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EDITED TRANSCRIPT

COH.AX - Cochlear Ltd FY20 Earnings Guidance Withdrawal Due to
Coronavirus Impacts Conference Call

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PRESENTATION

Operator

Thank you for standing by, and welcome to the Cochlear Limited announcement. (Operator Instructions)

I would now like to hand the conference over to Mr. Dig Howitt, CEO and President. Please go ahead.

Diggory William Howitt - *Cochlear Limited - CEO, MD, President & Executive Director*

Okay. Good afternoon, everyone, and thank you for joining us at short notice. There's obviously a lot going on in the world at the moment. I thought I'd start just with a few opening comments on the release that we put out this morning and then go to questions.

So to start with, up until last Friday, our run rate in terms of our revenue and our CI surgeries had continued to be strong. However, as we've seen over the last week and particularly over the weekend, an increasing number of health authorities, including the U.S. Surgeon General coming out on Friday, U.S. time, recommending deferral or delay or cancellation of elective surgeries, and clearly, most cochlear implant surgeries are elective. We've also heard, over the last week or so anecdotes from some patients who are reluctant to go into surgery or go into hospital. And with both those 2 things in mind, we expect to see quite a significant impact on our surgeries and, therefore, our revenue going forward. We do expect that this impact will vary by country.

And just to give sort of an update across a couple of countries. We made announcement on China 4 weeks ago. We've actually started to see some recovery in surgeries in China, still well below our normal run rate but definitely a recovery. In South Korea, which has had obviously a significant number of cases of COVID-19, we continue to see strong surgery run rates through last week. Conversely, in Italy, we have seen a fall-off in surgery rates in Italy over the last few weeks, albeit Italy being a relatively small market.

So with all of that in mind, we have done projections on our revenue to model our cash requirements as we look forward. And we've done this modeling on the basis of a very significant decline in revenue for the remainder of this financial year and then subdued level of sales right through to the end of the calendar year. We obviously don't know how long the impact will be and whether countries' sales will move the way China has. So we've tried to be what we think is conservative in estimating both the magnitude of the dip in revenue and the time over -- the time that it



would take for surgeries and therefore revenue to come back to normal levels. What we are not expecting is a rapid dip and then a very rapid recovery. We're expecting as things start to recover that that will happen slowly.

So we've used all that to model the cash requirements for the business. We do have cash on hand. We do have headroom in our existing debt facilities. We have a dividend payment due in April, which we have covered with our existing debt facilities. And we are also in discussion with our banks about increasing our debt facilities. And we are confident that with our current requirements and some new facilities that we will be able to have cash to fund the business right through on the projections that we have made at this stage.

As we said in the note, we're obviously taking actions inside the business to adjust to the reduction in revenue. We are not looking to reduce our employee base because we believe this is a temporary issue, but we are reducing our CapEx. We obviously cut back on travel, cutting back on discretionary expenditure to conserve cash while we see how this plays out over the next few months.

So I think with that, I'll stop there as an introduction and happy to go to any questions.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Your first question comes from Sean Laaman from Morgan Stanley.

Sean M. Laaman - *Morgan Stanley, Research Division - Australian Healthcare Analyst*

Just with respect to trying to model the shape of the recovery, just thinking about what you've observed in China today, you said you've seen some growth that offer much lower run rate or a much smaller base. How is China giving you, I guess, sort of some comfort about your forecasting of any expected recovery?

Diggory William Howitt - *Cochlear Limited - CEO, MD, President & Executive Director*

Yes. In our forecasting, we have assumed a slower rate of recovery -- a longer dip and a slower rate of recovery than we have seen in China. Now albeit China's recovery is still in its early days, but I think it's probably prudent to assume that other countries won't respond and unable to respond as quickly as China has responded.

Sean M. Laaman - *Morgan Stanley, Research Division - Australian Healthcare Analyst*

Sure. And just one quick follow-up. Just on some of the cost management initiatives, how material are they? I mean are we going to expect a significant impact to the bottom line because of the top line collapse? So how much can that cost management strategy moderate that top line decline?

Diggory William Howitt - *Cochlear Limited - CEO, MD, President & Executive Director*

Yes. Look, in the short run, I would expect a very significant impact on the bottom line because a significant part of our cost -- the majority of our costs are employees, and we intend to maintain that cost because we see this as temporary because our employees make -- have terrific knowledge and contribution. And we want to make sure that at whatever point this does turn around, we're in a strong position to benefit from the recovery.



Operator

Your next question comes from David Low from JPMorgan.

David A. Low - *JP Morgan Chase & Co, Research Division - Research Analyst*

Dig, just -- did I hear you right in saying that you're not expecting a rapid dip when you're modeling?

Diggory William Howitt - *Cochlear Limited - CEO, MD, President & Executive Director*

Yes. No. David, we are expecting the revenue -- surgeries and revenue to fall very quickly. Look, we just don't know. I said up till Friday, we haven't seen it. But with the announcements that we've seen over the weekend and the way that governments have tightened restrictions on travel, public gatherings, all of those things, we are expecting a very rapid dip.

David A. Low - *JP Morgan Chase & Co, Research Division - Research Analyst*

No, that's clear. Sorry, I misheard that. Just the only other question I had is just perhaps if I could get you to talk to the implications of postponing implantation perhaps for pediatrics and for adults, just how we're sure or how you think patients will be instructed by their doctor as to what they should be expecting and what they should be pushing for, please.

Diggory William Howitt - *Cochlear Limited - CEO, MD, President & Executive Director*

Yes. So let's separate the 2. So pediatrics, look, a child born with hearing losses and neurological emergency, they should have access to sound quickly. And there's very clear evidence that the faster they get access to sound, the better that child does and the better outcomes that they get. And so we would hope that for children, to the extent there is a delay, it's not a long delay because of the consequences for that child's speech and language.

I think for adults and seniors, post-lingual adults and seniors is quite different. There, many of those people have already had 10, 12 years with a very significant hearing loss. So a delay of another few months or even another year, while individually may be devastating in terms of overall health, doesn't -- clearly doesn't have the priority for a pediatric.

So again, in terms of when things recover, we expect to see a faster recovery in pediatrics because of the urgency and a slower recovery in adults and seniors because there is the option to defer. And obviously, there are many elective surgeries that will be deferred here and there'll be pretty significant competition for operating theater space when things do recover. And I think out of that, we'll then likely to see adults and seniors placed at a lower priority than children and probably at a lower priority than some other elective procedures.

Operator

Your next question comes from Andrew Goodsall from MST Marquee.

Andrew Goodsall - *MST Marquee - Healthcare analyst*

You mentioned Korea you're starting to see -- South Korea is starting to see a little bit of a recovery. Do you think that's a better proxy of, sort of, I guess, the experience of the West or other Western nations in terms of sort of perhaps, I guess, a more extended period of containment and recovery? And is that sort of how you'd sort of profile that so far?



Diggory William Howitt - Cochlear Limited - CEO, MD, President & Executive Director

Yes. Andrew, thanks for the question. Actually, in South Korea, we haven't seen a dip. We actually said continued strong surgery run rates. And the point of highlighting is just that the impact here will be different by countries. And our modeling has assumed significant declines across all the major countries. So South Korea may be an outlier. It would be nice if that's not the case.

Andrew Goodsall - MST Marquee - Healthcare analyst

Yes. Okay. Yes, I was just trying to sort of pinpoint a country that might be a little bit ahead of the curve and try to understand how the profile looks, but you're probably trying to do the same.

Diggory William Howitt - Cochlear Limited - CEO, MD, President & Executive Director

Yes.

Andrew Goodsall - MST Marquee - Healthcare analyst

Just quickly, I mean prior to all this taking place, just trying to understand sort of how you're seeing the U.S. market particularly after AB had their recall with the -- just reading sort of through your release, does sound like things are going quite well for you there.

Diggory William Howitt - Cochlear Limited - CEO, MD, President & Executive Director

Yes. Look, without giving too specific commentary, we were pleased with the CI surgery run rate that we were seeing right across the developed world and across the emerging countries as well. So we were on track for the guidance that we've put out.

Andrew Goodsall - MST Marquee - Healthcare analyst

Okay. And probably my final question. Just probably trying to look forward but just any thoughts around where dividend goes or impact to dividend.

Diggory William Howitt - Cochlear Limited - CEO, MD, President & Executive Director

Yes. Look, I think too early to call. I mean our dividend payout policy is 70% of net profit. So the first step is it depends on what our -- and that's what we've done in the first half. It depends on what our net profit is in the second half as to implications to dividend, and obviously, the Board reviews the dividend at each payment and with a view to maintaining a prudently geared balance sheet.

Operator

Your next question comes from David Bailey from Macquarie.

David Bailey - Macquarie Research - Research Analyst

Yes. Dig, just in relation to that commentary in relation to pediatrics versus adults, just any rough splits in terms of implant, CI implant, what's the proportion that you would expect or we should think about from a pediatric volume versus adult perspective?



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Diggory William Howitt - Cochlear Limited - CEO, MD, President & Executive Director

Yes. Thanks, Dave. So what we've said on this is it varies by country. So in the U.S. and Germany, pediatric proportion of our surgeries for CI is about 25%. Through most of Western Europe -- the rest of Western Europe, it's about 50%. And in Japan and Korea, we're about 50% children.

David Bailey - Macquarie Research - Research Analyst

Got it. And then in relation to your top 5 markets, just wondering if you could just list those. It would be helpful for us to be able to track how things are going in the...

Diggory William Howitt - Cochlear Limited - CEO, MD, President & Executive Director

Yes. We don't explicitly display as our top 5. Obviously, the U.S. is the biggest by a good bit. And we don't because they move around from time to time depending on how each one of them is tracking.

Operator

Your next question comes from Saul Hadassin from UBS.

Saul Hadassin - UBS Investment Bank, Research Division - Executive Director & Research Analyst

Can you provide any color on what your expectations are for the upgrades particularly in Western Europe and the U.S.? I know with China, you mentioned there's an outpatient clinic service on the basis that U.S. and Western Europe maybe is done in doctors -- in clinic rooms or the audiologist rooms. What are your thoughts on decline in sales for that particular line item?

Diggory William Howitt - Cochlear Limited - CEO, MD, President & Executive Director

Yes. So a good question. We're trying to get a good understanding, but we do expect that some of our upgrade sales will continue where they don't go through a hospital. So we've got reasonable expectations in the U.S. that upgrades will continue on. It's been hard at country by -- not hard, it's just been different country by country as to how upgrades are delivered to patients. And so it's hard to model overall. And the other issue here is just what -- where will getting an upgrade be in terms of patient priority because it obviously, again, that's a -- it's a decision people will have to make. It is a pretty easy decision to defer for a few months if people are concerned about social contact and want to stay at home, which we're increasingly seeing.

Saul Hadassin - UBS Investment Bank, Research Division - Executive Director & Research Analyst

Just a quick one. In thinking about inventory in the channel, post the recall and post GFC, I mean international, there's not a lot of inventory that sits in -- sitting on hospital shelves. Is that the case that whatever inventory is currently sitting with hospitals and clinics, it will just remain there until it starts to be utilized again? Will any inventory come back to you, guys?

Diggory William Howitt - Cochlear Limited - CEO, MD, President & Executive Director

Not yet. My expectation is that the inventory that is out in the channel will stay there, and you're quite right, there's not a lot of it out there. We wouldn't expect to see significant returns.



Operator

Your next question comes from David Stanton from Jefferies.

David Andrew Stanton - Jefferies LLC, Research Division - Equity Analyst

I just had one. We know that you're saying you're reducing nonessential spending and capital expenditure for the balance of financial year. You have talked to about \$180 million in F '20 for CapEx. Is there any way you can give us sort of at least preliminary help on what you think CapEx might be for the -- this financial?

Diggory William Howitt - Cochlear Limited - CEO, MD, President & Executive Director

Yes. David, we won't guide explicitly on that, but we have said the 2 biggest items of CapEx in that \$180 million are the China factory and the relocation of our Denver office. Both of those projects are well advanced, and it makes sense for us to finish those up rather than the whole. It would actually cost us more to try to stop them given the stage of development that they're at. And they're both important investments for our future in terms of having facilities to house our very significant North American team. And obviously, the production facility in China is a core part of our strategy going forward.

David Andrew Stanton - Jefferies LLC, Research Division - Equity Analyst

So it would be safe to say that wouldn't be -- you wouldn't see a precipitous drop in CapEx for the year.

Diggory William Howitt - Cochlear Limited - CEO, MD, President & Executive Director

No, no. We'll take a bit off of it but it won't be...

Unidentified Company Representative

I mean we've only got 3 months left.

Diggory William Howitt - Cochlear Limited - CEO, MD, President & Executive Director

Yes?

David Andrew Stanton - Jefferies LLC, Research Division - Equity Analyst

Exactly.

Unidentified Company Representative

Yes.

Diggory William Howitt - Cochlear Limited - CEO, MD, President & Executive Director

Yes.



Operator

Your next question comes from Steve Wheen from Evans & Partners.

Steven David Wheen - *Evans & Partners Pty. Ltd., Research Division - Executive Director of Healthcare*

Just quickly the -- and apologies if this has been covered. But the strategy that you've had to reinvest in the business particularly around SG&A, the implications of where you are at the moment. And is that something that gets deferred or you just continue to do that to complete that strategy?

Diggory William Howitt - *Cochlear Limited - CEO, MD, President & Executive Director*

Yes. Steve, look, we will defer some elements of our SG&A spending, but again, we'll do so prudently. I mean we will look, as you would expect, in detail at all of our spending and work out what of that can we stop, what of that can we defer, being mindful that we do think this is temporary. So -- but we're not sure how long it will run. And we do want to be well positioned whenever the point in time is that we start to see a recovery.

Steven David Wheen - *Evans & Partners Pty. Ltd., Research Division - Executive Director of Healthcare*

Okay. So do you have any idea as to what sort of percentage of SG&A investment that is flexible to that degree?

Diggory William Howitt - *Cochlear Limited - CEO, MD, President & Executive Director*

Not that we would disclose at this point. Obviously, we know what we can flex. But it's not a significant part of our SG&A. The -- as I said, the majority of our costs are in people and we intend to maintain our workforce. So you won't see huge reductions in any of our expense lines from where we are now.

Steven David Wheen - *Evans & Partners Pty. Ltd., Research Division - Executive Director of Healthcare*

Yes. Okay. Great. Secondly, I was just going to ask around the deferral rate of surgeries particularly in the elderly. Do you think there's any component of those deferrals that ultimately get lost completely?

Diggory William Howitt - *Cochlear Limited - CEO, MD, President & Executive Director*

Yes. Look, I think there's a real risk of that. For many people or for certainly for adults and seniors, the decision to get a cochlear implant is quite an emotional one, and it's one that people -- many people think about quite some time. So I could easily see that, a, just people rightly being distracted with what's going on in the world at the moment and, therefore, putting that decision off for quite some time. I'm not sure that people will get lost forever, but it would be -- it's not inconceivable for some people to push this back a year or 2 years just given many have struggled with hearing loss for 10 or 12 years and rightly could be quite distracted by other things right now. So I think some could get lost or significantly delayed.

Steven David Wheen - *Evans & Partners Pty. Ltd., Research Division - Executive Director of Healthcare*

Yes. Okay. So it's not a pure timing difference, really. There is the potential for some to drop off the other...



Diggory William Howitt - Cochlear Limited - CEO, MD, President & Executive Director

Yes. Look, I think so. And it all depends on the -- in some countries, on the screening and diagnosis steps. If those steps were to be deferred, then there will be a hole in the pipeline, if you can sort of think of it that way, because once people are diagnosed, there's been quite a process to go through. And if that diagnosis doesn't happen or is delayed, then the whole process gets delayed.

Steven David Wheen - Evans & Partners Pty. Ltd., Research Division - Executive Director of Healthcare

Yes, yes. And then just lastly from me. You talked about the rebound certainly amongst the pediatrics being fast and slower for adult. There's obviously that race for surgical theater time in that environment. Does that have any pressure or potential pressure on the cost of conducting these procedures?

Diggory William Howitt - Cochlear Limited - CEO, MD, President & Executive Director

I don't think on the cost. I think it's more just a straight-up capacity issue. There's a limited number of operating theater hours and there's going to be a lot of calls on those hours from orthopedics and other procedures, which are elective. And I think, therefore, pediatrics are likely to get a pretty good hearing in terms of priority, but adults and seniors, less so.

Operator

(Operator Instructions) Your next question comes from Chris Cooper from Goldman Sachs.

Chris Cooper - Goldman Sachs Group Inc., Research Division - Research Analyst

Just one, please. Just on your commentary earlier, you talked about subdued sales development through to the end of the calendar year. I mean this implies the majority of the recovery I guess is going to be in calendar year '21. The health care funding caps and the role that they may play, I mean I know you bumped up against these just in normal times. Is that not going to be a real key to the pace of recovery in calendar '21 is limited to some extent by the funding caps imposed by some of those tender markets in Europe in particular? Or I guess there's also a scenario here where potentially the regulators apply a bit more of the common sense approach and maybe sort of stack the funding caps between calendar '20 and calendar '21. Can you just give your thoughts on that, please?

Diggory William Howitt - Cochlear Limited - CEO, MD, President & Executive Director

Yes, Chris. It's a good question. I think the short answer is we just don't know but I would be -- I think it's reasonable to assume that funding that doesn't get -- I think it's pretty unlikely that funding that doesn't get used this year gets rolled into next year. And that may happen in a few places. But given the demands on the -- likely demands on the health system from COVID-19, I don't think there's going to be spare money floating around to bump the caps next year. So I would expect that at this stage, we're more likely to run into those caps in countries that have them than there'll be extra budget allocated.

Chris Cooper - Goldman Sachs Group Inc., Research Division - Research Analyst

Great. And can you just remind us which countries have these caps? I get that the U.S. doesn't. The majority of Western Europe does. Is that correct?

Diggory William Howitt - Cochlear Limited - CEO, MD, President & Executive Director

Yes. Look, U.S. is fine. Germany is fine. Japan is fine. And then across most of the rest of Western Europe, there's either a form of cap or type indications. So there's a sort of range of things that restrict.

Operator

Your next question comes from Lyanne Harrison from Bank of America.

Lyanne Harrison - *BofA Merrill Lynch, Research Division - VP*

Talking about pipeline, I know you talked about where the surgeries are up to screening and diagnosis. Can we talk about further earlier in the pipeline phase and what you're seeing or if there's any evidence, anecdotal or otherwise, that's showing that your lead or potential leads from audiologists are slowing down? I know it's still early days, but do you have any information on that?

Diggory William Howitt - *Cochlear Limited - CEO, MD, President & Executive Director*

Lyanne, thanks for the question. Look, it's probably too early just to have insight into are those leads slowing down. And we get leads from a whole range of different places, from audiologists, from doctors, from our own awareness-generating activities, from our volunteer network, from people bumping into other people with implants. So it's also hard to, when you look at the range of sources, sort of isolate these sources [with delay there] and these aren't. But it's all up, I think, too early to see if we're seeing a delay in those referrals at this stage.

Lyanne Harrison - *BofA Merrill Lynch, Research Division - VP*

Okay. And then just a follow-up about a potential hole in the pipeline, if there is any delays. What -- can you talk to us about what Cochlear can do to help, I guess, reduce the size of the hole, I guess, once the risk of coronavirus has passed? And would that be putting more or funding into sales and marketing as well as other aspects or other activities?

Diggory William Howitt - *Cochlear Limited - CEO, MD, President & Executive Director*

Okay. So we will hold our employee base. And particularly in sales and marketing, a lot of those people are working to either generate leads or help people as they consider implant as part of their hearing care to understand the pros and cons and the advantages and so on. So that will continue. So I think that they're activities that we would take in the normal course of business just to try to avoid a hole. Where it could happen is in countries where there is less audiological screening because -- for a whole host of reasons associated with COVID-19 that there still could be some delay. Look, it's just very hard to know right now what that means, but I think what we'd be cautioning against is that all of the surgeries that get missed over whatever period is -- all of a sudden come rushing straight back in when things return to normal. I think there will be some dropouts there. I think there will be some significant delays in some areas. So just cautioning against sort of taking out the demand for the next few months and piling it into the few months after that. We don't expect that to happen.

Operator

There are no further questions at this time. I will now hand back to Mr. Howitt for closing remarks.

Diggory William Howitt - *Cochlear Limited - CEO, MD, President & Executive Director*

Okay. Just to finish up, I would thank you all for joining. Thanks for the questions.



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