

Company announcement no 2020-12

Interim Management Statement covering the period year-to-date

13 October 2020

Continued strong recovery in most hearing healthcare markets supported by pent-up demand
Guidance for revenue growth (including EPOS) in H2 narrowed to 8-13% in local currencies (prev. 5-15%)
Strong profitability so far in H2 supported by both temporary and structural cost savings
New EBIT outlook for H2 of DKK 1,200-1,500 million before negative EPOS one-offs of DKK 85-105 million

- Since publication of our Interim Report in mid-August, revenue for the **Group** has continued its positive trend towards normalisation driven by continued strong recovery in most hearing healthcare markets supported by pent-up demand, even though some important markets and channels have only recovered at a modest pace. Based on the performance so far, we narrow our guidance for revenue growth (including EPOS) in H2 to 8-13% (previously 5-15%) in local currencies. We expect a negative exchange rate effect on revenue of around 3% in H2, including exchange rate hedging.
- Due to the **IT incident** that occurred on 3 September 2019, our comparative figures in H2 are very weak. As previously announced, we estimate that the incident had a total negative impact on revenue of around DKK 575 million in H2 2019 of which roughly DKK 300 million relates to hearing aid wholesale and roughly DKK 275 million to hearing aid retail.
- Since mid-August, revenue in our **hearing aid wholesale business** has continued to recover, first and foremost driven by improved sales in the private market. The activity levels in the two government channels, VA in the US and the NHS in the UK, and in a number of emerging markets are still considerably below normal. For H2, we expect more or less flat growth in local currencies in our wholesale business.
- Our **hearing aid retail business** has continued its strong recovery in most markets since mid-August, and revenue is currently close to the normal level supported by pent-up demand. For H2, we expect growth in local currencies in mid-single digits.
- In **Hearing Implants**, the market has continued to recover at a slow pace, but we have nevertheless seen broadly based improvements in both our CI and BAHS businesses. For H2, we expect less negative growth in local currencies than the run rate level in mid-August.
- Despite difficult market conditions, **Diagnostics** has since mid-August continued to perform well driven by Asia and Europe, whereas sales growth in North America has lagged behind growth in these regions. For H2, we expect slightly positive growth in local currencies.
- In **Communications**, EPOS continues to see very strong demand for its virtual collaboration tools driven by the surge in remote working. For H2, we expect EPOS to contribute by 9-10 percentage points to the Group's total growth in local currencies (7 percentage points in H1).
- While **cost savings** peaked in H1, we have continued to drive material savings in OPEX, and in H2, we only expect low-single-digit growth in total OPEX (including EPOS) in local currencies compared to the same period last year. These savings include both temporary and structural savings of which the latter amount to around DKK 250 million annually.
- In H2, **EBIT** for the Group has so far been strong. Based on this and on the expected revenue growth, we now expect an EBIT in H2 of DKK 1,200-1,500 million before negative EPOS one-offs of DKK 85-105 million (previously DKK 75-125 million). Including the negative EBIT of DKK 193 million realised in H1, our outlook corresponds to an EBIT for the full year of DKK 1,007-1,307 million before EPOS one-offs.
- Our current **cash flow generation** is strong and better than expected thanks to the strong EBIT and to tight working capital management, and we now expect CFFO and FCF for H2 to increase relative to the levels in H1. Share buy-backs remain suspended.
- Our **outlook** for H2 (summarised in the table below) is based on the assumptions of no further wide-spread lockdowns occurring before the end of the year and of total sales in the hearing healthcare market approaching normalisation towards the end of the year on a run rate basis. There are large differences between markets and business areas, and we have seen material support from pent-up demand in some areas while it is still to materialise in others. The recent spike in coronavirus infections in many of our

main markets may, however, pose a risk to our outlook, and in general, the market situation is still more uncertain than usual, but so far, we have not seen an impact on our business.

Growth (in local currencies)	Reported H1 2020 (vs. H1 2019)	Mid-August 2020 run rate (vs. mid-August 2019 run rate)	Outlook for H2 2020 (vs. H2 2019)
Group revenue:	-18%	-5% to 5%	8% to 13%
Hearing aid wholesale	-25%	-15% to -5%	More or less flat
Hearing aid retail	-31%	-10% to 0%	Positive mid-single digit
Hearing Implants	-18%	-20% to -10%	Less negative vs. mid-August
Diagnostics	-2%	-5% to 5%	Slightly positive
Communications (EPOS)	7pp*	-	9-10pp*
OPEX	-4%	-5% to 5%	Positive low-single digit
EBIT and EPOS one-offs (DKK million)			
EBIT before EPOS one-offs	-193	-	1,200-1,500
EPOS one-offs	307	-	-85 to -105

* Contribution to the Group's total growth in local currencies (EPOS was not consolidated 2019).

“Thanks to continued strong recovery in our hearing healthcare businesses and to continued tailwind in our headset business EPOS, we’re more optimistic than previously about the positive development of the half-year. We’ve seen strong profitability so far in the second half-year, supported by tight cost control and the release of pent-up demand, and with the improved visibility, we’re now able to provide an outlook for operating profit that reflects our current strong performance and includes more permanent cost reductions, which means that our Group is well positioned for the future. I’m pleased that we’ve managed to steer well through the crisis, and our employees have done a tremendous job to improve the conditions for this innovative Group of hearing healthcare and audio businesses to enable us to serve our valued customers and users,” says Søren Nielsen, President & CEO of Demant.

Demant will host a conference call on 13 October 2020 at 14:00 CEST. 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 20675505#. A presentation for the call will be uploaded to www.demant.com shortly before the call.

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Financial review

Revenue

After seeing revenue growth of -18% in local currencies in the first half-year, growth for the Group improved significantly in June and July, and as of mid-August, growth was on a run rate basis between -5% and 5% relative to last year, including revenue generated by EPOS (not consolidated in 2019). Since mid-August, revenue has continued its positive trend towards normalisation, driven by continued strong recovery in most hearing healthcare markets where we have seen a positive effect of pent-up demand. However, some important markets and channels have only recovered at a modest pace and have not yet – or only recently – benefitted from pent-up demand. This includes the important US market. On a reported basis, revenue growth increased very significantly in September, mainly due to the negative impact on comparative figures of the IT incident that occurred on 3 September 2019. We have previously estimated that the incident had a total negative impact on revenue of around DKK 575 million in the second half of 2019 of which roughly DKK 300 million relates to hearing aid wholesale and roughly DKK 275 million to hearing aid retail.

Gross profit

In the second half-year, the gross margin has so far improved sequentially relative to the level in the first half-year driven by the recovery in production output and a higher average selling price (ASP) in our hearing aid wholesale business driven by positive mix effects. Relative to the levels seen in prior years, the gross margin is diluted by the consolidation of EPOS and to a lesser extent by an increasing share of sales of re-chargeable hearing aids and higher freight costs.

Operating expenses (OPEX)

Thanks to the significant cost-reducing actions taken in the first half-year, we entered the second half-year at a lower-than-normal OPEX level. We continue to drive material cost savings, and for the second half-year, we only expect low-single-digit growth in total OPEX in local currencies compared to the same period last year, when including the effect of the consolidation of EPOS. Savings are predominantly driven by lower sales and marketing costs, lower travelling expenses and lower labour costs due to headcount reductions carried through in the first half-year combined with fewer new hirings than expected. Savings also include continued global support from government compensation schemes of around DKK 100 million, predominantly in July and August (around DKK 350 million in the first half-year).

As part of our cost-reducing actions, we have implemented savings of a structural nature of around DKK 250 million on an annual basis. These include savings related to the headcount reductions made in the first half-year, which primarily relate to the elimination of double functions after the full integration of a large acquisition completed in the US in 2018. Additionally, we have aligned the marketing model across our US retail network, which has improved efficiency in our sales and marketing activities. The store network remains largely unchanged. Lastly, we expect part of the current savings in travelling and conference expenses to persist going forward as we will convert to virtual ways of meeting and collaborating. The vast majority of the structural savings impact distribution costs, whereas impacts on R&D costs and administrative expenses are only minor.

Operating profit (EBIT)

Due to the strong recovery in revenue combined with both temporary and structural cost savings, the Group's EBIT in the second half-year has up until now been strong. Profitability has developed strongly supported by pent-up demand, which has resulted in a higher-than-normal return on our sales and marketing activities.

Cash flow

In the second half-year, cash flow from operating activities (CFFO) has up until now exceeded expectations thanks to the strong EBIT coupled with tight working capital management. This has contributed to offsetting the negative impact of the low revenue level in the second quarter of the year. We have so far not seen a material negative impact due to late customer payments, but uncertainties about our trade receivables is still higher than usual. Free cash flow before acquisitions (FCF) continues to be positively impacted by the suspension since mid-March of non-essential investments. Relative to the first half-year, we expect both CFFO

and FCF to increase in the second half-year. As far as M&A are concerned, we have seen an increased activity level after a relatively quiet period since the outbreak of coronavirus.

Outlook for 2020

Based on the performance in the second half-year up until now, we narrow our guidance for revenue growth in local currencies to 8-13% (previously 5-15%). Please note that revenue in the comparative period was negatively impacted by the IT incident by an estimated DKK 575 million. We expect growth in the second half-year to be driven by the following:

- Hearing aid wholesale: More or less flat growth in local currencies.
- Hearing aid retail: Mid-single digit growth in local currencies.
- Hearing Implants: Less negative growth in local currencies than the -20% to -10% run rate in mid-August.
- Diagnostics: Slightly positive growth in local currencies.
- EPOS (not consolidated in 2019): Contribution of 9-10 percentage points to growth in local currencies (7 percentage points in the first half-year).

We expect a negative exchange rate effect on revenue of around 3% in the second half-year, including the impact of exchange rate hedging.

Based on the strong profitability realised up until now in the second half-year and on the expected revenue growth outlined above, we now expect an EBIT in the second half-year of DKK 1,200-1,500 million before EPOS one-offs. This range reflects the uncertainty that still exists in our markets. Including the negative EBIT of DKK 193 million realised in H1, our outlook corresponds to EBIT for the full year of DKK 1,007-1,307 million before EPOS one-offs.

We now expect to recognise negative EPOS one-offs of DKK 85-105 million (previously DKK 75-125 million) in the second half-year related to extraordinary spending on establishing the EPOS brand in the market.

We maintain the suspension of our share buy-backs. Year-to-date, we have bought back shares worth DKK 197 million.

Our outlook above is based on the assumptions of no further widespread lockdowns occurring before the end of the year and of total sales in the hearing healthcare market approaching normalisation towards the end of the year on a run rate basis. There are large differences between markets and business areas, and we have seen material support from pent-up demand in some areas while it is still to materialise in others. The recent spike in coronavirus infections in many of our key markets may, however, pose a risk to our outlook, and in general, the market situation continues to be more uncertain than usual, but so far, we have not seen an impact on our business.

Hearing Devices

Market trends

In our Interim Report 2020, we estimated that unit sales in the global hearing aid market had declined by approx. 30% in the first half of 2020. With significant recovery after the lows in April and May, we estimate that unit sales in the third quarter saw negative mid-single-digit growth due to a significant drag from the two large government channels, Veterans Affairs (VA) in the US and the NHS in the UK, which are both recovering at a slower pace than the commercial market.

According to statistics from the Hearing Industries Association (HIA), unit sales in the US declined by 6.3% in the third quarter, with roughly flat growth in the commercial part of the US market of 0.5% and a decline in Veterans Affairs (VA) of 34.5%.

Elaborate market statistics for the third quarter are not yet available, but we estimate that if we exclude the NHS in the UK, which is still operating significantly below their normal activity level, the recovery in Europe is significantly ahead of the recovery in the commercial part of the US market. This is driven by strong growth in

both the large markets, not least in Germany, and in some of the mid-sized and small markets, such as the Netherlands, Denmark and Switzerland.

We also lack available market statistics for Asia, but we estimate that the picture is mixed with solid growth in China and negative growth in Japan in the third quarter.

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 ASPs on the hearing aid wholesale and retail markets.

With regard to the new over-the-counter (OTC) category of hearing aids, the US Food and Drug Administration (FDA) has indicated that it expects that the next Unified Agenda, which will be announced in autumn, will include an update on the expected timing of a draft ruling on the establishment of the new category. Such draft ruling will then go out for consultation before a final ruling can be issued. We maintain our view that any impact of the OTC category will be limited.

Wholesale

After seeing growth of -25% in local currencies in the first half-year due to coronavirus, our hearing aid wholesale business has recovered significantly. As of mid-August, the revenue run rate corresponded to a growth rate between -15% and -5%, and the recovery has continued at a gradual pace since then supported by pent-up demand in a number of markets. For the second half-year, we expect more or less flat growth in local currencies, when we include the negative impact of the IT incident last year on comparative figures.

The recovery has first and foremost been driven by improved sales in the commercial part of the market where sales to independent hearing care professionals are close to normal in most markets. Sales to large retail chains have also seen strong recovery, although some chains are still in the process of ramping up activities after reopening their clinics. In the public market, however, the two large government channels, VA in the US and the NHS in the UK, continue to operate below their normal activity levels despite gradual improvements month by month. Along with a number of emerging markets that are currently heavily impacted by coronavirus, this is a drag on revenue.

From a commercial perspective, growth is driven by Oticon Opn S, which continues to offer industry-leading audiology based on the powerful Velox S platform and on the OpenSound paradigm – an approach to sound processing that remains clearly differentiated from competing products. We also see good traction for the new mid-priced product families that we launched in all brands in February, including Oticon Ruby, which is also based on the Velox S platform. This is not least the case for the rechargeable options, and generally speaking, we continue to see a gradual shift towards rechargeability.

In terms of regions, the recovery has progressed the most in Asia and Pacific where we are seeing particularly strong growth in China driven by the very successful launch of Philips HearLink.

Supported by pent-up demand, revenue in Europe in the second half-year has also seen strong recovery so far driven by a number of markets, including France, Germany, Spain and Italy. However, the UK has remained a drag on the region with significantly lower-than-normal sales to both the NHS and the private market.

In the second half-year, revenue in North America has so far only improved gradually and at a slower pace than in Europe. This is mainly due to slow recovery in sales to VA in the US, but we are also seeing a continued impact of coronavirus in some parts of the commercial market in both the US and Canada.

Retail

Our hearing aid retail business saw growth of -31% in local currencies in the first half-year due to coronavirus. However, revenue recovered significantly in June and July as lockdown restrictions were eased, and as of mid-August, revenue growth was between -10% and 0% relative to last year on a run rate basis. The recovery has continued since then, and revenue is currently close to normal. For the second half-year, we expect mid-single-digit growth in local currencies, consisting mainly of organic growth but also of minor acquisitive growth. This includes the negative impact of the IT incident last year on comparative figures.

In the second half-year, the strong recovery has so far been supported by pent-up demand by hearing aid users that were not serviced during the widespread lockdowns in the first half-year. This has led to an increase in the share of business from existing users relative to new users and resulted in a higher-than-normal return on our sales and marketing activities. However, the balance between existing and new users is approaching its normal level, as we have continued to increase our lead-generating activities targeted at new users. With very few exceptions, all our retail clinics are currently open, and the total number of test appointments is approaching its normal level, although coronavirus still has a negative impact on store traffic in some local regions.

Geographically, the recovery in the second half-year has so far been strong in our European markets driven by France, Ireland, Spain and Switzerland. Our business in the UK has been slower to normalise but has recently seen strong improvement and is close to normal .

In North America, the recovery of revenue in the US has lagged behind that of Europe, but there are large regional differences and the overall trend is positive. In Canada, organically generated revenue is below normal, but acquisitive growth has contributed to revenue.

Our retail business in Australia has been negatively impacted by new local lockdowns and other restrictions in the state of Victoria in August in response to a spike in infections. Consequently, revenue in the second half-year is so far below normal.

Hearing Implants

Our Hearing Implants business activity has been severely impacted by coronavirus and saw negative growth in local currencies of 18% in the first half-year. Despite gradual improvements in the market after the lows in April and May, the revenue run rate as of mid-August corresponded to a growth rate between -20% and -10%. Since then, the market has continued to slowly recover, and we have seen improvements in both our cochlear implants (CI) and bone anchored hearing systems (BAHS) businesses. For the second half-year, we expect less negative growth in local currencies in both our CI and BAHS businesses than the run rate level in mid-August.

Overall, recovery in the CI market has been slow, as the number of surgeries in most markets is still at a reduced level. Furthermore, many hospitals currently prioritise paediatric patients – an area where we have a relatively lower exposure compared to adult patients. In spite of this, the recovery in our CI business has progressed further since mid-August driven by positive development in a broad range of our markets.

At the end of March, we submitted our final application for pre-market approval of the Neuro system in the US to the FDA. However, due to a delay in the auditing process related to coronavirus, we now expect to be able to access the US market in the second half of 2021 at the earliest. Recently, we published an updated reliability report, showing excellent results for our implants.

Compared to our CI business, our BAHS business has recovered slightly faster due to strong sound processor sales, driven by a combination of upgrades for existing users and the possibility to use soft bands as an alternative to an actual implant. We are also seeing signs of improvement in the sales of implants in our BAHS business, which is an indication that clinics are restarting surgery activities. Since mid-August, growth has thus improved despite very strong comparative figures, and we estimate that we have continued to gain market share.

Diagnostics

Revenue in Diagnostics proved fairly resilient to the negative market conditions in the first half-year with only a modest decline of 2% compared to last year, and as of mid-August, the revenue run rate corresponded to a growth rate between -5% and 5%. Since then, Diagnostics has continued to perform well despite difficult market conditions and has seen continued market share gains. Revenue from the sale of instruments and consumables is still modestly impacted by lower activity levels in some customer segments, whereas revenue generated by our service business has recovered strongly thanks to pent-up demand. For the second half-year, we expect slightly positive growth in local currencies.

Regionally, sales in Asia are at a normal level and sales in Europe are close to normalisation. So far, sales growth in North America has lagged behind growth in these regions in the second half-year.

Communications

In Communications, our EPOS business had a very successful first half of 2020, and in the second half-year, the strong performance has continued. The key driver is still the surge in remote working, which has led to extraordinary demand for virtual collaboration tools in the Enterprise Solutions segment. Our Gaming segment is also seeing tailwind and is thus ahead of the original plans. At the end of the first half-year, we had a certain level of backorders, but we have since then increased production volumes, and since June, the number of backorders has been reduced. For the second half-year, we expect EPOS to contribute by 9-10 percentage points to the Group's total growth in local currencies (7 percentage points in the first half-year).

As outlined above, we expect to recognise negative one-offs of DKK 85-105 million in the second half-year related to extraordinary branding costs in EPOS.