

# 2011 CHAIRMAN'S ADDRESS

## COCHLEAR LIMITED ANNUAL GENERAL MEETING

OCTOBER 18<sup>TH</sup>, 2011

AUSTRALIA BALLROOM  
THE MENZIES SYDNEY  
14 CARRINGTON STREET  
SYDNEY

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Ladies and gentlemen, let me now start my address.

### **Chairman's Overview**

The 2011 Financial Year to June 2011 (F11) was another successful year for Cochlear involving record results in terms of sales, profit, operating cash flow and dividends.

Compared to the previous Financial Year (F10) the record results in F11 were:

- Revenue of \$809.6 million, an increase of 10% in reported currency and 17% in constant currency
- Implant sales of 24,661, an increase of 17%
- Net profit after tax of \$180.1 million, an increase of 16%
- Dividend for the second half to June 2011 of \$1.20, an increase of 14%, and
- Total dividend for the full year of \$2.25, an increase of 12.5%

Further at the end of June 2011, Cochlear had net cash of \$9 million after reducing all borrowings by \$123 million.

This was a pleasing result given the complex and uncertain world economic climate throughout F11, in particular in the face of the continued strengthening of the average Australian dollar rate. The average Australian dollar rate appreciated 12% against the US dollar and 14% against the Euro.

The overall result put the company in a strong position at the end of F11.

## **Events in the 2012 Financial Year (F12)**

I now want to discuss the decision on September 11<sup>th</sup> to suspend the sales and distribution of all CI 500 series implants, effectively triggering a voluntary recall of one component of our Nucleus 5 system.

This decision was taken by our Safety Committee and ratified by the Board and then advised to all relevant parties as fast as possible.

It was an unfortunate event and we regret the difficulties it has created for so many of our stakeholders, but it was the right thing to do especially when our primary consideration is always the welfare of our recipients and our long term reputation.

Immediately following this decision we made recipient support and recipient welfare our primary focus. This included support for our clinicians and all related professionals.

We have also initiated a range of activities in line with our internal procedures.

Since that time the Board has been actively and closely working with the Senior Management Team to understand and monitor what is happening.

An important role has been carried out by the Board Medical Committee capably chaired by Professor Ed Byrne AO and the full Board has attended regular meetings of this committee to stay close to unfolding events.

I note that we continually monitor failures of all devices and track the numbers carefully.

In the period leading up to the 11<sup>th</sup> September 2011 there was an increased rate of failure of the CI 500 series implant.

We have always set very high standards and our clear objective is to make every implant series more reliable than its predecessor. Our concern was heightened by the possibility that this objective may not be met.

Given our diversified range of products, we were able to immediately substitute the CI 24RE implant and continue to sell a cochlear implant system that did not compromise hearing performance.

The CI 24RE implant was the implant in our Freedom cochlear implant system, is compatible with the latest Nucleus 5 externals and accounted for around 30% of all implant sales in F11.

We have already manufactured over 70,000 of these CI 24RE implants since 2005. Importantly when combined with the Nucleus 5 externals, it provides the same hearing performance.

We have covered financial and liquidity issues and have considered the likely market impacts and other variables.

I will discuss the estimated recall costs shortly but there are still many variables that are not yet clear.

We have taken actions to ensure that all our existing banking facilities continue to be available, and increased.

We have also ensured all regulators have been kept appropriately informed and we are working diligently to ensure they are satisfied with our actions and continue to allow all other activities to continue.

We have started the process of considering the implications for all our employees to ensure this high quality team of talented people understands what we are doing and continues to be committed to the long term success of the company.

At a high level and in these current circumstances I want to say that as a company we have been very grateful for the enormous support we have received from a wide range of stakeholders.

We expect to be better informed to provide more details when the half year results are announced in February next year.

Notwithstanding, I would now like to cover two important issues.

First, I want to discuss the expected one off cost that I will categorise as the Recall Cost and that will be contained in a Provision.

This Provision will comprise many items, including costs relating to the recall, stock write offs, other related write offs or impairments, and relevant costs that may be incurred over time.

These items have been internally discussed at length from a financial and reporting viewpoint. They need to be refined further and will be finalised and taken up in the results for the 6 months to 31<sup>st</sup> December 2011.

Based on current information, our view for this provision item or "Recall Cost" is that the financial impact will be in the range of \$130 million to \$150 million.

The Provision includes a number of non-cash items and we expect the after tax cash cost impact of this Provision to be in the range of \$20 million to \$30 million.

The second important issue relates to dividends.

The Board and Senior Management believe the company will continue to generate strong cash flows and that we will be successful in dealing with the current issues.

Therefore we aim to preserve our current dividend pattern. We will increase your first half dividend to \$1.20 per share, the same amount as the final dividend for F11. In the absence of further information, we will continue to pay dividends at this level.

We will only reconsider this view if we see unfolding performance significantly below what we expect.

In simple terms we are committed to supporting our shareholders with dividends through this time providing we do not jeopardise the long term security of the company.

I would now like to hand over to Dr Chris Roberts and I will say more when he has finished.

Thank you Chris.

Chris has expanded on a range of topics and I hope his information has been useful.

As you would understand we are conscious of our current situation but I need to say that the Board and Senior Management believe that Cochlear is a strong company, we are the global market leader, and we have employees of the highest calibre all committed to our long term success.

Successful companies deal realistically with difficult issues, solve problems, learn the lessons and as a result become stronger. We are all committed to Cochlear continuing to be a successful company.

I will now take questions that must only come from shareholders.

### **Financial Results for F11**

As I mentioned at the start, F11 was a successful year and placed Cochlear in a strong position.

As I summarised earlier and compared to the previous Financial Year F10:

- F11 revenue grew 10% in reported currency and 17% in constant currency.
- The strengthening Australian dollar in F11 adversely impacted sales by \$83 million. (This was partially mitigated by gains from the foreign exchange contracts taken out in line with our long term FX hedging guidelines.)
- Implant sales of 24,661 were up 17%. (This growth was a strong performance and was above our long term trend line)
- Net profit after tax of \$180.1 million was up 16%. (If F10 exchange rates had prevailed, this profit would have been \$14.9 million higher.)

### **Dividends**

Until now dividends have been increased each year since we listed in 1995 and a payout ratio of approximately 70% has been maintained.

For F11, the total dividend for the year was \$2.25, up 12.5% on F10.

The final dividend of \$1.20 was partially franked to 70% and the unfranked portion of the dividend has been declared Conduit Foreign Income.

I have already spoken of our intention to pay the dividend at \$1.20 for the next six month period and note there will be a lower percentage that is franked.

### **Capital management**

We are proud of our past achievements in this field and believe our prudence and conservatism in this area stands us in good stead in the current circumstances.

At the end of June 2011, Cochlear had net cash of \$9 million compared to a net debt position of \$114 million at the same time a year earlier.

During F11 the new headquarters building in the Macquarie University precinct was completed on time and within budget. In line with our agreements, Macquarie University paid Cochlear \$130.3 million which was applied against debt taken out specifically for this building project.

In addition the strong cash generation from operations of \$201.3 million supported our dividend payments and enabled further reduction of our debt.

In April 2011 Cochlear renegotiated its facility with Westpac ahead of the scheduled expiry date of 9 June 2012. The corporate facility was reduced to \$150 million.

Subsequent to the voluntary recall, we have obtained access to an additional \$50 million under this facility. Further, we are compliant with, and expect to stay compliant with all banking covenants.

### **World economic conditions and impact on Cochlear**

Cochlear sells into over one hundred countries and has an expanding range of product lines. This portfolio of products and geography are important to our business risk profile as together they provide a diversified base of opportunity.

Having said that, world financial and economic events impact our performance and results, as does the resulting fluctuating foreign exchange rates.

Cochlear's life changing products, together with established and economically viable reimbursement regimes in most major countries, means that to date Cochlear has been resilient to the negative impact of both world economic and political events, but we are not immune.

### **Board matters**

I would now like to touch briefly on board matters.

As announced at last year's AGM, Mrs Yasmin Allen was appointed to the board on 2<sup>nd</sup> August 2010 and she was appointed Chair of the Audit Committee from 19<sup>th</sup> October 2010.

Your Board has taken an active role in the oversight and review of the recent recall activities.

The Medical Committee, led by Prof Ed Byrne AO has reviewed the clinical results in detail and provided valuable oversight and input to the process. Prof Byrne is a physician and his expertise in this area has been invaluable.

In addition Donal O'Dwyer and Andy Denver have international senior management experience in the medical device industry and in the current situation we are fortunate to benefit from their experience and guidance.

You will see from the agenda we are seeking an increase in the total remuneration cap for director remuneration.

This is the first increase we have sought since 2007 and the main intention was to give room for the addition of a further director if we felt someone with unique skills and experience was identified.

We understand this is a sensitive issue at this time and note there may a degree of negative sentiment, at the same time we need to proceed with these matters and obtain your support.

The Board's remuneration for F12 was set to increase 4% from 1 July 2011 in line with inflation.

The level of Directors Fees is reviewed annually using a number of external and independent reference points. At the time of the decision the increase was seen to be fair and could be met within the existing cap.

In light of the recall and its impact we have decided to leave the Director's Fees at the 2010 level.

It is an action we feel is appropriate at this time.

We have always tried to ensure Directors Fees reflect the market and are fair for the Directors and the Shareholders. They have always been, and will continue to be, carefully assessed.

I also note we have a standing policy that Non-Executive Directors hold shares with a value that equals their base fee.

We feel this aligns us with our shareholders.

### **Cochlear staff**

The strong F11 result, achieved in such a tough global environment, was only achieved through the enormous hard work by each of our over 2,500 employees. We are very fortunate to have such a dedicated, passionate and committed team of people.

Their task in F12 is made much more complicated by the voluntary recall but their efforts to date in difficult circumstances have been outstanding and we continue to see clear evidence of their dedication and professionalism.

### **Summary**

In summary, your Board believes the long term outlook for Cochlear remains positive notwithstanding the current voluntary recall situation.

This is supported by the Company's strong financial position and our on-going investment in research and development, and in our marketing and sales growth initiatives.

Continued improvements in internal capabilities are necessary to support this growth and they are being executed.

We are committed to the welfare of all our recipients, to maintaining the highest standards and protecting our long term reputation. The challenges facing us now will be met and we must ensure we are a stronger company as a result.

Our recipients and health care professionals are vital to our future, but so too are our employees. Our staff continue to be the most important asset for our future and we are committed to support them as we work through the current situation.

We will make sure that we protect this great company and provide shareholders the long term sustainable value they want and deserve.

Ladies and gentlemen that now concludes my comments.

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

Rick Holliday-Smith  
18 October 2011