Financial report

Financial review

In the 2018/19 financial year, Sonova generated sales of CHF 2,763.2 million, an increase of 4.4% in Swiss francs and 4.1% in local currencies. Adjusted Group EBITA reached CHF 594.0 million, up 7.7% in Swiss francs or 6.7% in local currencies.

Sales driven by organic growth – Momentum accelerating

In the 2018/19 financial year Sonova Group sales reached CHF 2,763.2 million, an increase of 4.4% in Swiss francs. In local currencies, sales increased by 4.1%, representing an organic growth of 4.9%, while the net impact of acquisitions and divestments reduced growth by 0.8%. Disposals consisted of the sale of the US hearing service plan business as well as the streamlining of the US store network. Exchange rate fluctuations had a small positive impact, and contributed 0.3% to the reported growth in Swiss francs, due to the strength of the Euro and US dollar.

Sales driven by strong performance in the EMEA region

Europe, Middle East and Africa (EMEA), the Group's largest region, achieved a strong increase in sales of 8.3% in local currencies. This was driven by the successful introduction of Phonak Marvel in November 2018, generating double-digit growth in the hearing instruments business since the launch, in particular in Germany and France. The audiological care business in the region grew by mid-single digits and benefited from strengthened operational execution after the AudioNova acquisition and the completion of streamlining activities in the Netherlands. Sales in the cochlear implants business were mainly driven by strong upgrade sales. The EMEA share of Group sales increased from 53% in 2017/18 to 55% in the period under review.

As a result of previously announced divestments, sales in the United States declined by 3.7% in local currency but were up 2.3% excluding these divestitures. In the hearing instruments business, the successful introduction of Phonak Marvel to independent customers and a next generation Phonak Brio product at Costco drove strong growth in their respective channels in the second half. Sales to the US Department of Veterans Affairs (VA) declined ahead of the upcoming launch of Phonak Marvel in this channel in May 2019. The streamlining and strategic repositioning of the audiological care store network was completed mid-year and sales on a same-store basis accelerated strongly compared to the prior year. Following the launch of the HiRes™ Ultra 3D implant in September, growth in the cochlear implants business accelerated. The region accounted for 27% of Group sales in 2018/19, versus 28%

in the prior year. The rest of the Americas (excluding the US) posted a 2.7% sales increase in local currencies; this reflects, in the cochlear implants business, reduced tender activity compared to the previous year in Latin America and, in the hearing instruments business, pricing pressures in the public channel affecting sales in Canada.

Sales in the Asia/Pacific (APAC) region rose by 5.4% in local currencies, with both the hearing instruments and the audiological care business growing in the high single digits. Geographically, results were mixed, with a double digit growth in New Zealand compensating for weaker growth in Australia, Japan, and China. This was partly due to lower demand ahead of the upcoming Phonak Marvel launch in China and Japan. Sales in the cochlear implants business grew in the high teens excluding the impact of lower deliveries under central government tenders in China.

Sales by regions

in CHF m			2018/19		2017/18
	Sales	Share	Growth in local currencies	Sales	Share
EMEA	1,521.0	55%	8.3%	1,398.8	53%
USA	746.7	27%	-3.7%[1]	759.6	28%
Americas (excl. USA)	228.5	8%	2.7%	230.8	9%
Asia/Pacific	267.0	10%	5.4%	256.7	10%
Total sales	**2,763.2**	**100%**	**4.1%**	**2,645.9**	**100%**

1) Excluding divestments: +2.3%

Solid margin development

Reported gross profit reached CHF 1,966.2 million. This included restructuring costs of CHF 8.8 million for the streamlining of operations in the UK, Germany, and Canada. Adjusted for these costs, gross profit reached CHF 1,975.1 million, an increase of 5.7% in Swiss Francs and 5.3% in local currencies. The adjusted gross profit margin was 71.5%, up from 70.6% in the prior year. The improvement was driven by an increased share of the audiological care business, overall higher unit volumes, and a rise in average sales price (ASP) in the hearing instruments business during the second half year. In the cochlear implants segment, the gross margin improved significantly due to manufacturing cost improvements, the higher ASP of the new HiRes Ultra 3D implant, and a reduction in deliveries under lower margin China central government tenders.

Excluding acquisition-related amortization, operating expenses were CHF 1,383.7 million (2017/18: CHF 1,335.7 million). These included restructuring costs of CHF 2.6 million (2017/18: AudioNova integration costs of CHF 19.2 million). In the following, we refer to the operating expenses adjusted for these items. Adjusted operating expenses before acquisition-related amortization rose by 4.9% in Swiss francs or by 4.7% in local currencies to CHF 1,381.1 million, reflecting the sales growth and continued investment in research and development, sales, and marketing.

Adjusted research and development (R&D) expenses before acquisition-related amortization were CHF 147.8 million, an increase of 3.2% in local currencies, underpinning Sonova’s continued commitment to innovation. Technology developments in the field of eSolutions, wireless connectivity, rechargeability, and audiological performance again represented an important share of R&D efforts. R&D spending as a percentage of sales was stable at 5.4%.

Adjusted sales and marketing costs before acquisition-related amortization were up 4.2% in local currencies to CHF 969.1 million. The increase reflects continued investment in expanding the audiological care store footprint and expansion of the sales force in the hearing instruments and cochlear implants businesses.

Adjusted general and administrative costs increased by 6.0% in local currencies to CHF 268.6 million, representing 9.7% of sales, up from 9.5% in the prior year. The increase includes patent litigation cost in the cochlear implants business and investment in a new integrated IT platform for our audiological care business; together, these account for more than half of the increase.

Other income for the current period was CHF 4.4 million, down from CHF 7.2 million in the prior year. The bulk of this income related to a provision release for cochlear implant product liabilities that resulted from better-than-expected development in related claims. Within the cochlear implants business, this provision release was broadly offset by the above mentioned litigation cost.

Adjusted operating profit before acquisition-related amortization (EBITA) was CHF 594.0 million (2017/18: CHF 551.6 million), an increase of 7.7% in Swiss francs or 6.7% in local currencies. The adjusted EBITA margin rose to 21.5% (2017/18: 20.8%), mainly reflecting the solid gross margin development. The reported EBITA increased by 9.4% in Swiss francs or 8.4% in local currencies to CHF 582.5 million, corresponding to a margin of 21.1%. Acquisition-related amortization amounted to CHF 46.3 million (2017/18: CHF 49.5 million). Reported operating profit (EBIT) reached CHF 536.2 million (2017/18: CHF 483.0 million), up by 11.0% in Swiss francs.

Sonova Group key figures

in CHF m unless otherwise specified	**2018/19**	**2017/18**	**Change in Swiss francs**	**Change in local currencies**
Sales	2,763.2	2,645.9	4.4%	4.1%
Gross profit	1,966.2	1,868.2	5.2%	4.8%
EBITA[1]	582.5	532.5	9.4%	8.4%
EBIT[1]	536.2	483.0	11.0%	10.0%
Basic earnings per share (CHF)	6.98	6.13	13.9%	
Operating free cash flow[1]	411.8	419.2	(1.8%)	
ROCE[1]	20.6%	18.4%		
Gross profit (adjusted)[1]	1,975.1	1,868.2	5.7%	5.3%
EBITA (adjusted)[1]	594.0	551.6	7.7%	6.7%
EBITA margin (adjusted)	21.5%	20.8%		
Basic earnings per share (CHF) (adjusted)[1]	7.11	6.36	11.7%	

1) For detailed definitions, please refer to “5 year key figures”.

Double-digit increase in earnings per share

Reflecting the growth in EBIT, basic earnings per share (EPS) reached CHF 6.98 (2017/18: CHF 6.13), a significant increase of 13.9% from the prior year. The adjusted EPS increased 11.7% to CHF 7.11. Net financial expenses, including the result from associates, increased from CHF 4.0 million to CHF 6.6 million. The effective tax rate was 13.1% (2017/18: 14.9%); the lower tax rate reflects the completed integration of AudioNova. Income after taxes was CHF 460.2 million (2017/18: CHF 407.4 million).

Headcount

The Group's total workforce at the end of the 2018/19 financial year was 14,740 full-time equivalents, an increase of 498 due to an increase in manufacturing capacity in Asia as well as customer facing staff in the audiological care and hearing instruments business. The expected reduction of the workforce by about 250 employees resulting from the restructuring program announced in March 2019 is not yet reflected in the year-end workforce number. Good progress was made in directing new hires to lower-cost locations.

Hearing instruments segment – New products and improved execution driving growth

Sales in the hearing instruments segment grew by 4.2% in Swiss francs and 3.9% in local currencies to CHF 2,524.8 million. Organic growth was 4.8%, while the contribution from acquisitions in the reporting period and the full-year effect of prior year acquisitions was 1.0%. Growth was reduced by 1.8% through the previously mentioned disposals. Exchange rate fluctuations, primarily a stronger Euro and US dollar, contributed 0.3% to growth in Swiss francs.

After a more moderate start to the year, the hearing instruments business, which includes sales to independent audiologists, retail chains, multinational and government customers, but excludes our own audiological care business, had an excellent last four months of the year following the launch of the Phonak Marvel platform in November 2018. Sales reached CHF 1,474.7 million, an increase of 2.0% in local currencies. Organic growth was 4.5%, in part offset by the disposal of the US hearing service plan business, reducing sales by 2.5%. Both Europe and Asia/Pacific achieved high single digit growth rates. The performance in the United States was held back by the upcoming product transition in the government channel (VA).

The audiological care business increased sales by 6.7% in local currencies to CHF 1,050.1 million; the increase was driven by organic growth of 5.2% along with bolt-on acquisitions, and partially offset by the disposal of a number of stores in the US. Many of the key markets, including Germany, New Zealand, Canada, and Italy, achieved above market growth rates. The streamlining and strategic repositioning of the business in the US and the Netherlands were successfully completed and the growth momentum in both countries accelerated significantly on a same store basis. France exhibited a slow-down in the second half of the year as a result of a reimbursement change in 2019 and the general economic environment. The roll-out is underway of a new integrated IT platform enabling better lead generation, consumer database management and store front and back office processes. This roll-out is global and will take three years to complete.

Sales by business – Hearing instruments segment

in CHF m			**2018/19**		**2017/18**
	Sales	Share	Growth in local currencies	Sales	Share
Hearing instruments business	1,474.7	58%	2.0%	1,441.6	59%
Audiological care business	1,050.1	42%	6.7%	981.5	41%
Total hearing instruments segment	**2,524.8**	**100%**	**3.9%**	**2,423.1**	**100%**

Reported EBITA for the hearing instruments segment amounted to CHF 563.1 million, up 7.1% in local currencies. The adjusted EBITA increased by 5.4% in local currencies to CHF 574.6 million, corresponding to an EBITA margin of 22.8% (2017/18: 22.3%). The segment achieved strong margin expansion through the sale of the low margin US hearing service plan business, tight cost controls, and a positive product and business mix.

Cochlear implants segment – Growth driven by new product introductions

The cochlear implants segment achieved sales of CHF 238.4 million, up 7.0% in Swiss francs and 6.3% in local currencies. The business achieved double-digit growth adjusted for the decreased level of sales under government tenders. Systems sales grew in high single digits, supported by the successful launch of the HiRes Ultra 3D implant. Upgrade revenue growth was moderate at 2.4% against a challenging prior year comparison, particularly in the US, but accelerated in the second half. The segment also benefited from an improved position in the private market in China resulting from the roll-out of the Naída CI processor.

Sales by product groups – Cochlear implants segment

in CHF m			2018/19		2017/18
	Sales	Share	Growth in local currencies	Sales	Share
Cochlear implant systems	178.9	75%	7.7%	165.1	74%
Upgrades and accessories	59.5	25%	2.4%	57.8	26%
Total cochlear implants segment	**238.4**	**100%**	**6.3%**	**222.9**	**100%**

Improved pricing, driven by a better business mix and new product introductions, as well as by structural and productivity improvements, led to a step-up in profitability. The effects of increased litigation costs and a provision release for product liabilities broadly offset each other. EBITA for the year was CHF 19.7 million versus CHF 11.9 million in the prior year, resulting in a margin of 8.2% (2017/18: 5.3%).

Stable cash flow

Cash flow from operating activities was CHF 533.2 million, compared to CHF 523.4 million in the prior year; higher profitability was offset by adverse changes in working capital and higher income tax payments. The accelerated growth of the hearing instruments business in the second half led to higher receivables and inventory balances.

Net investments in tangible and intangible assets increased to CHF 117.3 million from CHF 95.5 million in the prior year, mainly as a result of investments in site expansion in the hearing instruments business, as well as in IT systems and store improvements in the audiological care business.

This resulted in an operating free cash flow of CHF 411.8 million, down by 1.8%. Cash consideration for acquisitions net of disposals amounted to CHF 64.9 million, compared to 59.2 million in the prior year. In summary, this resulted in a free cash flow of CHF 346.9 million, compared to CHF 360.0 million in the prior year.

Cash outflow from financing activities was CHF 522.1 million, compared to CHF 186.2 million in the prior year. This reflects the repayment of a bond of CHF 150.0 million, which was part of the financing of the AudioNova acquisition, and net share repurchases of CHF 194.6 million, mainly related to the share buyback program. Cash outflow from financing also includes dividend payments of CHF 169.8 million.

Balance sheet remains strong

Reported net working capital was CHF 163.0 million, compared to CHF 190.5 million at the end of the prior year. This reflects higher current liabilities in the amount of CHF 77.6 million related to the implementation of IFRS 15, partly offset by higher inventory and receivables due to the accelerated growth of the hearing instruments business in the last quarter of the year. The implementation of IFRS 15 reduced both the capital employed and the company’s equity position by CHF 127.2 million. Capital employed was CHF 2,630.0 million, a slight reduction from CHF 2,702.9 million in the prior year. The Group’s equity position amounted to CHF 2,376.1 million, down from CHF 2,474.9 million in the previous year, partly as a result of the share buyback program, resulting in a solid equity ratio of 55.4%. The net debt position stood at CHF 253.9 million, compared to CHF 228.0 million at the end of the prior year. The return on capital employed (ROCE) increased to 20.6% from 18.4% in the prior year. Excluding the impact of the implementation of IFRS 15, the ROCE increased to 19.6%.

In light of the solid profitable growth and a healthy financial position, the Board of Directors will propose a dividend of CHF 2.90 to the Annual General Shareholders’ Meeting on June 13, 2019. This proposed distribution is up 11.5% over the prior year, and represents a stable adjusted payout ratio of 41% (reported: 42%).

Outlook 2019/20

The global hearing care market offers both general and specific opportunities for continued growth. Our strategy is tuned to capture these benefits while delivering further advances in commercial excellence and operational efficiency. We therefore expect to increase consolidated sales in 2019/20 by 6-8% in local currencies, while further expanding profitability.

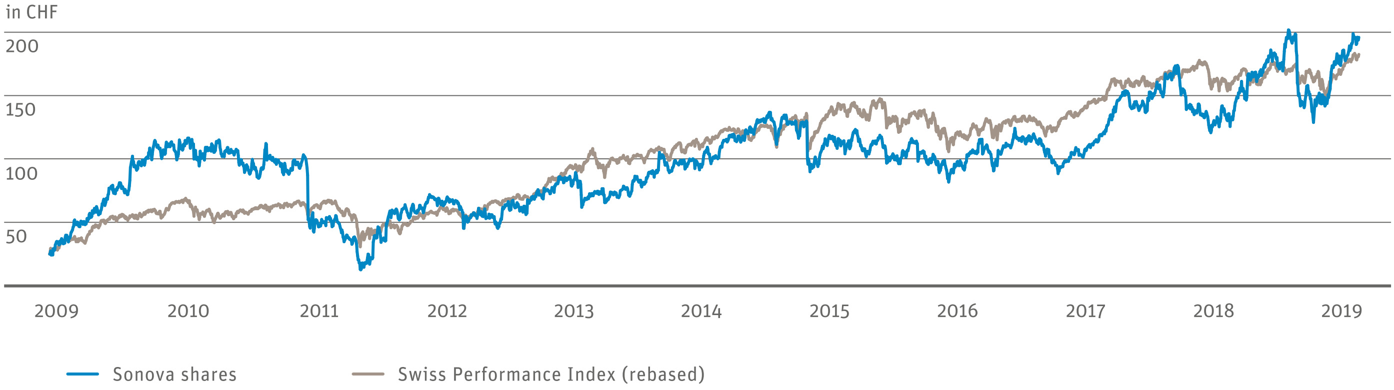
Reconciliation of non-GAAP financial measures

April 1 to March 31, CHF million	Income statement as reported	Acquis. related amortization	Income statement EBITA separation	Adjustments[3]	Income statement adjusted
					2018/19
Sales	**2,763.2**		**2,763.2**		**2,763.2**
Cost of sales	(797.0)		(797.0)	8.8	(788.1)
Gross profit	**1,966.2**		**1,966.2**	**8.8**	**1,975.1**
Research and development	(149.4)	1.0	(148.4)	0.6	(147.8)
Sales and marketing	(1,015.7)	45.4	(970.3)	1.3	(969.1)
General and administration	(269.3)		(269.3)	0.8	(268.6)
Other income/(expenses), net	4.4		4.4		4.4
Operating profit before acquisition-related amortization (EBITA)[1]			**582.5**	**11.5**	**594.0**
Acquisition-related amortization		(46.3)	(46.3)		(46.3)
Operating profit (EBIT)[2]	**536.2**		**536.2**	**11.5**	**547.7**
Basic earnings per share (CHF)	**6.98**		**6.98**	**0.13**	**7.11**

April 1 to March 31, CHF million	Income statement as reported	Acquis. related amortization	Income statement EBITA separation	Adjustments[3]	Income statement adjusted
					2017/18
Sales	**2,645.9**		**2,645.9**		**2,645.9**
Cost of sales	(777.7)		(777.7)		(777.7)
Gross profit	**1,868.2**		**1,868.2**		**1,868.2**
Research and development	(144.0)	1.1	(142.9)		(142.9)
Sales and marketing	(982.8)	48.3	(934.5)	6.3	(928.2)
General and administration	(265.5)		(265.5)	12.9	(252.7)
Other income/(expenses), net	7.2		7.2		7.2
Operating profit before acquisition-related amortization (EBITA)[1]			**532.5**	**19.2**	**551.6**
Acquisition-related amortization		(49.5)	(49.5)		(49.5)
Operating profit (EBIT)[2]	**483.0**		**483.0**	**19.2**	**502.1**
Basic earnings per share (CHF)	**6.13**		**6.13**	**0.23**	**6.36**

1) Earnings before financial result, share of profit/(loss) in associates/joint ventures, taxes and acquisition-related amortization (EBITA).
2) Earnings before financial result, share of profit/(loss) in associates/joint ventures and taxes (EBIT).
3) Excluding restructuring costs of CHF 11.5 million in 2018/19 to optimize local operations in selected markets and integration costs of CHF 19.2 million in 2017/18 in connection with the acquisition of AudioNova.

Share price development – Sonova versus Swiss Performance Index (rebased)



Share price performance history[1]

	10 years	5 years	3 years	2 years	1 year
Sonova shares	186.3%	52.5%	60.4%	41.8%	29.8%
Swiss Performance Index (SPI)[2]	171.7%	37.1%	35.2%	16.6%	10.3%
Sonova shares relative to the SPI	+14.6%	+15.4%	+25.3%	+25.2%	+19.5%

1) Performance of the Sonova shares and SPI refers to the respective period prior to the last trading day of the 2018/19 financial year.

2) The Swiss Performance Index (SPI) is considered Switzerland's overall stock market index. It comprises practically all of the SIX Swiss Exchange-traded equity securities of companies that are domiciled in Switzerland or the Principality of Liechtenstein.