SuperPower



Cochlear™ Baha® SoundArc



Cochlear™ Baha® Smart App

## Acoustic implants



Cochlear™ Carina® System



# New products and services



Retain market leadership

- **Nucleus® Profile™ Plus** Series cochlear implant (CI600): enhanced MRI compatibility
- **Nucleus® 7 ForwardFocus:** hearing better in noise
- **Remote check:** in pilot roll-out stage
- **Cochlear™ Research Platform ECoHG:** focus on improving hearing preservation
- **Nucleus® 7 Android Audio Streaming enabled:** for Android devices with Google's Audio Streaming for Hearing Aids (ASHA) protocol

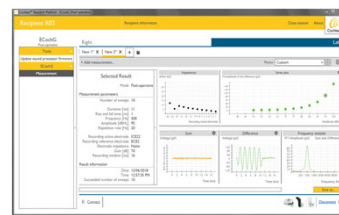


Cochlear™ Nucleus® Profile™ Plus with Slim Modiolar Electrode

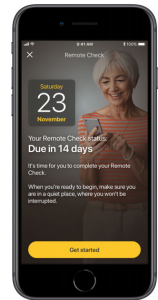


**Nucleus 7 Android Audio Streaming** (enabled)

**Remote Check** convenient, at-home testing tool



Cochlear™ Research Platform ECoHG 'unblinding' the electrode insertion process



# Strategies to improve awareness and access vary by segment



Grow the hearing implant market



**Adults & seniors**  
Developed markets  
Current penetration\*: 3%

Increase penetration



**Children**  
Developed markets  
Current penetration\*: 60%

Grow share



**Children**  
Emerging markets  
Current penetration\*: 10%

Increase penetration, funding and affordability

\* Estimate based on information available to Cochlear

# Cochlear is investing operating cash flows to drive growth



Deliver consistent revenue and earnings growth

## Investment priorities

### Investing to grow

- Building awareness and access requires multi-year investment in sales, marketing and R&D activities
- Aim: invest to grow, maintaining the net profit margin

### Delivering operational improvements

- Optimising cost of production strengthens our competitive position
- Aim: reinvest efficiency gains from growing scale in to market growth activities

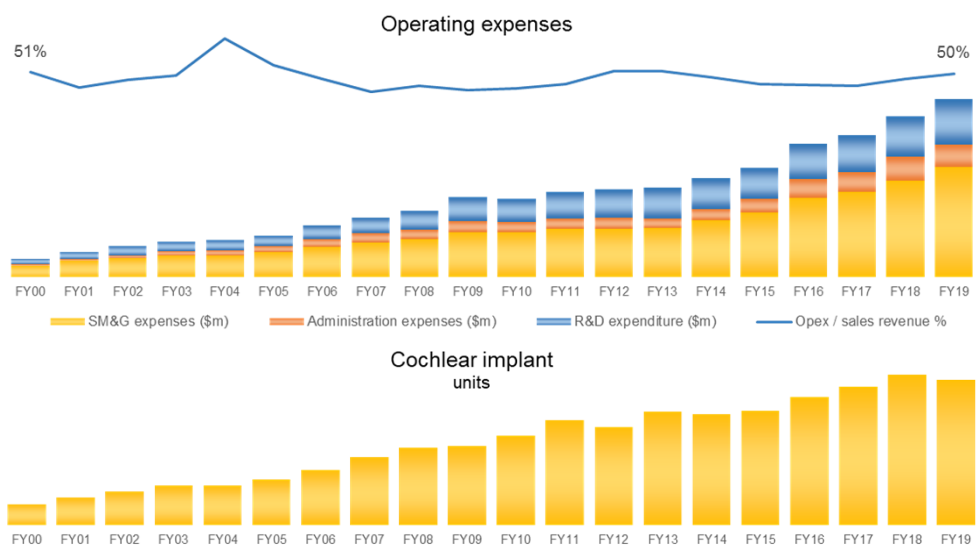
### Maintaining a strong financial position

- Strong cash flow generation funds investment in growth
- Aim: maintain the strong balance sheet position and continue to target a dividend payout of around 70% of net profit

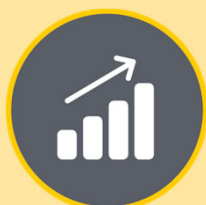
# Long term history of investing to grow



Deliver consistent revenue and earnings growth



## Revenue growth drivers



Deliver consistent revenue and earnings growth

### Cochlear implants

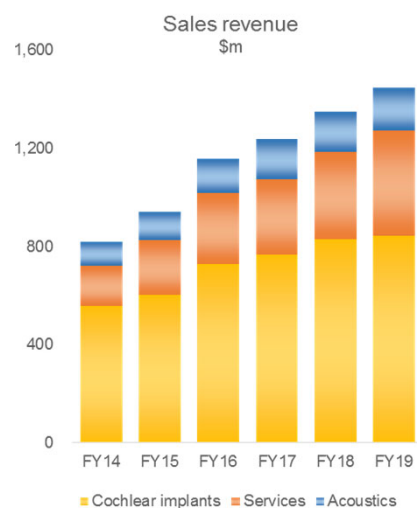
- Growing awareness and uptake by adults and seniors
- Emerging market expansion
- New products driving market growth and market share

### Services

- Growing recipient base
- Greater connectivity and engagement with recipients
- Next generation sound processor upgrades

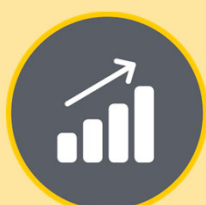
### Acoustics

- New products
- Market expansion



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## FY20 outlook



Deliver consistent revenue and earnings growth

### FY20 net profit guidance of \$290-300m, up 9-13% on underlying net profit for FY19

#### Key guidance considerations:

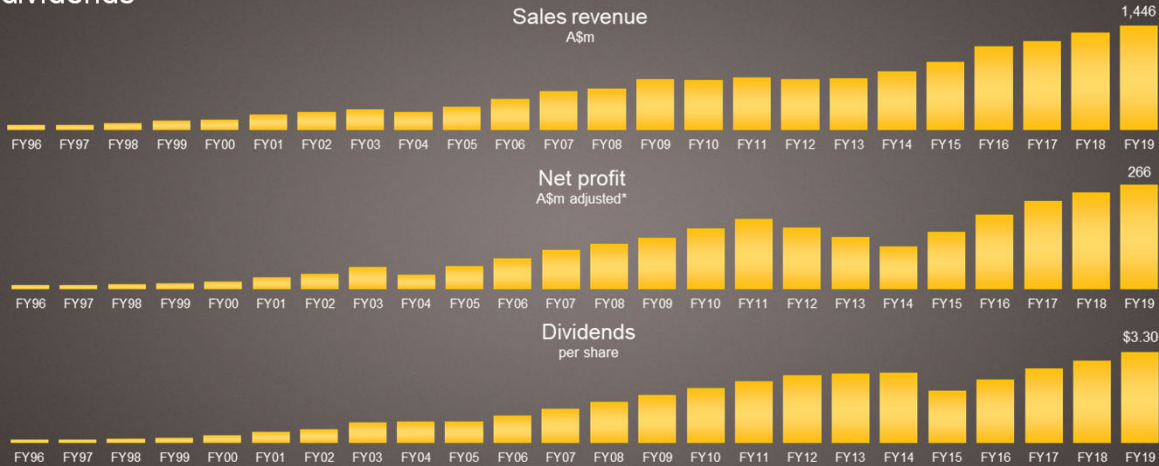
- Expect stronger growth in cochlear implant units in developed markets
- Emerging market growth rates over time continue to be strong, however, annual growth rates can be variable
- Expect to release the new OSIA product later in FY20
- Capex of ~\$180m in FY20 and ~\$100m in FY21
- Includes an estimated \$2-3m pre-tax earnings impact from the introduction of AASB 16
- Excludes any revaluation of innovation fund investments that may occur
- Targeting to maintain the net profit margin
- Forecasting a weighted average AUD/USD exchange rate of 70c for FY20 (72c in FY19) and AUD/EUR of 0.62 EUR (0.63 EUR in FY19)

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# Financial history



Cochlear has a long track record of delivering growing sales revenue, profits and dividends



\* FY12 excludes product recall costs of \$101 million after tax, FY14 excludes patent dispute provision of \$16 million after tax and FY19 excludes a net \$11 million gain after tax from the revaluation of innovation fund investments.

# Investing to grow



Cochlear takes a long term approach to investing and has invested in growing the market for implantable solutions since listing in 1995

### Consistent investment in sales and marketing

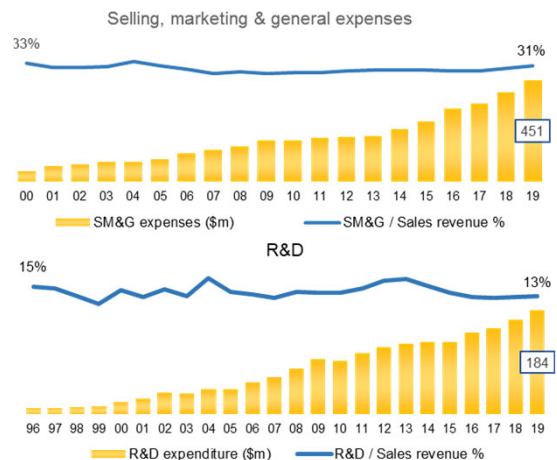
Our investment in sales and marketing activities is building awareness of and access to implantable solutions and driving market growth.

The increase in investment in Selling, marketing & general expenses (SM&G) over the last six years has supported sales force expansion and investment in awareness building activities, particularly direct-to-consumer marketing initiatives, across a growing number of markets.

### Growing research & development capability

The investment in R&D continues to strengthen our leadership position through the development of market-leading technology.

Cochlear has a wide range of fully-featured products and a broad patent portfolio that protects the Company's intellectual property. Over \$1.9bn has been invested in R&D since listing with 13% of sales revenue invested in R&D in FY19.



# Operational improvement



## Disciplined capital investment and optimising cost of production strengthens our competitive position

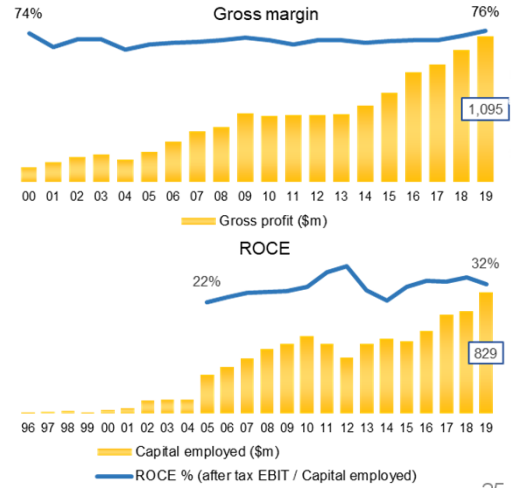
### Stable gross margin

Cochlear's gross margin has been relatively stable since listing. We use our scale to generate efficiency gains to reinvest back into market growth activities.

### High return on capital employed (ROCE)

ROCE measures the cash return for each dollar invested in the business. Cochlear generates a high ROCE reflecting its competitive position in the market and the high barriers to entry to the cochlear implant industry which have proven to be robust over many decades.

The high ROCE is also a function of the low level of tangible assets employed by the business. Cochlear's competitive advantage is driven by its strong product and patent portfolio, a result of investment in R&D over many years. As R&D investment is expensed through the income statement, no value for this important asset is captured on the balance sheet.



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# Strong financial position



## Strong free cash flow generation provides funding for market growth activities and R&D as well as the ability to reward shareholders with a growing dividend stream

### Quality operating cash flows

One of the highlights of Cochlear's financial history has been the conversion of reported profits to cash. There is a strong and consistent correlation between reported net profit and the operating cash flows generated by the business.

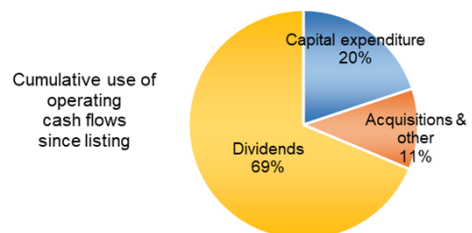
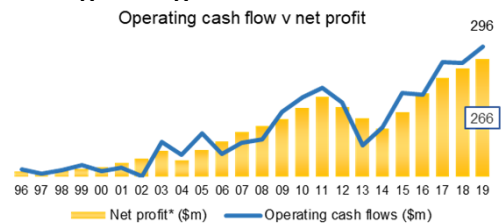
### Disciplined use of capital

Operating cash flows have been primarily used to fund dividends, capital expenditure and acquisitions.

The dividend policy has been to payout 70% of net profit as dividends to shareholders since FY00. Since listing, Cochlear has cumulatively paid out around 70% of operating cash flows as dividends.

Key acquisitions have been focused on building the core implant business:

- Cycle – hearing aid practice management software business (FY17)
- Otologics – implantable microphone technology (FY10)
- Brisbane manufacturing facility (FY07)
- Entific – bone conduction implant business (FY05)



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## Strong financial position



Strong free cash flow generation provides funding for market growth activities and R&D as well as the ability to reward shareholders with a growing dividend stream

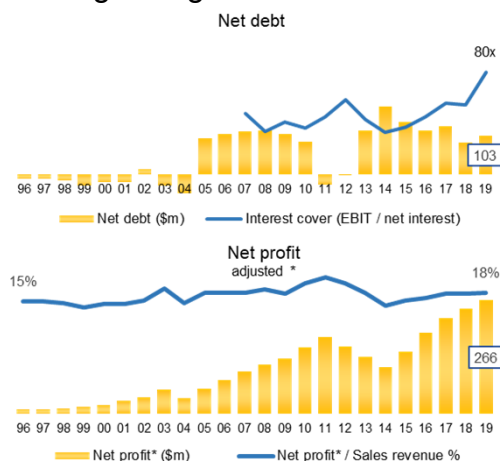
### Conservative gearing levels

Cochlear has a strong balance sheet. It is a growth company that, since listing, has been able to fund investing activities, dividends, capital expenditure and acquisitions whilst maintaining conservative gearing levels.

### Delivering stable net profit margins

Cochlear will continue to invest operating cash flows in market growth activities 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.



\* FY12 excludes product recall costs of \$101 million after tax, FY14 excludes patent dispute provision of \$16 million after tax and FY19 excludes a net \$11 million gain after tax from the revaluation of innovation fund investments.

## Notes



### References

<sup>1</sup> Clinical Evaluation of the Cochlear Nucleus CI532 Cochlear Implants in Adults. 2019 Jan; Data on file.

### 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.