Company announcement no 2020-07 5 May 2020

Interim Management Statement covering the period year-to-date

Very strong start to the year driven by strong performances in all hearing healthcare business activities
Significant negative growth since mid-March due to severe market impact of coronavirus
Level of unutilised funding facilities significantly expanded on terms similar to terms of existing facilities
Outlook for 2020 remains withdrawn due to continued uncertainty of impact of coronavirus

- Year-to-date, the Group's performance has been extraordinarily mixed as a result of the global coronavirus pandemic. Until mid-March, the Group (excluding EPOS) saw double-digit organic growth significantly above the estimated growth rate of the hearing healthcare market. However, the lockdowns of virtually all our key markets in Europe and North America in response to the spreading of coronavirus have almost completely eliminated the ability to service patients and have had an unprecedented negative impact on the hearing healthcare market since mid-March. We estimate that the global hearing aid market is currently seeing a sales run rate of around 20% of what we would normally expect.
- The negative impact on the Group accelerated in most major markets in mid-March, and since then revenue has been approx. 30% of our original expectations (including EPOS). Consequently, revenue and profits have year-to-date been significantly below the levels in the same period last year.
- Our hearing aid wholesale business started the year with double-digit organic growth driven by broad-based success generated particularly by Oticon Opn S and Philips HearLink. However, sales have declined very significantly since mid-March, as lockdowns across the world have forced most customers to temporarily close their clinics or materially reduce their activity level. In the first quarter as a whole, organic growth was roughly flat, but the current revenue run rate is only approx. 20% of our original expectations.
- In our hearing aid retail business, the year started with strong organic growth driven by Europe, particularly by France where comparative figures were low as a result of the negative effect last year of the new hearing healthcare reform. However, the lockdowns of almost all our markets have led us to temporarily close the vast majority of our shops and the impact has been severe. The current revenue run rate is approx. 20% of our original expectations.
- In Hearing Implants, the continued success of the Ponto 4 sound processor helped drive exceptionally strong growth in our bone anchored hearing systems (BAHS) business until mid-March, whereas growth in our cochlear implants (CI) business was slightly negative due to lower-than-expected sales in France. Coronavirus has had a very negative impact on both businesses since mid-March, particularly on the CI business, and the current revenue run rate is approx. 20% of original expectations.
- Our Diagnostics business started the year with strong and broad-based organic growth, and even though the impact of coronavirus has been significant, the orders placed in past periods and a recurring stream of revenue from services and disposables have supported the business. Year-to-date, organic growth has – despite the impact of coronavirus – been slightly positive thanks to the strong start to the year. However, the current revenue run rate is only approx. 60% of our initial expectations.
- Communications (EPOS) faced supply chain headwinds in the first months of the year, which hampered sales. However, sales have since then accelerated significantly driven by Enterprise Solutions, which has benefitted from the working-from-home trend that has followed in the wake of coronavirus. The current revenue run rate for EPOS is approx. 120% of our initial expectations of strong double-digit growth.
- Year-to-date, the Group's gross profit margin has been below the same period last year. This is to a large extent caused by expected dilutions due to the consolidation of EPOS and an increasing share of sales of rechargeable products. In April, we started to reduce our production level, and with a lower coverage of fixed costs in operations, the gross profit margin will temporarily see significant headwind until the production level normalises, despite actions taken to reduce costs at our production sites.

Demant A/S
Kongebakken 9
2765 Smørum
+45 3917 7300
info@demant.com
www.demant.com
CVR 71186911

- In terms of OPEX, we saw low double-digit growth until mid-March of which organic growth accounted for around half and the other half was attributable to the consolidation of EPOS and to acquisitions. Since then, we have taken numerous actions to reduce our costs. These include significant savings in staff costs due to the availability of publicly funded salary compensation schemes in most major markets as well as savings due to significantly reduced sales and marketing activities, mainly in Hearing Devices and Hearing Implants. At this point in time, the OPEX run rate is around 60% of our original plans. The savings are obtained in both distribution costs and administrative expenses, whereas R&D costs are deliberately kept more in line with our original plans.
- As a result of our strong start to the year, the free cash flow has year-to-date been positive, but after acquisitions and share buy-backs, the net cash flow has been negative. We expect a significant negative impact on cash flows in the coming months, and available credit facilities have been expanded considerably since the beginning of the year. As of today, unutilised credit facilities and other available liquidity amount to around DKK 6.0 billion compared to around DKK 2.1 billion at the beginning of the year. The Group's debt to credit institutions with maturity in 2020, which excludes rolling short-term bank facilities, amounts to DKK 1.0 billion compared to DKK 2.0 billion at the beginning of the year.
- As previously communicated, we believe that the negative impact of coronavirus will be temporary, and we see no changes to the fundamental drivers of demand for hearing healthcare products and services. However, we believe that the hearing healthcare market will only see a gradual recovery, which will likely carry over into 2021. Uncertainty as to whether any pent-up demand will start materialising in 2020 has increased over the last couple of weeks due to the fact that it has taken longer than initially expected to re-open society after the lockdown.
- The Group's outlook for 2020 was withdrawn on 15 March as a direct consequence of coronavirus, and we still lack visibility when it comes to the duration of the lockdown in individual markets and the pace of the subsequent recovery. Consequently, we are still not able to provide a financial outlook for 2020.

"The Demant Group entered 2020 on a very positive note with high growth rates and market share gains in all hearing healthcare business activities. However, our good momentum came to a sudden halt when the hearing healthcare market almost completely stalled with the outbreak of coronavirus. Governments' restrictions to prevent the spreading of the virus have particularly affected the elderly, who are staying at home. We make a huge effort every day to serve customers and users in the best possible way with remote services, and in countries that are open, we meet people with safety procedures as well as innovative solutions for delivering our services and products. But the situation for the Group is very challenging as we are facing a long road towards normalisation. It is difficult to estimate the time horizon, but it could carry over into 2021, and we are dedicated to doing what we can to get through this as fast as possible – with very high concern for people's well-being," says Søren Nielsen, President & CEO of Demant.

Hearing Devices

Market trends

We estimate that the market growth rate was at the high end of our general expectation of 4-6% unit growth until the outbreak of coronavirus, which had a substantial, negative impact on demand in key markets from around the middle of March. Currently, we estimate that the sales run rate in the global hearing aid market is around 20% of what we would normally expect.

According to statistics from the Hearing Industries Association (HIA), unit sales in the US increased by 0.7% in the first quarter of the year driven by very strong unit growth at the beginning of the year until the outbreak of coronavirus put a halt to hearing care activities in most of the country. The very strong unit growth was driven by increasing sales through managed care channels in the private market and sales to US Veterans Affairs (VA). In the first quarter as a whole, the commercial part of the US market grew by 0.9% and growth in VA was -0.1%. However, we estimate the current run rate to be around 10% of what we would normally expect for the region. No later than in August 2020, the US Food and Drug Administration (FDA) is required to introduce draft legislation to establish a new over-the-counter (OTC) category of hearing aids, but the exact timing has not been confirmed officially yet. Whether or not there will be changes to the timeline due to coronavirus has not been communicated either. We maintain our view that any impact of the new OTC category will be limited.

We estimate that unit growth in Europe was in line with our medium- to long-term expectations of 4-6% in the first two months of the year. Since then, we have seen the market rapidly deteriorating, and we currently estimate the market run rate to be around 20% of what we would normally expect in the region.

In Asia, we saw market lockdowns at the beginning of the year – especially in China – but we have since then seen gradual improvements in market conditions in the region. We do not have definitive market statistics for the region, but we estimate the current market run rate to be around 75% of what we would normally expect.

In many countries, governments have announced plans to partly re-open society, and while we are monitoring the developments closely, it is too early to estimate the impact and duration of the gradual market recovery.

There are no reliable industry statistics available on the development of prices in the global hearing aid market, and given the current market environment, we are unable to accurately estimate the development in average selling prices (ASP) for the hearing aid wholesale and retail markets.

Wholesale

Year-to-date, our hearing aid wholesale business has seen significant negative organic growth. In line with our plans, the business saw double-digit organic growth in the first months of the year, but lockdowns of almost all markets have forced most customers to temporarily close their clinics or materially reduce their activity level. In the first quarter as a whole, organic growth was roughly flat, but we are currently seeing a revenue run rate of only approx. 20% compared to our original plans. While our customers have materially reduced their activity level, we encourage and support their use of virtual solutions, such as Oticon RemoteCare, to service the users in the best possible way.

The increased momentum that we saw towards the end of last year carried over into the beginning of this year where we realised very strong, broad-based organic growth in line with our plans up until mid-March despite the fact that a number of our small markets were impacted already at the early stages of the outbreak of coronavirus. Growth was driven by our highly competitive product portfolio, including an increased uptake of Oticon Opn S. Geographically, growth was driven particularly by the US, Germany, France and export sales. Improved mix effects drove a low, double-digit increase in the ASP, while unit growth was solid. We continued to see strong demand for rechargeability, and in February, Oticon launched a new series of mid-priced rechargeable products, Oticon Ruby, which are based on the powerful Velox S platform. The introduction of these products has naturally been impacted by the outbreak of coronavirus, so the products have only generated negligible sales year-to-date. Nonetheless, they are an important addition to our already strong product portfolio.

We continue to broaden the reach of Philips-branded products by adding rechargeability in additional price points as well as by roll-outs in new markets, and at the beginning of the year, we launched Philips HearLink in China and other Asian markets where we saw strong interest due to the unique combination of leading technology and a well-known consumer brand that is trusted and recognised all over the world. The planned roll-out and sales in this region have naturally been delayed by the outbreak of coronavirus, but are now beginning to pick up, and we continue to see Philips-branded hearing aids as a meaningful growth driver over the coming years.
We also recently launched new mid-priced rechargeable products in our Sonic and Bernafon brands to meet the increasing demand for rechargeable solutions. Naturally, these launches have also been affected by the outbreak of coronavirus, but they will support our overall growth when we see a normalisation of the market.

Since the middle of March, the global outbreak of coronavirus has triggered a significant deterioration in market conditions, as quick lockdowns of all major markets have severely impacted the hearing healthcare market. In Europe, we saw strong growth rates in many countries before the outbreak of coronavirus, but as a result of widespread lockdowns, organic growth has year-to-date been negative. Italy, France and Spain have been hit the hardest by the outbreak of coronavirus, and sales in these countries quickly dropped to a fraction of what we expected prior to the outbreak. In some countries, including Sweden and the Netherlands, we have not seen the same market deterioration, but in general, the current impact of coronavirus in Europe is severe.

In North America, we had a strong start to the year with very strong organic growth driven by continued momentum in sales to independent customers and strong sales to a large customer in the US. Since the middle of March, we have seen a rapid deterioration in market conditions similar to the one in Europe, albeit with material differences across states. Year-to-date organic growth has thus been negative, and we are currently seeing very limited sales.

The outbreak of coronavirus has also had severe implications for sales in Asia, but the timing and severity have been somewhat different than what we have seen in Europe and North America. In China, we have seen a gradual re-opening of the market in March and April with improvements in sales compared to previous months. We are monitoring the development in China very closely, but current indications suggest a gradual recovery, and it will take some months before market conditions are back to normal.

We had a very strong start to the year in the Pacific region, but market conditions have also deteriorated in this region as a result of coronavirus, albeit so far to a lesser extent than in Europe and North America.

Retail

Our retail business had a strong start to the year with strong organic growth before the outbreak of coronavirus. The lockdowns of almost all our markets have led us to temporarily close our shops or dramatically reduce our activity level, and year-to-date organic growth has been significantly impacted and is thus negative. The current revenue run rate is approx. 20% of our original expectations. In markets where we are unable to meet the users in person, we focus on servicing them in the best way possible at a distance through our call centres, by delivering batteries directly and through virtual solutions, including Oticon RemoteCare.

In Europe, we saw strong organic growth in the first months of the year, which was partly due to weak comparative figures as a result of the introduction of the French hearing healthcare reform last year, and partly due to strong performances in a number of other markets. However, most clinics in Europe are currently closed.

In North America, we were slightly behind plans in the first two months of the year, partly due to optimisations of the operating model in stores acquired as part of a large acquisition in 2018 in the US, and partly due to an increasing share of sales through managed care channels. In the rest of our US clinic network, performance in the first two months of the year was in line with the original plans, as productivity gains compensated for a lower ASP due to growth in managed care. Currently, our clinic network in North America is almost completely closed except in a few states that have avoided lockdown.

Performance in the Pacific region in the first two months of the year was in line with expectations in the first two months of the year, as we delivered solid organic growth in Australia despite the anticipated spill-over effect of last year's IT incident. Year-to-date, organic growth has been negative due to the outbreak of coronavirus, although we have kept most of our clinics open in the region.

In many countries, governments have announced plans to partly re-open society, and we are monitoring the developments closely and evaluating on an ongoing basis when and where it is safe to open our clinics. We are therefore preparing our clinics to ensure that they work optimally and meet the increased safety and health precautions required when we re-open the shops.

Hearing Implants

Our Hearing Implants business activity has seen negative organic growth year-to-date. Growth in the CI business was slightly negative at the beginning of the year due to strong comparative figures, lower-than-expected sales in France and the timing of tender sales. Since the middle of March, the outbreak of coronavirus has caused a postponement of most elective surgeries, including hearing implants, in almost all markets, and we are currently seeing very little commercial activity. Our CI production facilities in Nice, France, are temporarily closed as a precautionary measure related to coronavirus, but we have sufficient stock to meet short- to medium-term demand, and we continue to operate critical service functions to support our clients. At the end of March, we submitted our final application for pre-market approval of the Neuro system in the US to the FDA.

In our BAHS business, the momentum from the second half of last year carried over into 2020, and we saw exceptionally strong organic growth rates at the beginning of the year driven by the Ponto 4 sound processor. The growth momentum was interrupted by the outbreak of coronavirus, and we are currently seeing a significant impact on sales, albeit to a somewhat lesser extent than in our CI business. The current revenue run rate in Hearing Implants as a whole is approx. 20% of our original expectations.

Diagnostics

In Diagnostics, we saw strong organic growth in the first months of 2020, as our momentum from last year continued into 2020. Growth was broadly based across product segments, brands and geographies with US as the primary driver. The outbreak of coronavirus has naturally impacted sales of diagnostic equipment, and we have seen a material slowdown in new orders for instruments and other equipment since the middle of March, which may result in a somewhat lagging effect of coronavirus. Still, orders placed in past periods and recurring revenue from services and disposables have supported the business. Year-to-date, organic growth in Diagnostics has been slightly positive thanks to the strong start to the year. However, the current revenue run rate is only approx. 60% of our initial expectations.

Communications

EPOS, our premium audio and video solutions business for enterprises and gamers, was fully consolidated into the Group with effect from 1 January 2020. Year-to-date, sales, have been slightly ahead of our initial expectations due to a strong uplift in demand in the last part of March and in April after a soft start to the year where EPOS faced supply chain headwinds, which hampered sales. The supply chain situation has now normalised and in contrast to the hearing healthcare market, we have seen a surge in demand for headsets in our Enterprise Solutions segment following the outbreak of coronavirus, as it has led to a significant increase in the use of virtual collaboration tools. Gaming has also seen an increase in demand as a result of coronavirus. Despite a now normalised supply chain situation, we are seeing a significant level of backorders as a result of the high demand, and the current revenue run rate is approx. 120% of our initial expectations of strong double-digit growth.

Other matters

Gross profit and OPEX

Year-to-date, the Group's gross profit margin has been below the same period last year. This is to a large extent caused by expected dilutions due to the consolidation of EPOS and an increasing share of sales of rechargeable products. We have also seen a temporary negative impact of increased shipping costs related to coronavirus. In the first months of the year, we continued to produce hearing healthcare products at close to full capacity to ensure healthy local stock levels in all markets and to mitigate the risk of constraints in our supply chain in this unprecedented situation, but in April, we started to reduce our production output. Consequently, the gross profit margin will due to the lower coverage of fixed costs in operations temporarily see significant headwind until the output normalises. Meanwhile, we maintain strict focus on recalibrating the activity level in production to accommodate lower demand, including actions taken to reduce costs at our production sites.

In terms of OPEX, we saw low double-digit growth until mid-March of which organic growth accounted for around half and the other half was attributable to the consolidation of EPOS and to acquisitions. Since then and in response to the impact of coronavirus, we have taken numerous actions to reduce our costs. This includes significant savings in staff costs due to the availability of publicly funded salary compensation schemes in most major markets and a significant number of employees having been temporarily furloughed or working under similar arrangements. The vast majority of these furloughed employees work in our distribution activities, primarily in retail clinics that are temporarily closed, and some work in administrative functions. Our R&D activities are unaffected. Also, we have significantly reduced our sales and marketing activities, mainly in Hearing Devices and Hearing Implants. At this point in time, the OPEX run rate is around 60% of our original plans. The savings are obtained in both distribution costs and administrative expenses, whereas R&D costs are deliberately kept more in line with the original plans made.

Remuneration to the Executive Board and the Board of Directors

To support the business and the employees in this challenging situation, the Executive Board have voluntarily decided to reduce their salaries by 10% for the remaining part of 2020, and the Board of Directors have decided to reduce their fees by 20% in the same period.

Financial position and share buy-backs

As a result of our strong start to the year, the free cash flow has year-to-date been positive, but after acquisitions and share buy-backs, the net cash flow has been negative. As a logical consequence of the currently low level of revenue generation and an expected delay in payments by customers, we anticipate a significant negative impact on cash flows in the coming months until market conditions approach a normalisation.

The Group continues to have ample access to funding, and in order to ensure some degree of financial flexibility, we have expanded our available credit facilities considerably since the beginning of the year. As of today, unutilised credit facilities and other available liquidity amount to around DKK 6.0 billion compared to around DKK 2.1 billion at the beginning of the year. The Group's debt to credit institutions with maturity in 2020, which excludes rolling short-term bank facilities, amounts to DKK 1.0 billion compared to DKK 2.0 billion at the beginning of the year. We continue to see very strong support from both commercial and non-commercial banks, and financing is still available on terms similar to the terms of our existing facilities. With our current access to funding, we do not foresee any short- to medium-term liquidity challenges. As a result of the expansion of our credit facilities, financial expenses in 2020 will be higher than last year.

Share buy-backs have been suspended since 15 March. Prior to the suspension, the Group had bought back shares worth DKK 197 million.

One-offs related to the consolidation of EPOS

As a natural consequence of the withdrawal of our outlook for 2020, we are also unable to guide on one-offs related to the consolidation of EPOS. However, in the first half of this year, we expect to recognise a material, positive fair value adjustment related to the demerger and a negative revaluation of inventory purchased as part of the demerger. None of these one-offs will have cash flow effects. We also expect to incur one-off costs related to extraordinary spending on the branding of EPOS, which will impact cash flows and are likely to be back-end loaded. In summary, we still expect a positive net effect on reported profit this year, but a negative net effect on cash flows.

Hearing healthcare market outlook

We believe that the negative impact of coronavirus will be temporary, and we see no changes to the fundamental drivers of demand for hearing healthcare products and services. However, we believe that the hearing healthcare market will only see a gradual recovery that will likely spill over into 2021. The duration of the market recovery will depend not only on the timing of the re-opening of society, but also on how quickly people – particularly the elderly population – will start to feel comfortable leaving their homes to buy hearing healthcare services. Uncertainty as to whether any pent-up demand will start materialising in 2020 has increased over the last couple of weeks due to the fact that it has taken longer than initially expected to re-open society after the lockdown.

Outlook for 2020

On 15 March, we withdrew our outlook for 2020 due to uncertainty of the impact of the current outbreak of coronavirus and the resulting changed outlook for the hearing healthcare market. We still lack visibility when it comes to the duration of the lockdown in individual markets and the pace of the subsequent recovery. Consequently, we are still not able to provide a financial outlook for 2020. Thanks to our strong competitive position, we delivered organic growth significantly above the estimated market growth rate until we began to see the effect of coronavirus in mid-March, but we lack visibility when it comes to guiding on our performance for the full year relative to the market.

We maintain the suspension of share buy-backs, pending a better overview of the financial implications of the current situation.

As soon as we are able to properly assess the impact of coronavirus on the hearing healthcare market and the derived impact on our own business, we will release an updated outlook for 2020, and we will publish any material new information as it becomes available.

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Demant will host a conference call on 5 May 2020 at 14:00 CET. To attend this call, please use one of the following dial-ins: +45 3544 5577 (DK), +44 3333 000 804 (UK) or +1 6319 131 422 (US). The pin code is 31432104#. A presentation for the call will be uploaded to www.demant.com shortly before the call.

Further information:
Søren Nielsen, President & CEO
Phone +45 3917 7300
www.demant.com

Other contacts:
René Schneider, CFO
Mathias Holten Møller, Head of Investor Relations
Christian Lange, Investor Relations Officer
Trine Kromann-Mikkelsen, VP Corporate Communication and Relations