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COCHLEAR FINANCIAL RESULTS FOR THE SIX MONTHS ENDED DECEMBER 2015

Positive momentum continues

- Sales revenue up 32% (up 16% in constant currency) delivered across developed and emerging markets
- Recent product releases and continued investments in strategic growth initiatives driving market growth
- Sales revenue and earnings benefit from the depreciation of the Australian dollar
- Interim dividend up 22% to 110.0 cents per share
- FY16 guidance range adjusted up to \$180-190 million driven primarily by FX

A\$m	HY16	HY15	% Change
Sales revenue	581.7	440.5	↑ 32%
FX contracts loss	(23.6)	(2.2)	
Total revenue	558.1	438.3	↑ 27%
Earnings before interest & tax (EBIT)	131.0	100.5	↑ 30%
Net finance costs	(4.7)	(5.5)	↓ 15%
Taxation expense	(32.3)	(23.6)	↑ 37%
Net profit	94.0	71.4	↑ 32%
Basic earnings per share (cents)	164.7c	125.3c	↑ 31%
Interim dividend per share (cents)	110.0c	90.0c	↑ 22%
Franking %	100%	35%	

FINANCIAL HIGHLIGHTS

- Sales revenue of \$581.7 million, up 32% (up 16% in constant currency);
- Total revenue of \$558.1 million, up 27%;
- Net profit of \$94.0 million, up 32%;
- Basic earnings per share of 164.7 cents per share, up 31%; and
- Interim dividend of 110.0 cents per share, up 22%, franked at 100%, representing a payout of 67% of first half net profit.

OVERVIEW

Cochlear's CEO & President Chris Smith said, "The positive momentum we saw in FY15 has continued into HY16 with both our Implant business and Services business delivering strong growth.

"We are particularly pleased with the Implant business, which delivered sales growth across both developed and emerging markets, with some countries like the United States (US) experiencing accelerated market growth.

"The business is benefitting from the rollout of new products launched in FY15 and the continued investment in strategic growth initiatives that commenced two years ago.

"The Services business continues to grow strongly and now represents around 25% of sales revenue. We are building a lifetime relationship with our recipients to provide products, programmes and services, and expect its contribution to continue to trend upward over time as the recipient base grows."

PRODUCT HIGHLIGHTS

	HY16	HY15	% Change	Constant currency
Cochlear implants (units)	14,748	11,689	↑ 26%	
Sales revenue (A\$m)				
Cochlear implants	362.7	271.2	↑ 34%	↑ 17%
Services (sound processor upgrades & accessories)	146.3	111.8	↑ 31%	↑ 16%
Bone conduction & acoustic implants	72.7	57.5	↑ 26%	↑ 9%
Total sales revenue	581.7	440.5	↑ 32%	↑ 16%

Cochlear implants – 62% of sales revenue

Cochlear implant unit sales grew 26% (12% excluding the benefit of ~1,700 China tender units) driven by both market growth and modest improvements in share in some markets.

There has been a strong uptake of the Nucleus® Profile implants since release in FY15.

The results also reflect earlier investments in sales and marketing capabilities including direct-to-consumer activities and field expansion in markets including the US and Germany. These initiatives help build awareness of implantable hearing solutions and support further penetration into the adult segment.

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

Services sales revenue increased 31% (16% in constant currency) driven by the continuing strong uptake of the Nucleus 6 Sound Processor.

With the launch of the Nucleus 6 for Nucleus 22 recipients this half, the latest sound processor is now compatible with all generations of implants.

Continued strong uptake of the Nucleus 6 is expected over the next few years with the current penetration rate still below 20%.

Accessories growth was supported by True Wireless™ and the Aqua+ for Nucleus 6 users.

As part of the commitment to provide recipients with great customer service and support, the business commenced the rollout of its membership programme, Cochlear Family and personalised online portal, MyCochlear.com, which connects recipients directly with Cochlear.

Bone conduction & acoustic implants – 13% of sales revenue

Bone conduction and acoustic implant sales revenue grew 26% (9% in constant currency) with solid performance across all regions.

The Baha® 5 System, which was launched in FY15 and includes the sound processor and smart app made for iPhone, continued its rollout during the first half.

The Baha 5 SuperPower, the latest and most powerful product on the market, was launched in selected markets in Europe in December 2015. It will be launched into other markets over the next 18 months as regulatory approvals are obtained.

REGIONAL REVIEW

Sales revenue (A\$m)	HY16	HY15	% Change	Constant currency
Americas	264.1	195.3	↑ 35%	↑ 11%
EMEA (Europe, Middle East & Africa)	210.4	181.6	↑ 16%	↑ 8%
Asia Pacific	107.2	63.6	↑ 69%	↑ 55%
Total sales revenue	581.7	440.5	↑ 32%	↑ 16%

Americas (US, Canada & Latin America) – 46% of sales revenue

Sales revenue increased 35% to \$264.1 million (11% in constant currency).

The highlight was the growth in the US with cochlear implant unit sales up ~10% driven by both market growth and modest share gains. Growth overall has been driven by new product capabilities such as Nucleus 6 True Wireless compatibility as well as strategic growth initiatives commenced over the past few years.

The expanded field sales organisation, direct-to-consumer marketing and new customer relationship management system (Salesforce.com) has supported accelerated market growth.

Services revenue increased by over 20% in constant currency driven by upgrades to the Nucleus 6 Sound Processor. The uptake by Nucleus 22 recipients has been enthusiastic since launch in November 2015.

Services revenue in the US is biased to the first half reflecting the seasonal impact of the annual US reimbursement cycle.

Overall Latin American sales revenue declined as a result of deteriorating conditions in Brazil. Excluding Brazil, Latin American sales revenue increased by 25% in constant currency.

EMEA (Europe, Middle East and Africa) – 36% of sales revenue

Sales revenue increased 16% to \$210.4 million (up 8% in constant currency) with solid performances across Western Europe, particularly Germany, while sales in Eastern Europe declined.

The highlight was the performance of the German business which grew units by over 10% driven by market growth and improvements in share. Germany is seeing some positive results from growth initiatives including candidate recruitment programmes, field sales expansion and broadening of cochlear implant indications.

Sales revenue in the Middle East grew strongly. While coming off a lower sales base in HY15, the Middle East is benefitting from Cochlear's expanded presence since the opening of a new office in Dubai.

Asia Pacific (Australasia & Asia) – 18% of sales revenue

Sales revenue increased 69% to \$107.2 million (up 55% in constant currency).

Australasian sales revenue increased by 12%, benefiting from field sales expansion and new marketing programmes.

The Melbourne Cochlear Care Clinic, which was opened in FY15, manages the after care of recipients. It has continued to deliver high levels of service to recipients as well as driving incremental Services revenue. The success of this clinic model is being expanded to other markets.

China performed strongly in both the private pay and tender markets. The region benefitted from a Chinese Central Government tender of around 1,700 units, with no tender sale units in the first half of FY15. A further ~300 units associated with the tender will be delivered in the second half of FY16.

In December 2015, Cochlear was awarded a further ~2,100 tender units with the majority of sales expected to be delivered in the first half of FY17.

STRATEGIC PRIORITIES & OUTLOOK

Strategic priorities

Chris Smith said, "The hearing loss market offers an incredible business opportunity with over 360 million people worldwide experiencing disabling hearing loss, with nearly one in three people over the age of 65 affected by hearing loss.

"With global market penetration for implantable hearing solutions less than 5%, there remains a significant, unmet and addressable clinical need that will continue to underpin the long-term sustainable growth of our business.

"As we look forward, our priorities will be centred on the customer with activities aimed at growing awareness and access to the industry for implant candidates. And with a growing recipient base, now numbering over 440,000, we are actively strengthening our servicing capability to provide products, programmes and services to support our lifetime relationship with recipients as well as drive revenue growth.

“We will continue with our commitment to being the technology leader in our industry by investing in research and development to improve hearing outcomes and expand the indications for implantable solutions so our recipients can have the quality of life they expect.”

Our priorities are centred on four strategic platforms for the business:

1. Grow the core business

Implantable hearing devices will continue to be the driver of our growth for the coming years. Our focus will be to:

- **Strengthen our technology leadership position.** Over the next 18 months we plan to launch a series of new products across all categories of our business focused on both share and market growth;
- **Stimulate market growth** by increasing awareness of hearing loss. Over the last two years we have developed a direct-to-consumer marketing strategy in the US to target potential candidates, follow up leads and nurture candidates through the channel. We are now taking the learnings from the US into other countries;
- **Improve access for candidates** by expanding the cochlear implant clinic base as well as continuing to work with the referral channel to assist our clinic partners to grow and become more efficient. The development of our hybrid and acoustic implants, together with a broader range of electrodes, play an important role in broadening the indications for our implantable hearing solutions; and
- **Business model innovation.** Exploring new referral pathways and servicing models and where appropriate open our own Cochlear clinics to manage the “after care” of recipients.

2. Build a service business

With an ever growing base of recipients, now totalling over 440,000, we have both a lifetime responsibility and a significant business opportunity to service these recipients with upgrades and services that improve their quality of life by improving hearing performance. We will:

- **Support our growing recipient base** with upgrades, accessories and seamless service and repair;
- **Increase connectivity** and engagement with recipients with enhanced digital services; and
- **Introduce technology solutions for clinicians** to help our clinic partners grow and make after care for recipients seamless.

3. Shape the organisation

We are reshaping the organisation to better utilise and deploy resources. We will:

- **Expand our presence in customer facing activities** across developed markets by expanding the field force and marketing activities to be closer to our customer and clinic partners. We will also increase our presence in emerging markets like China;
- **Globally integrate enabling activities** such as IT to drive efficiencies and leverage best practice to fund our market growth activities; and
- **Build organisational capabilities** to support customer focused activities.

4. Value creation

To deliver long-term sustainable growth, we will:

- **Develop alliances and partnerships**, like the Smart Hearing Alliance with GN Resound, that enable us to leverage our technology and leadership position to either expand the market or fast-track our growth.

2016 Financial outlook

For FY16, net profit expectations have been adjusted up to a range of \$180-190 million with the increase in guidance driven primarily by FX. This guidance range would deliver net profit growth in a range of 23-30% on last year.

Chris Smith said, “Cochlear has made steady progress in the first half. We have continued to invest in technology and market expansion activities that underpin the long-term growth of the company.

“We believe the strong market acceptance of recently launched products, including Nucleus Profile implants, the Nucleus 6 Sound Processor with True Wireless and for Nucleus 22 implant recipients, have driven market growth across many countries over the past 12 months.

“Looking forward, we have an exciting pipeline of products to be released over the next 18 months across all categories of our business.”

As previously advised, there are a number of factors that will impact second half earnings:

- Services sales revenue is expected to be weighted to the first half given the seasonality of US upgrade sales;
- The China tender of ~2,000 units is around the same level for the full year as FY15. ~1,700 units were booked in HY16 with ~300 units forecast in the second half;
- Ongoing investments in technology and market expansion activities will be weighted to the second half; and finally
- A weighted average USD/AUD FX rate of approximately 72c is now forecast for the full year (previously 75c).

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

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FINANCIAL REVIEW

Profit & Loss

A\$m	HY16	HY15	\$ Change
Cost of goods sold	171.3	127.3	44.0
% of sales revenue	29.4%	28.9%	
Research & development	70.2	61.4	8.8
Selling & general expenses	158.8	122.6	36.2
Corporate administration	34.7	28.6	6.1
Other income	(7.9)	(2.1)	(5.8)
EBIT	131.0	100.5	30.5
% of total revenue	23.5%	22.9%	

EBIT increased by \$30.5 million to \$131.0 million, with the operating margin (EBIT to total revenue) increasing by 0.6% to 23.5%.

Cost of goods sold (COGS) increased \$44.0 million to \$171.3 million, primarily as a result of growing volumes. COGS as a percentage of sales revenue increased by 0.5% to 29.4% reflecting product and geographic mix as well as the higher COGS associated with the initial introduction of the Nucleus Profile series implant, offset by changes in FX. An inventory write-down of \$5.1 million was booked during the first half with the majority related to older generation sound processors and components.

Investment in research & development (R&D) increased \$8.8 million to \$70.2 million which is consistent with Cochlear's stated commitment to continue to invest in research and development to strengthen its technology leadership position and follows several years of limited incremental investment in R&D.

Selling & general expenses increased by \$36.2 million to \$158.8 million. The 30% increase reflects the increased investment in market growth initiatives as well as the impact on translation of the depreciation of the Australian dollar. In constant currency, the increase in selling & general expenses was 15%.

Corporate administration increased by \$6.1 million to \$34.7 million driven by investments in processes and systems.

Other income increased by \$5.8 million. A \$5.2 million increase in FX gains on asset translation is included in this line item.

Foreign currency impacts on income statement

Income statement impacts	A\$m
Sales revenue & expenses (translation impact) ¹	
- Sales revenue	62.6
- Total expenses including tax	(30.1)
	<u>32.5</u>
FX contract gains/(losses) on hedged sales (transaction impact)	
- FX losses – HY15	(2.2)
- FX losses – HY16	(23.6)
	<u>(21.4)</u>
Asset translation (translation impact)	
- FX gain on asset translation – HY15	0.6
- FX gain on asset translation – HY16	5.8
	<u>5.2</u>
Total benefit to net profit from changing FX rates	16.3

1. HY16 actual v HY16 at HY15 rates

Cochlear derives over 90% of revenue in foreign currencies with around 50% of costs denominated in foreign currency. As most of the cash is repatriated to Australia to fund operating and investing activities including R&D and dividends, expected cash flows are hedged back to Australian dollars to provide some certainty around near term cash flow.

The Australian dollar (AUD) depreciated against most of the major currencies during the half which provided an overall benefit of \$16.3 million to net profit for HY16. The key impacts include:

- A net benefit to sales revenue of \$62.6 million from translating foreign sales into AUD; and
- FX contract losses were \$23.6 million for HY16 compared with a loss of \$2.2 million in HY15. This is consistent with Cochlear's long-term hedging policy.

Capital employed

A\$m	HY16	FY15	\$ Change
Trade receivables	258.4	236.7	21.7
Inventories	150.8	145.9	4.9
Less: Trade & other payables	(107.3)	(99.9)	(7.4)
Working capital	301.9	282.7	19.2
<i>Debtor days</i>	81	83	(2)
<i>Inventory days</i>	161	193	(32)
Property, plant & equipment	80.5	80.8	(0.3)
Intangible assets	234.7	228.5	6.2
Other net liabilities	(68.9)	(96.1)	27.2
Capital employed	548.2	495.9	52.3

Capital employed increased by \$52.3 million to \$548.2 million since 30 June 2015 primarily as a result of an increase in working capital and a reduction in other net liabilities.

Working capital increased by \$19.2 million to \$301.9 million as a result of strong sales growth.

Trade receivables increased \$21.7 million to \$258.4 million. In constant currency, trade receivables increased by 6%. Debtors days declined two days to 81 days reflecting the strong sales during the half.

Inventories increased \$4.9 million to \$150.8 million. Inventory days reduced 32 days to 161 days reflecting the reduction in stock which had been built up in June 2015 ahead of tender shipments made during the half and the higher sales.

Property, plant & equipment remained largely unchanged.

Intangible assets increased by \$6.2 million to \$234.7 million as a result of revaluation to period end FX rates. All intangible assets are tested for impairment on an annual basis. There were no impairments or write-downs of intangible assets in HY16.

The provision for patent dispute has remained unchanged at \$21.3 million since 30 June 2015.

Other net liabilities reduced by \$27.2 million largely reflecting higher tax payments made during the half.

Cash flow

A\$m	HY16	HY15	\$ Change
EBIT	131.0	100.5	30.5
Depreciation & amortisation	16.3	14.3	2.0
Change in working capital & other	(19.4)	1.3	(20.7)
Net finance costs	(6.3)	(5.3)	(1.0)
Taxation paid	(48.1)	(20.9)	(27.2)
Operating cash flow	73.5	89.9	(16.4)
Capital expenditure	(13.4)	(7.8)	(5.6)
Other	(3.3)	(2.7)	(0.6)
Free cash flow	56.8	79.4	(22.6)

Free cash flow decreased by \$22.6 million to \$56.8 million. An increase in EBIT of \$30.5 million was offset by a net investment in working capital to fund business growth and an increase in taxation paid.

The \$27.2 million increase in taxation paid was driven by improved profitability and changes to the timing of Australian tax payments. The effective tax rate has remained at approximately 25%.

Net debt

A\$m	HY16	FY15	\$ Change
Loans & borrowings			
Current	168.5	168.1	0.4
Non-current	44.7	44.6	0.1
Total debt	213.2	212.7	0.5
Cash	(80.3)	(72.2)	(8.1)
Net debt	132.9	140.5	(7.6)
Total loan facilities	350.0	350.0	
Unused Portion of Debt Facilities	135.0	135.0	

Net debt reduced by \$7.6 million to \$132.9 million since 30 June 2015. At 31 December 2015, there was \$350.0 million in total loan facilities and the unused portion of the bank facility was \$135.0 million.

Dividends

	HY16	HY15	% Change
Interim ordinary dividend (cents)	110.0c	90.0c	22%
Payout ratio %	67%	72%	
Franking %	100%	35%	
Conduit foreign income %	0%	40%	

Strong free cash flow generation and the continued strength of the balance sheet has supported the payment of an interim dividend of 110.0 cents per share, franked at 100%, representing a payout of 67% of net profit.

The Record date for determining dividend entitlements is 11 March 2016 and the interim dividend will be paid on 1 April 2016.

Non-IFRS financial measures

Given the significance of FX movements the directors believe the presentation of non-IFRS financial measures is useful for the users of this document as they reflect the underlying financial performance of the business.

The non-IFRS financial measures included in this document have been calculated on the following basis:

- Constant currency: restatement of IFRS financial measures in comparative years using FY16 FX rates

The above non-IFRS financial measures have not been subject to review or audit. However, KPMG have separately undertaken a set of procedures to agree the non-IFRS financial measures disclosed to the books and records of the consolidated entity.

Forward looking statements

Cochlear advises that these presentation slides contain 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 you are cautioned not to place undue reliance on any forward looking statement.

Appendix

Change in segment reporting

Segment reporting has been changed to better reflect product segments within the business. The new Services segment, which includes upgrades and accessories, reflects sales revenue from products sold to existing cochlear implant recipients.

The following table provides FY15 comparatives.

New reporting format

	FY15
Sales revenue (<i>A\$m</i>)	
Cochlear implants	604.3
Services (sound processor upgrades & accessories)	222.5
Bone conduction & acoustic implants	115.1
Total sales revenue	941.9

Relevant FX rates

The following table includes FX contract cover and rates as at 31 December 2015:

Total FX hedges expressed in foreign currency (local currency - millions)	USD 228.5	EUR 161.9	JPY 1,558.0	Total
FX hedges expressed in \$Am	293.9	248.1	17.8	559.8
% of total cover	53%	44%	3%	100%
3 year weighted average rates				
- FX contracts 31/12/15	0.78	0.65	87.4	
- FX contracts 31/12/14	0.89	0.67	88.7	
H2 FY16 weighted average rates				
FX contracts at 31/12/15	0.81	0.66	89.7	
Cover for H2 FY16 (\$Am)	89.1	73.2	5.2	167.5

Summary of relevant FX rates:

	HY16	HY15	% change
Average rates (used for translating P&L)			
USD	0.73	0.89	(18%)
Euro	0.66	0.69	(4%)
JPY	88.17	96.77	(9%)
GBP	0.47	0.55	(15%)
Contract rates (used to repatriate FX to Australia)			
USD	0.84	0.92	(9%)
Euro	0.67	0.69	(3%)
JPY	89.7	89.6	0%
	HY16	FY15	
Period end rates (used for translating balance sheet)			
USD	0.73	0.77	(5%)
Euro	0.66	0.69	(4%)
JPY	87.6	95.0	(8%)
GBP	0.49	0.49	0%