



Biotech Daily

Friday February 21, 2025

Daily news on ASX-listed biotechnology companies

Dr Boreham's Crucible: Cochlear

By **TIM BOREHAM**

ASX code: COH

Share price: \$268.81; **Shares on issue:** 65,429,930; **Market cap:** \$17.6 billion

Chief executive officer: Diggory 'Dig' Howitt

Board: Alison Deans (chair), Mr Howitt, Glen Boreham (no known relation), Prof Bruce Robinson, Michael Daniell, Christine McLoughlin, Michael del Prado, Karen Penrose, Caroline Clarke

Financials (first half to December 2024): revenue \$1,171.8 million (up 7%), earnings before interest and tax \$275 million (up 8%), net profit \$205.1 million (up 7%), earnings per share \$3.125 (up 7%), dividend per share \$2.15 (up 7%), net cash \$383 million (down 21%)

Identifiable major shareholders: Blackrock Inc 7.2%, State Street Corp (5.5%), Vanguard Group 5.2%, Pinnacle Investment Management 5%

How many Iphone users cling to their ageing handsets as Apple rolls out yet another iteration of the device?

Personally, your columnist won't rush out to buy the Iphone17 when it's released in September, because the Iphone 12 does the job perfectly well.

In truth, he would still be on an Iphone 7 because he likes the headphone jacks – since abolished - but Apple have their ways and means of forcing redundancy.

Cochlear is facing a similar scenario with slow sales of the latest version of its processor, Nucleus 8, which interprets the signals from the cochlear implants.

Revenue from Cochlear's services division (mainly processors) slumped an unexpected 12 percent in the December (first) half year.

The problem is the latest Nucleus 8 devices haven't exactly been walking off the shelves, mainly because of alleged US cost-of-living pressures.

Launched in October 2022, Nucleus 8 has refinements such as Bluetooth connectivity and background noise suppression.

CEO Dig Howitt notes a higher rate of cancelled orders after customers saw their out-of-pocket cost and said: "Happy with the old one, buddy".

"We didn't expect it to come off as much as [it] did," he says of the services arm.

Investors concurred, wiping more than 20 percent off Cochlear's shares following last Friday's results release.

From snail's pace to world domination

Just as Resmed strides the sleep-disorders sector, fellow home-grown hero Cochlear is the leader in cochlear devices with a circa 60 percent market share.

Cochlear is Latin for 'snail shell', by the way.

The Cochlear name refers to the cochlea spiral tunnel of the inner ear that receives vibrations and sends them to the brain for interpretation.

The Cochlear implant is implanted in the cochlea.

The devices are applicable for people with severe or profound hearing loss, mixed hearing loss or deafness in one ear.

Cochlear was founded in 1981, to commercialize the device invented by otolaryngologist (ear specialist) Graeme Clark - later a professor - in the 1970s.

Prof Clarke famously derived the idea while examining a shell and a blade of grass on a beach. This Eureka moment made him realize there was a safe way to insert electrodes into the inner ear.

And to think the rest of us were scoffing Chiko Rolls and trying to pick up beach babes.

The first device was implanted in 1978 - a great victory for Australians' famous 'shell be right' attitude.

Prof Clark partnered with Australian entrepreneur Paul Trainor (Nucleus Group) to commercialize an implant, the Nucleus 22.

Nucleus Group was acquired by the doomed conglomerate Pacific Dunlop but morphed into Cochlear, which listed on the ASX in 1995.

As with fellow big cap CSL, Cochlear is on only its third CEO.

Dr Chris Roberts ran the show until September 2015, before the US-based Chris Smith presided for a short period.

(in an ultra-trivial vein, two of CSL's CEOs were - and are – Pauls).

Formerly Cochlear's chief operating officer, Mr Howitt has been CEO since July 2017.

Product line-up

Cochlear has provided more than 700,000 implants in more than 180 countries.

Its revenue derives from implants, as well as the processors and other bits and bobs such as cables and remote controls.

As with Iphones - or Resmed's pumps and masks - Cochlear is about constant refinement of the core product.

However, a key innovation has been in acoustics, or bone-conducting implants. These are suitable for patients with mixed or single-sided hearing loss.

Mixed hearing loss refers to both conductive hearing loss (problems in the outer or middle ear) and damage to the inner ear or auditory nerve.

Cochlear's acoustics products are Osia (as in 'osseo integrated steady state implant') and Baha (as in bone-anchored hearing aid).

Finances and performance

Cochlear's reported net profit for the December 2024 half rose 7.2 percent to \$205.1 million.

Sales revenue grew faster than unit growth, helped along by higher-priced private reimbursement.

"Overall, we were happy with the outcome but there were some mixed results," Mr Howitt says.

Management has stuck to its August 2024 guidance of an underlying net profit of \$410 million to \$430 million – albeit at the lower end of the range.

This reflects the lower contribution from services revenue and a big boost in internet ‘cloud’ investment to improve the company’s business systems and customer management.

Sales revenue rose five percent to \$1,170 million, owing to strong growth in cochlear and acoustic implants.

Cochlear’s net cash balance declined 21 percent to \$383 million, mainly the result of boosting product inventory ahead of new product releases.

Still, there’s plenty of excess dosh and the company bought back \$19 million of shares as part of an ongoing share buyback program of up to \$75 million.

Break it down

Cochlear’s implant revenue increased 12 percent to \$724.5 million, with 25,390 implants undertaken (up five percent).

The company reports developed market growth of six percent, with US and the Asia Pacific performing strongly while a few Western European markets were off the pace.

Emerging market revenue grew three percent. This reflected lower-than-expected tender volumes but strong growth in the smaller - but higher-priced - private pay segment in China and India.

The 12 percent decline in services revenue compares with 29 percent growth in the previous December half year - a robust hurdle to overcome.

Acoustics revenue climbed 22 percent to \$140 million, driven by growth in Osia implants after the product was launched in the US late in the half.

Shareholders were rewarded with an eight percent increase in the interim dividend, to \$2.15 per share.

Cochlear expects to spend around \$250 million in rejigging its operating models and core business systems over the next four years, \$100 million more than estimated previously.

‘Cloud’ computing-related costs are expected to be \$40 million this year - \$6 million more than guided - with \$120 million to be incurred over the subsequent two years.

Over the last 12 months, Cochlear’s shares have crept between last Friday’s low point of \$262 and the historic peak of \$350 on February 29 last year.

Growth levers

Cochlear is on track for its full-year target of 50,000 people to undergo a cochlear or acoustic implant.

Meanwhile, management is preparing for the release of the company's next-generation cochlear implant, which is expected to be commercially available from mid-2025.

The details are under more wraps than Apple's next device, but presumably it will be replete with 'artificial intelligence' features.

In addition, the roll-out of the new, 'off the ear' Nucleus Kanso 3 sound processor from mid-2025 should boost services revenue in the 2025-'26 year.

With emerging markets, Indian tendering activity was less than expected during the half, but Mr Howitt says "demand clearly is there".

The Chinese market is one to watch, as Beijing adopts a volume-based pricing model for drugs and devices across-the-board.

In effect, healthcare providers get lower prices, but expanded access (meaning higher volume) and better reimbursement.

While Cochlear doesn't break out its China contribution, the geography is included in Asia Pacific which accounted for 20 percent of revenue.

Mr Howitt says of all the cochlear implant providers, Cochlear is least exposed to China. In the context of Trump's tariffs, that's a pertinent observation.

"But we believe China has significant long term growth opportunities."

Golden oldies

Mr Howitt dubs the seniors' market as "by far the biggest opportunity".

Indeed, Cochlear's focus on the adults and seniors market looks to be paying off, with growth of around 10 percent in this segment during the half.

The kids' sector declined "modestly", having grown in double digits in the prior December half year.

"We continue to see strong growth in adult referral rates in a number of key markets, in part driven by initiatives to improve awareness and access for adult cochlear implant candidates," the company says.

Cochlear feels constrained by long waiting lists for hearing tests and/or surgery in key countries. However, the problem is being addressed by adopting remote access (telehealth) and streamlining post-operative appointments.

Keep an eye (and ear) on the rivals

Are Cochlear's rivals (such as Oticon and Advance Bionics) getting ahead of the game with new features, rather like Samsung and its cameras with more pixels?

"There's a bit of feedback that some of your competitors have released new features and stolen some of your share," one analyst remarked.

Another concern is that private insurers won't necessarily agree to fund every tweaked device, if the economic benefits are deemed to be sub-optimal.

Mr Howitt says Cochlear is confident of its "long run" position, especially in developed markets.

"Our competitors are always going to find things that we aren't doing, and try to differentiate themselves," he says.

"They will have some successes here and there, but we are not seeing that happening at a material level.

Mr Howitt says the company spends a lot on research and development - "and we are spending it wisely".

Seeing you asked: December half research and development expenses were \$144 million, up 13 percent and amounting to 12 percent of Cochlear's sales revenue.

"We have a full pipeline of products coming out over the next several years and we don't see our competitors as having the financial capacity to keep up with what we are doing," Mr Howitt says.

Dr Boreham's diagnosis:

If only Cochlear could 'do an Apple' and refuse to support the older implants and processors - but we suspect the health regulators would have something to say about that.

The vibe of last week's results is that Cochlear isn't getting too many free hits - and management can't afford a moment of complacency.

So, the new products had better excite users and be pitched at the right price.

As with Resmed - and apologies for straining the comparisons - Cochlear says it's only scratching the surface of the addressable market.

Globally, 460 million people suffer hearing loss, with one in three over 65-year-olds having disabling impaired hearing.

The biggest growth opportunities lie in convincing hard-of-hearing adults to do something about their condition - and they are often deaf to the imploring of family and friends.

Mr Howitt says there's a "significant, unmet and addressable clinical need for cochlear and acoustic implants that [should] continue to underpin the long-term sustainable growth of the business".

That's true, but many sector incumbents have been caught out by unanticipated seismic shifts, such as the old (print) media.

That said, Cochlear would have to be completely tone deaf not to pick up on the threats - and opportunities - posed by advances such as artificial intelligence.

As with Apple, we reckon Cochlear's ears are pricked up to the evolving competitive landscape.

Disclosure: Dr Boreham is not a qualified medical practitioner and does not possess a doctorate of any sort. He shall never view a visit to the beach in the same way again.