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ASX Announcement
15 February 2023

Cochlear Limited Financial Results

For the half year ended December 2022

Sales revenue increased 9% (7% in constant currency*) to a record $893 million, driven by strong growth in cochlear and acoustic implant revenue. Cochlear implant units increased 14% driven by strong demand for the Cochlear™ Nucleus® 8 Sound Processor, which was launched during the second quarter, and the continuing recovery from COVID surgery delays across the emerging markets.

- Sales revenue increased 9% (7% in CC) to $893m
- Statutory net profit decreased 16% to $142m, with one-off gains included in HY22
- Underlying net profit** decreased 10% (6% in CC) to $142m, reflecting an increase in cloud computing-related expenses, new product launch costs and the impact of the weighting in operating expenses to the second half of FY22
- Underlying net profit margin before the impact of cloud computing-related expenses was 17%, a little below the 18% long-term target
- Strong balance sheet and cash flow generation supports the maintenance of the interim dividend at $1.55 per share
- A progressive on-market share buy-back program will commence in March with the aim of progressively reducing the cash balance to around $200m over a number of years
- The FY23 underlying net profit guidance range has been maintained at $290-305m, a 5-10% increase on FY22 underlying net profit, an increase of 8-13% when adjusted for the increase in cloud computing-related expenses

	HY23	HY22	Change % (reported)	Change % (CC)*
Sales revenue ($m)	892.6	815.3	⬆ 9%	⬆ 7%
Underlying net profit ($m)**	**141.6**	**157.5**	**⬇ 10%**	**⬇ 6%**
% Underlying net profit margin**	16%	19%		
% Underlying net profit margin (pre cloud investment)**	17%	20%		
One-off and non-recurring items after-tax ($m)	-	11.8		
Statutory net profit ($m)	**141.6**	**169.3**	**⬇ 16%**	**⬇ 12%**
Underlying earnings per share**	$2.15	$2.40	⬇ 10%	⬇ 6%
Interim dividend per share	$1.55	$1.55	0%	

*Constant currency (CC) removes the impact of foreign exchange (FX) rate movements to facilitate comparability of operational performance (refer p8). **Excluding one-off and non-recurring items (refer p8).

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Operational review

$m	HY23	HY22	Change % (reported)	Change % (CC)	Sales Mix
Cochlear implants (units)	21,249	18,598	⬆ 14%		
Sales revenue					
Cochlear implants	513.1	457.9	⬆ 12%	⬆ 9%	57%
Services (sound processor upgrades and other)	258.6	256.5	⬆ 1%	0%	29%
Acoustics	120.9	100.9	⬆ 20%	⬆ 17%	14%
Total sales revenue	**892.6**	**815.3**	**⬆ 9%**	**⬆ 7%**	**100%**

Cochlear implants

Cochlear implant units increased 14% to 21,249 units, with strong growth across both developed and emerging markets. Sales revenue increased 12% (9% in CC) to $513.1 million.

Developed market units grew over 10% with the US, Western Europe and Asia Pacific all delivering strong growth with average selling price in line with last year. The Cochlear™ Nucleus® 8 Sound Processor has been well received, commencing its rollout in Western Europe from October and the US during November. While clinical capacity appears to have stabilised across most countries, COVID infections and hospital staffing constraints continued to impact volumes in some regions. Market share remained strong supported by the strength of the product and services portfolio and the introduction of the Nucleus® 8 Sound Processor.

Emerging market units grew around 20% with strong growth across most countries, with most now trading well above pre-COVID levels. Growth was particularly strong in markets most impacted by COVID, including India and Latin America. Government tender activity increased following subdued activity during COVID shutdowns and private pay continued to perform strongly. China delivered strong growth despite the surge in COVID cases.

Services

Services revenue increased 1% (flat in CC) to $258.6 million. Revenues slowed in anticipation of the launch of the Nucleus® 8 Sound Processor as an upgrade for recipients with the rollout commencing late in the half. It also follows the strong HY22 result where revenues increased 21% in CC as the business benefited from a strong lift in demand following COVID-related clinic shutdowns.

Acoustics

Acoustics revenue increased 20% (17% in CC) to a record $120.9 million, with strong demand across all regions as the business benefits from a strong product offering and a continued recovery in surgery volumes following COVID delays. The Cochlear™ Osia® 2 System continues to gain momentum with new accounts opened in existing markets and a growing presence in new markets. The Cochlear™ Baha® 6 Max Sound Processor continues to generate demand for sound processor upgrades across all regions.

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Financial review & outlook

Underlying net profit decreases 6% in CC to $142 million

Underlying net profit decreased 10% (6% in CC) to $142 million, with the benefit of strong revenue growth offset by the impact of lower operating expenses in HY22. The underlying net profit margin, excluding the impact of cloud computing-related expenses, was 17%, just below the 18% long-term target.

Record sales revenue of $893 million, an increase of 9% (7% in CC), was driven by strong demand for cochlear and acoustic implants.

The gross margin was maintained at 75% and was aligned to the longer-term target.

Operating expenses excluding cloud investment increased 15% (14% in CC) reflecting growing investment in R&D and market growth activities as well as new product launch costs which were primarily incurred in the first half. The increase is also a function of the lower operating expenses in HY22, with FY22 operating expenses weighted to the second half.

Cloud computing-related investment increased $12 million to $17 million, in line with guidance. Elevated investment is expected for the next few years as we transform our business processes and IT platforms.

The effective tax rate of 25% was in line with expectations.

Strong financial position

The balance sheet remains strong with net cash of $505 million and operating cash flows sufficient to fund investing activities and capital expenditure.

An interim dividend of $1.55 per share has been determined, in line with last year and representing a payout of 72% of underlying net profit.

Commencement of on-market share buy-back

We will commence a progressive on-market share buy-back program with the aim of reducing the cash balance to around $200 million over a number of years. This program complements the existing dividend policy which targets a 70% payout of underlying net profit.

Pursuant to the program, the Board has approved an initial buy-back of up to $75 million in shares over the next 12 months, equivalent to around half a percent of Cochlear shares on issue. The number of shares purchased will be contingent on the prevailing share price and market conditions.

A progressive buy-back program aligns with the interests of our shareholders by reducing shares on issue, providing gradual accretion in earnings per share and dividends per share over the long term.

Net cash was $505 million on 31 December 2022 and is expected to reduce by approximately $170 million following the acquisition of Oticon Medical.

The Board reserves the right to vary, suspend or terminate the buy-back at any time. Subject to market conditions, we expect to commence the buy-back in March.

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FY23 outlook

As we look to the future, we remain confident of 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. Our clear growth opportunity and strategy, combined with a strong balance sheet, mean we are well placed to create value for our stakeholders now, and over the long term.

For FY23, we continue to expect to deliver underlying net profit of $290-305 million, a 5-10% increase on FY22 underlying net profit, an increase of 8-13% when adjusted for the increase in cloud computing-related expenses. We expect to deliver strong growth in sales revenue and around 18% underlying net profit margin before cloud computing-related expenses.

FY23 net profit is expected to be weighted to the second half driven by the rollout of the Nucleus® 8 Sound Processor. Demand for the new sound processor has been strong since its launch which commenced in October.

Trading conditions have been progressively improving, in line with expectations, with intermittent COVID-related hospital or region-specific elective surgery restrictions or staffing shortages continuing. While surgical and clinical capacity to serve implant candidates appears to have stabilised, we continue to be mindful of the pressure on the healthcare system globally to contend with surgical waiting lists, ongoing staffing challenges and growing demand.

We will continue our investment in R&D and market growth activities to support long-term market growth.

Cloud computing-related investment is expected to lift in FY23 to around $36 million ($25 million after tax), a $14 million increase ($10 million after tax) on FY22.

Guidance is based on a 70 cent AUD/USD and 65 cent AUD/EUR.

Capital expenditure is expected to be around $100 million.

The Board maintains a dividend policy that targets a 70% payout of underlying net profit.

Guidance does not factor in earnings from the proposed acquisition of Oticon Medical, which is targeted to complete by the end of FY23.

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Detailed financial review

Profit & loss

$m	HY23	HY22	Change % (reported)	Change % (CC)
Sales revenue	**892.6**	**815.3**	**9%**	**7%**
Cost of sales	**226.9**	**207.7**	**9%**	**7%**
% Gross margin	*75%*	*75%*	*0 pts*	*0 pts*
Selling, marketing and general expenses	275.4	231.6	19%	17%
Research and development expenses	102.6	98.6	4%	5%
% of sales revenue	*11%*	*12%*	*(1 pt)*	*(1 pt)*
Administration expenses (excluding cloud investment)	76.2	65.1	17%	17%
Administration expenses (cloud investment)	17.3	5.2	233%	233%
Operating expenses	**471.5**	**400.5**	**18%**	**17%**
Other income / (expenses)	(1.1)	5.1		
FX contract gains / (losses)	(7.4)	5.4		
EBIT (underlying)*	**185.7**	**217.6**	**(15%)**	**(10%)**
*% EBIT margin**	*21%*	*27%*		
Net finance expense	2.0	(3.5)		
Income tax expense*	(46.1)	(56.6)	(19%)	(14%)
% Effective tax rate	*25%*	*26%*		
Underlying net profit*	**141.6**	**157.5**	**(10%)**	**(6%)**
*% Underlying net profit margin**	*16%*	*19%*		
*% Underlying net profit margin (pre cloud investment)**	*17%*	*20%*		
One-off and non-recurring items (after-tax):				
Innovation fund gains	-	11.8		
Statutory net profit	**141.6**	**169.3**	**(16%)**	**(12%)**

* Excluding one-off and non-recurring items (refer p8).

Sales revenue increased 9% (7% in CC) to $892.6 million and underlying net profit decreased 10% (6% in CC) to $141.6 million. Statutory net profit decreased 16% to $141.6 million.

Key points of note:

- Cost of sales increased 9% (7% in CC) to $226.9 million, in line with the increase in sales revenue. The gross margin was maintained at 75% and was in line with the long-term target gross margin;
- Selling, marketing and general expenses increased 19% (17% in CC) to $275.4 million reflecting continued investment in market growth activities, standard of care and market access initiatives and new product launch costs which were primarily incurred in the first half. The increase also reflects the impact of the weighting in expenses to the second half of FY22;
- Investment in R&D increased 4% (5% in CC) to $102.6 million with continued investment made in key R&D projects and development of the product and services pipeline;
- Administration expenses (excluding cloud investment) increased $11.1 million to $76.2 million primarily driven by increases in short-term incentives and costs associated with the Oticon Medical transaction;
- Cloud investment of $17.3 million was in line with expectations and forms part of the $100-150 million investment in cloud-based technology solutions which will be incurred over four to five years; and
- Other expenses of $1.1 million includes a $7.2 million increase in FX revaluation losses on the balance sheet.

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Cash flow

$m	HY23	HY22	Change
EBIT (underlying)	185.7	217.6	(31.9)
Depreciation and amortisation	37.3	35.8	1.5
Changes in working capital and other	(85.3)	(79.0)	(6.3)
Net interest paid	2.0	(3.5)	5.5
Income taxes paid	(50.6)	(45.9)	(4.7)
Operating cash flow	**89.1**	**125.0**	**(35.9)**
Capital expenditure	(42.7)	(38.1)	(4.6)
Other net investments	(17.9)	(42.3)	24.4
Free cash flow	**28.5**	**44.6**	**(16.1)**
(Outlay) / proceeds from issue of shares	-	(1.2)	1.2
Dividends paid	(95.4)	(92.1)	(3.3)
Other	(14.4)	(10.3)	(4.1)
Change in net cash – increase / (decrease)	**(81.3)**	**(59.0)**	**(22.3)**

Operating cash flow decreased $35.9 million to $89.1 million.

Key points of note:

- Underlying EBIT declined by $31.9 million reflecting the $12.1 million increase in cloud computing investment, new product launch costs which were largely incurred in the first half and the impact of the weighting in operating expenses to the second half of FY22;
- Changes in working capital and other of $85.3 million reflects the $75.8 million increase in working capital, with trade receivables and inventory increases a function of the timing of the launch of the Nucleus® 8 Sound Processor late in the half;
- Capital expenditure (capex) increased by $4.6 million to $42.7 million, reflecting stay-in-business capex; and
- Other net investments of $17.9 million comprises additional investment in the innovation fund for Precisis.

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Capital employed

$m	Dec22	Jun22	Change
Trade receivables	337.5	308.4	29.1
Inventories	285.7	270.2	15.5
Less: Trade payables	(201.2)	(232.4)	31.2
Working capital	**422.0**	**346.2**	**75.8**
*Working capital / sales revenue**	*24%*	*21%*	
Property, plant and equipment	263.0	260.2	2.8
Intangible assets	408.3	392.5	15.8
Investments & other financial assets	175.1	187.9	(12.8)
Other net liabilities	(58.5)	(87.8)	29.3
Capital employed	**1,209.9**	**1,099.0**	**110.9**
Funding sources:			
Equity	1,715.3	1,685.7	29.6
Less: Net cash	(505.4)	(586.7)	81.3
Capital employed	**1,209.9**	**1,099.0**	**110.9**

* Dec22 calculation based on doubling HY23 sales revenue.

Capital employed increased $110.9 million to $1,209.9 million since June 2022.

Key points of note:

- Working capital increased $75.8 million, lifting from 21% to 24% of sales revenue, with the increase partly timing related. The Nucleus® 8 Sound Processor was launched during the second quarter with inventory build in anticipation of the launch. The $29.1 million increase in trade receivables reflects the timing of sales which was weighted to the end of the half. The $31.2 million increase in trade payables reflects the timing of payments. Stay-in-business inventory levels remain higher than pre-COVID levels reflecting the building of safety stocks of both finished goods and some componentry over the past few years in anticipation of potential ongoing global supply chain shortages; and
- Net cash decreased $81.3 million to $505.4 million.

Dividends

	HY23	HY22	Change %
Interim ordinary dividend (per share)	$1.55	$1.55	0%
% Payout ratio (based on underlying net profit)	72%	65%	
% Franking	35%	0%	

An interim dividend of $1.55 per share has been determined, in line with HY22 and representing a payout of 72% of underlying net profit. The interim dividend is franked at 35%. The franking balance had been depleted by losses incurred in FY20.

The ex-dividend date is 21 March 2023. The record date for calculating dividend entitlements is 22 March 2023 with the interim dividend expected to be paid on 14 April 2023.

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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 is not placed on any forward-looking statement.

Non-International Financial Reporting Standards (IFRS) financial measures

Cochlear uses non-IFRS financial measures to assist readers in better understanding Cochlear's financial performance. Cochlear uses three non-IFRS measures in this document: Sales revenue, Underlying net profit and Constant currency. The directors believe the presentation of these non-IFRS financial measures are useful for the users of this document as it reflects the underlying financial performance of the business. Each of these measures is described below in further detail including reasons why Cochlear believes these measures are of benefit to the reader.

These non-IFRS financial measures have not been subject to review or audit. However, Cochlear's external auditor has separately undertaken a set of procedures to compare the non-IFRS financial measures disclosed to the books and records of the group.

Sales revenue

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 gains/losses on hedged sales.

Underlying net profit

Underlying net profit allows for comparability of the underlying financial performance by removing one-off and non-recurring items. The determination of items that are considered one-off or non-recurring are made after consideration of their nature and materiality and is applied consistently from period to period. Underlying net profit is used as the basis on which the dividend payout policy is applied. The Financial Review section includes a reconciliation of Underlying net profit (non-IFRS) to Statutory net profit (IFRS) which details each item excluded from Underlying net profit.

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 EBIT and net profit is adjusted to calculate the result at constant currency.

Reconciliation of constant currency net profit

$m	HY23	HY22	Change %
Underlying net profit	**141.6**	**157.5**	**(10%)**
FX contract movement		(12.8)	
Spot exchange rate effect to sales revenue and expenses*		12.4	
Balance sheet revaluation*		(7.2)	
Underlying net profit (CC)	**141.6**	**149.9**	**(6%)**
One-off net gains	-	11.8	
Statutory net profit (CC)	**141.6**	**161.7**	**(12%)**

* HY23 actual v HY22 at HY23 rates.

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