

# **2013 CHAIRMAN'S ADDRESS COCHLEAR LIMITED ANNUAL GENERAL MEETING**

**OCTOBER 15<sup>TH</sup>, 2013**

**EXCHANGE SQUARE AUDITORIUM  
AUSTRALIAN SECURITIES EXCHANGE  
20 BRIDGE STREET, SYDNEY NSW 2000**

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Ladies and gentlemen, let me now start my address.

The past financial year, Fiscal13 (F13), was a busy one for Cochlear. As I will outline later, we are making determined progress to ensure Cochlear's sustainable long-term growth.

Every day we consider how to fulfil our obligations and ambitions, including our front of mind goal of being the best in our field and staying the world leader.

## **F13 results**

The strategic review initiated in F12 led to a new strategic plan, presented to and approved by the Board, and this plan is now being rolled out across the global organisation.

The strategic plan includes initiatives to introduce a range of new products, regain momentum, and refocus effort to support overall market growth, all of which will enhance our opportunity as the market leader.

In F13 we achieved record cochlear implant sales of 26,674 units, which was up 16% on F12. We also achieved solid sales in the Baha® range of products.

This achievement means we again helped a record number of people hear and be heard.

Total revenue for F13 was \$752.7 million, down 3%, with sales in constant currency up 3%.

Net profit after tax was \$132.6 million, up 133% on F12 (the F12 result included our provision for costs associated with the voluntary recall of the CI500 series implant).

The high volatility of the Australian dollar over the last five years continued to impact our business with hedging related foreign exchange contract revenues down \$36.7 million from F12.

We also experienced a slowdown in sales in the second half of F13 ahead of new product introductions, in particular the Nucleus 6® sound processor. In F13 upgrade sales revenues were down \$24 million heavily biased to the second half.

During the year, the Company's growth settings were further developed including plans for new product introductions, market growth and support activities, and reinforcement of our systems and processes.

These settings will help us deliver the gift of sound to more people around the world and drive shareholder value in the coming years.

### **New and innovative products**

Cochlear continues to develop its range of advanced products and services, which are innovating for the implantable hearing solution market and which should broaden indications and increase the number of people who can benefit from them.

Cochlear Nucleus 6 – the world's most advanced sound processor – has just begun to be launched in F14 and will be discussed in detail shortly by your CEO. It delivers industry-first innovations as well as being the smallest sound processor on the market.

The Cochlear Baha DermaLock™ Abutment was launched in F13 with an advanced new coating that offers significant recipient benefits in terms of reduced surgery and healing times. We expect sound progress into F14.

Initial sales from our emerging acoustic implant range were also made in F13 following our acquisition of Otologics LLC's assets. This product range is expected to see further progress in F14.

An original Pre-Market Approval (PMA) has been filed in the USA for a hybrid cochlear implant system. If approved, it will expand cochlear implant indications in the USA. This important step forward in the USA will be covered by the CEO.

This suite of new products is indicative of the breadth of our products and the long technologic lead times necessary for true innovation.

As I said, your CEO, Chris Roberts, will further detail the current status of product regulatory approvals and releases in his remarks, and will explain how these products fit into Cochlear's strategy.

### **Growth initiatives**

A key focus in F13 was ensuring readiness for the launch of the suite of new products. This included marketing, messaging and training of our employees; and obtaining regulatory approvals.

A number of new market growth initiatives were developed in the context of our overall strategy and these are now being executed in F14.

We have placed significant focus on further improving the lifelong hearing experience and needs of our recipients in today's world.

The aim of these initiatives is to grow the market.

### **Evolving systems and processes**

Cochlear has hundreds of thousands of recipients worldwide; we produce a number of different products and sell into many countries, many of which vary significantly.

To manage this effectively and to support future growth requires modern systems and processes that are robust and reflect the realities of our business.

We continue to review our systems and processes, aligning and simplifying them as required.

In F13, we invested \$14 million on an Oracle upgrade to Release 12 and on many other process improvements, all of which we deem to be essential for our connected global supply chain, sales and patient management systems.

We will continue to invest in these important system initiatives in F14 and beyond.

### **Remuneration settings updated**

I now want to talk to important work your board has been involved in regarding remuneration.

At the last AGM, 30% of those Cochlear shares voted at the meeting were against the Board's Remuneration Report in what was the Company's 'first strike'.

Since then, much work has been done to reach out to shareholders and experts in these areas.

We carefully reviewed the reasons for the 'first strike' to the F12 Remuneration Report. We spent considerable time understanding the range of views on the related matters, determining appropriate and sensible responses and changes, and generally adopting an approach that this is now part of an important ongoing process.

The inputs obtained have been carefully considered and formed part of a full review of the Company's remuneration structures and related arrangements for F14.

The reformatted F13 Remuneration Report contained in the Directors' Report is a major step forward.

There has been and will continue to be interaction and discussion with a range of interested parties, most importantly shareholders, on these matters over the coming years.

The remuneration approach and structures adopted for F14 are set out in the detailed Remuneration Report that is in a new expanded format and is, we believe, an appropriate improvement from prior years.

The key changes for F14 include the Long Term Incentive (LTI) program where awards are now in performance rights (instead of shares), and options. All LTI participants are required to take a minimum of 30% of their award in options.

We maintained the ability for executives to choose options as we consider ourselves a growth company.

For option awards the approach for valuing and awarding options has been changed from “cost to company” to “fair value” or “gross value”.

This eliminates a range of adjustments used in the “cost to company” approach that were not easily understood and were not supported by many of our shareholders.

We also reduced the number of participants in the LTI program and suitably restructured the Short Term Incentive (STI) program including the inclusion of a 2 year deferred portion, with the deferred portion taken in performance rights.

While this has properly been the preserve of the Human Resources Committee and Board, senior management fully supports the new arrangements, which aim to motivate and retain employees, while aligning them with Cochlear’s owners, its shareholders.

The remuneration review included a detailed look at the CEO’s remuneration.

As disclosed in the Remuneration Report and Notice of Meeting, the CEO’s total remuneration for F14 has been reviewed both internally and against external benchmarks.

We evaluated the prior year packages consistent with the new F14 approach for LTI and STI, we considered the mix between Base, STI and LTI, and we considered the overall package against various criteria.

I believe we did a comprehensive review; I am confident that in the new structure we have the right proportions of base, STI and LTI. I also believe the overall CEO package is within the appropriate market range.

Details of the CEO and Key Management Personnel remuneration are contained in the Remuneration Report and I would seek your support for both the Remuneration Report and CEO LTI Award resolutions.

## **The Board**

The Board has worked cohesively over several years as we have dealt with a range of complex issues.

In the current circumstances, we again decided not to change the directors’ fee levels for F14 but we will make minor changes to committee chair fees.

We are now commencing a process of Board renewal. This has been mentioned in prior years. It is envisaged we will introduce a new Board member by rotation over the next year and, in addition, may increase the Board numbers by one over the next two years.

This will involve external consultants and is an opportunity to add more talent and strength to the Board.

During the year we repositioned the Technology and Innovation Committee (previously within the main Board) as a separate committee under the chairmanship of Andrew Denver.

The Medical Science Committee and the Technology and Innovation Committee are working closely together. They provide the appropriate oversight, and a review function, across a range of areas including new product approval processes, product pipeline and priorities, and the new technologies being developed to support enhanced services to our clinics and to our recipient base.

I believe we have a strong and experienced board that is dealing with the current issues well, we are continually making complex judgement decisions and are doing all we can to oversee and support the company through a challenging period.

### **Cochlear's dedicated employees**

Cochlear has a global team of over 2,700 people in 25 countries. The diversity of experience and expertise is a positive strength for Cochlear. As a global business we are heavily reliant on their broad knowledge and multi-cultural experience.

Our team members have worked very hard for many years now, and they are making substantial effort as we implement the new strategic plan.

The board has visited many of our global business locations and interacted with our team members on the ground.

We appreciate their enthusiasm, effort and commitment.

The Board sincerely thanks them all for their dedication and continued focus on the tasks at hand.

### **Outlook**

The current year is important in establishing the base for later years, it involves new product launches and market growth initiatives designed to develop sales growth in F14 and beyond.

We are conscious of the impact of these activities on the business, and are conscious of the headwind issue created by the F14 reduction in FX hedge revenues, this is expected to be the final significant reduction followed by a more normalised impact going forward.

It should be noted that these hedging activities only smooth FX volatility over a number of years but recent years have involved a wide range.

We have maintained our support for the R&D spend and have maintained the growth potential inherent in the business structure.

These decisions mean there is some pressure in the short term on the operating margin and we have decided to provide guidance for F14 now to ensure the implications of our decisions are understood.

We expect the F14 NPAT to be at the prior year level, with a heavy bias to the second half.

We need to execute our business plans well and there will be more discussion by the CEO of the activities underway.

If our outlook is unchanged we propose to support the interim dividend at \$1.27 per share, and also the final dividend at this level.

This is always subject to ensuring the financial stability of the Company and will be reviewed in the event of unforeseen events.

Overall, Cochlear remains confident in its long term growth prospects.

## **Conclusion**

In conclusion, the business fundamentals for implantable hearing solutions remain strong and we believe the right settings and strategy are in place for F14 that, with solid and disciplined execution, should generate strong momentum into F15 and beyond.

We understand we are in an increasingly competitive environment, we still believe we have the most reliable and innovative products, and we are committed to achieving long term growth; while at the same time positively changing the world of the hearing impaired.

F14 is the year when we must execute our strategy and if done well we believe F15, and beyond, will see the positive results we expect.

Ladies and gentlemen, that concludes my address.

A copy of my address has been lodged with the Australian Securities Exchange and is available from a table in the foyer. A copy is also available on the web site.

Rick Holliday-Smith  
15 October 2013