

# Cochlear Limited

## 2019 Annual General Meeting

### Chairman's Address

**22 October 2019**

**Rick Holliday-Smith** Chairman

Ladies and gentlemen...

FY19 was a busy year for Cochlear with a focus on building awareness and market access to cochlear implants, expanding our marketing activities and customer servicing capability, while maintaining our commitment to product innovation through our investment in research and development.

In August we reported a net profit of \$276.7 million, an increase of 13% from FY18. Reported net profit includes a \$10.8 million net gain from the revaluation of innovation fund investments. Net profit excluding the revaluation was \$265.9 million, an increase of 7%.

Earnings growth, combined with strong cash flow generation, supported a second half dividend of \$1.75, with full year dividends increasing by 10% to \$3.30, fully franked.

The current dividend policy has been maintained with the objective to pay out around 70% of net profit as dividends. This policy is reviewed annually.

I will now discuss some of the important initiatives that we hope will contribute to the uptake of cochlear implants across the coming decade....

Firstly, the importance of **building a consistent treatment pathway for adults and seniors.**

Over the past 30 years, cochlear implants have been established as the standard of care for children born with a severe to profound hearing loss, with high adoption rates across most developed countries.

The challenge today, in developed markets, is the lack of a consistent treatment pathway for diagnosing and treating adults. For many adult candidates the pathway to cochlear implants is often haphazard with most unaware of the existence of these solutions.

Cochlear is working to build grass roots awareness with adult candidates including through its successful direct-to-consumer marketing activities. In the US we focused on building referrals from the hearing aid channel through the establishment of the Cochlear Provider Network, which links surgeons

with hearing aid clinics, while at the same time building professional awareness through improved education.

We are encouraging initiatives within the professional community, including leading cochlear implant surgeons and audiologists, to develop a consensus on the appropriate treatment pathway for adults.

In March, an independent steering committee and panel of 30 audiologists and ENT surgeons, across 13 countries, chaired by Professor Craig Buchman from Washington University, reached a consensus that could lay the foundations for the creation of international clinical practice guidelines for cochlear implantation, including patient identification, referral, implantation and rehabilitation.

This independent process received funding support from a cross-industry group, including Cochlear, none of whom had a voting role in the consensus.

One of the growth drivers for cochlear implants is the **expansion of indications** for funded implants. There are many countries that have either restrictive clinical indications, or capped funding, which limits access. We have been building our global market access capability to advocate for the expansion of both indications and for the funding for cochlear implants.

In March, the National Institute for Health and Care Excellence (NICE), in England, expanded the criteria health professionals use when determining who is suitable for a cochlear implant within the National Health Service to include candidates with a severe hearing loss. And in August, Riziv, the Belgian Medicines Verification Organisation, also announced the expansion of reimbursement criteria for cochlear implants to also include candidates with a severe hearing loss.

These changes more than double the number of people who can now access a cochlear implant in both countries. The news is a major milestone that is expected to support growth in the UK and Belgium over the coming years. It follows recent changes in Japan and Taiwan (Greater China) where the expansion of clinical indications and/or reimbursement for cochlear implants has driven growing demand for implants following the changes.

From a long-term product development perspective, we achieved a major milestone this year by entering the **next phase in the development of a totally implantable cochlear implant**, with the start of a further clinical feasibility study.

This study will evaluate the performance and safety of our totally implantable cochlear implant technology, which can be used with and without an external sound processor, providing people with 24-hour hearing.

The clinical feasibility study is being conducted in Australia, led by Associate Professor Robert Briggs (The Royal Victorian Eye and Ear Hospital) and Professor Robert Cowan (The HEARing CRC). It is

expected to build on the initial clinical research conducted in 2005 with the first-generation device and will inform further technology development.

The development of totally implantable cochlear implant technology is complex, and we do not expect a commercially available product for many years.

Developing and strengthening strategic alliances is important for Cochlear.

In November, **Cochlear and GN Hearing agreed to further strengthen their technology and commercial alliance** to develop best-in-class integrated hearing solutions.

The deepening of this relationship includes joint R&D, shared technology and a strengthened global Smart Hearing Alliance collaboration between Cochlear and GN Hearing, the hearing aid division of the GN Group.

Working closely with GN Hearing allows us to bring the latest in connectivity and wireless technology to our implant recipients more quickly. We are also able to give recipients with a cochlear implant in one ear, and a GN hearing aid in the other ear, unparalleled performance and a seamless experience with both devices.

As two leaders in hearing health, this collaboration demonstrates our commitment to design and to bring to market the best hearing solutions available.

In November, Cochlear made a **new addition to the innovation fund**, investing €13 million (A\$21 million) in Nyxoah S.A.. Nyxoah is a medical device company focused on the development and commercialisation of a best-in-class hypoglossal nerve stimulation therapy for the treatment of obstructive sleep apnea.

The Nyxoah investment is part of Cochlear's innovation fund, an internal fund established to invest in novel technologies and implantable devices that over the long term could leverage or enhance Cochlear's core technology.

We have also made sound progress in the development of our new manufacturing facility in China, which is running to schedule. As you can see from the slide, the construction phase is well underway, and we expect to complete this stage by mid-2020. The next stage will be the regulatory approval process in China, a process expected to take approximately two years for this type of complex manufacturing facility.

Now to a short update on the long-running **patent dispute** that has been well disclosed and is set out clearly in our financial statements. As you are aware, we have made every effort to disclose the financial implications of the worst-case negative outcome, and the nature of the issues confronting us.

This complex matter has been running for many years and has seen both ups and downs. The last decision favoured the other side being the Alfred E. Mann Foundation for Scientific Research (AMF) and our major competitor Advanced Bionics LLC (AB), now part of the Sonova Group.

We have lodged an insurance bond for US\$335 million as part of our counter appeal process, and we have many disagreements with the latest rulings in this gyrating process.

The Board has always and continues to obtain independent legal advice on Cochlear's actions and prospects. The Board believes it is probable that Cochlear's appeal will result in the lawsuit being remanded to the District Court for a retrial on damages.

Most importantly, Cochlear's current product portfolio is not affected by this litigation as the patent at issue has expired, and we maintain a very strong balance sheet with conservative gearing levels.

In the event the appeal is unsuccessful, the Board is confident that Cochlear can access necessary debt facilities to fund the Judgment and to cover any award of interest and costs.

Turning now to a more positive topic being our employees, we strongly believe that **training, development and engagement** with them is vital for us to thrive into the future. We are a fast-growing organisation and there have been over 900 people hired or promoted in FY19, up 26% on FY18.

Training and development have both been strengthened with the implementation of globally consistent leadership programs, with Cochlear recognised by the Association for Talent Development as a 'Best Learning Organisation'.

We have continued to progress succession planning and implement targeted development for our senior executives and managers, with an increase in women identified as successors for many roles.

We are pleased our employees continue to find Cochlear a rewarding place to work, and overall employee engagement scores remain high at 79%, up one percentage point on FY18.

I would now like to talk about proposed **changes to the long-term incentive plan**.

This year we are proposing to extend the length of the plan from three to four years, as well as recalibrate the EPS targets.

The EPS targets are shifting from 10% to 20% compound annual growth over three years to 7.5% to 12.5% over four years. The change is material and requires some context.

The current EPS targets have been in place for at least fifteen years and are now considered inconsistent with our expectations and our strategic objectives for growth. The shift will provide better alignment to our strategy, factoring in the market conditions, and related growth rates, that we believe are realistic.

Fifteen years ago, our industry was at an earlier stage of development with 15-20% unit growth more common as we penetrated the newborn segment across our developed markets.

Today, cochlear implantation for newborns is the standard of care across most developed markets with most children receiving cochlear implants at around 12 months of age, an enormous achievement.

While there are still some developed markets with opportunities for growth in the children segment including the US, Japan and France, future growth will be focused on the adults in developed markets and children in emerging markets. Each poses its challenges but provides a long-term opportunity.

The Board believes the components of our diversified revenue base, including the growth in the Services business, and our focus on delivering steady long-term profit growth means the new EPS targets better aligns this component of long-term incentives to the Company's strategy.

We want to deliver consistent growth in revenue over time, with earnings expected to grow at a similar rate to revenue as we invest strongly to grow the business into the future, with an intention to hold the net profit margin.

We believe the revised range reflects stretch performance and will ensure executives are engaged and incentivised appropriately to deliver results.

I will now turn to Board matters. As a Board we recognise the importance of 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 have added one new director this year with Abbas Hussain appointed to the Board effective last December. Abbas worked in the pharmaceutical industry for over 30 years and has significant global experience in building relationships with professionals within the healthcare industry.

Abbas brings expertise to business development and growth opportunities across a diverse range of markets. He is well-equipped to provide valuable strategic insight and has demonstrated strong values in customer focus which is intrinsic to Cochlear's strategic objectives.

The appointment of Abbas follows the retirement of long-serving director Prof Edward Byrne at the last AGM.

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

We are also conscious of the need to diversify the Board and there are active plans to do that over the next few years and before I leave. We are conscious of the importance of every director appointment and there are excellent candidates that we strongly believe will become available to us in the next 2 years that are well worth waiting for.

As you know, I have been a director of Cochlear for 14 years. After discussion with the Board, I will present myself for re-election at this AGM to serve my last term as Chairman.

I will be working closely with the Board on the renewal process for my role and it is likely I will retire from the Board during this new three-year term.

I think the Board works well together and I thank my Board colleagues for their hard work and commitment.

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

Now moving onto our **new shareholder reports**.

We are committed to providing transparency to shareholders across a broad range of areas including our policies and strategies which is done through our growing reporting suite. This year we published our first Strategy Overview and ESG (Environmental, Social and Governance) reports, and improved the usability of our Corporate Governance Statement.

The Strategy Overview provides an insight into Cochlear's strategy to retain market leadership, grow the hearing implant market and deliver consistent revenue and earnings growth. It provides greater detail around our long-term priorities as well as laying out the over 20 years of historical financial performance of your company.

In April, we published our inaugural ESG Report. With a strong history in helping people and the communities we live in, we want to lead with purpose and address serious challenges such as global hearing health, climate change, culture and gender equality. The ESG disclosure will provide a platform to communicate our progress and outline our goals in leading the way to a sustainable future.

Given it is our first report, I thought it would be valuable to call out some of the elements of the report.

With respect to the environment...

We are expanding our environmental management system to capture our environmental impact and improving our energy mix by transitioning to renewable sources. While we are making progress in reducing our carbon footprint, we are seeking new ways to improve our energy efficiency and other opportunities in our global operations and our partners across the supply chain.

As part of this process we have sourced renewable energy in Australia, Belgium, Sweden, Switzerland and UK, including the installation of roof-top solar at our head office in Macquarie Park, Sydney.

When it comes to our people....

Cochlear is committed to providing an inclusive workplace that is diverse and representative of our stakeholders, including our customers, shareholders, employees and the communities. We employ over 4,000 people from over 75 nationalities, with products sold into over 100 countries. Since the introduction of Cochlear's Diversity and Inclusion Framework last year, we have invested in several initiatives to grow and attract talent while ensuring a respectful and inclusive culture.

Some examples of progress made this year...

- Our CEO & President Dig Howitt joined Male Champions of Change, an Australian organisation that engages senior men in championing gender equality
- We implemented Flex@Cochlear to better support our people in balancing their work and personal commitments
- We tripled paid parental leave for both primary and secondary carers in Australia
- We introduced purchased leave and domestic violence support
- And we increased female representation during the interview and selection process, with global female hire increased from 56% to 58% in FY19

Regarding good governance....

We are committed to high standards of corporate governance. Good corporate governance is important for the creation, protection and enhancement of shareholder value.

We see ourselves as a business particularly committed to serve our recipients and that means we take a very long-term view. The children implanted today will likely live for 100 years, we need to be there to support and serve them through life's journey; we think about the next 100 years.

We must consider all stakeholders in our decision processes and it goes without saying we expect our directors, senior executives and employees to act ethically, lawfully and responsibly at all times.

The ESG report, Strategy Overview and Corporate Governance Statement are all available on the website and I encourage you to read them.

I will now **confirm our financial expectations for the 2020 financial year.**

In August, Cochlear announced that we expect to deliver reported net profit in FY20 of \$290-300 million, a 9-13% increase on underlying net profit for FY19, and this continues to be the case.

Growth is expected to broadly continue across the business in FY20, underpinned by the continuing investments made in product development and market growth initiatives over the previous few years.

We will continue to invest in activities aimed at building awareness and market access, with the objective to deliver consistent revenue and earnings growth over the long-term.

Through disciplined investment, we are targeting to maintain the net profit margin, reinvesting any efficiency gains, currency or tax benefits into market growth activities.

Our balance sheet and free cash flow generation remain strong and we continue to target a dividend payout ratio of 70% of net profit.

Finally, I would like to acknowledge the contribution by each of our 4,000 **Cochlear employees.**

The knowledge, expertise and passion of our employees are key to our future and the focus on delivering excellence for our customers is an important part of our success and our market leadership position.

Our employees understand the importance of Cochlear being successful over the long-term so we can continue to support our recipients.

There are few companies that start a lifetime journey with each new customer every day.

On behalf of the Board, I congratulate and thank all Cochlear employees for their outstanding efforts and contributions this year.