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ASX Announcement

18 August 2020

Cochlear Limited Financial Results

For the year ended June 2020

Cochlear had a strong start to FY20 with cochlear implant units growing 13% in the first half. The impact of patent litigation expenses and COVID-19 on sales revenue during the second half, however, resulted in the reporting of a net loss of $238.3 million. Despite these impacts, Cochlear has maintained its commitment to investing in market growth activities and R&D programs to enable the business to emerge from the pandemic in a stronger competitive position. The recommencement of surgeries is positive, and the $1.1 billion capital raising has strengthened the balance sheet.

- Sales revenue declined 6% (11% in constant currency[1]) to $1.4bn, with the first half up 9% and second half down 22%
- Cochlear implant units declined 7% to 31,662 with the first half up 13% and second half down 26%
- Underlying net profit[2] declined 42% to $153.8m due to the rapid fall in sales in the second half, a consequence of COVID-19-related surgery deferrals
- Reported net loss of $238.3m includes $416.3m in patent litigation expenses and $24.2m in innovation fund gains after-tax
- In March Cochlear suspended the dividend until trading conditions improve. As a result, no final dividend has been declared
- No net profit guidance will be provided given the uncertainty in forecasting revenues for FY21

	FY20	FY19	FY20 % Reported	FY20 % CC	H1 20 % Reported	H2 20 % Reported
Cochlear implant units	31,662	34,083	⬇ 7%		⬆ 13%	⬇ 26%
Sales revenue ($m)	**1,352.3**	**1,446.1**	⬇ 6%	⬇ 11%	⬆ 9%	⬇ 22%
Earnings before interest & tax (EBIT - $m)[2]	206.9	359.3	⬇ 42%	⬇ 42%	⬆ 2%	⬇ 87%
Net profit (underlying - $m)[2]	**153.8**	**265.9**	⬇ 42%	⬇ 42%	0%	⬇ 84%
% net profit margin[2]	11%	18%				
Innovation fund gains after-tax ($m)[3]	24.2	10.8				
Patent litigation expense after-tax ($m)	(416.3)	-				
Net profit / (loss) (reported - $m)	**(238.3)**	**276.7**	⬇ 186%			
Basic earnings per share	($4.00)	$4.80	⬇ 183%			
Final dividend per share	-	$1.75	⬇ 100%			
Total dividends per share	$1.60	$3.30	⬇ 52%			

[1]Constant currency (CC) removes the impact of foreign exchange (FX) rate movements and FX contract gains/(losses) to facilitate comparability. [2]Excluding innovation fund gains and patent litigation expense. [3]Includes revaluation of investments and equity accounted losses.

Operational review

Cochlear had a strong start to FY20 with cochlear implants delivering a 13% increase in unit growth in the first half. The launch of the Cochlear™ Nucleus® Profile™ Plus Series cochlear implant was well-received, driving share gains in many markets. The impact of COVID-19 on the business during the second half was substantial, with the deferral of cochlear implant surgeries across the world.

As COVID-19 started to impact the business, we were very clear that we wanted to emerge from the pandemic in a stronger competitive position, placing a high priority on keeping our valuable workforce intact and continuing to invest in our R&D programs and market growth activities. While still early days, surgeries have resumed in many markets.

The impact of COVID-19 on profitability was significant with underlying net profit declining by 42% to $153.8 million. After factoring in patent litigation expenses and innovation fund gains, Cochlear recorded a net loss of $238.3 million for FY20. In response, we have taken actions to strengthen our balance sheet and liquidity position to enable the business to weather the expected business disruption caused by COVID-19.

$m	FY20	FY19	Change % (reported)	Change % (CC)	Sales mix
Cochlear implants (units)	31,662	34,083	⬇ 7%		
Sales revenue					
Cochlear implants	817.9	845.1	⬇ 3%	⬇ 8%	61%
Services (sound processor upgrades and other)	395.5	427.2	⬇ 7%	⬇ 12%	29%
Acoustics	138.9	173.8	⬇ 20%	⬇ 24%	10%
Total sales revenue	**1,352.3**	**1,446.1**	⬇ **6%**	⬇ 11%	**100%**

Cochlear implants

Cochlear implant units declined 7% with first half units up 13% and second half units down 26%.

In the first half, cochlear implant units increased 13% as the Nucleus Profile Plus Series cochlear implant was launched across major markets. The new implant has been well-received by professionals and consumers with improvements in market share experienced across many markets.

From January to mid-March, cochlear implant volumes across the developed markets were tracking in line with expectations. However, from mid-March we experienced a substantial, short-term negative impact on cochlear implant surgeries, particularly in the US and Western Europe, as healthcare systems diverted resources to meet the increasing demands of managing COVID-19.

In April, cochlear implant unit sales across the developed markets declined by around 80% (compared to April 2019), with most elective surgeries postponed. To the extent there were surgeries, they were predominantly for children.

Surgeries recommenced across many markets from early-May. Market conditions however still varied across our developed markets by the end of June with surgery volumes recovering relatively quickly in the US, Germany, Benelux and Australia and more slowly in the UK, Spain and Italy. By the end of June, over 80% of cochlear implant surgical centres in the developed markets had recommenced surgeries.

Emerging markets, which represent around 20% of cochlear implant revenue, delivered a strong start to the year with volumes up over 20% in the first half. January/February volumes were weaker as surgeries were delayed in China, Cochlear's largest emerging market, due to COVID-19. Surgeries recommenced in China in March and have recovered quickly. Surgeries in China continue to grow as a result of the market opportunity and investments we have made to expand our presence over the last few years. Surgeries however across most other markets, including India and Latin America, have remained very low as COVID-19 cases continue to grow.

Services

Services revenue declined 7% (12% in CC) with first half revenue up 9% and second half revenue down 23%.

Services were materially impacted by COVID-19 in the fourth quarter of FY20. While some recipients have been able to access sound processor upgrades remotely, clinic closures have delayed access to sound processor upgrades for many people.

Cochlear's remote servicing capability, with tools including Cochlear™ Link and Remote Check, are assisting clinicians and recipients with performance, mapping, and troubleshooting in markets where they are approved. Many countries and clinics have been adapting, enabling greater levels of remote access and programming to assist recipients unable to visit clinics as a result of COVID-19. In recognition of the importance of providing support, the FDA fast-tracked approval of Remote Check in April.

Acoustics

Acoustics revenue declined by 20% (24% in CC) with first half revenue down 9% and second half revenue down 32%.

In the first half, we experienced some loss of market share from competitor product launches. The market also slowed more than expected in anticipation of the launch of the next generation bone conduction implant, the Cochlear™ Osia® 2 System, which commenced its rollout in the US in February. Like cochlear implants, the second half was materially impacted by COVID-19 due to the delay of elective surgeries.

Acoustics revenue is largely generated from the US and the UK. Surgery volumes have improved in the US since May with increasing demand for the Osia 2 System. Acoustic implant surgeries in the UK, however, have not yet restarted following the COVID-19 shutdowns.

Managing through the pandemic

Since the outbreak of COVID-19, the normal structures of business life needed to rapidly and radically adapt. We changed the way we managed the business, setting aside the normal planning cycles, and enacting our business continuity plan. Guided by our mission, our immediate priorities were to:

- Ensure the health and safety of our employees;
- Provide ongoing support to our recipients, clinics and professional partners; and
- Maintain the financial health of the Company.

Our employees represent around two-thirds of our operating costs. They have valuable experience and make great contributions to Cochlear's mission. We do not want to reduce our workforce as we believe the disruption will be temporary. We have however significantly reduced non-essential spending and capital expenditure and will continue to do so until there is a sustained increase in surgeries. We also implemented a hiring freeze, with temporary pay reductions for the Board and senior management across the business in the last quarter of FY20.

We changed the way we worked together with the majority of employees working from home across the globe from mid-March. The rapid and successful transition to communicating via video meetings, best practice sharing sessions, rebalancing workloads across the business via our 'marketplace' initiative and conducting weekly global town hall meetings has actually enhanced workplace engagement for most, with many of the new ways of doing business to continue post pandemic.

Cochlear's teams have remained focused on providing support to recipients, while continuing their outreach programs with candidates through the Company's direct-to-consumer marketing efforts. The rapid adoption of online and video conferencing tools with our professional partners, candidates and recipients is to be commended and has ensured that we can continue to provide valuable education and support throughout the pandemic.

We have continued to invest in the R&D pipeline with the majority of projects progressing to schedule, including products currently in the regulatory approval process. With the rapid changes in the operating landscape, including clinic closures and access to telemedicine in some markets, we took the opportunity to review our R&D priorities, opting to scale up our connected care efforts even more.

We have spent many years developing our remote care solutions, with the connectivity of the Cochlear™ Nucleus® 7 Sound Processor to the cloud enabling a suite of remote capability. We are now starting to gain regulatory approval for remote care solutions that can provide recipients and audiologists with the ability to access efficient and convenient care. We continue to work on securing reimbursement for these solutions as a way to drive greater adoption.

Customer servicing has been largely unaffected with the Global Repair Centre fully operational. Cochlear's manufacturing and service and repair centres have been deemed as essential services and continue to operate. Manufacturing output of cochlear and acoustic implant systems has been reduced to manage inventory levels.

The supply chain continues to be largely intact. Our conservative approach to inventory management and long-term supplier relations ensured that there were no supply shortages for components. The business continues to carry adequate levels of inventory for most components and is managing distribution in line with customer demand to enable continued supply of products to customers.

Maintaining the financial health of Cochlear ultimately enables us to pursue our mission. The liquidity position has been strengthened through a $1.1 billion capital raising and $225 million increase in debt facilities during March and April. There is no doubt the last few months have been very challenging. As we progressively return to working from the office, we are also taking the opportunity to learn. Many of the new ways of doing business both internally and with our customers will be continued post pandemic.

Retaining market leadership

Cochlear has been the global leader in implantable hearing solutions for 40 years. The investment in R&D aims to strengthen our leadership position through the development of market-leading technology. In FY20, we invested $185 million in R&D, in line with FY19 levels, and representing 14% of sales revenue. Investment in the R&D pipeline continued despite COVID-19 with the majority of projects progressing to schedule, including products currently in the regulatory approval process.

The highlight for the year has been the approval of a number of important new products spanning all components of the product portfolio, with many approvals received either just before, or during, the COVID-19 shutdowns. These include:

Implants and electrodes

- Cochlear™ Osia® 2 System
- Cochlear™ Nucleus® Profile™ Plus with Slim 20 Electrode

Sound processors

- Cochlear™ Nucleus® Kanso® 2 Sound Processor
- Cochlear™ Nucleus® 7 Sound Processor for Nucleus 22 implant recipients

Clinical and surgical support tools

- Custom Sound® Pro fitting software
- Nucleus® SmartNav System

Connected care

- Remote Check solution for cochlear implants

Growing the market for hearing implants

As the global leader, Cochlear is focused on driving long-term market growth by transforming the way people understand and treat moderately severe to profound hearing loss through awareness and access activities. In FY20, we continued to invest in expanding our programs for driving growth of the adults and seniors segment which include direct-to-consumer marketing activities, building hearing aid channel referrals from the hearing aid and ENT channels, and standard of care initiatives aimed at building a consistent treatment pathway for adults with severe to profound hearing loss.

The Cochlear Provider Network continued to expand and is building education of the indications and benefits of cochlear implants to hearing aid audiologists in the US and is starting to provide a referral pathway to cochlear implant surgeons.

We also hit some key milestones with improved indications and/or funding for our products across a number of markets including:

- US: approval to lower the age of paediatric cochlear implantation from 12 to nine months for Cochlear's implant portfolio (Mar20)
- Belgium: expansion of reimbursement criteria for cochlear implants to include candidates with a severe hearing loss (Aug19)
- Czech Republic: funding for cochlear implants for adults (Jan20)
- France: reimbursement approved for Baha sound processors (Sep19)

Trading update and FY21 outlook

As COVID-19 started to impact the business, we were very clear that we wanted to emerge from the pandemic in a stronger competitive position, placing a high priority on keeping our valuable workforce intact and continuing to invest in our R&D programs and market growth activities. Our market position has strengthened during FY20, with growing share and a continuing shift to our cochlear implants with perimodiolar electrodes, now representing around 60% of our implant mix in markets where it is available. And the product portfolio has been expanded with a range of new products that are expected to drive further improvements in share.

In April cochlear implant revenue fell by nearly 60%. We have been experiencing an improving trend in trading since May with the recommencement of surgeries across most markets. In June/July cochlear implant revenue was 85% of last year as a result of a combination of new surgeries and rescheduled surgeries. There continues to be a significant level of variability across countries, with developed market momentum well ahead of the emerging markets.

For the developed markets, unit volumes were in line with last year for the June/July trading period, reflecting both a return to surgery and market share gains. While the resumption of surgeries in the US, Germany, Japan and northern Europe has been quite rapid, there are still a number of markets with lower levels of surgery activity including the UK, Italy and Spain.

It has also been pleasing to see that the segment mix, that is, the split between children, adults and seniors, reflects the pre-COVID-19 mix across most countries. In countries where surgery rates remain relatively low, the clear priority continues to be the implantation of children.

While the resumption of elective surgeries is positive, we caution that there is still risk, noting that second waves of COVID-19 cases are likely to remain a reality for some time and may result in new restrictions to elective surgery, complicating recovery plans and timing.

We also recognise that the surgeries currently occurring, particularly for adults and seniors, include a catch up of delayed surgeries from March to May. We will get a clearer picture of the impact of clinic closures in April and May on the new candidate pipeline over the next few months. While the majority of clinics have re-opened, many are still running below capacity as they recommence operations sensibly, mindful of the need to continue social distancing disciplines. As a result, we expect there to be some impact on the number of patient assessments for cochlear and acoustic implants until clinic throughput normalises. Our direct-to-consumer activities, which continued throughout COVID-19 shutdowns, have been aimed at providing additional support to candidates, and potential candidates, and it is hoped that these activities may assist in more quickly rebuilding the candidate pipeline.

For the emerging markets, unit volumes were at 50% of last year for the June/July trading period. Surgeries in China are growing quickly, and we remain committed to continuing to invest in further growth. In other markets, including India and Latin America, surgeries have remained very low as COVID-19 cases continue to grow.

Services revenue run rates have been improving since May with June/July revenue at around 70% of last year. The launch of the Kanso 2 Sound Processor, the growing recipient base and the adoption of remote care tools are expected to underpin demand for upgrades over the longer term. In the near term, however, we expect clinic capacity for upgrades to be lower than normal.

Acoustic revenue run rates have also been improving since May with June/July revenue at around 70% of last year. Surgery volumes have been recovering in the US since May with strong demand for the Osia 2 System. Acoustic implant surgeries in the UK, however, have not yet restarted following the COVID-19 shutdowns. We continue to be excited about the potential for the Osia 2 System. It represents a significant improvement in performance, aesthetics and quality of life for bone conduction patients and has received an enthusiastic response from surgeons and patients in the US since launch. We are aiming to get regulatory approval for the Osia 2 System in Europe by mid 2021.

Cochlear's liquidity position is strong following the $1.1 billion capital raising and expansion of debt facilities in March. Combined net cash and undrawn debt facilities total $987 million as at 30 June. With revenues improving, operating cash flow is currently around breakeven levels. In considering use of cash for FY21, we are forecasting around $90 million in capital expenditure. It should also be noted that the payment of US$75 million in prejudgment interest and attorneys' fees relating to the litigation case is conditional upon the outcome of an appeal by Cochlear to the US Supreme Court. Cochlear will deposit the funds into an escrow account pending the outcome of the appeal.

In March, Cochlear announced the suspension of the dividend until trading conditions improve. The Board expects to resume payment of a dividend once a clear and sustained improvement in sales revenue has been established and cash flow generation is sufficient to support its resumption.

Due to the uncertain timing of a global recovery from the pandemic, we cannot reliably estimate FY21 revenues, so will not be providing earnings guidance. A trading update will be provided at the AGM on 20 October. Our investment priorities for FY21 will be focused on market growth activities and strengthening our competitive position, while continuing to limit non-essential spending until we have greater confidence in the outlook. There are a number of cost base considerations for FY21, which may be adapted if trading conditions materially change:

- Operating expenses (excluding R&D) are forecast to increase by around 4% with the growing investment in market growth activities and re-instatement of the short-term incentive provision, partly offset by lower levels of more discretionary spending;
- Investment in R&D is expected to increase to around $190-195 million;
- We expect to receive some further government support following the receipt in FY20 of $24 million in COVID-19-related government assistance from a number of countries;
- FX contracts gains/(losses) are expected to be close to zero as a result of minimal hedging in FY21; and
- Depreciation and amortisation (including AASB16-related) is expected to be around $80 million.

Longer-term outlook

As we look to the future, we remain confident about the opportunity to grow our markets. There remains a significant, unmet and addressable clinical need for cochlear and acoustic implants that is expected to continue to underpin the long-term sustainable growth of the business.

As we transition from dealing with a health crisis to assessing the long-term economic impacts of the pandemic, we are thinking more about what may change in the hearing implant landscape. There will no doubt be opportunities as well as risks that mean we may need to adapt our strategy.

Front of mind is the debt burden that economies will face and the increased competition for health funding. We see a real potential for payers to accelerate the adoption of health economic considerations, allocating spending to more cost-effective interventions. Cochlear implants provide a cost-effective solution for all age groups, delivering significant returns on the investment made by the healthcare system. While we believe our intervention is well-positioned, it is too early to understand what, if any, implications there will be for healthcare spending or how our products may be prioritised.

The pandemic has also driven the rapid adoption of telehealth and telemedicine which may lead to faster than expected structural changes in healthcare delivery. We experienced this first hand with the FDA fast-tracking the approval of our Remote Check solution in the US. Our professional partners too have shown greater interest and demand for our connected care solutions over the last few months which also include Cochlear Link and Remote Programming in many markets. We have been investing in connected care solutions for many years and believe they provide the opportunity to open up access to our products and optimise outcomes for recipients by transforming the care model while delivering efficiencies to clinics.

We are also aware that there may be other risks and we are carefully monitoring business performance.

Regional review

$m	FY20	FY19	Change % (reported)	Change % (CC)	Sales mix
Americas	650.3	688.6	⬇ 6%	⬇ 11%	49%
EMEA	479.6	519.2	⬇ 8%	⬇ 11%	35%
Asia Pacific	222.4	238.3	⬇ 7%	⬇ 10%	16%
Total sales revenue	**1,352.3**	**1,446.1**	**⬇ 6%**	**⬇ 11%**	**100%**

Americas (US, Canada & Latin America)

Sales revenue declined by 6% (11% in CC) with the first half up 9% and second half down 21%.

H1: The Americas had a solid start to the year with strong cochlear implant revenue growth moderated by low growth in Services revenue and a decline in Acoustics revenue. The launch of the Nucleus Profile Plus Series cochlear implant in the US in late June 2019 was well-received by the market, driving an uplift in market share throughout the year.

Services revenue in the US was flat in the first half as the business cycled very strong sales in HY19, with penetration rates reaching high levels. Acoustics sales declined with some loss of share from competitor product launches and a slowdown in surgeries in anticipation of the launch of the Osia 2 System.

H2: Second half revenue for the Americas declined by 21% (26% in CC), materially impacted by the elective surgery deferrals from mid-March. Surgeries have started to recommence across North America with clinics progressively reopening. There are still very few surgeries in Latin America as COVID-19 infection rates continue to rise. The decline in Latin American implant revenue has been partly offset by growth in Services revenue.

EMEA (Europe, Middle East and Africa)

Sales revenue declined by 8% (11% in CC) with the first half up 6% and second half down 20%.

H1: EMEA delivered strong cochlear implant revenue growth in the first half moderated by low growth in Services revenue and a decline in Acoustics revenue.

Like the US, Services revenue growth slowed in the first half as the business cycled very strong sales in HY19, with penetration rates reaching high levels and Acoustics revenue declined. EMEA's emerging markets grew in the first half as a result of the timing of a number of tenders, underpinned by investments in the organisation in recent years.

H2: Second half revenue for EMEA declined by 20% (23% in CC), as a result of the deferral of elective surgery from mid-March. Surgery volumes across Western Europe started improving during May with significant variability across countries. Germany and Benelux have recovered quickly while the UK, Italy and Spain continue to record a small, but growing number of surgeries.

Asia Pacific (Australasia & Asia)

Sales revenue declined by 7% (10% in CC) with the first half up 18% and second half down 29%.

H1: In the first half, Japan and South Korea experienced strong growth across both cochlear implant units and sound processor upgrades. China recorded strong growth in sales revenue, benefiting from increased investment in sales and marketing capability over the past few years.

H2: Second half revenue declined by 29% (32% in CC) as a result of the impact of the deferral of elective surgeries which varied greatly by country. China has recovered quickly and is growing strongly. South Korea delivered strong growth in FY20 with Cochlear gaining share in a market that continued to conduct elective surgeries throughout the pandemic. Australia and China delivered solid growth in Services revenue. India however continues to experience high infection rates from COVID-19 with very few surgeries since April.

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Financial review

Profit & loss

$m	FY20	FY19	Change % (reported)	Change % (CC)
Sales revenue	**1,352.3**	**1,446.1**	**(6%)**	**(11%)**
Cost of sales	344.4	351.1	(2%)	(5%)
% gross margin	*75%*	*76%*	*(1) pt*	*0 pts*
Selling, marketing and general expenses	470.0	450.9	4%	0%
Research and development expenses	185.1	184.4	0%	(1%)
% of sales revenue	*14%*	*13%*	*1 pt*	*(1) pt*
Administration expenses	93.8	94.8	(1%)	(1%)
Operating expenses	**748.9**	**730.1**	**3%**	**0%**
Other income / (expenses)	(20.4)	13.8		
FX contract losses	(31.7)	(19.4)		
EBIT (underlying)*	**206.9**	**359.3**	**(42%)**	**(42%)**
% of sales revenue	*15%*	*25%*		
Net finance expense	8.9	4.5	98%	
Income tax expense*	44.2	88.9	(50%)	
% effective tax rate	*22%*	*25%*		
Net profit (underlying)*	**153.8**	**265.9**	**(42%)**	**(42%)**
*% net profit margin**	*11%*	*18%*		
Innovation fund gains after-tax	24.2	10.8		
Patent litigation expense after-tax	(416.3)	-		
Net profit / (loss) (reported)	**(238.3)**	**276.7**	**(186%)**	**(187%)**

* Excluding innovation fund gains and patent litigation expense

Sales revenue declined by 6% (11% in CC) to $1,352.3 million, with revenue up 9% in the first half and down 22% in the second half. Underlying net profit declined 42% to $153.8 million due to the rapid fall in sales in the second half, a consequence of COVID-19-related surgery deferrals and clinic closures. After factoring in patent litigation expenses and innovation fund gains, Cochlear recorded a net loss of $238.3 million for FY20.

Key points of note:

- Cost of sales declined by 2% (5% in CC) to $344.4 million, reflecting declining sales in the fourth quarter. The gross margin declined by 1 percentage point to 75%. Gross margin benefited from lower warranty costs, the result of improved sound processor manufacturing and design that has resulted in lower warranty repairs. This benefit was offset by the impact of lower overhead recovery arising from lower manufacturing volumes since May;
- Selling, marketing and general expenses increased by 4% (0% in CC) to $470.0 million, with the first half up 9% in CC and the second half down 8%. Continued investment was made in market growth activities including direct-to-consumer marketing, standard of care and market access initiatives. The second half decline reflects actions to limit all non-essential spending from mid-March and includes a hiring freeze and temporary pay reductions for the Board and senior management across the business in the fourth quarter. These savings were partially offset by a $10.0 million increase in the doubtful debts provision resulting from higher collections risk associated with COVID-19;
- Investment in R&D was in line with FY19 (down 1% in CC) at $185.1 million, representing 14% of sales revenue;
- Operating expenses include a $23.6 million benefit from the suspension of short-term incentive payments;

- FX contract losses increased by $12.3 million to $31.7 million as a result of the weaker Australian dollar against major trading currencies;
- Net finance expenses increased by 98% to $8.9 million and includes $6.1 million in interest expense resulting from the adoption of new leasing accounting standard AASB16. Net finance expenses (excluding the lease-related expense) declined by 38% to $2.8 million with the business benefitting from lower interest rates and interest on cash deposits from the March capital raising;
- $24.2 million in innovation fund gains after-tax includes a $25.0 million gain from the revaluation of the Nyxoah shareholding and $0.8 million in equity accounted losses; and
- $416.3 million in patent litigation expenses after-tax relates to an adverse litigation judgment in the long-running AMF patent infringement case. $420.1 million was paid in June and a provision was made for US$75 million in prejudgment interest and attorneys' fees with payment conditional upon the outcome of an appeal by Cochlear to the US Supreme Court.

Other expenses

$m	FY20	FY19	Change
Government assistance (COVID-19-related)	23.6	-	23.6
Release in the contingent consideration (Sycle)	13.2	10.8	2.4
Ineffective forward exchange contracts	(26.1)	-	(26.1)
Carina write-down	(17.3)	-	(17.3)
Otoconsult NV write-down	(12.5)	-	(12.5)
Other	(1.3)	3.0	(4.3)
Other income / (expenses)	**(20.4)**	**13.8**	**(34.2)**

The Profit & loss includes other expenses of $20.4 million, which are largely one-off in nature, including:

- Due to the impact of COVID-19, Cochlear has received $23.6 million in government assistance through the US Coronavirus Aid, Relief and Economic Security Act (CARES Act), Australia's JobKeeper Program and other assistance programs offered in Europe and Asia;
- $13.2 million non-cash benefit related to the final release in the contingent consideration value of Sycle;
- $26.1 million in expenses relating to ineffective forward exchange contracts, predominantly FY21 USD contracts, due to the combined effects of COVID-19 and the adverse litigation judgment on the probable foreign currency cash flows anticipated to be received during that period. As a result, those cash flow hedges no longer met the criteria for hedge accounting and were closed;
- $17.3 million in the write-down of assets associated with the Carina acoustic implant following the decision to cease sales of the product due to low volumes; and
- $12.5 million in the write-down of assets and licencing costs associated with Otoconsult NV following the decision to pursue the development of different AI-assisted mapping in-house.

Adverse litigation outcome

In March, the US Court of Appeals for the Federal Circuit in Washington, DC affirmed the US District Court award of patent infringement damages against Cochlear and its US subsidiary Cochlear Americas in the lawsuit by the Alfred E Mann Foundation for Scientific Research (AMF) and Advanced Bionics LLC (AB), with payment of US$280 million, including post judgment interest, made in June. Cochlear intends to lodge an appeal with the US Supreme Court against the Judgment.

The case related to two patents that have long expired. The Court had previously invalidated the first patent with the remaining patent much narrower in scope. We believe the amount of damages awarded was out of proportion with the limited application of the patented feature, acknowledging that inflated damages awards are a risk of patent disputes in the US.

Subsequent to year-end, Cochlear agreed to a settlement with AMF and AB of pre-judgment interest and attorneys' fees totalling US$75 million. At 30 June 2020, Cochlear has provided US$75 million in relation to this settlement which is included in the patent litigation expense within the Income Statement. The settlement is conditional upon the outcome of an appeal by Cochlear to the US Supreme Court against the US$280 million Judgment. If Cochlear's Supreme Court appeal is successful, there may be a new trial to redetermine the quantum of damages.

As the patent at issue in the litigation has expired, the judgment will not disrupt Cochlear's business or customers in the US.

Cash flow

$m	FY20	FY19	Change
EBIT (underlying)	206.9	359.3	(152.4)
Depreciation and amortisation (excl AASB16 impact)	49.1	38.5	10.6
Depreciation and amortisation (AASB16-related)	28.4	-	28.4
Changes in working capital and other	66.9	(6.6)	73.5
Cash impact of patent litigation expense	(420.1)	-	(420.1)
Net interest paid	(8.9)	(4.5)	(4.4)
Income taxes paid	(80.1)	(90.7)	10.6
Operating cash flow	**(157.8)**	**296.0**	**(453.8)**
Capital expenditure	(111.4)	(86.6)	(24.8)
Acquisition of other intangible assets	(19.1)	(28.0)	8.9
Other net investments	(14.2)	(23.2)	9.0
Free cash flow	**(302.5)**	**158.2**	**(460.7)**
Proceeds from issue of shares	1,081.9	7.4	1,074.5
Dividends paid	(193.7)	(181.8)	(11.9)
Payment of lease liability & other	(25.7)	(0.6)	(25.1)
Change in net debt – decrease / (increase)	**560.0**	**(16.8)**	**576.8**

Free cash flow declined by $460.7 million to be an outflow of $302.5 million, driven by payment of costs associated with an adverse litigation judgment in June and the impact on earnings from the COVID-19-related fall in revenue during the fourth quarter. Cochlear's financial position was bolstered by the $1.1 billion capital raising in March which resulted in net debt declining by $560.0 million, more than offsetting the decline in free cash flow.

Key points of note:

- EBIT (underlying) declined by $152.4 million as a result of the significant decline in sales revenue in the fourth quarter;
- $420.1 million in cash impact of patent litigation expenses reflects the payment of damages and post judgment interest associated with an adverse litigation judgment in June;
- Changes in working capital and other of $66.9 million reflects the benefit of the reduction in trade receivables resulting from lower sales revenue in the fourth quarter;
- The $10.6 million reduction in income taxes paid reflects the impact of COVID-19 during the second half. The tax credit resulting from the patent litigation expenses will result in lower tax payments in FY21;
- Capital expenditure (capex) increased by $24.8 million to $111.4 million, reflecting stay in business capex, the continued development of the China manufacturing facility, fitout of the new, larger Denver office and IT platform development;
- The acquisition of intangible assets includes the licencing of a range of R&D-related assets; and
- Other net investments primarily relate to the additional investment made in Nyxoah.

Capital employed

$m	Jun20	Jun19	Change
Trade receivables	211.4	299.5	(88.1)
Inventories	223.8	195.4	28.4
Less: Trade payables	(155.3)	(160.8)	5.5
Working capital	**279.9**	**334.1**	**(54.2)**
Working capital / sales revenue	*21%*	*23%*	
Property, plant and equipment	230.5	166.5	64.0
Intangible assets	410.3	424.4	(14.1)
Investments (including equity accounted)	94.9	47.8	47.1
Other net liabilities	(71.1)	(143.9)	72.8
Capital employed	**944.5**	**828.9**	**115.6**

Capital employed increased by $115.6 million to $944.5 million since June 2019 reflecting an increase in property, plant and equipment and other net liabilities and a reduction in working capital.

Key points of note:

- Trade receivables reduced by $88.1 million, a consequence of the reduced sales revenue;
- Inventories increased by $28.4 million, a consequence of the reduced sales revenue and a decision to build inventory levels to enable the business to cater to demand as surgeries recommence;
- Property, plant and equipment increased by $64.0 million and includes the investment in the China manufacturing facility and fitout of the new Denver office;
- The increase in investments includes a $35.8 million pre-tax increase in the value of Cochlear's investment in Nyxoah;
- Other net liabilities decreased by $72.8 million to $71.1 million reflecting movements across a number of other assets and liabilities. Net current tax assets increased by $84.8 million reflecting refundable FY20 tax payments. Tax losses resulting from the patent litigation expense and COVID-19 impacts were incurred late in the year, resulting in an overpayment of tax instalments for the year. The $85.9 million increase in provisions primarily reflects the US$75 million provision for prejudgment interest and attorneys' fees with payment conditional upon the outcome of an appeal by Cochlear to the US Supreme Court. A $25.5 million reduction in net FX contract liabilities represents the mark-to-market value of all FX hedging contracts as at 30 June 2020.

Net debt

$m	Jun20	Jun19	Change
Loans and borrowings:			
Current	393.1	3.3	389.8
Non-current	79.9	178.3	(98.4)
Total loans and borrowings	**473.0**	**181.6**	**291.4**
Less: Cash, cash equivalents and term deposits	(930.0)	(78.6)	(851.4)
Net debt / (cash)	**(457.0)**	**103.0**	**(560.0)**
Facility limit	1,003.8	414.5	589.3
Debt drawn	473.9	182.4	291.5
Balance remaining	529.9	232.1	297.8

Net debt declined by $560.0 million, resulting in a net cash position of $457.0 million. Cochlear's liquidity position has increased as a result of a $1.1 billion capital raising in March and expanded debt facilities. Combined net cash and undrawn debt facilities total $986.9 million as at 30 June.

Dividends

	FY20	FY19	Change %
Interim ordinary dividend (per share)	$1.60	$1.55	3%
Final ordinary dividend (per share)	-	$1.75	(100%)
Total ordinary dividends (per share)	**$1.60**	**$3.30**	**(52%)**
% payout ratio (underlying)	60%	72%	
% franking	100%	100%	

In March, Cochlear announced the suspension of the dividend until trading conditions improve. As a result, no final dividend has been declared. Full year dividends declined by 52% to $1.60 per share, representing a payout of 60% of underlying net profit.

The Board expects to resume payment of a dividend once a clear and sustained improvement in sales revenue has been established and cash flow generation is sufficient to support its resumption.

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

Sales revenue is the primary revenue reporting measure used by Cochlear for the purpose of assessing revenue performance of the Consolidated Entity. It represents total revenue excluding foreign exchange contract losses on hedged sales. 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.

Reconciliation of constant currency net profit

$m	FY20	FY19	Change %
Net profit (underlying)	**153.8**	**265.9**	**(42%)**
FX contract movement		(38.4)	
Spot exchange rate effect to sales revenue and expenses*		37.9	
Balance sheet revaluation*		(2.4)	
Net profit (underlying) (CC)	**153.8**	**263.0**	**(42%)**
Patent litigation expense and innovation fund gains after-tax	(392.1)	10.8	
Net profit (reported) (CC)	**(238.3)**	**273.8**	**(187%)**

* FY20 actual v FY19 at FY20 rates

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