

Cochlear Limited

2017 Annual General Meeting

Chairman's Address

17 October 2017

Rick Holliday-Smith Chairman

Ladies and gentlemen...

Financial results

Cochlear reported a record net profit of \$224 million, an increase of 18% on the FY16 result.

The positive momentum we have experienced over the past few years continued throughout the 2017 financial year with strong growth in both sales revenue, and units, delivered across all product categories and regions.

Our market leadership strengthened with market growth and market share improvements throughout the year, all underpinned by successful new product launches, additional investment in direct-to-consumer marketing, and continued expansion of the sales force.

During the year we launched a number of new products that all experienced strong uptake. These include the Kanso® Sound Processor, our first off-the-ear sound processor, the Nucleus® Profile Slim Modiolar electrode, the world's slimmest electrode, as well as the Baha® 5 range of sound processors.

In July 2017, we introduced the Nucleus 7 Sound Processor, the world's first Made for iPhone cochlear implant sound processor; this allows users to stream sound from an iPhone®, iPad® and iPod touch® directly to their sound processor. This product offers our recipients greater accessibility, connectivity and wireless solutions.

Our continued investment in sales and marketing supported a healthy rate of industry growth for cochlear implants across the developed world, we estimate the market to have grown by

around 8-10% per annum over the past three years, a marked improvement from the previous three years.

Cochlear continues to lead the market with innovative new initiatives that improve the quality of life of so many people around the globe and contributes to the continued growth of the industry. We have a global team of over 300 engineers who work together to develop innovative technologies that really change the lives of our recipients. In FY17, we invested over \$150 million – representing 12% of revenue – in our R&D activities.

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

We made solid progress in our business priorities focused on growing the core, building a service business, shaping the organisation and on long term value creation. This focus includes continuing to expand the sales force across major developed and emerging markets, expanding our direct-to-consumer programs in the US, Australia, Germany, UK and India, and building greater engagement with our recipient base.

The balance sheet and free cash flow generation remained strong, and supported the 17% increase in the fully franked final dividend to \$1.40 per share. This takes dividends paid for the year to \$2.70 per share, fully franked, an increase of 17% on FY16.

There have also been a number of important developments for the Company and hearing awareness over the past 12 months which I will touch on now.....

Cochlear implants recognised as a cost effective intervention by the World Health Organization

In March this year, the World Health Organization (WHO) reaffirmed the importance of dealing with the rising prevalence of hearing loss with ageing.

The WHO estimated that over 360 million people – some 5% of the world's population – live with disabling hearing loss, 32 million of them are children. The global cost of unaddressed hearing loss has been estimated at \$750 billion per year.

Hearing loss is a significant public health issue that in their view requires all countries to make hearing health a priority, with the need for national action plans around prevention, intervention and treatment of hearing loss.

In May, the World Health Assembly (WHA), the WHO's governing body, passed a resolution outlining practical, cost effective steps to deal with hearing loss; starting with awareness, hearing screening programs, and making hearing aids and assistive hearing technologies, such as cochlear implants, more accessible to those who need them.

Passed unanimously, this is the first WHA resolution tackling prevention of deafness and hearing loss in 22 years and sets out the ground work needed for further action.

At Cochlear, we are driven by our mission to improve the lives of people with hearing loss, and as a hearing health expert, we join with other global stakeholders to play our part in tackling this global health issue.

Hearing loss links to cognitive decline, social isolation and depression

A major part of Cochlear's business is in developed markets like Australia, North America and Western Europe. Over the past decade, we have experienced a shift in these markets to cochlear implantation in seniors – by that I mean those over 65 years old.

This is largely driven by the ageing population and the higher incidence of hearing loss in this age group.

Cochlear implantation for seniors is important, especially as we begin to better understand the link between high levels of hearing loss and cognitive decline, social isolation and depression, with a growing body of research pointing to the need for early intervention.

We have recently increased our investment in health economics, we have expanded our collaborative partnerships with the medical research community, and we have directed effort and attention to better confirm and communicate these hearing loss impacts on individuals and societies. We want to create stronger awareness and to build better access for those affected.

During FY17, Cochlear also made some significant investments....

Expanding global manufacturing footprint

In July 2017, we announced plans to expand our global manufacturing capacity for cochlear implants with a new \$50 million facility to be built in Chengdu, Sichuan Province, China. Products produced in the new facility, which is expected to commence production within four years, will be for China and our emerging markets business.

We believe this investment should allow us to further extend our market position and deepen our commitment to China. The new facility will have the capacity to increase our global cochlear implant production by around 50%.

The investment is part of a broader plan to increase production capacity across the product portfolio. In 2010, we opened our state-of-the-art global headquarters and manufacturing facility on the Macquarie University campus, in Sydney.

Earlier this year, we purchased our Lane Cove manufacturing facility, and we are currently upgrading and adding capacity to our Brisbane manufacturing facility.

Acquisition of global leader in audiology practice management software

In May this year, we announced the acquisition of Sycle, the world's largest provider of audiology practice management software, for an estimated US\$78 million.

The acquisition is a strategic investment that will strengthen our service offering to our clinical partners. Sycle offers a market-leading practice management solution with a product suite that can be expanded over time to provide solutions for cochlear implant clinics.

This acquisition should enable our partners to enhance clinic efficiency, freeing up more time to deliver patient care.

We are also excited by the opportunity to strengthen the relationship between the hearing aid and cochlear implant channels. There is an opportunity to leverage best practice, processes and systems across the hearing services industry, and streamline patient care.

Sycle provides a single platform from which we can assist to build market awareness of the hearing loss treatment options available as patients are managed through the continuum of care.

CEO & President transition timeline announced

In July 2017, we announced the retirement timeline for Chris Smith as Chief Executive Officer & President, and the appointment of Dig Howitt as Cochlear's new CEO & President.

Dig became President, Cochlear, effective 31 July 2017 and is working closely with Chris as operating responsibilities and relationships are transferred. Chris will retire effective 2 January 2018.

Dig has been our Chief Operating Officer since July 2016. Dig joined Cochlear in 2000 and has been a key member of the leadership team for many years. He has a wealth of experience across the Company in roles including Chief Operating Officer; President, Asia Pacific; and SVP, Manufacturing and Logistics.

Chris has overseen a period of substantial growth for Cochlear with the Company exceeding a billion dollars in annual sales revenue during his tenure. With his leadership team, Chris has focused the strategic priorities on the customer, and reorganised the management team around growth initiatives for a sustainable future.

Chris will leave the Company and its management in a strong position.

The Board and management wish Chris well in his retirement and thank him for his substantial contributions during a distinguished 13-year career at Cochlear.

Dig will complete the transition into the CEO & President role over the coming months and you can expect Cochlear to continue to pursue its well-established strategic priorities under his leadership.

The importance of supporting Australian innovation

I now want to discuss innovation, a subject that is very important to Cochlear.

Much has been said recently in Australia about innovation, and Cochlear broadly supports the National Innovation and Science Agenda. The Ferris, Finkel and Fraser Report states

that “R&D activities are a key driving force of productivity and economic growth”. We agree, which is why we continue to be active in the public debate around proposed changes to incentives.

Cochlear spends over \$150 million a year on R&D related activities. This is a significant investment, amounting to 12% of our revenue, with the majority of our R&D occurring here in Australia. As a consequence, while over 95% of our revenue is generated outside Australia, we pay over 75% of our taxes in Australia.

Importantly, the valuable Intellectual Property, or IP, generated from this R&D is largely owned in Australia. And by conducting these activities here, we are also providing a training ground for leaders of the next generation of innovators, especially in the field of medical technology.

Cochlear has historically benefited from the government’s R&D tax concession. This incentive program aimed to encourage local innovation and is particularly important for globally mobile, export focused, advanced manufacturing companies like Cochlear. These R&D related tax incentives have supported the commercial decisions that allow Cochlear to stay in Australia to the fullest extent possible, and conduct the majority of its research in Australia.

As we called out last year the government’s R&D tax concession regime is being changed and adversely impacts Cochlear from an Australian viewpoint. The changes are complex but seem designed to cap the levels of eligible R&D and introduce a range of qualification variables.

We note that Australia is reducing these R&D incentives at a time when many other countries appear to be increasing incentives to attract R&D investment. We note that there are further proposed changes to incentives which could further materially reduce the R&D tax benefits to Cochlear in Australia.

Unfortunately, the impact of these decisions can only be fully understood over the longer-term. There may be little or no apparent impact from changes to taxation policy in the first year, but over time I fear we will see the loss of an increasing amount of our incremental research investments to overseas jurisdictions.

Cochlear will continue to vigorously promote the maintenance of a globally competitive R&D tax concession regime in Australia.

Of equal importance to our global success is the effectiveness of our relationships with policy makers and regulators. We note that for many markets, other than the US and Europe, we need the approval of our local regulator, the TGA, before other jurisdictions will approve our products. As such the timely support of the TGA can play a major part in our global success. We will continue to work hard to strengthen these relationships and enhance our global competitiveness.

We believe Australia needs global leaders in non-mining export oriented businesses, and we suggest Australia should encourage research-oriented companies like Cochlear, especially ones that are involved in advanced manufacturing and who are globally mobile.

Confirmation of FY18 financial outlook

I will now touch on our financial expectations for the 2018 financial year.

For FY18, we gave guidance that we expect reported net profit to increase to \$240-250 million, with currency headwinds expected to moderate strong underlying business growth. We have previously set out our currency expectations and continue to monitor these assumptions. We also note our currency exposures are hedged to some degree in the shorter term.

We are comfortable with the momentum across our range of businesses and we continue to expect the significant investments we made, in product development and market growth initiatives over the previous few years, to underpin growth in FY18 and beyond.

In particular, we expect the launch of the Nucleus® 7 Sound Processor, which commenced its full market release in September, to contribute to both implant growth and upgrade demand over the coming years.

It is good to note that our balance sheet and free cash flow generation remain strong and we continue to target a dividend payout ratio of around 70% of net profit.

It is appropriate to look at the issue of guidance for FY18 and on that front, we would summarise the key guidance considerations as follows:

- We continue to maintain our previous guidance for FY18 of NPAT in the range of \$240-250 million.
- We are still maintaining an expected weighted average AUD/USD exchange rate of 80 cents for FY18 versus 75 cents in FY17.
- We expect solid momentum in unit growth to continue, supported by further investment in market access and market growth activities;
- We expect net profit to be weighted to the second half given the timing of the Nucleus 7 Sound Processor launch; and
- We expect R&D expenditure to be \$160-170 million.

Board renewal

I will now turn to Board matters. As a Board we recognise the importance of undergoing a regular process of renewal. Over recent years we have implemented a Board renewal process, bringing onto the Board a number of new directors with diverse backgrounds and relevant experience.

We have sought to maintain a balance of continuity, and to introduce new skill sets. We have been pleased with all the recent appointments, with the new directors adding great perspective and value to our Board discussions.

We believe Cochlear is well served by experienced directors with knowledge of our business and our culture. That requires some period of knowledge development, and in some instances, at the end of service, an appropriate knowledge transfer.

We note several governance bodies are prescriptive about tenure, we are conscious of these issues, and regularly test the performance of our directors and their independence, but we do not agree with that prescriptive approach. At all times we seek to take actions in the best interests of the Company and its stakeholders, and to look after the Company into the longer term.

This renewal process will continue in 2018 and beyond as we seek to balance tenure, diversity and experience on the Board, and ensure we have a smooth transition of longer-serving Board members over the next few years.

In particular we are currently seeking to increase our diversity, to identify and consider experienced directors with medical device and related manufacturing backgrounds, to

strengthen our medical health capabilities on the Board and within the Company, and to generally develop and transfer knowledge and experience to all directors.

The Board fully endorses those directors who will be presenting themselves to you later in this meeting, we hope they receive your support.

Our employees

Finally, I would like to acknowledge the contribution of each of our 3,000 plus employees. Their knowledge, expertise and passion is key to our future and their focus on delivering excellence for our customers is an important part of our success and our market leadership position.

It is our people who ensure Cochlear is such a strong and sustaining Company.

As a Board, and on behalf of you, our shareholders, I congratulate and thank all of Cochlear's employees for their outstanding efforts and contributions.