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The information presented in this report is based on publicly available information and information provided by Australian Hearing, Office of Hearing Services and other parties. We have indicated within this report the sources of the information provided. Unless otherwise stated in this report, we have relied upon the truth, accuracy and completeness of any information provided or made available to us in connection with the Services without independently verifying it.

In relation to the forecasts and projections included in the report, we do not make any statement as to whether any forecasts or projections will be achieved, or whether the assumptions and data underlying any such forecasts and projections are accurate, complete or reasonable. We do not warrant or guarantee the achievement of any such forecasts or projections. There will usually be differences between forecast or projected and actual results, because events and circumstances frequently do not occur as expected or predicted, and those differences may be material.

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Procedures and Information

Our work commenced on 23 July 2012 and our fieldwork was completed on 14 September 2012. We have not undertaken to update this report for events or circumstances arising after that date. We have indicated in this report the sources of the information presented.

Distribution

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Yours faithfully

Ronan Gilhawley
Partner
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## Glossary

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<th>Definition</th>
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<tr>
<td>Approx.</td>
<td>Approximately</td>
</tr>
<tr>
<td>A$</td>
<td>Australian Dollars</td>
</tr>
<tr>
<td>A$ m</td>
<td>Australian Dollars in millions</td>
</tr>
<tr>
<td>ABS</td>
<td>Australian Bureau of Statistics</td>
</tr>
<tr>
<td>AH</td>
<td>Australian Hearing</td>
</tr>
<tr>
<td>AIHW</td>
<td>Australian Institute of Health and Wealth fare</td>
</tr>
<tr>
<td>ALD</td>
<td>Assisted Listening Device</td>
</tr>
<tr>
<td>AU</td>
<td>Australia</td>
</tr>
<tr>
<td>BAU</td>
<td>Business As Usual</td>
</tr>
<tr>
<td>CAGR</td>
<td>Compounded Annual Growth Rate</td>
</tr>
<tr>
<td>CAPD</td>
<td>Central Auditory Processing Disorder</td>
</tr>
<tr>
<td>CapEx</td>
<td>Capital Expenditure</td>
</tr>
<tr>
<td>CN</td>
<td>Competitive Neutrality</td>
</tr>
<tr>
<td>CRM</td>
<td>Customer Relationship Management</td>
</tr>
<tr>
<td>CSO</td>
<td>Community Service Obligation</td>
</tr>
<tr>
<td>CY</td>
<td>Calendar Year</td>
</tr>
<tr>
<td>DHS</td>
<td>Department of Human Services</td>
</tr>
<tr>
<td>DoHA</td>
<td>Department of Health and Aging</td>
</tr>
<tr>
<td>e.g.</td>
<td>exempli gratia (for example)</td>
</tr>
<tr>
<td>FFS</td>
<td>Fee-for-service</td>
</tr>
<tr>
<td>FY</td>
<td>Fiscal Year</td>
</tr>
<tr>
<td>GBE</td>
<td>Government Business Enterprise</td>
</tr>
<tr>
<td>KPI</td>
<td>Key Performance Indicator</td>
</tr>
<tr>
<td>MoU</td>
<td>Memorandum of Understanding</td>
</tr>
<tr>
<td>NAL</td>
<td>National Acoustic Laboratories</td>
</tr>
<tr>
<td>NSW</td>
<td>New South Wales</td>
</tr>
<tr>
<td>NT</td>
<td>Northern Territory</td>
</tr>
<tr>
<td>OHS</td>
<td>Office of Hearing Services</td>
</tr>
<tr>
<td>p.a.</td>
<td>per annum</td>
</tr>
<tr>
<td>PBT</td>
<td>Profit Before Tax</td>
</tr>
<tr>
<td>POS</td>
<td>Point Of Sale</td>
</tr>
<tr>
<td>QLD</td>
<td>Queensland</td>
</tr>
<tr>
<td>ROCE</td>
<td>Return On Capital Employed</td>
</tr>
<tr>
<td>SA</td>
<td>South Australia</td>
</tr>
<tr>
<td>TAS</td>
<td>Tasmania</td>
</tr>
<tr>
<td>VIC</td>
<td>Victoria</td>
</tr>
</tbody>
</table>
2 Background

Australian Hearing is a statutory authority constituted under the Australian Hearing Services Act 1991. Australian Hearing was established in 1947 in response to the high rate of hearing loss in returning World War II veterans. In 1996, the Government announced the introduction of a voucher system for hearing services, allowing for greater private sector involvement in the provision of Government funded services. In March 1997, the Office of Hearing Service (“OHS”) was formally established as a unit within the Department of Health and Aging to manage stakeholders and implement reforms. Since the establishment of Australian Hearing the market for hearing services in Australia has experienced significant growth. This has been accompanied by new market entrants and increasing competition. The majority of the market participants are small local providers with a portfolio of a few locations. Recently, the industry has been going through a period of consolidation as larger international providers and equipment manufacturers try to get a larger exposure to the Australian market.

The Office of Hearing Services recently announced policy changes to the frequency of voucher re-issuance which will reduce the volume of vouchers from January 2012 onwards. Due to demographic, economic and policy changes, the outlook is for the fee-for-service (“FFS”) market to grow at a significantly higher pace (~7.1% p.a. from FY13 to FY17) than that of the voucher (~5.5% p.a. from FY13 to FY16) and the CSO (~2.5% p.a. Government funding growth from FY13 to FY17) markets, both currently serviced by Australian Hearing.3

In 2012, the Government announced the expansion of the CSO program coverage to include the 21-26 year old population segment. As such, Australian Hearing was provided the exclusive right to service 21 to 26 year old clients, with a corresponding increase in funding to undertake this.

2.1 Purpose of this report
3 Market overview

The provision of hearing services in Australia occurs via public (Australian Hearing) and private providers. The Australian hearing services industry allows hearing impaired individuals to access services (excluding cochlear implants) through:

- **CSO program**: individuals meeting the requirements to qualify for CSO can receive free services from Australian Hearing, who is the only provider in the CSO market. Australian Hearing receives funding from the Government to provide this service.

- **Voucher program**: pensioners can access free or significantly subsidised services, provided through 208 contracted providers (including Australian Hearing) across 2,344 sites. Of these, there are 860 permanent sites; 1,451 visiting sites and 33 remote area sites that are staffed by 1,479 qualified practitioners.

- **Fee-for-service ("FFS") market**: through the private hearing services market, customers pay for services at full commercial price. Services to the FFS market are provided through all private market participants. Australian Hearing is currently not allowed to participate in this market.

3.1 Hearing services market size and drivers

The Australian market for hearing services (the "Australian Market") represents the total revenue generated from assessments, fittings, audiological case management, rehabilitation services and maintenance services, as well as sales of devices, top-ups and assisted listening devices ("ALDs") to Australian CSO, Voucher and FFS market customers.

The total market for hearing services in Australia is currently estimated to be A$729m in FY12 and A$692m in FY13 and it's expected to grow at ~5.8% p.a. from FY13 to FY17, as illustrated in Figure 1.

It should be noted that estimates of the size and growth in the FFS market, as well as the projected growth in the voucher market, are not readily available. The market size and growth shown below has been estimated by KPMG and then tested with Australian Hearing management, who are of the view that it is reasonable. KPMG undertook a bottom-up market sizing approach and there are no significant variations between KPMG and the Australian Hearing management market estimates.

---

4 Source: Unpublished OHS data as of 30 June 2012.
5 Analysis throughout this document excludes ALD sales due to limited available market information.
The hearing services market in Australia has grown by ~6% p.a. from FY08 to FY12, mainly driven by:

- **Ageing population**: The prevalence of hearing loss increases exponentially with age. The youngest of the Baby Boomer generation (1946-64) are starting to reach the age at which the prevalence of hearing loss tips above 10%. Currently the prevalence of hearing loss in Australia is estimated to be one in six; a figure which is expected to more than double by 2050 to one in four, driven by the ageing baby boomer generation.

- **Population growth and increased detection**: Access Economics estimate the number of children under 15 identified as having a hearing impairment is likely to increase from 10,268 to 11,031 during the forecast period as a result of population growth and increased detection through universal neonatal screening.

Inhibitors to the hearing services market could be technologic innovation and technological changes, which is currently expected to be minimal. There is research being undertaken to find a cure for deafness utilising stem cell technology. If research is successful, the hearing aid market will be negatively impacted. However, such a change is long-term and hypothetical at this stage.

The CSO market is completely funded by the government and Australian Hearing is the only eligible provider to the market. The Government funding for CSO services has grown steadily at ~2% p.a. In 2012, the Government expanded the CSO coverage to include individuals between the ages of 21 to 26. The Government provided an additional A$7m spend over FY12 and FY13 to cover the increase in eligibility. This

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6 Source: Australian Hearing
7 Source: Deloitte Access Economics Superslim model
8 Source: [http://nature.com](http://nature.com), Restoration of auditory evoked responses by human ES-cell-derived otic progenitors
additional funding drives the 11% increase between FY12 and FY13, however growth is expected to return the steady ~2% p.a. increase after FY13.

Even though the total hearing services market in Australia is expected to grow, there is a noticeable shift in growth from the Voucher to the FFS market due to:

- **Increasing portion of self-funded retirees** ineligible for the Voucher Program;
- **OHS voucher issuance policy changes**: OHS announced re-issuance changes of vouchers, from every 2 years to every 3 years, effective as of 1 January, 2012, meaning there would be no vouchers issued during the CY14. OHS encouraged market participants to smooth CY12 and CY13 return customers over the three years from CY12 to CY14. This policy change and voucher life extension from OHS will have a significant impact on the volume of vouchers issued during FY13 and FY14. This is estimated to cause a drop of the voucher market by ~15% in FY13, creating excess capacity in the industry and intensifying the competition. After FY15, the voucher market is expected to return to "normal" growth rates which are lower than historical rates due to the increasing portion of self-funded retirees.

As illustrated in Figure 2 below, even though the voucher market is significantly larger than the FFS market, the FFS market is growing at a higher pace and may surpass the voucher market by 2050 (assuming short term projected growth rates continue).

**Figure 2**: Voucher and FFS relative market size and growth (based on devices fitted)

As illustrated by the figure above:

- the voucher market is larger than the FFS market and has historically grown at a faster rate;
- slow growth in the FFS market has been due to the lower frequency at which customers get re-fitted (voucher customers have historically been fitted
approximately once every 2 years, while FFS customers typically return less frequently);

- the increasing number of self-funded retirees in Australia inflate the growth rate for FFS, which, alongside the recent voucher re-issuance policy changes, will lead to the FFS market growing at higher rates than the voucher market after FY13; and
- the FFS's higher rate of conversion from assessment to device fittings, coupled with higher profit margins, establishes a relatively more attractive market in which to compete than the voucher market.

3.2 Competitive dynamics

The key sources of competitive advantage in the Australian hearing services market are location (i.e. customer convenience) and marketing (i.e. customer awareness). As such, many of the market participants seek to increase their geographic footprint.

The hearing services market in Australia is highly fragmented. There are currently 208 registered service providers that service the voucher market and a small number (exact number is unknown) of providers that service only the private market. Even though the market is highly fragmented, it is also highly concentrated with the top six major participants holding a combined market share of ~62% outlets, as illustrated by Table 1 below.

Table 1: Australian hearing services market participants, Nov-09 and Oct-11

<table>
<thead>
<tr>
<th>Provider</th>
<th>Registered Sites (Nov-09)</th>
<th>Registered Sites (Oct-11)</th>
</tr>
</thead>
<tbody>
<tr>
<td>William Demant (Denmark)</td>
<td>130</td>
<td>149</td>
</tr>
<tr>
<td>Audio Clinic</td>
<td>68</td>
<td>86</td>
</tr>
<tr>
<td>Hearing Life</td>
<td>45</td>
<td>47</td>
</tr>
<tr>
<td>Adelaide Digital</td>
<td>17</td>
<td>16</td>
</tr>
<tr>
<td>Amplifon (Italy)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>National Hearing</td>
<td>87</td>
<td>118</td>
</tr>
<tr>
<td>Australian Hearing (AU Government)</td>
<td>109</td>
<td>111</td>
</tr>
<tr>
<td>Widex (Denmark)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Active Hearing</td>
<td>5</td>
<td>62</td>
</tr>
<tr>
<td>Connect Hearing (Switzerland)</td>
<td>40</td>
<td>44</td>
</tr>
<tr>
<td>Bay Audio (New Zealand)</td>
<td>17</td>
<td>32</td>
</tr>
<tr>
<td>Zail (AU)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Attune</td>
<td>9</td>
<td>20</td>
</tr>
<tr>
<td>Other</td>
<td>307</td>
<td>299</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>704</strong></td>
<td><strong>835</strong></td>
</tr>
</tbody>
</table>

9 Source: Australian Hearing and OHS data
The number of registered service providers in Australia grew by ~5% p.a. from 2000 to 2011, with the number of permanent and visiting sites growing by 9% and 4% p.a. respectively during the same period. Since 2011, the number of permanent sites continued to grow steadily at ~7% p.a. to 2012; however the number of registered providers in the market shrunk from 220 to 208, as illustrated by Figure 3 below.

There are two key themes in the Australian hearing services competitive landscape:

- **Industry consolidation:** key competitors (and international market participants) have been acquiring smaller market participants to create retail conglomerates. This is evident from the recent reduction in registered market participants while the total locations continue to exhibit strong growth (as illustrated by Figure 3).

- **Vertical integration across the value chain:** with device manufacturers leveraging existing Australian market access by buying and consolidating smaller local providers. This is evident in Table 1, which illustrates the market entrance and rapid expansion of two multi-national hearing aid device manufacturers since 2010; William Demant Holding and Amplifon S.P.A:
  
  - William Demant Holding took over Otix Global Inc. Within Australia, Otix Global develops and sells hearing aids under the brand of Sonic and the Hearing Life distributor network. William Demant’s Australian distributor network is branded as AudioClinic. This company is now the largest Hearing Provider in Australia.
  
  - Amplifon S.P.A. acquired 100% of the Australian Group and, National Hearing Care. This company is now the second largest hearing provider in Australia.
3.3 Conclusions

The overall market for hearing service in Australia is projected to grow at ~6% p.a. from FY13 to FY17.

Recent policy changes caused a decline of ~15% in the voucher market in FY13, however the voucher market will return to growth from the rebased lower starting value of FY13. The policy change and resulting market decline in FY13 will create excess capacity in the voucher service providers market.

The FFS market is growing at a significantly faster pace than the voucher market due to the reduction in the proportion of potential customers eligible for a pension and the ability to price services competitively. The FFS market is more attractive than the voucher market due to its higher growth rates, insulation from policy change and better margins.

The overall hearing services market in Australia is highly competitive with strong competition from multinationals and vertically-integrated device manufacturers. Key competitive advantage in the market is location. The total number of outlets in Australia has increased at ~9% p.a. from 2000 to 2012; faster than overall market growth which indicates intensifying competition.
4.2 Business as usual service levels KPIs

When reviewing the BAU performance of Australian Hearing under the status quo, there are numerous non-financial KPIs that have to be assessed alongside the financial performance. Those KPIs were agreed with OHS in the MoU which was renewed in early 2012 and are designed to measure Australian Hearing’s ability to service the CSO market.

Australian Hearing has been meeting all of its KPIs.
Market outlook

As previously outlined in Section 3, the recent change to the frequency of voucher issuance has lead to a 15% decline in volumes in FY13. The overall market for hearing service in Australia is projected to grow at ~6% p.a. from FY13 to FY17. However the FFS market is projected to grow at a faster pace than the voucher market in this period and longer term...
Commercial in Confidence

s.47/47G

Australian Hearing
Advisory
September 2012
The governance structure is the mechanism by which the organisation will be directed and controlled. The optimal governance structure is fundamentally determined by the goals and reasons for existence of the organisation. The governance structure guides the organisation's regulatory requirements and market competitive behaviour and the roles and relationships between the company's management, its board and other stakeholders.

The organisation governance can mitigate conflict of interests between stakeholders, determine the nature and extent of accountability of management and employees and will impact the organisation's economic efficiency.

The current governance structure for hearing services is as provided in Australian Hearing Corporate Plan.

**Figure 11: Australian Hearing governance**

Commercial in Confidence

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Commercial in Confidence

<table>
<thead>
<tr>
<th>Commercially Independent</th>
<th>Statutory Authority</th>
<th>Government Division</th>
</tr>
</thead>
<tbody>
<tr>
<td>Maximum control of the CSO delivery</td>
<td>Requires primary legislation, this has less administrative flexibility and therefore responsiveness to Government, as well as clear accountability to Parliament through the minister.</td>
<td>No ministerial control. Entity’s management, responsible for both setting and meeting performance targets</td>
</tr>
<tr>
<td>Maximum financial autonomy. Can enter transaction, borrow money and invest further permissions.</td>
<td>No financial autonomy, financially tight to the relevant department. Not allowed to hold money in its own account, to borrow money or to invest money.</td>
<td>No administrative flexibility.</td>
</tr>
<tr>
<td>No control of the CSO delivery.</td>
<td>No ministerial reporting requirements.</td>
<td>No control of the CSO delivery</td>
</tr>
<tr>
<td>No control of the CSO delivery process of agreed DHS KPIs.</td>
<td>Can hold money on its own account but no further permissions.</td>
<td>No Government funding</td>
</tr>
<tr>
<td>Can participate in commercial activities.</td>
<td>Complete transparency on the purpose and function.</td>
<td>Complete financial autonomy. Can enter transaction, borrow money and conduct activities without further permissions.</td>
</tr>
<tr>
<td>Vacant positions in the organisation.</td>
<td>Independent entity with maximum commercial flexibility.</td>
<td>Completely independent entity that operates with a completely commercial focus and an intent to maximise profits</td>
</tr>
<tr>
<td>Suitable for functions of government that require close ministerial involvement, direction and responsibility. These include functions such as budget implementation, defence, policy formulation and incident of market failure.</td>
<td>Financially part of commonwealth and require an appropriation authority to support expenditures.</td>
<td>Financially part of commonwealth and require an appropriation authority to support expenditures.</td>
</tr>
<tr>
<td>Financially independent and subject to audit by the auditor general.</td>
<td>Largely reliant on budget funding or raises public money.</td>
<td>Largely reliant on budget funding or raises public money.</td>
</tr>
<tr>
<td>Complies with the Public Service Act and the CSO Act.</td>
<td>Can have commercial or entrepreneurial focus.</td>
<td>Can have commercial or entrepreneurial focus.</td>
</tr>
<tr>
<td>Minimal ministerial control. Minister directs in the performance of functions on general or specific matters. Direction in the actual functions to be performed is defined in the enabling legislation.</td>
<td>Body operates commercially with intent to make a profit. In a competitive environment, has an entrepreneurial focus.</td>
<td>Body operates commercially with intent to make a profit. In a competitive environment, has an entrepreneurial focus.</td>
</tr>
<tr>
<td>Maximum ministerial control. Minister dictates office holders and sets rigid direction about the entity’s functions. Clear application of accountability laws and processes.</td>
<td>Clear rational for the assets not to be owned or controlled by the Commonwealth. Degree of independence from general policies.</td>
<td>Clear rational for the assets not to be owned or controlled by the Commonwealth. Degree of independence from general policies.</td>
</tr>
</tbody>
</table>

19 Source: Governance Arrangements for Australian Government Bodies, August 2005
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Advisory
September 2012

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9 Appendix
B Australian Hearing stakeholder map

Outlined below are the relevant Australian Hearing stakeholders which have been taken into consideration, throughout our analysis

Figure 16: Australian Hearing stakeholder map

---

25 Source: Derived from Australian Hearing Corporate Plan.
s.47/47G
D Case Studies

It should be noted that the comments in the following case studies have been sourced from Australian Hearing management and have not been independently verified by KPMG.

D.1 Expansion into the 21-26 year old market:

Background: The Government announced an expansion of the CSO offering to include individuals between the ages of 21 to 26 years old.

To facilitate a smooth transition, IT systems had to be expanded to accommodate for this new group, sales and marketing had to be modified to target individuals in the group and capacity had to be planned to be able to accommodate the increase in demand.