

Cochlear Limited

2018 Annual General Meeting

Chairman's Address

16 October 2018

Rick Holliday-Smith Chairman

Ladies and gentlemen...

Cochlear reported a record net profit of \$246 million for FY18, an increase of 10% from last year.

FY18 was a busy year, with a focus on building awareness and market access to cochlear implants, expanding our marketing activities and customer servicing capability and at the same time maintaining our commitment to product innovation through our extensive investment in research and development.

Steady progress was made with the successful launch of the Nucleus® 7 Sound Processor and Baha® SoundArc underpinning our solid sales and earnings growth.

We achieved an important milestone during the year reaching our 500,000th implant sale. We also saw increased focus on hearing awareness with the World Health Organization (WHO) calling for broad based public health actions to prevent and treat hearing loss.

Through the year we continued to increase our investment in health economics, as well as in our market access capabilities, including the collaborative partnerships we have with the medical research community. There was increased focus on obtaining the clinical evidence that demonstrates the effectiveness of our products and the importance of hearing for healthy ageing.

Finally, we made several prospective small investments in early stage innovation that we hope will enhance or leverage our own R&D in the coming years.

Growing dividends

Earnings growth, combined with strong free cash flow generation, supported the 14% increase in the fully franked final dividend to \$1.60 per share. This took dividends paid for the year to \$3.00 per share, fully franked, an increase of 11% YOY. It reflected a payout of 70% of net profit.

The Board policy is to pay out as dividends around 70% of net profit. I note this has been the policy since FY00 and although it continues, it is still subject to annual review.

Over 500,000 implants sold

Cochlear reached a major milestone in early FY18, selling its 500,000th implant. We have now delivered to market more than 550,000 cochlear implants, bone conduction implants and acoustic implants, helping a growing number of people hear with our implantable devices, many adopting bilateral implants.

Although it is a wonderful milestone for Cochlear, it is also a reminder of the challenge, and the opportunity, with fewer than 5% globally of the people who could benefit from an implantable hearing solution currently being treated.

SLIDE 4 – 40th ANNIVERSARY SLIDE

40th anniversary of the first multi-channel cochlear implant surgery

We also celebrated the 40th anniversary of Rod Saunders receiving his cochlear implant.

In a surgical procedure on 1 August 1978, at the Royal Victorian Eye and Ear Hospital in Melbourne, Graeme Clark, assisted by Dr Brian Pyman, carried out a procedure that made Rod the first person to have his hearing restored, and to understand speech, with the aid of a multi-channel cochlear implant.

This marked the beginning of a new era in implantable hearing solutions and paved the way for many hundreds of thousands of people to hear today thanks to cochlear implant technology.

[SLIDE – AGM HOLDING SLIDE]

The growing global burden of hearing loss

We know hearing loss affects a significant number of people.

The WHO revised up its figures this year, revealing that globally over 466 million people suffer from disabling hearing loss.

The vast majority are adults, with one third of people over 65 years affected by disabling hearing loss.

Hearing loss is now the fourth biggest contributor to disability globally, with the WHO estimating the cost of untreated hearing loss to now exceed US\$750 billion per annum.

With the ageing global population growing, especially with improved medical interventions, the number of people with hearing loss is increasing at a rapid pace.

WHO projections suggest that unless action is taken, there will be 630 million people living with disabling hearing loss by the year 2030, with that number expected to grow to over 900 million by 2050.

The WHO is advocating for public health actions to prevent and treat hearing loss through control of risk factors and by ensuring that the needs of those with hearing loss can be addressed adequately.

To do this will take a collaborative effort from governments, academia, industry, health professionals, and the general public to improve future hearing health outcomes.

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.

SLIDE 5 – HEALTHY HEARING FOR HEALTHY AGEING SLIDE

Healthy hearing for healthy ageing

Cochlear implantation for seniors is an important trend, especially as we better understand the connection between high levels of hearing loss with cognitive decline, social isolation and depression.

Developing evidence of the impact of untreated hearing loss for our communities and for the global economy is critical to ensuring hearing loss is treated properly.

Cochlear is investing to build collaborative partnerships within the global medical research community and to be actively involved in delivering evidence-based research. This will let us better understand, address and provide access to treatment options for individuals and communities impacted by hearing loss.

Establishment of long-term research collaborations

In March 2018, we pledged to gift US\$10 million over 10 years to the Johns Hopkins Bloomberg School of Public Health to establish the 'Cochlear Center for Hearing and Public Health'.

This Center is the first of its kind at any academic institution. It will focus on addressing hearing loss as a global public health priority, and is led by Prof. Frank Lin, MD, PhD.

The Center will address the global impact of hearing loss to public health by conducting research studies to determine the gravity and impact of hearing loss, particularly among older adults.

It will also seek to develop and test interventions to mitigate the effects of hearing loss, and will help craft policies and strategies to ensure successful implementation of hearing loss interventions at the local, national and global levels.

In October 2017, we announced the establishment of the co-funded Cochlear Chair in Hearing and Healthy Ageing at Macquarie University.

This Chair will oversee the implementation of collaborative research and education strategies, with the long-term goal of developing a leading platform for further meaningful and globally relevant research in hearing in Australia.

Macquarie University is the location of our Headquarters and is home to the Australian Hearing Hub. This community, supported by Cochlear, continues to lead the market with innovative new hearing technologies.

Together, we exemplify the strategic industry-academic engagement called for in the Australian Government's National Innovation and Science Agenda, and we are well placed for further impactful research in the hearing space.

As well as supporting research into hearing and healthy ageing, we aim to encourage research into alternative models for delivering hearing care in growing economies.

In China we are collaborating with their Government and local universities with the aim of establishing a hearing research centre. The centre will seek to co-ordinate and support a range of hearing health related organisations to collaborate on improving access to hearing healthcare in China.

It will be located next to our new manufacturing facility in Chengdu, which is currently being constructed and should open in 2020.

[SLIDE – AGM HOLDING SLIDE]

Investments in advanced innovation

Cochlear continues to lead the market with innovative new technologies that improve the quality of life of many people around the world. We seek to support the growth of the industry, promote improved market awareness and search for novel new technologies that may enhance or leverage our own innovation.

There is continued innovation occurring in the life sciences space. In the past year alone, we assessed over 50 investment opportunities. We must however be disciplined and stay within our stringent investment parameters. As a result, we have made only a few select investments in early-stage innovation over the past 18 months.

One investee, Otoconsult, provides technology that is expected to enable a faster and more consistent fitting of cochlear implants to deliver the best possible patient outcomes.

A collaboration with Sensorion, a French biotech company, will evaluate therapeutic approaches, in combination with cochlear implants, focused on improving hearing outcomes.

And Epi-Minder is developing a breakthrough monitoring device aimed at improving the treatment of patients suffering from epileptic seizures using implant and neural stimulation knowledge and capabilities available within Cochlear.

Cochlear announces next phase in development of totally implantable cochlear implant technology

Last week we announced the next phase in our long-term research and development program towards a totally implantable cochlear implant, with the start of a further clinical feasibility study.

Incorporating implantable microphone technology that we acquired in FY10, we have been able to progress the technology to the next stage.

The latest technology includes an implanted microphone, an implanted rechargeable battery, and an implanted sound processor. This means that the patients can choose between using an external sound processor or taking it off and relying on the implanted microphone and internal sound processor, while still maintaining hearing function.

Our long-term goal of research is to develop a commercially viable, totally implantable cochlear implant, that will enable people to hear with and without any externally worn components, helping them to have useful hearing 24 hours a day.

This clinical feasibility study should enhance our knowledge from the initial clinical research conducted in 2005 with the first-generation investigational device. It will inform further technology development.

It is an exciting area of product development for Cochlear. However, we remain in the very early stages, and given the remaining technical, clinical and regulatory requirements, the technology is not expected to be commercially available for years.

Changes to the R&D tax concession

Moving now to tax....

Cochlear welcomed the Australian Government's decision in May 2018 to support R&D intensive companies like Cochlear, by changing the way tax incentives are structured.

The announced changes will increase the cap on eligible expenditure from \$100 million to \$150 million, as well as increase the effective tax concession rate.

The new scheme is expected to provide Cochlear with a small reduction in tax rate in the initial years and, importantly, it should enable us to sensibly invest more in R&D locally.

This means more higher paying jobs in Australia, more valuable intellectual property held in Australia, and more spill-overs for the Australian hearing sector and broader medical technology industry.

Inquiry into impediments to business investment

In May 2018, Cochlear and CSL made a joint submission to the House of Representatives Standing Committee on Economics' 'Inquiry into Impediments to Business Investment'.

As the nation's two largest and most successful innovation-focussed advanced manufacturing companies, who actively and successfully competing globally from an Australian base, we are united in urging the Australian Government to do even more to ensure our nation actively competes for investment and is able to maximise and sustain the social and economic benefits flowing from innovation.

The submission articulates many of the current challenges Australia faces in retaining existing innovation-based companies here and building the CSLs and Cochlear's of the future.

It makes recommendations for enhancing Australia's international competitiveness including targeted tax and other investment incentives, ensuring access to global talent, improving

regulatory timeframes, and improving consistency and coordination of Commonwealth and State policy. A copy of the full submission is available on our website.

Confirmation of FY19 financial outlook

I will now touch on our financial expectations for the 2019 financial year.

Cochlear announced in August that we expect to deliver reported net profit in FY19 of \$265-275 million, an 8-12% YOY, and this continues to be the case.

Growth is expected to broadly continue across the business in FY19, underpinned by the significant investments made in product development and market growth initiatives over the previous few years.

We will continue to invest operating cash flows 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.

Over the next few years, we are undertaking several large long-term investment projects including the development of our China manufacturing facility. In Chengdu the construction phase is expected to be complete by the end of FY20.

We are also investing in our IT platforms to strengthen our connected health, digital and cyber security capabilities.

These projects are expected to increase capital expenditure levels to \$80-100 million per annum over the next few years.

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

For FY19, we expect:

- Continued growth across the developed markets, which represent around 80% of cochlear implant revenue;

- Emerging market growth rates to be strong, however, we note that annual growth rates can be variable driven by the timing of tender based activity and the impacts of macro-economic conditions; and
- Continued investment to retain market leadership and to drive long-term market growth with the target of maintaining the net profit margin.

Retirement of Prof Edward Byrne, AC as director and board renewal

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.

In August this year we announced that long-serving director Prof Edward Byrne, AC will be retiring from the board at the end of this annual general meeting.

Ed has provided invaluable counsel during his 16 years of service. His extensive experience in medicine, clinical neurology and research, as well as his dedication to Cochlear, have all contributed to Cochlear's strategic direction and success over many years.

On behalf of the board, I would like to sincerely thank Ed for his service and his great contribution to Cochlear. We all wish him well for the future.

The Board anticipated Ed's retirement and appointed Prof Bruce Robinson, AM to the Board in December 2016 to allow for an orderly transition and to ensure the Board had the necessary ongoing depth of experience in research, healthcare and medicine, and tertiary education.

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 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 2019 and beyond as we seek to balance tenure, diversity and experience on the Board, and to ensure we have a smooth transition of longer-serving Board members over the next few years.

In particular, we seek to maintain the highest levels of competency, to increase our diversity, to identify and consider experienced directors with medical device and related manufacturing backgrounds, to strengthen our medical health capabilities (both on the Board and within the Company), and to generally develop and transfer knowledge and experience to all directors.

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 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 by each of our 3,500 Cochlear employees.

Their knowledge, expertise, and passion is key to our future; their focus on delivering excellence for our customers is an important part of our success and plays a major part in our market leadership position.

It is our long-term orientation, our commitment to research and quality, and our people who ensure Cochlear is a strong and sustaining Company.

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