ANNUAL REPORT **2007**

*I'm just a normal kid with a bit of extra hardware.*

*Jack McLeod*
*Sydney, Australia Age 11*

Celebration of Hearing 25 years

Hear now. And always

Cochlear™

# Cochlear is committed to helping the hearing impaired hear now and always. Through delivering innovative cochlear implant and bone anchored solutions, Cochlear's technologies enable them to interact with the world of sound.

Over the past 25 years Cochlear has changed the lives of more than 120,000 people worldwide. A selection of these recipients and their words are featured throughout this report.

## Recipient milestones

**1982**

**Recipient with first commercial Nucleus® implant**

Graham Carrick, aged 37 years, is implanted with the first commercial Nucleus implant at the University of Melbourne.

**1985 – 1986**

**Research paediatric recipients implanted**

Prof Graeme Clark, AC, inventor of the cochlear implant, with first two research paediatric recipients implanted Scott Smith, 10 years (right) – first child, and Bryn Davies, 5 years (left) – second child.

## Product milestones

**1982**

**First multi-channel cochlear implant system to market**

The first commercially available multi-channel cochlear implant system hits the market featuring the Wearable Speech Processor. First titanium casing technology and 22-channel implant.

**1986**

**First Nucleus 22 cochlear implant**

Developed with a smaller receiver-stimulator device.

## Corporate milestones

**1982**

**Cochlear established within Nucleus Group**

After years of close collaboration between Prof Graeme Clark, AC, inventor of the cochlear implant, and Paul M Trainor, owner of Nucleus Group, Cochlear is established as a division of Nucleus Group.

**1983**

**Cochlear established as a corporate entity**

**Contents**

10,000 CI recipients 1994 | 25,000 CI recipients 1999 | 50,000 CI recipients 2003 | 100,000 CI and Baha recipients 2006 | 2007

### 1988

**Second patient to receive a Baha® in the Netherlands**

Belinda Liebrecht, who received her first Baha implant in 1988, became a bilateral Baha recipient in 1996.

Today, she is one of 35,000 global Baha recipients with the opportunity for continual and economical upgrades for enhanced sound performance.

### 1997

**First paediatric recipient in China**

At the age of 3, Mengwen Kang (Beijing, China) received a Nucleus 22 implant. In 2006, at age 13, she upgraded from her original Spectra speech processor to an ESPrit™ 3G.

### 2002

**Heather Whitestone McCallum, Miss America**

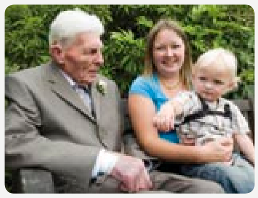
Heather Whitestone McCallum becomes a Nucleus recipient.

She is the first woman with a disability to be crowned Miss America (1995).

### 2006

**First recipient upgrade 25 years on and going strong**

Rod Saunders, now 75 years of age, still enjoys the wonders of sound through continual technological advancements with his processor upgrades to the SPrint™ in 1988 and Nucleus Freedom™ in 2006.



### 2007

**Oldest recipient soon to celebrate his 100th birthday**

At age 83, Jack Walley received his Nucleus 22 implant at the University Hospital Birmingham in 1991. At the time, there was some debate over whether a man in his 80s would really benefit from the expensive technology. Now 99, Jack is physically very well and his implant is working just as good as the day of receiving the implant.

### 1994

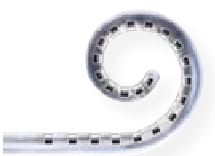
**Spectra processor introduced**

Utilises SPEAK, an improved speech coding strategy.

### 1998

**ESPrit – first multi-channel behind-the-ear (BTE) processor introduced**

A sound processor worn entirely behind the ear, freeing recipients from extra components.



### 2002

**Nucleus 24 Contour Advance™ implant with Softip™ introduced**

Nucleus 24 Contour Advance implant includes the Softip designed to protect the delicate cochlea structures.

### 2005

**Nucleus Freedom featuring SmartSound™**

Nucleus Freedom, the industry's first water resistant processor, offers input processing technologies designed to mimic natural hearing.

### 2007

**Baha Intenso™ introduced**

The Intenso is a headworn device with advanced digital signal processing, extra power and reduced size.

### 1984

**Cochlear: Americas**

Americas office established in Denver, Colorado.

### 1987

**Cochlear: Europe**

European office established in Basel, Switzerland.

### 1989

**Cochlear: Japan**

Cochlear opens office in Tokyo, Japan.

### 1995

**Cochlear listed on the Australian Securities Exchange (ASX)**

ASX

### 2005

**Cochlear acquires Entific Medical Systems AB, manufacturer of Baha® bone conduction implants**

The Baha technology expands Cochlear's implantable hearing solutions to different types of hearing loss such as conductive hearing loss and single sided deafness.

### 2007

**Cochlear streamlines manufacturing**

Cochlear expands manufacturing capabilities through the acquisition of a key supplier's operations.

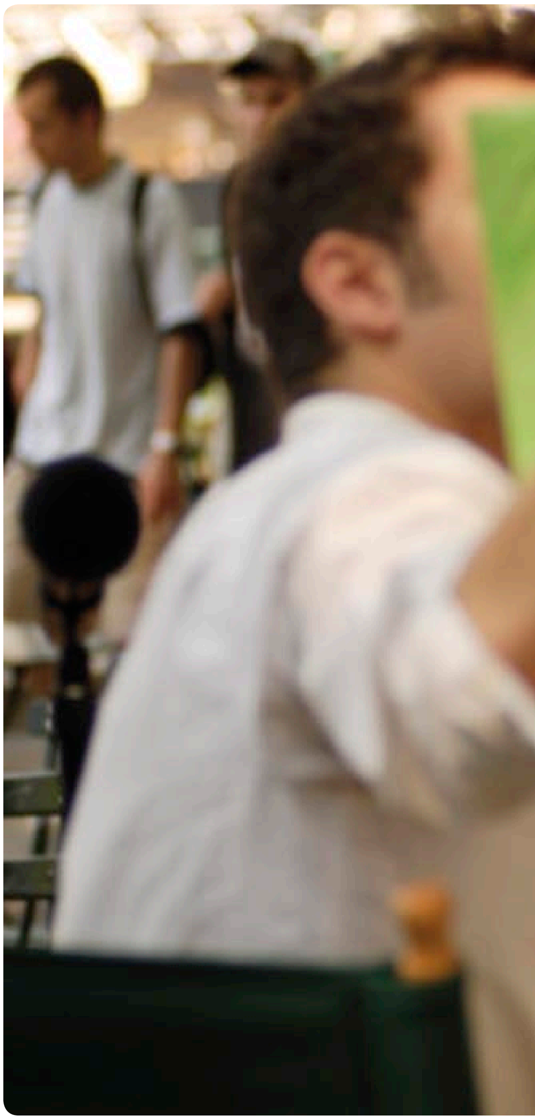
Music and singing are very important to me.
I started when I was 6 years old
and now Jazz is my favourite.

Arnold Baderstscher
Bern, Switzerland Age 64

**Arnold Baderstscher**
Hearing loss in right ear

**First implant**

| | |
|---|---|
| Year | 2006 |
| Age at implantation | 63 |
| Device | Baha Divino |



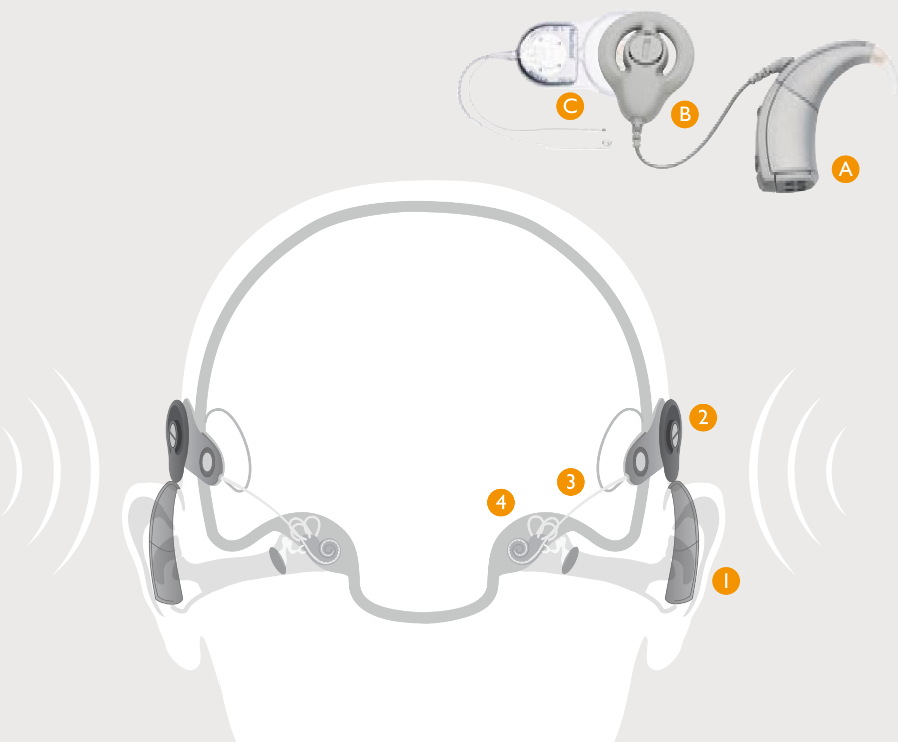
Two ears are always better than one. At Cochlear, we are leading the way in providing binaural hearing solutions for recipients – whether it be bilateral cochlear implants, Baha for single sided deafness or bilateral Baha devices.

Having the ability to hear with a hearing implant is an amazing and life-enriching event for a hearing impaired individual.

However, it is estimated that nearly six out of 10 recipients with a single hearing implant could benefit even more from implantation in the second ear (bilateral implantation). The significant benefits of binaural hearing are contributing to bilateral implants becoming accepted as the standard of care.

Hearing with both ears (binaural hearing) enables optimal use of the auditory system. It enables us to determine the direction of sound and to differentiate between sounds, and increases the quality and comfort of hearing.

Since 2000, the number of bilateral implant recipients worldwide has increased seven fold.[i] This dramatic increase can be explained by the multitude of reported benefits that bilateral implantation delivers to a recipient.




**How bilateral cochlear implant systems work**

Each ear is implanted with a cochlear implant system. The cochlear implant system has both external and internal parts:

- the sound processor A with coil B is worn behind the ear; and
- the implant C is placed just under the skin, behind the ear.

1 The sound processor captures sound and converts it into digital code.

2 The sound processor transmits the digitally coded sound through the coil to the implant just under the skin.

3 The implant converts the digitally coded sound to electrical signals and sends them along the electrode array, which is positioned in the cochlea.

4 The implant's electrodes stimulate the cochlea's hearing nerve fibres, which relay the sound signals to the brain to produce hearing solutions.

**Providing our recipients with binaural hearing improves their overall hearing performance:**

- ability to judge the direction sounds are coming from;
- increased personal safety by localising sounds such as sirens or approaching vehicles;
- increased ability to "tune in" to hear and understand a single speaker despite the presence of competing background noise;
- improved speech understanding in quiet environments;
- significant subjective improved "quality of life" implications;
- less effort is required in stressful listening situations, making the process less tiring;
- ease of listening without having to try and position their "good" ear to the sound source;
- better sound quality (stereo hearing) for more natural and balanced hearing; and
- when there is moderate to profound hearing loss in both ears, implanting both ears can avoid auditory nerve atrophy.[(i), (ii)]

(i) Bilateral Implantation Trends and Directions with Prof Bruce Black, MD, Cochlear Limited, 2007.

(ii) Bosman, et al. Audiometric Evaluation of Bilaterally Fitted Bone-anchored Hearing Aids, Audiology 2001; 40: 158 – 167.

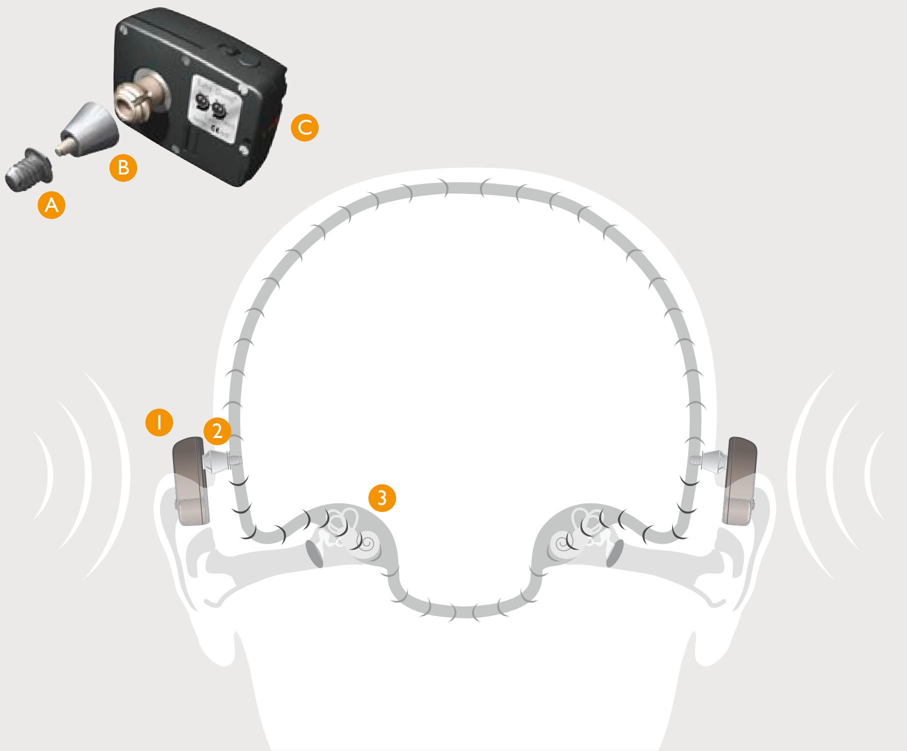
### How bilateral Baha implant systems work

Each Baha system combines a small titanium implant A, a connecting abutment B, and a detachable sound processor C.

1 The sound processor on each ear captures the sound via the microphone.

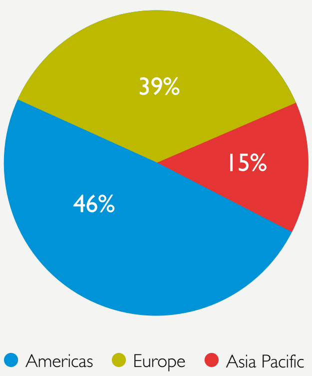
2 The Baha transducer in the sound processor converts the acoustic signal to vibratory force. This vibratory force is sent via the abutment, to the implant in the skull bone.

3 The skull bone provides a direct pathway for sound to travel through bone conduction to the cochlea which in turn relays the sound signals to the brain. While sound is transferred from each Baha to both cochleas, the head transfer function ensures that the interaural timing and loudness differences are preserved thus ensuring that binaural cues are retained.

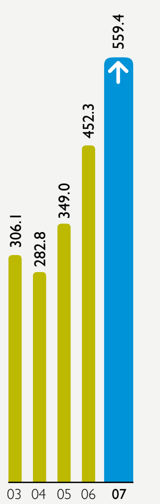


# PERFORMANCE SUMMARY

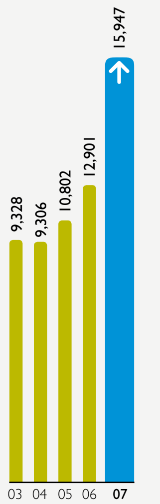
- Revenue for the year was $559.4 million, up 24%, continuing the strong momentum built over the last few years.
- Cochlear implant unit sales grew 3,046 or 24% to 15,947. This was the second highest unit growth on record and was supported by strong bilateral implantation sales.
- Baha sales revenue of $62.7 million was up 23% in constant currency terms. This is ahead of our acquisition targets.
- Earnings before interest and taxes (EBIT) of $150.2 million increased by $38.7 million or 35% and was 27% of revenue, up by 2 percentage points from last year.
- Earnings before interest, taxes, depreciation and amortisation (EBITDA) of $170.9 million and was 31% of revenue, up by 2 percentage points from last year.
- Net profit attributable to equity holders of the parent of $100.1 million increased $20.1 million or 25% from last year. The tax rate of 32% (F06 28%) was impacted by $1.5 million of prior year adjustments. The underlying rate remains approximately 30%.
- Basic earnings per share (EPS) increased by 36.1 cents or 25% to 182.9 cents per share.
- Core earnings (expensing all development costs as incurred and excluding amortisation of acquired intangible assets and share based compensation) were $107.6 million, up $21.2 million or 24% on last year.
- Core basic EPS increased by 38.1 cents or 24% to 196.5 cents per share.
- The directors declared a final dividend of 70.0 cents per share, which will be paid on 27 September 2007. This brings the full year's dividend to $1.25 per share, fully franked, 25.0 cents per share or 25% up on last year.
- The Freedom processor for Nucleus 24 was launched during the year with enthusiastic uptake from our installed base. Already 20% of the Nucleus 24 recipients have upgraded to a Freedom processor. Clinical results for the Freedom system at the 24 month mark are now available and show a significant improvement in speech performance in quiet and noisy situations which has helped drive the sales of the system.
- Bilateral sales are underpinning the growth of Cochlear. Only 5% of our total recipients have bilateral implants; however, we are continuing to promote the advantages of binaural hearing. Bilateral implantation is a long-term trend and will contribute to growth for many years.
- Cochlear continued to roll out infrastructure systems to support ongoing growth. During F07, further investments were made in implementing the Oracle enterprise resource planning (ERP) system in Europe as well as convert manufacturing to Oracle. These will both be implemented in F08 and will complete our major implementation program.
- As part of a three year transformation program, Cochlear has redesigned the supply chain to support future growth. Significant increases in capacity and reductions in lead-times have resulted in improved responsiveness to customers. The program is a target to produce further improvements in cost and productivity.



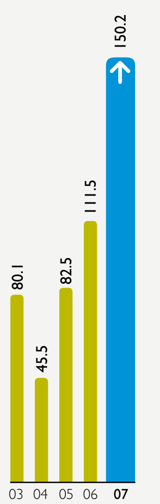
Revenue by segment



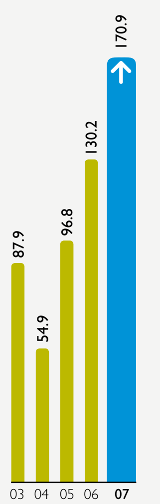
Total revenue ($million)



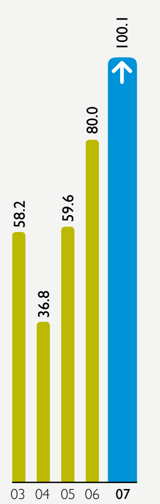
Cochlear implant system sales (units)



Earnings before interest and taxes (EBIT) ($million)



Earnings before interest, taxes, depreciation and amortisation (EBITDA) ($million)



Net profit attributable to equity holders of the parent (NPAT) ($million)

Financial amounts for 2005 to 2007 are in accordance with AIFRS.
Financial amounts for 2003 and 2004 are in accordance with previous GAAP.

# 2007 KEY FINANCIALS

| Year ended 30 June<br>(amounts in $million unless otherwise stated) | 2007 | 2006 | % change |
|---|---|---|---|
| **Income statement** | | | |
| Total revenue | 559.4 | 452.3 | 24% |
| R&D expenditure excluding capitalisation and amortisation | 63.8 | 56.7 | 12% |
| Selling, general and administration expenses | 179.7 | 154.8 | 16% |
| EBIT | 150.2 | 111.5 | 35% |
| EBITDA | 170.9 | 130.2 | 31% |
| Net interest expense | 6.7 | 2.7 | 147% |
| Profit before tax | 143.5 | 108.8 | 32% |
| Income tax expense | 45.8 | 30.6 | 50% |
| Net profit attributable to equity holders of the parent (NPAT) | 100.1 | 80.0 | 25% |
| Core earnings | 107.6 | 86.4 | 24% |
| **Balance sheet** | | | |
| Total assets | 585.7 | 545.9 | 7% |
| Total liabilities | 324.9 | 336.1 | (3%) |
| Inventories | 91.9 | 76.8 | 20% |
| Intangible assets | 196.3 | 205.2 | (4%) |
| Net debt | 115.5 | 109.0 | 6% |
| **Cash flow** | | | |
| Cash flow from operations before changes in assets and liabilities | 149.6 | 115.5 | 30% |
| Net capital and investment expenditure | 37.1 | 14.6 | 154% |
| Dividends paid | 60.4 | 49.1 | 23% |
| **Regional revenue** | | | |
| Americas | 249.8 | 198.2 | 26% |
| Europe | 213.0 | 173.7 | 23% |
| Asia Pacific | 80.1 | 59.7 | 34% |
| **Key statistics** | | | |
| Employees (number) | 1,655 | 1,100 | 50% |
| Gross profit on revenue (%) | 71% | 71% | 0% |
| EBITDA margin on revenue (%) | 31% | 29% | 6% |
| EBIT margin on revenue (%) | 27% | 25% | 9% |
| Gearing ratio (debt/debt and equity) (%) | 43% | 48% | (10%) |
| Net debt gearing ratio (%) | 31% | 34% | (10%) |
| Basic EPS (cents) | 182.9 | 146.8 | 25% |
| Core basic EPS (cents) | 196.5 | 158.4 | 24% |
| Dividends per share (DPS) (cents) | 125.0 | 100.0 | 25% |

# It is my pleasure to report on another successful year for Cochlear, with growth and advancement in all areas of the organisation.

## Strong financial performance

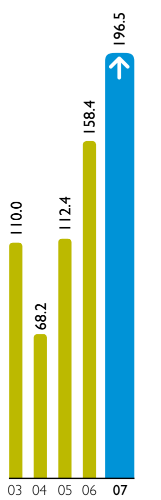
In 2007, Cochlear achieved a record reported profit result of $100.1 million up 25% on last year's net profit after tax.

Total revenue grew 24% to $559.4 million and cochlear implant unit sales grew 24% to 15,974 units. This is the second highest annual unit growth on record.

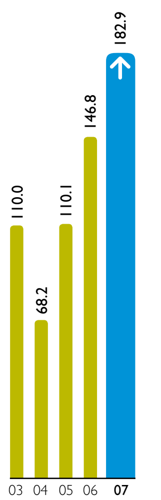
All regions contributed strongly to the result and we now operate in over 90 countries. A major trend developing in the market is the move to bilateral implantation where recipients have an implant in each ear. This is a long-term trend, which will contribute to growth for many years to come. Only 5% of our current cochlear implant recipient base of approximately 90,000 currently has bilaterals, and we will continue to promote the advantages of binaural hearing to our existing and new recipients.

Earnings per share of 182.9 cents increased 25% on last year and return on equity was 43%. Cash provided by operating activities increased $25.3 million or 49% over the prior year to $76.8 million.

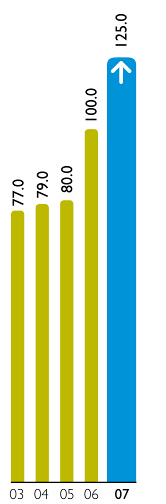
Total shareholder return (TSR) for the year was 14%. Cochlear takes a long-term approach to TSR and for the three years ended 30 June 2007, we were ranked in the top 10 of the ASX 100 companies in terms of TSR.




Core basic earnings per share (cents)




Basic earnings per share (cents)




Dividends per share (cents)

Financial amounts for 2005 to 2007 are in accordance with AIFRS.
Financial amounts for 2003 and 2004 are in accordance with previous GAAP.

Operationally, we have made consistent progress on a number of fronts. The integration of the Entific (Bone Anchored Solutions) business is now complete and sales growth of 21% was ahead of our acquisition targets. The acquisition of Entific has proved to be very successful and value adding.

We continue to make significant progress in manufacturing and supply chain areas and the three year transformation program started in 2005 is on target to produce further organisational improvements.

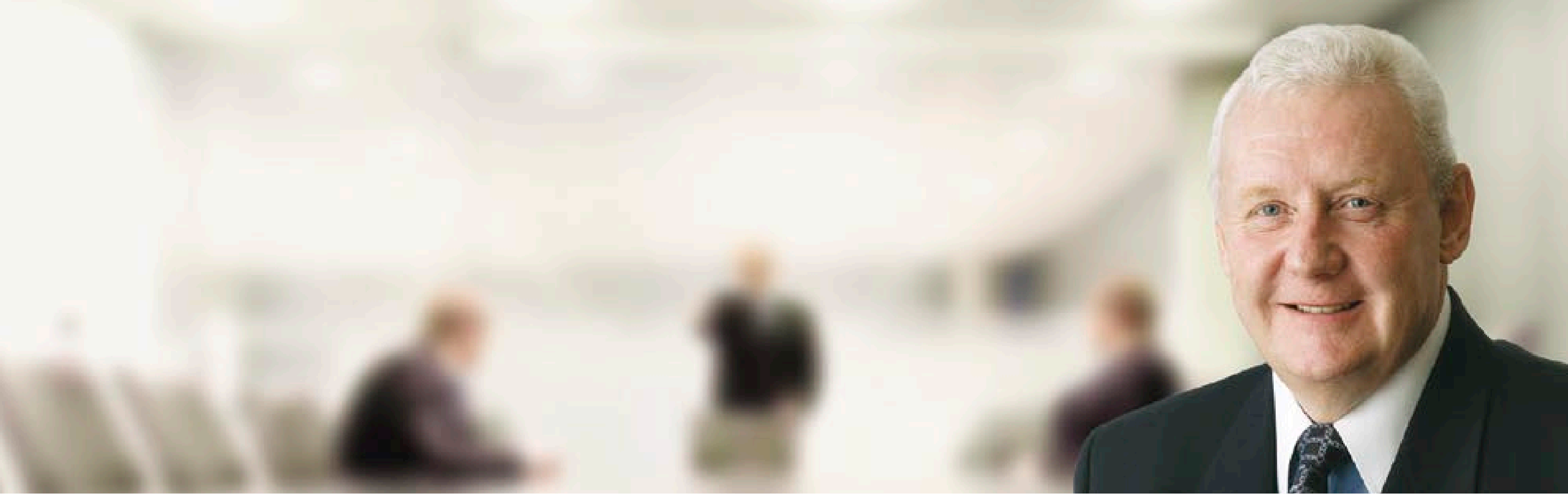
In addition, our major external parts supplier, the Brisbane based Crystalaid Manufacture Pty Limited, was acquired in January 2007. This acquisition increases our control and security of the external parts supply chain and provides additional opportunities for improvements in cost and productivity.

## Foreign exchange

Over 90% of Cochlear's sales and over 50% of total expenses are in foreign currency. This provides a natural hedge on a good portion of the foreign currency exposure. In addition, we manage the balance of the foreign currency exposure by taking out cover on the net foreign cash flows back to Australia. These contracts cover a three year period at a declining level of cover.

The Australian dollar has strengthened significantly during the year, particularly against the US dollar and Japanese yen. Reported foreign exchange gains on our hedge contracts of $16.5 million were down on last year's $20.7 million and the newer contracts are at higher foreign exchange rates.

Over the past four years, Cochlear has continued to manage growth within a rising Australian dollar environment and we are confident that our foreign currency strategy will continue to serve us well in managing a volatile currency outlook.



### Dividend

The year's strong financial performance and an ongoing confidence that Cochlear will continue to grow enabled the Board to increase the final dividend to 70 cents per share, fully franked, making a total for the year of 125 cents. Cochlear's long-term goal is a payout ratio of approximately 70% and this year's dividend is consistent with that.

### Board changes

Ongoing assessment of the Board's competence and experience profiles relative to the challenges we face as a fast growing, global company is a vital part of the corporate governance process. This is especially important for Cochlear, which is a dynamic and international company.

The Board was delighted to welcome Mr Andrew Denver to the Board effective 1 February 2007. Mr Denver has a background in managing international technology businesses, most recently as President Asia for Pall Corporation.

Mr Peter North, AM and Mr Justus Veeneklaas retired at the last AGM. Dr John Parker also retired from the Board on 31 March 2007. These long-serving directors made significant contributions to Cochlear's development. I would like to again thank them and wish them well for the future.

### Corporate governance

As we have reported in previous years, the Board and management have a strong commitment to both transparency and good corporate governance. Cochlear has its own corporate governance framework to ensure compliance and this is refined each year. Our approach is detailed in Cochlear's Corporate Governance Report set out on pages 34 to 41 of this Annual Report.

The Board has again this year actively contributed to the oversight of the group's business, strategy and people development. This has involved reviews at both local and overseas operations.

### Office of Inspector General (OIG) investigation in the USA

As advised in March 2004, our American subsidiary Cochlear Americas received a request for information from the United States Department of Justice (DOJ). The request sought a variety of documents including those concerning Cochlear Americas' relationships with healthcare professionals.

During the year under review, the DOJ passed the investigation on to the OIG for administrative processing.

We will continue to cooperate fully with the OIG, but at present, there is nothing further to report.

### Employees

Cochlear has a dedicated and engaged workforce who will always be fundamental to our ongoing success. Our people form the very foundation of our business strategy and the strong performance during the year was made possible by the commitment and hard work of our 1,655 employees.

On behalf of the Board, I thank my fellow directors, the CEO/President, Chris Roberts, his management team and all employees for their ongoing dedication.

### Outlook

Cochlear continues to be well placed to maintain its strong growth trend.

Our ongoing investment in R&D, marketing, production and infrastructure will support Cochlear's ambitious growth planned for the future.

T. Bergman

Mr Tommie CE Bergman
*Chairman*

# The momentum continues!

## The momentum, with which Cochlear entered F07, was maintained throughout the year.

**Record financial results**

Total revenue for the year increased 24% to a record $559.4 million (compared to $452.3 million in F06). This increase in sales was driven by both an increase in cochlear implant revenues (up 26%) and increase in Bone Anchored Solutions (Baha and Vistafix) revenue (up 21%). Offsetting the increases in cochlear implant and Baha revenues was a 20% reduction in gains from foreign exchange hedge contracts (used to hedge our net foreign currency cash flow) from $20.7 million in F06 to $16.5 million in F07.

NPAT of a record $100.1 million increased 25% over F06, and our key management metric of core earnings was a record $107.6 million, 24% ahead of F06 and ahead of our market guidance of $100 million. Core earnings is defined as NPAT assuming all R&D is expensed, and excluding both acquired intangible assets amortisation and share based compensation. Earnings per share and core earnings per share were $1.83 (up 25%) and $1.97 (up 24%) respectively.

**Nucleus Freedom: setting a new benchmark for hearing performance and implant reliability**

The Nucleus Freedom cochlear implant system was launched in April 2005. Since then, clinical data have clearly demonstrated that patients are hearing better, far earlier than with previous systems, and indeed that hearing performance continues improving beyond where canonical wisdom would suggest. Nucleus Freedom has truly set a new benchmark in hearing performance. In addition, reliability data demonstrate unsurpassed implant reliability. These results underpinned the 24% growth in cochlear implant units sales to 15,947 units.

Nucleus Freedom is a product platform, on which we can expand the product offering. During the year, we launched a range of accessories, including rechargeable batteries and a comprehensive range of paediatric options.

The Freedom for Nucleus 24 was also launched, allowing recipients of one of our prior implant systems (approximately 36,000 patients) to upgrade to the Freedom speech processor. That recipients of previous implant generations can benefit from new technology is a profound demonstration of our lifetime commitment to improved hearing outcomes for our recipients and a key element of the value proposition of receiving a cochlear implant from us. Recipients can benefit from many aspects of the Freedom speech processor, from better hearing performance in difficult listening environments (using the pre-processing strategies known as SmartSound), through to accessing the wide range of accessories. During F08, we will be releasing the Freedom for Nucleus 22, enabling recipients of another earlier implant system, access to Nucleus Freedom.

**Bone Anchored Solutions (BAS): growth and continued investment**

BAS sales were a record $62.7 million up 21% from F06. Since acquiring the Baha and Vistafix™ product lines from Entific Medical Systems AB in 2005, we have accelerated R&D, with an important new product, Intenso launched towards the end of F07. Widening the indications, through technologic advances is an important reason for continuing an aggressive R&D program. The Intenso has a redesigned vibrator (transducer) that is at least 10 times more powerful (i.e. 10 dB more force output) than previous ear-level systems. This extra power means patients with more mixed hearing loss (i.e. including some sensorineural loss, rather than conductive loss only) can be fitted with a Baha.

The Baha and cochlear implant systems do not compete with each other as they are indicated for different types of hearing loss, and are very complementary from a business perspective.

**Bilateral cochlear implantation: accelerating**

The advantage of binaural hearing refers to a range of benefits derived from being able to compare and contrast input from two ears e.g. localising sound, or hearing sound in spatial context. We have two ears for a good reason and being deaf in one ear is a significant impairment.

Cochlear implantation is moving from unilateral implantation (one implant) to bilateral implantation (an implant in both ears) being the standard of care. The clinical results are compelling, and in factors broader than just hearing performance e.g. a child being less fatigued after school who can now comfortably do homework rather than being exhausted just from concentrating listening during the day. In both Europe and the Americas regions, at least 15% of our cochlear implant unit sales are for bilateral implants, and this percentage is increasing. Bilateral implantation is an important reason cochlear implant units sales remain above our long-term average cochlear implant growth rate.

### Growth across all regions

All geographic regions contributed to growth. In constant currency terms (i.e. constant foreign exchange rates), sales in the Americas were up 33%, Europe up 20% and Asia Pacific up 38%. All regions are successfully implementing regional specific growth initiatives.

The Americas growth was driven by the success of Nucleus Freedom and Baha products, as well as the successful launch of the Freedom for Nucleus 24 upgrade. The Americas also expanded its consumer advocacy activities and its service activities around the installed patient base. Its Hear Always activities are reducing the clinics' burden of managing the ever-growing installed base.

The expanded direct market activities of the European region continue supporting growth, and over 70% of European revenue is from countries where Cochlear is operating directly. That said, our distributor activities in Central and Eastern Europe continue expanding as the various economies grow.

Asia Pacific's growth of 38% was particularly strong, underpinned by strong growth across the region, with particular strength in China and India. Last year, we reported on a large philanthropic donation of Cochlear implants for China. It took much of the year for the donation mechanisms to be finalised, and by April surgeries of donated units had started. However, the contribution to growth from the donation units was modest, and there were more non-donation units in China in F07 than donation units. It is appropriate that all steps are taken to ensure the donation program is successful, and the cautious and well thought through approach of the donation program is appropriate.

### Product innovation

Research and development (excluding capitalisation and amortisation of development costs) was up 12% to $63.8 million, representing 11% of revenue. This reflects the opportunity for improving clinical outcomes through technologic innovation. It is the lifeblood of a company like Cochlear. We continue developing a range of implantable devices for the hearing impaired. The four key product areas are: cochlear implants, bone conduction implants (Baha), implants for electro-acoustic stimulation (EAS) and implants for direct acoustic cochlear stimulator (DACS).

The EAS implants are cochlear implants with specially designed electrodes, that when combined with the appropriate surgical technique preserve the delicate structures of the inner ear, consequently preserving residual hearing. Two electrodes, Hydrid S and Hybrid L, are in clinical trials with encouraging results.

The DACS implant was being developed as a joint venture (with Phonak AG). During the year, the joint venture was disbanded, with both parties sharing all costs and intellectual property in such a way that the parties can continue their own development paths. This has delayed the project in the short term, but longer term creates synergies that will be beneficial.

### People

We continue expanding our headcount to support growth – with employee numbers now over 1,600. The passion and commitment of our people make Cochlear special, and we would not have been able to maintain momentum without their dedication. To all employees, thank you.

### Outlook

We ended the year with continuing momentum, which when supported by the entire team's unrelenting passion, gives us confidence about our future ability to help the hearing impaired in a way that delivers sustainable growth for our shareholders. While our focus is on long-term sustainable growth around helping people hear, we also recognise the need to deliver growth each and every year. While 25% more people gained hearing, than did last year, our implantation rate is less than incidence, thus our potential market continued growing faster than we did! At Cochlear, we truly see ourselves as a 25 year old "start-up" company and are confident in delivering growth for F08.

**Dr Chris Roberts**

***CEO/President***

**Revenue – growth momentum continues**

Revenue grew 24% to $559.4 million.

All regions grew ahead of their long-term growth profiles and are well positioned for continued growth. Details of the growth of each region are covered in the regional reports on pages 16 to 23.

Revenue for cochlear implants increased by 26% to $480.2 million. This was driven by a 24% growth in unit sales to 15,947 units. This is the second largest unit growth in the Company's history.

Bilateral implants underpinned this strong unit growth and approximately 10% of all systems sales are now bilaterals. The installed base of patients is driving the growth in bilaterals and we anticipate this will continue to contribute to growth for many years to come.

The release of the backwards compatible Freedom processor for Nucleus 24 was enthusiastically taken up and 20% of the Nucleus 24 patients have now upgraded to the Freedom processor.

**Foreign exchange – impact largely mitigated**

Over 90% of our sales are in foreign currency with nearly 50% in United States dollars and approximately 40% are in European currencies. More than 50% of our expenses are in foreign currency. This provides a natural hedge on a good portion of the foreign currency exposure. To help manage the remaining foreign currency risk, Cochlear maintains an active hedge book in line with a Board approved Foreign Exchange Policy. Details of the forward exchange contracts totalling $453 million as at 30 June 2007 (2006: $389 million) are included in Note 31 to the financial statements.

Foreign exchange gains of $16.5 million on hedged sales were lower than 2006 ($20.7 million) as the rates secured in prior years in line with policy were lower.

The strengthening of the Australian dollar during the year negatively impacted our gross margins but this was offset by manufacturing efficiencies realised from the operations improvement strategy.

**Research and development – continued focus on innovative products**

Research and development costs expensed as incurred increased $7.1 million or 12% to $63.8 million. The increase included additional costs of nearly $2.0 million on the Baha product range as we ramped up research expenditure in line with our strategic intent to accelerate the technological advances possible.

Further progress was also made on the other three areas of development for cochlear implants, the hybrid implant and the DACS program. R&D spend is now 11% of revenue.

**Interest and tax increase**

Net interest expense increased by $4.0 million to $6.7 million. This was largely driven by the increase in the variable interest rate on the loan taken out to acquire the Baha business in 2005, as well utilising

| | 2007 AIFRS | 2006 AIFRS | 2005 AIFRS | 2004 previous GAAP | 2003 previous GAAP | 2002 previous GAAP | 2001 previous GAAP | 2000 previous GAAP | 1999 previous GAAP | 1998 previous GAAP |
|---|---|---|---|---|---|---|---|---|---|---|
| Cochlear implant system sales (units) | 15,947 | 12,901 | 10,802 | 9,306 | 9,328 | 7,845 | 6,482 | 4,941 | 4,128 | 3,507 |
| Total revenue ($million) | 559.4 | 452.3 | 349.0 | 282.8 | 306.1 | 255.0 | 220.1 | 144.2 | 127.2 | 91.7 |
| R&D expenditure ($million) | 63.8 | 56.7 | 44.6 | 44.5 | 37.0 | 37.7(i) | 27.7 | 20.9(ii) | 13.5 | 11.6 |
| EBITDA ($million) | 170.9 | 130.2 | 96.8 | 54.9 | 87.9 | 56.2 | 49.0 | 33.0 | 25.8 | 19.3 |
| EBIT ($million) | 150.2 | 111.5 | 82.5 | 45.5 | 80.1 | 51.5 | 45.5 | 30.4 | 23.1 | 17.5 |
| NPAT ($million) | 100.1 | 80.0 | 59.6 | 36.8 | 58.2 | 40.1 | 31.2 | 20.2 | 16.3 | 13.3 |
| Basic EPS (cents) | 182.9 | 146.8 | 110.1 | 68.2 | 110.0 | 76.6 | 60.2 | 39.6 | 32.3 | 26.6 |
| Core earnings ($million) | 107.6 | 86.4 | 60.8 | 36.8 | 58.2 | 40.1 | 31.2 | 20.2 | 16.3 | 13.3 |
| Core basic EPS (cents) | 196.5 | 158.4 | 112.4 | 68.2 | 110.0 | 76.6 | 60.2 | 39.6 | 32.3 | 26.6 |
| DPS (cents) | 125.0 | 100.0 | 80.0 | 79.0 | 77.0 | 51.0 | 41.0 | 30.0 | 20.0 | 15.5 |
| Closing share price ($) | 61.00 | 54.63 | 39.20 | 22.72 | 32.30 | 34.05 | 39.00 | 28.76 | 12.00 | 6.27 |
| Market capitalisation as at 30 June ($million) | 3,341 | 2,985 | 2,123 | 1,231 | 1,714 | 1,788 | 2,029 | 1,469 | 606 | 313 |
| Number of employees | 1,655 | 1,100 | 982 | 816 | 814 | 722 | 639 | 543 | 432 | 376 |

(i) Excludes $5.2 million acquisition of core technology from Implex AG Hearing Technology.
(ii) Excludes $4.4 million acquisition of core technology from Philips Hearing Implants NV.

additional cash for strategic investments such as the acquisition of a key supplier's operations this year, as discussed on page 91.

The effective tax rate is 32% this year. This reflects $1.5 million of prior year adjustments to tax, largely in our overseas subsidiaries.

### Core earnings – key driver of our business

To assist with an understanding of the accounts, Cochlear has also disclosed movements in core earnings to the ASX at the time of its half and full year announcements. A full reconciliation between reported and core earnings has been provided.

The three key differences between reported and core earnings are that in core earnings:

- all research and development is expensed as incurred;
- there is no amortisation of acquired intangible assets; and
- there is no expensing of share based compensation.

### Balance sheet

#### *Cash*

Cash from operating activities increased $25.3 million or 49% over last year to $76.8 million. However, net cash usage for the year was $17.5 million due to increases in receivables and inventories of $28.7 million as discussed below, progress payments for the acquisition of a key supplier's business of $10.0 million and dividend payments to shareholders of $60.4 million.

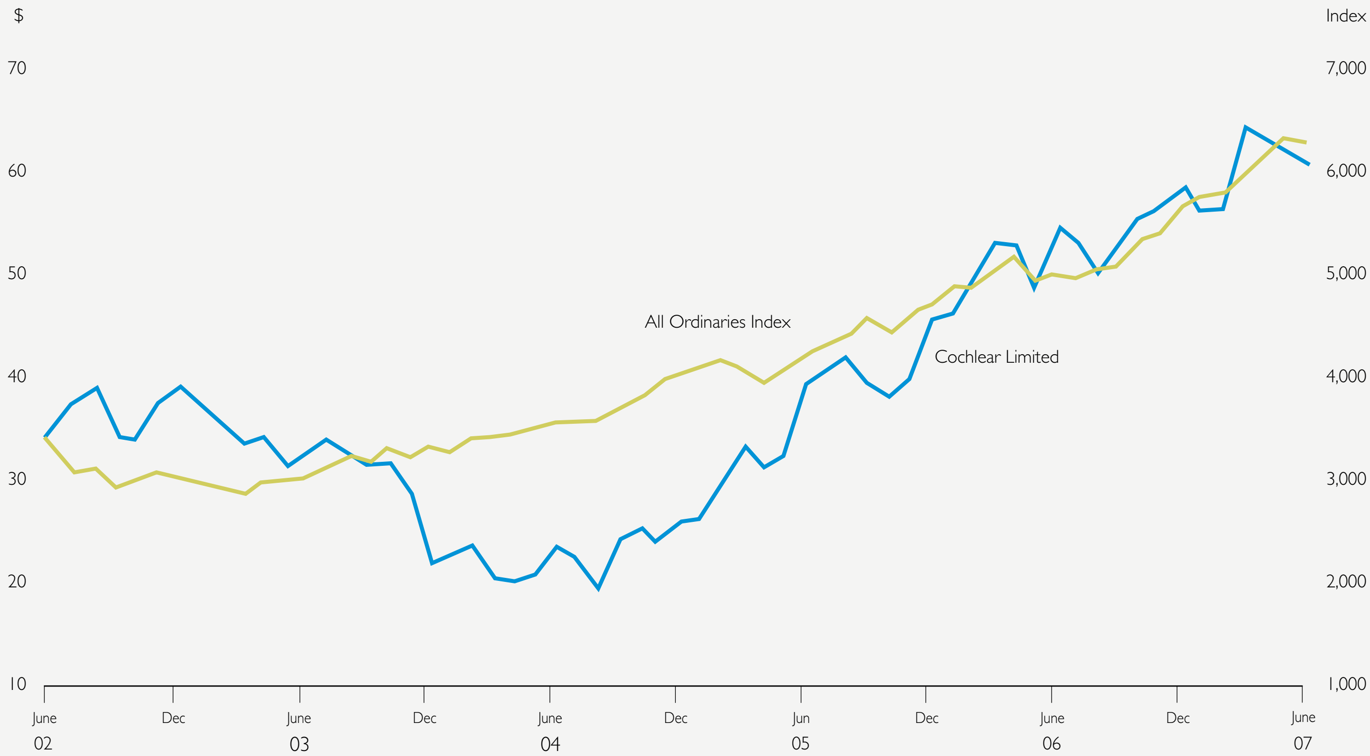
#### *Working capital*

Debtors days were slightly higher at 79 days (2006: 74 days). This is largely a result of going direct in countries with typically longer payment terms and was in line with our revised targets.

Inventories of $91.9 million were higher than the previous year at $76.8 million but the rate of growth is below that of sales. The acquisition of the Crystalaid Manufacture Pty Limited operations also resulted in a one-off $10 million increase in inventories.

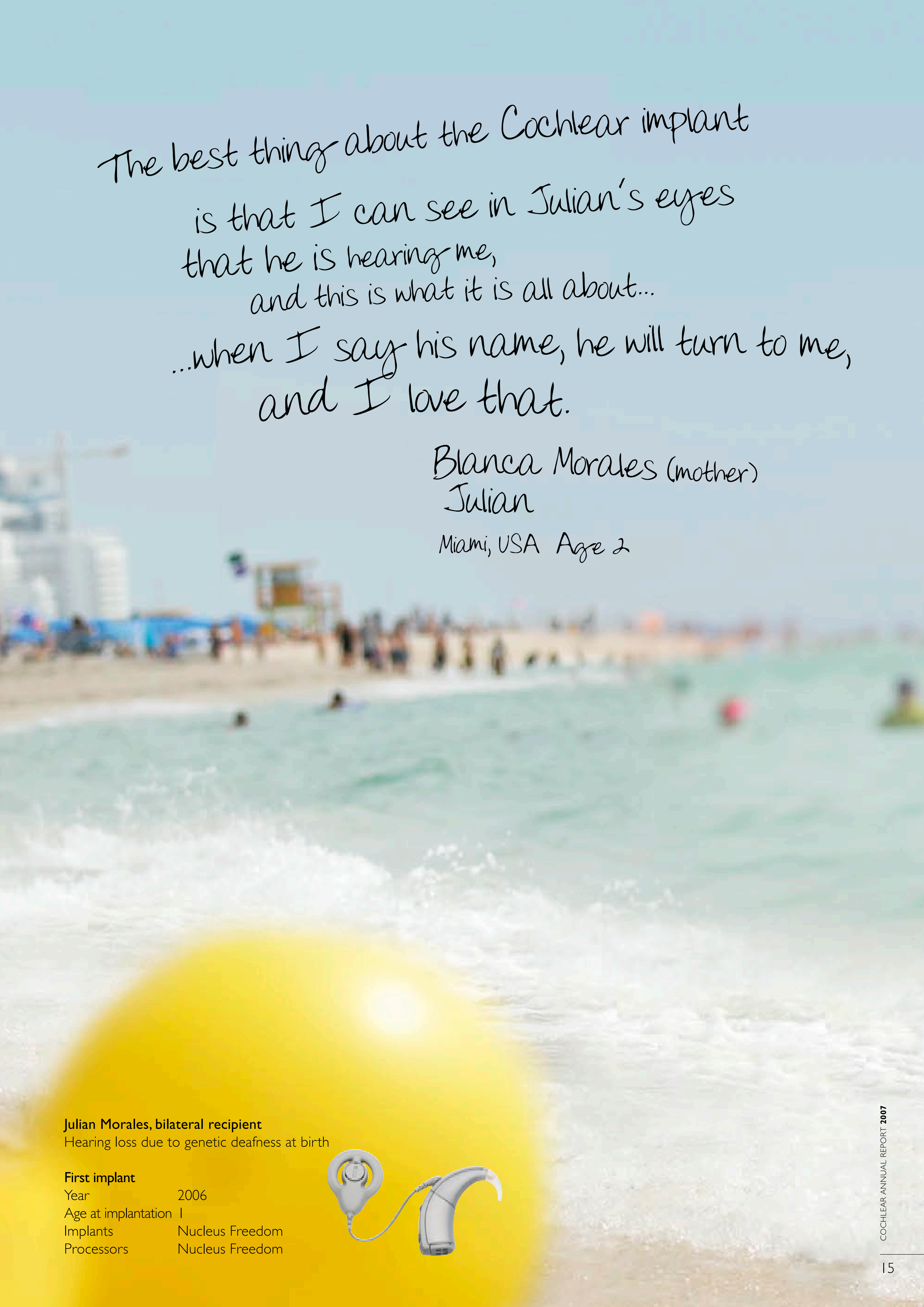
#### *Intangible assets*

Intangible assets of $196.3 million (2006: $205.2 million) decreased predominantly due to the effect of movements in foreign exchange. All intangible assets were tested for impairment and no impairment charges were required.




Cochlear Limited daily average share price vs All Ordinaries Index (accumulated total return)
Source: Australian Securities Exchange


BEACH
BOUND



The best thing about the Cochlear implant
is that I can see in Julian's eyes
that he is hearing me,
and this is what it is all about...
...when I say his name, he will turn to me,
and I love that.

Blanca Morales (mother)
Julian
Miami, USA Age 2

**Julian Morales, bilateral recipient**
Hearing loss due to genetic deafness at birth

**First implant**

| | |
|---|---|
| Year | 2006 |
| Age at implantation | 1 |
| Implants | Nucleus Freedom |
| Processors | Nucleus Freedom |

All geographic regions contributed to the strong growth during the year. Revenue increased 26% in the Americas, 23% in Europe and 34% in Asia Pacific. All regions are successfully implementing regional-specific growth initiatives.

## Americas

### Achievement against goals

#### *Growth targets*

Revenue growth of 26% was above the growth target of 20% due to sales of the Freedom processor for Nucleus 24 being ahead of targets together with the strong growth in bilateral sales. This growth was made possible by the expansion of the field force last year and positive impact from the Cochlear Awareness Network.

#### *Freedom for Nucleus 24 launch success*

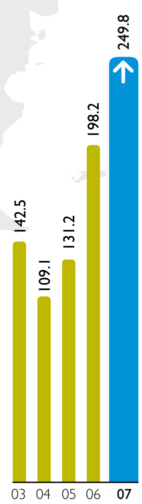
The Freedom processor for Nucleus 24 implant recipients was launched in September 2006. There has been tremendous market response across the entire region for the backwards compatible Freedom processor. To date, penetration is approximately 34% of the Nucleus 24 recipients who could benefit from the upgrade.

#### *Bilateral promotion*

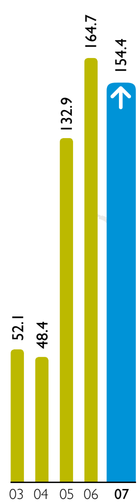
Cochlear continued to promote the benefits of bilateral implants, including sponsoring the first Bilateral Cochlear Implant Symposium during April 2007. Bilaterals accounted for nearly 15% of total implant sales during the year, up from approximately 9% last year.

### Outlook

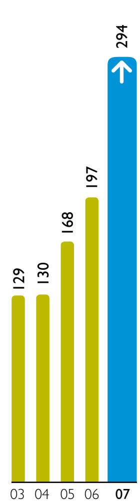
- Maintain profit growth in line with Cochlear's long-term target of at least 20%.
- Launch Nucleus Freedom backwards compatible processor for Nucleus 22 in 2008.
- Continue promotion of the benefits of bilateral implants to recipients and candidates.
- Launch the Baha Intenso processor, including a backwards compatible processor.



Sales revenue ($million)



Total assets ($million)



Employees (number)

Financial amounts for 2005 to 2007 are in accordance with AIFRS.
Financial amounts for 2003 and 2004 are in accordance with previous GAAP.

## Europe

### Achievement against goals

*Growth targets*

Revenue growth of 23% was across the portfolio of countries which make up the European region. This was driven by the growing momentum of bilateral implantations particularly in developed markets, growing awareness and penetration in newer markets and the successful launch of Freedom for Nucleus 24. This is ahead of the long-term growth target of 20%.

*Synergies from Baha integration*

Synergies in the sales and marketing functions were achieved with strong sales growth of Baha products across the region. These synergies and control of overall spending growth in the year contributed to EBIT growth outpacing the revenue growth for the region.

*Define and execute growth strategies*

In 2007, the leadership team further refined their three year strategic plan for Europe. The first set of growth initiatives from this plan were actioned in the second half this year and will go on to form the basis of the business plan for the coming year.

### Outlook

- Maintain profit growth in line with Cochlear's long-term target.
- Implement Oracle ERP system to gain benefits of worldwide integration of systems.
- Strong growth for newly introduced products, including Baha Intenso, Freedom for Nucleus 22 and paediatric kit.
- Strengthen infrastructure and support for both clinic partners and our installed base of recipients.

## Asia Pacific

### Achievement against goals

*Growth targets*

Revenue growth of 34% was above the long-term target. Geographic depth was highlighted by strong sales in China from donation and non-donation sectors, and continued strong growth in India.

*Freedom for Nucleus 24 launch success*

The Freedom processor for Nucleus 24 implant recipients was successfully launched in the major markets where regulatory approval has already been obtained. China and Japan are still to approve the sale of the device.

*Supply implants for the China donation*

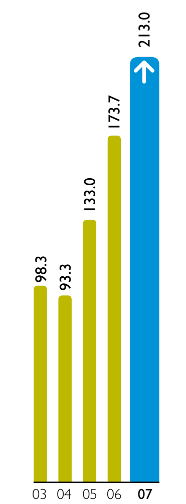
The first shipment of donation units to China was undertaken in the first half of the financial year. This delivery is the first of a contract to supply almost 15,000 cochlear implant systems into the Chinese market over the next six years.

*Meet the requirements of emerging regulatory regimes*

The Asia Pacific region continues to see increased complexity in the regulatory environment. India, Hong Kong and Singapore joined the growing ranks of countries that require country-specific product registration and/or regulatory approval. Cochlear continues to meet these requirements as they arise.

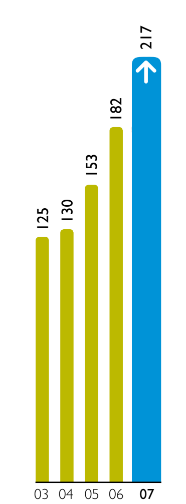
### Outlook

- Maintain profit growth in line with Cochlear's long-term target.
- Develop hearing health infrastructure in China to support the donation order.
- Regulatory approval of Nucleus Freedom in China and Japan.
- Increase bilateral implantation uptake rates in Australasia.

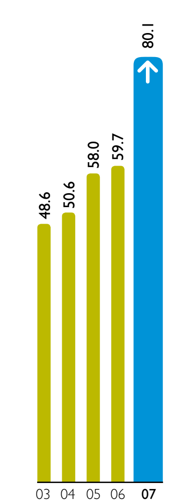



Sales revenue ($million)

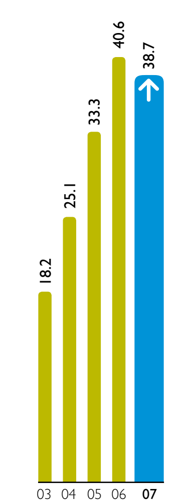

Total assets ($million)



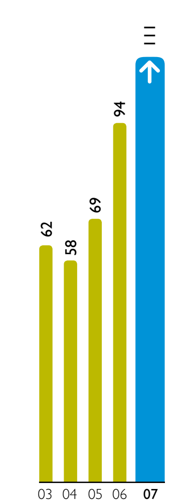

Employees (number)



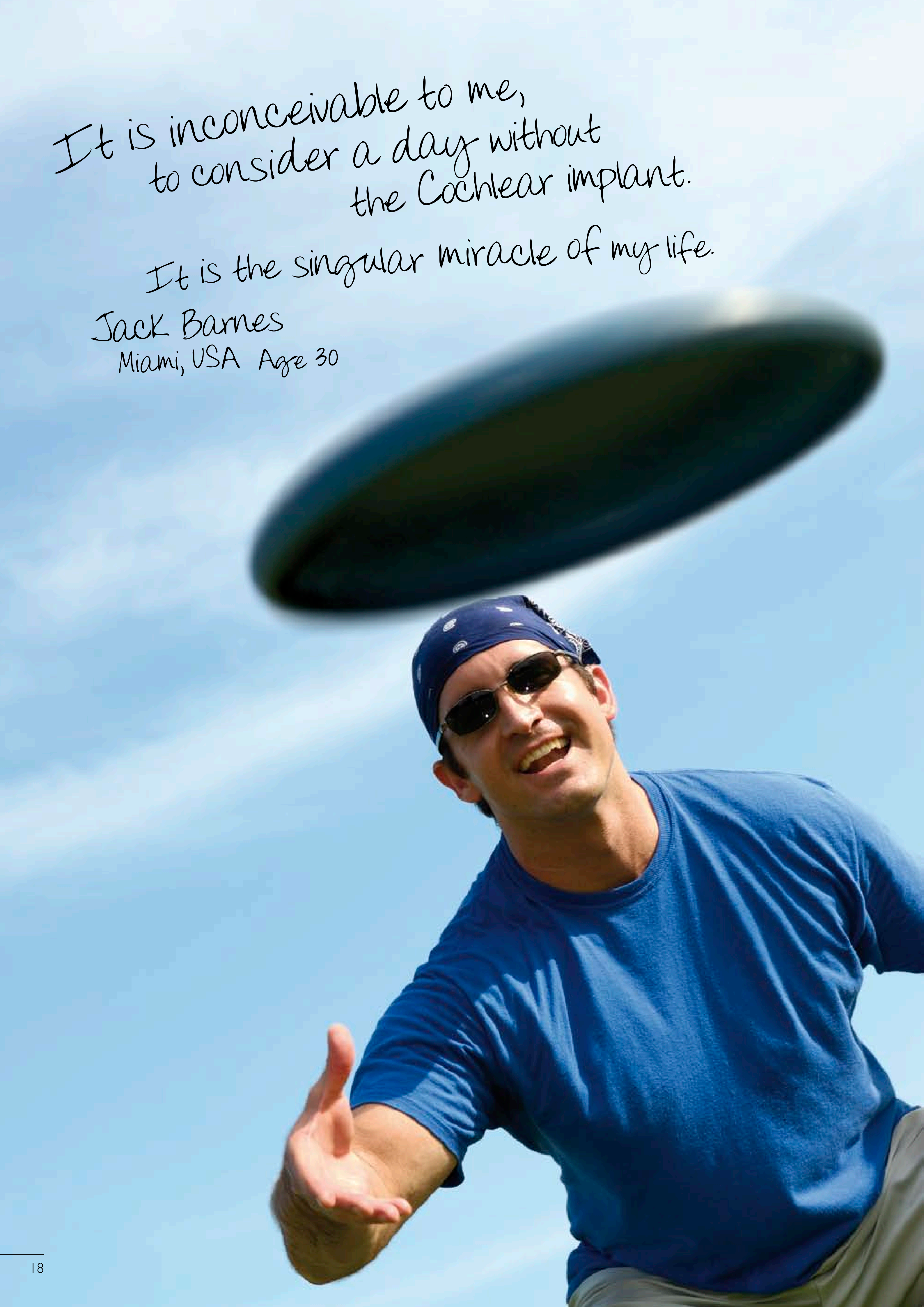

Sales revenue ($million)




Total assets ($million)




Employees (number)



It is inconceivable to me,
to consider a day without
the Cochlear implant.

It is the singular miracle of my life.

Jack Barnes
Miami, USA Age 30

# The Americas region continued its strong growth with revenue up 26% to $249.8 million (up 33% in constant currency terms) driven by the successful rollout of the Freedom processor for Nucleus 24 and continuing growth in bilateral implantation.

**Significant revenue and EBIT growth**

The 26% increase in revenue reflects the strong market uptake of the Freedom for Nucleus 24 launched during the year together with the continued uptake of bilateral implantation. The expansion of the field force during 2006, focus on bilateral implant market growth initiatives, freeing-up of clinic capacity and reimbursement approval for the Baha product all contributed to the 26% revenue and 48% EBIT growth.

**Freedom for Nucleus 24 launch led strong revenue growth**

The Freedom processor for Nucleus 24 was launched in September 2006. The performance benefits recipients have gained from this upgrade underpinned the strong sales. Approximately 34% of Nucleus 24 implant recipients have already upgraded to the Freedom processor.

**The benefits of binaural hearing drove bilateral sales growth**

The Americas region continued promoting the enhanced use of the auditory system that bilateral implantation provides. The improved hearing performance and benefits experienced by bilateral recipients and their promotion have helped drive up sales of bilaterals. In the current year, bilateral implants comprised nearly 15% of total implant sales in the region up from approximately 9% last year.

Cochlear sponsored the first Bilateral Cochlear Implant Symposium, which was held in Charlotte, North Carolina in April 2007. Over 450 clinicians attended the Symposium, which explored the advances in technology, outcomes and reimbursement of bilateral cochlear implants. The Symposium generated considerable interest in bilateral implantation by the clinicians and will likely stimulate demand.

**Advocacy and awareness continuing to drive sales**

The Cochlear Awareness Network was further strengthened in 2007, with the number of volunteer advocates almost doubling in the year. Advocates raise awareness about hearing loss and provide a solid support network for those with or considering a cochlear implant, including their families. Advocates provide an enthusiastic voice, communicating about their life-changing experiences with a Cochlear implant.

The second annual Cochlear Celebration was held in San Antonio, Texas in February 2007 with over 900 Cochlear recipients and their families attending. Prof Graeme Clark, AC, inventor of the multi-channel Cochlear implant, and Rod Saunders, the first recipient, also attended. This energising event presented an excellent opportunity for the Cochlear community to share their life experiences. Cochlear gathered user feedback on products and programs, provided education sessions, recruited volunteer advocates and discussed the importance of awareness development and advocacy. There was considerable interest from the Cochlear community around bilateral implants and the Freedom upgrade programs.

**Strengthening organisational capability with a focus on market development**

Towards the end of the financial year, the Americas region began the next stage in expanding the field organisation. This expansion is aimed at capitalising on opportunities in the hearing aid channel, including hearing aid dispensers. It is estimated that over 300,000 patients with hearing loss in the United States who wear a hearing aid are clinically indicated for, and so would obtain greater benefit from, a cochlear implant or Baha product. The expanded field force will focus on educating professionals on how to identify cochlear implant candidates in the hearing aid channel.

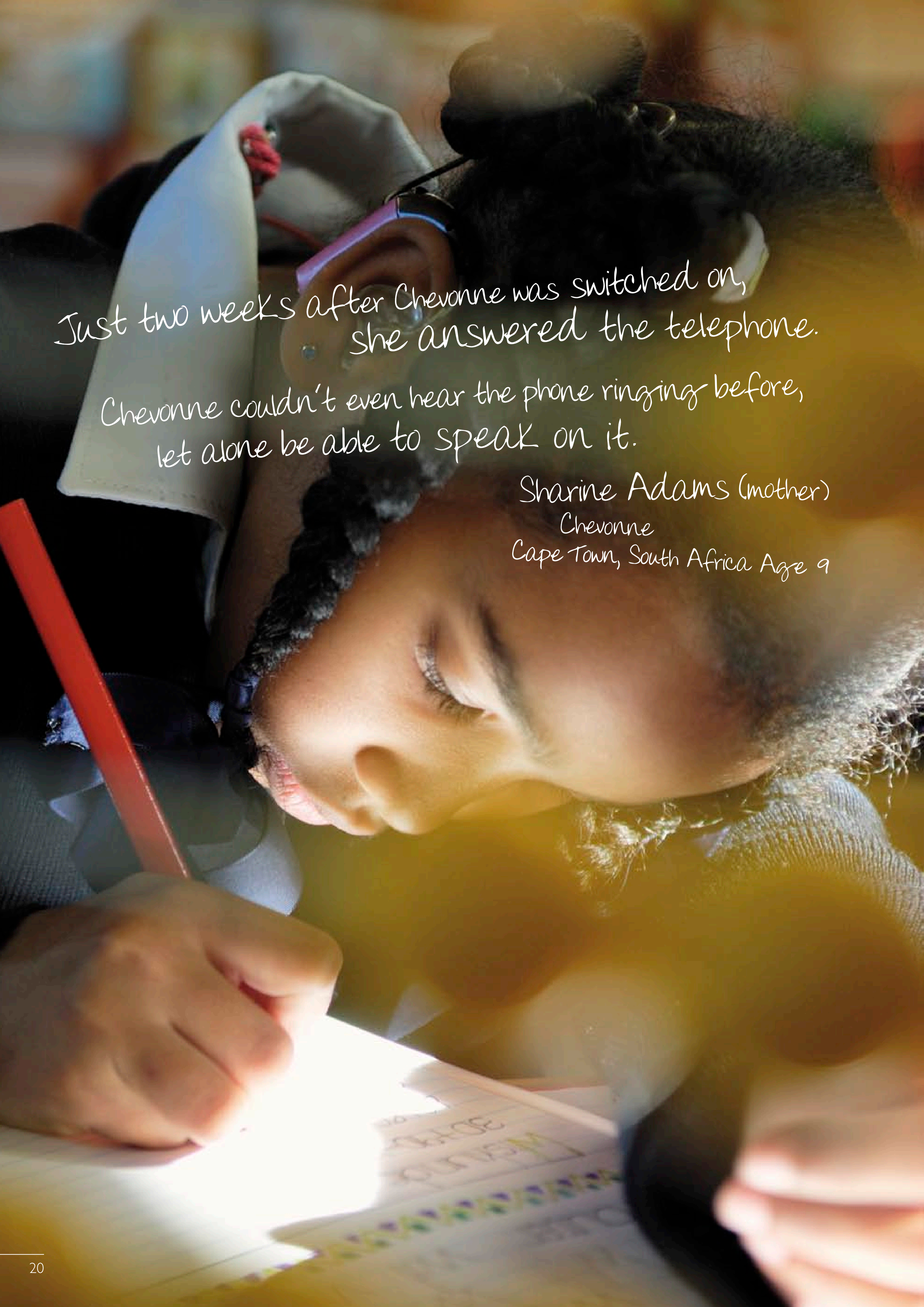
**Expanding clinic capacity through Sound Partnership**

Cochlear Americas launched the Hear Always program as part of the continuous Sound Partnership during the year. This is a first for the cochlear implant industry and is designed to improve clinic efficiencies and enhance patient care. Hear Always is focused on Cochlear providing complete technical support directly to recipients, including processor troubleshooting, recipient tips and techniques, and warranty management and maintenance. We estimate that removing this work from the clinics has the potential to save participating clinics an average of four hours of non-reimbursable time per week. This translates to a material saving of non-reimbursable expenses across clinics nationally. Importantly, it also helps address the clinic capacity restraints.

**Jack Barnes**
Hearing loss was due to meningitis

**First implant**

| | |
|---|---|
| Year | 1988 |
| Age at implantation | 11 |
| Implant | Nucleus 22 |
| Processor | ESPrit 3G |



Just two weeks after Chevonne was switched on,
she answered the telephone.

Chevonne couldn't even hear the phone ringing before,
let alone be able to speak on it.

Sharine Adams (mother)
Chevonne
Cape Town, South Africa Age 9

# The European region continued its strong sales growth, recording revenue of $213.0 million, up 23% from the previous year.

### Continuing strong financial performance

Revenue increased 23% to $213.0 million, reflecting significant sales volume growth across the region and our increased direct presence in many key markets. Bilateral sales grew strongly in many of our markets.

EBIT increased by 39% to $63.4 million, due to the increased revenue, augmented by the positive impact of direct representation in Sweden and Finland.

### Product releases driving strong revenue growth

The Freedom processor for Nucleus 24 was launched in the major markets within the region. Market response has been positive. The release of the Freedom for Nucleus 24 as well as other enhancements such as rechargeable batteries and the mini BTE processor, demonstrate the commitment Cochlear has to its existing recipients.

A paediatric range of product enhancements was launched in the second half of the year. These enhancements include improved fit to a child's ear and tamper proofing and complete our product offering for all age ranges.

The Baha Intenso processor was launched at the end of the year. There has been positive uptake and this is expected to continue into next year.

### Direct distribution brings us closer to our customers

Cochlear's strategy of increased direct presence in key markets continued during 2007, with the first full year of being direct in Sweden resulting in higher revenue growth. Cochlear further extended its direct presence in the Nordics, going direct in Finland in October 2006. There has been positive customer response to this long-term investment and partnership that Cochlear has demonstrated by "going direct" in its key markets.

Being direct in the key markets has allowed Cochlear to get closer to customers with increased product awareness programs, resulting in increased sales and gross margins.

### Using technology to increase our reach and efficiency

The Cochlear Training and Education Centre in Mechelen, Belgium has continued to play a significant role in promoting Cochlear's products in Europe. The Centre provides audiologists and surgeons from Europe and the Middle East with a professional environment for furthering their knowledge of Cochlear products. The Centre began online training during the year, to expand its reach throughout the region.

### Operations and logistics improvements

Cochlear reorganised the structure of its logistics during the year. Specific roles and areas of responsibility were created and all processes reviewed. Significant improvements were made in the demand planning and supply process and quality control over outbound shipments. Key supply relationships were renegotiated to deliver more strategic and efficient agreements. These actions more than doubled the delivered-in-full-on-time metric by the end of the year.

### Organisational enhancements

Synergies from last year's integration of Baha were realised during the year. Further integration occurred this year with the Benelux organisations combining into one location. The final step of the Baha integration will take place next year as the two operations in France are integrated into one business in one location, enabling operations to be streamlined under one roof.

A General Manager for the Nordic region was appointed during the year. This region now has local management for customer and market development and is aligned with increasing the direct presence in Sweden and Finland.

The European region began the implementation of the Oracle ERP system during the year as part of the worldwide rollout. Oracle will go live in Europe in the first half of next year.

### Strategic plan development

During 2006, the European leadership team participated in strategic growth workshops and seminars held at IMD in Lausanne. In 2007, the leadership team started refining their three year strategic plan for the region. The first set of growth initiatives from this plan has been incorporated into the plan for the coming year.

**Chevonne Adams**
Progressive hearing loss

**First implant**

| | |
|---|---|
| Year | 2006 |
| Age at implantation | 7 |
| Implant | Nucleus 24 Contour™ |
| Processor | ESPrit 3G |

Finally at 79
I made the decision
and I am like a different person now,
and day by day my hearing is improving.

Eiko Tanaka
Tokyo, Japan Age 80

# The Asia Pacific region had strong growth, with revenue increasing 34% to $80.1 million. There was strong growth in North East Asia, driven by sales into China and Australasia.

### Outstanding financial performance

Revenue grew 34% to $80.1 million, reflecting significant sales growth in China of 105% from both donation and non-donation sales. Australasian growth was also strong. Sales in India increased 36% albeit from a low base. These demonstrate the geographic depth now achieved in the region and the result of investment in growing the various markets.

EBIT increased by 68% to $20.3 million, due to the impact of increased revenue.

Baha sales grew 18% but still did not have a material impact on the current year's results. There remains long-term potential for growth.

### Successful Freedom for Nucleus 24 rollout

The Freedom for Nucleus 24 was launched in Australasia, South and South East Asia, Korea, Hong Kong and Taiwan. The product release was driven through a direct marketing campaign, "Want more Freedom", that included a range of incentives to mobilise early take-up of the product. Acceptance in the addressable segment has been strong with 20% of Nucleus 24 recipients already upgraded to a Freedom processor.

### Strong growth in China sales and building of infrastructure

The first shipment of donation units to China this year marked the beginning of a six year contract to supply almost 15,000 cochlear implant systems. While delays were experienced as the details of candidacy selection and project administration were agreed between the donor and government agencies, donation surgeries have now commenced, with a waiting list of evaluated candidates.

Cochlear and its Chinese distributors jointly opened the inaugural Cochlear Training and Education Centre in Beijing, which will train up to 500 habilitation therapists over the course of the donation period. Expert resources in audiology and habilitation were also appointed in China to support the development of infrastructure for the donation. The benefits of these infrastructure developments are expected to endure beyond servicing the donation.

The publicity and activity around the donation drove an increase in demand in the non-donation sector, with more units sold in this sector than under the donation. Projections for growth in this sector remain positive.

### Relationship management enhancements

The Sound Partnership program, which focuses on the implementation of a regional relationship management process was launched in the Asia Pacific region. A key aspect of the program saw two of the key centres in Australia participating in a lean clinic initiative, in an effort to address their current constraints on capacity and define a sustainable clinic model to support growth forecast over the next 3 – 5 years.

Cochlear participated in a number of high profile industry meetings during the year. These included the Cochlear Implant Group of India meeting in Calicut, the Shanghai International Conference on Otology and Neurotology, the ENT Conference on Implants and Rehabilitative Otology in Hong Kong and the Bionics and Regeneration of the Ear Conference in Melbourne. Participation at these events provided further opportunities to build relationships and promote Cochlear's product advantages in hearing performance and reliability.

### Advocacy and awareness increasing market demand

The Asia Pacific region extended the reach of its advocacy programs with the launch of the Cochlear Awareness Network, incorporating both cochlear and bone conduction implant recipients. The program has already increased the acceptance and interest in bilateral implantation and will continue rollout next year. Seven new websites were launched to support campaigns to generate candidate enquiry.

### Solid Baha growth

Cochlear assumed direct distribution for Baha sales in Australia on the back of the launch of the new sound processor, Divino, and established new distribution in Korea and Taiwan. The integrated Baha business recorded an 18% sales increase on the previous year with a positive outlook for future growth.

**Eiko Tanaka**
Long-term progressive hearing loss

**First implant**

| | |
|---|---|
| Year | 2006 |
| Age at implantation | 79 |
| Implant | Nucleus 24 Contour |
| Processor | ESPrit 3G |

# Innovative engineering combined with scientific discipline have cemented Cochlear's position as the world's leading supplier of implantable hearing technology.

With continued high standards for quality and reliability, Cochlear remains committed to ensuring that implant recipients have access to ongoing technological advances.

## Global research and partnering

*Making a difference*

Access to international trends and thinking is vitally important in keeping Cochlear abreast of the latest developments in the implantable hearing device field. Cochlear's in-house research and development program is spread across campuses in Sydney, Melbourne, Mechelen, Denver and Gothenburg.

In addition, Cochlear works closely with leading international researchers to understand and develop ground-breaking innovations. Our focus is on clinically relevant research that will result in real improvements in the hearing performance for our recipients and candidates.

*Building processes and capability for the future*

An essential part of our long-term commitment to excellence is to provide the capability and structure to continue world-class research and industry leading developments. Cochlear continues to strengthen its research and development capability. In 2007, we invested 11% of our revenue in research and development expenditure and increased the number of employees by 22 or 11%.

## Four development streams

Cochlear is developing in four streams, which will provide sustainable growth into the future and strengthen our technology leadership in the implantable hearing space:

### 1. Cochlear implants

*Nucleus Freedom setting a new benchmark for hearing performance*

Reliability is a key characteristic of the Nucleus Freedom system, being the most reliable cochlear implant ever produced.

The Nucleus Freedom system was launched commercially in April 2005 and the results of longer-term clinical studies are now demonstrating the full benefits of the product. For example, recipients are achieving superior hearing outcomes faster and better than recipients of any previous cochlear implant system.

Nucleus Freedom has a powerful chip in the external speech processor enabling advanced pre-processing schemes. Cochlear's unique SmartSound input processing analyses sound and is designed to enhance hearing performance in difficult listening environments.

Studies show that more of our recipients choose to use SmartSound as they begin to understand and use the technology. SmartSound also increases the flexibility of the new system and is enabled in the Freedom system via new programming software, Custom Sound™.

*Successful launch of Cochlear implant enhancements*

Further enhancements to the Freedom system and Custom Sound Suite software continue to be launched. Improvements released to the market in the last year include rechargeable lithium ion batteries for the BTE Freedom speech processor, the Freedom Mini BTE Controller, and an integrated FM solution. All of these modifications improve customer usability and performance.

*Cochlear's commitment to a lifetime of hearing improvement*

Cochlear is committed to continuous improvement of its products. This includes applying knowledge learnt from existing products back into a continuous improvement loop.

At Cochlear, an important proposition is our lifetime commitment to recipients. During the year, the backwards compatible Freedom processor was made available to nearly 30,000 recipients of the earlier Nucleus 24 implant. This has been enthusiastically received as 20% of these recipients have already acquired the new Freedom processor. The main benefits of the Freedom processor are improved hearing performance, unique modular design to provide recipients with four wearing options and the world's first water resistant speech processor, making it suitable for all ages and lifestyles.

### 2. Bone anchored solutions

The second stream that Cochlear operates in is the area addressed by the Baha range of products. At the time we purchased this technology in 2005, we said there were exciting technology possibilities for improving both the performance and aesthetics of the Baha product. Good progress continues to be made on these programs and research and development spent on Baha has increased $4.5 million or 241% since F05 to tackle these challenging programs. New products are not expected until at least 2009.

*New Baha Intenso successfully launched*

In the interim, an important range of product enhancements is under development and in April 2007 we launched the Intenso. It delivers clearer sound quality in all types of listening environments plus far less irritation from feedback. The Intenso has been enthusiastically taken up by recipients.

### 3. Electro-acoustic stimulation (EAS)

*Good progress with clinical trials*

Another important area of implantable device research for Cochlear is the development of an EAS system.

This addresses the market where recipients have some residual hearing (usually low frequency), but require electrical stimulation for the higher frequencies. A combination device using a hearing aid and a cochlear implant is currently being developed. Cochlear is developing and trialling two products, the Hybrid S electrode and the Hybrid L electrode.

Clinical trials in the USA have progressed well for the Hybrid S, with almost 100 patients participating. The results to date are that hearing performance in complex listening situations is excellent. The clinical trial for the Hybrid L has been expanded to now include 10 centres. We are anticipating the launch of the EAS product in financial year 2009.

**4. Direct acoustic cochlear stimulator (DACS)**

*Cochlear developing DACS on its own to gain synergies*

Cochlear and Phonak AG mutually agreed to disband the joint venture to develop DACS, effective April 2007. The financial details are provided on page 46. All intellectual property and know-how related to DACS are shared and both companies are able to pursue the technology and product independently.

Cochlear remains committed to developing a DACS product. The separation is a strategic move for Cochlear as developing DACS entirely in-house will allow Cochlear to better exploit the synergies between all four technology platforms.

**Strong product pipeline for the future**

Cochlear has a solid line of products in development to sustain its growth. Future launches include:

- the Freedom for Nucleus 22. This is now in clinical evaluation with the launch expected mid way through F08;
- the EAS product, scheduled to launch towards the end of F08; and
- Custom Sound Suite 2.0. With this application, patient MAPs will be stored on a central online database that service centres and clinics can access, eliminating the need for clinicians to email MAPs to service centres.

The sound when I'm wearing my Intensos is clearer and more distinct than my earlier headworn devices.

I have even travelled around Asia with my Intensos. Even today I still hear new sounds I haven't heard before.

Marianne Hansson Ängelholm, Sweden Age 74

Marianne was one of the recipients involved in the clinical validation of the Baha Intenso in 2005. She is a bilateral recipient of Baha Intenso and has been wearing various Baha devices successfully for over 20 years.

**Marianne Hansson, bilateral recipient**
Hearing loss was due to chronic ear infections

**First implant**

| | |
|---|---|
| Year | 1984 |
| Age at implantation | 51 |

**Second implant and processor upgrade**

| | |
|---|---|
| Year | 2005 |
| Age at upgrade | 72 |
| Devices | Baha Intenso |

# Cochlear's operations strategy is to ensure we have best practice production methods and capacity to meet the growing demand for our products.

We are now half way through a three year operations improvement program focused on implementing "Lean Manufacturing" principles and introducing new technologies.

The first stage is now complete with lean based manufacturing now established in our production facilities in Sydney, Brisbane and Gothenburg. This has ensured scalability and introduced productivity improvements in essential processes.

### Benefits achieved from investment in supply chain

Cochlear has redesigned the supply chain to support future growth. Significant increases in capacity and reductions in lead-times have resulted in improved responsiveness to customers.

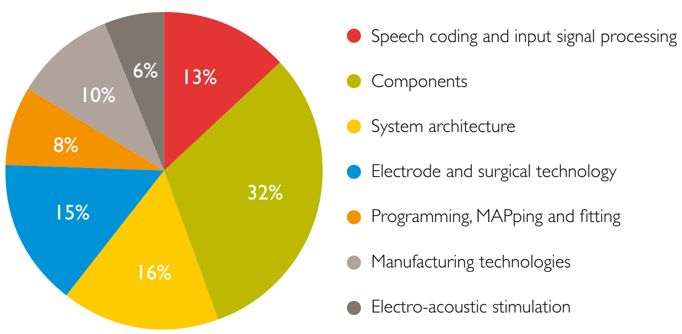
Major suppliers participate in regular operational reviews to ensure they are building the capacity and capability necessary to support our future growth and technology ambitions.

In January 2007, Cochlear acquired the Cochlear related manufacturing operations and assets from Brisbane based company, Crystalaid Manufacture Pty Limited, for approximately $19 million. The acquisition was part of a redesign of Cochlear's global supply chain and increases our supply chain flexibility and builds internal capability and capacity for future growth.

### Improvements in operational capability

The manufacture of our implantable hearing devices is a core competency and a source of sustainable competitive advantage to Cochlear. All key products are manufactured for worldwide distribution at three locations, two in Australia and one in Sweden, with almost 800 people employed in manufacturing and quality assurance globally.

We substantially upgraded our record keeping capability by implementing Windchill, an industry standard product lifecycle management system to manage product development configuration requirements. The system went live in April 2007 with over 4,000 parts and 10,000 documents now electronically stored.




Distribution of Cochlear's patents by technology

### Highest quality commitment

Cochlear has a worldwide quality management system in place to assure the highest quality for its products and services. This system complies with the applicable regulatory requirements around the world including in the USA and Europe. The regulations are enforced and confirmed by inspections and audits by independent authorities. Cochlear is fully compliant with these regulations.

Cochlear operates in a highly regulated environment with new regulatory bodies continually being created. We actively participate in the Global Harmonization Task Force, whose aim is convergence in regulatory practices related to ensuring safety, effectiveness and quality of medical devices on a global basis.

### Device approvals process

The relevant regulatory authorities must approve all medical device products prior to our marketing them. The approval process varies greatly by country and in certain jurisdictions can take several years. The process typically involves supplying details of the device, its design and the results of tests, such as biocompatibility and safety together with qualification and clinical trial results.

At present, Cochlear has the necessary licences and approvals for the Nucleus Freedom and Baha to enable it to conduct its business in all our major markets.

### Intellectual property

The generation and protection of intellectual property are a key competitive advantage for Cochlear. While there are no "blocking" patents in the cochlear implant field, Cochlear continues to generate key intellectual property in associated fields and holds approximately 700 patents and patent applications worldwide.

Cochlear regularly analyses its existing portfolio of patents and establishes priorities for new patent filings. We work to secure intellectual property at every stage of the product development cycle, from the development of the technology to its final application in products.

**Kimino Sugizaki**
Progressive sensorineural hearing loss

**First implant**

| | |
|---|---|
| Year | 2000 |
| Age at implantation | 32 |
| Implant | Nucleus 24 |
| Processor | ESPrit |

My Cochlear implant gave me back,
not only my hearing,
but my old self.

Kimino Sugizaki
Tokyo, Japan Age 38

# Cochlear employees are passionate about their work and delivering value to our recipients and customers, through products and services that offer leadership and innovation in meeting their needs.

To fulfil our vision of "Hear now. And always", we are building a workforce with continually improving capabilities and developing people related systems, processes and a culture that drives toward continued success. To do this, we are focused on:

### Attracting and keeping the best people

In an increasingly competitive global talent market, positioning Cochlear's unique employment value proposition remains a key priority in not only attracting but also retaining the best people. This year, we have:

- recruited and integrated over 300 new employees globally, building on the existing breadth, depth and diversity of our talent to face the changing needs of our growing business;
- enhanced the assessment process for recruitment of engineers to ensure we attract the brightest and most innovative talent available in the world;
- invested time and effort in developing our succession and talent planning processes, and recruiting globally for key roles;
- continued to build Cochlear's International Internal Transfers program, with 20 employees now on assignment internationally; and
- invested globally in improving the induction and integration processes so that new employees can quickly reach the expected level of performance and build a solid foundation for their long-term career with Cochlear. In Europe and Asia Pacific, we have built common induction frameworks across countries and globally we have improved the toolkits and information we provide to new starters.

Our workforce continues to reflect Cochlear's global approach to business e.g. over 60 nationalities are represented in the Sydney workplace alone. Cochlear promotes this diversity and continues to see benefits from having different cultures and viewpoints in the workforce.

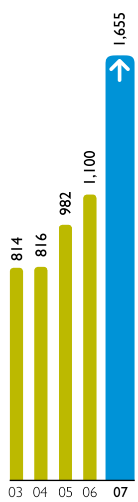
### Providing a workplace where people can achieve their best

The 2006 employee survey was a global initiative that gathered information on organisational strengths and areas of improvement. This initiative focused us on improving internal communication with employees and much work has now been concluded on the improvement initiatives identified in the survey.

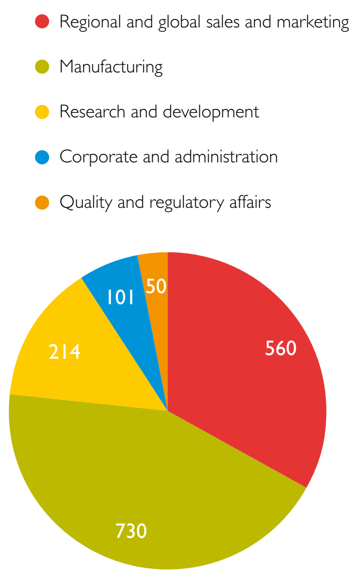
Performance management remains one of the key areas of focus in Cochlear, with a common process and framework being applied throughout the group. We are implementing improved process steps and tools to ensure employees and managers have clear and agreed expectations, documented objectives, and input from multiple sources to help guide the employees' development. On-going coaching remains an essential element of our performance management process.

### The health and safety of employees…

Cochlear continues to be committed to providing and maintaining a safe and healthy workplace for all employees. Occupational health and safety training for new employees and refresher training for existing employees have been improved to build understanding of, and commitment to, workplace safety.



Employees (number)



Employee numbers

There were only 12 injuries for the year, down 25% from last year. Cochlear's injury rate remains significantly below industry standards for the manufacturing industry. A return to work plan is developed for any significantly injured employees, including identification and deployment to other suitable duties wherever practicable and at the earliest opportunity.

There were no serious injuries or deaths again this year in any of our manufacturing sites and offices around the world.

Cochlear understands the benefits of improving the health and wellbeing of its employees and supports initiatives to this end. Manufacturing employees perform pause gymnastics twice a day during their shifts to improve their flexibility and assist with overall wellbeing. Other wellness programs include: an ergonomic consultant assessing workstation layout for individuals; free flu vaccinations; free eye screening; and in-house pilates classes.

### … as well as the environment

Cochlear has led support for an internal group of employees focusing on climate change and environmental impacts, called "Green Force". They are educating employees about environmental impacts and actions that can be taken by individuals and Cochlear to reduce that impact. An independent consultant performed an energy assessment, reporting on energy usage and emissions, including recommendations to reduce emissions. Our total emissions are well below the average for a manufacturing company of our size, owing to the nature of our production processes. Our two biggest areas of carbon emissions are electricity and air travel.

Cochlear participated in the Carbon Disclosure Project (CDP) for 2007. The CDP reports annually on carbon emissions and climate change stances of companies listed in the S&P/ASX 100. Cochlear partnered with Macquarie University's Graduate School of the Environment (GSE) to prepare its submission. The GSE students worked on this project, preparing the submission, comparing the CDP to other environmental initiatives and providing Cochlear with recommendations.

Cochlear is developing initiatives resulting from the recommendations from the GSE project and the energy assessment. Cochlear has implemented programs during the year to recycle mobile phones, electronic equipment, bottles, cans and paper. We are also investigating ways to reduce water usage.

### Continually investing in individual and team capability

To support new employees' integration into Cochlear, a support tool to guide their early experiences has been developed centrally and tailored to regional needs. Our Get Equipped induction program has become a valuable learning tool for helping new employees gain a detailed understanding of our products, organisation and values. During 2007, 124 employees attended a Get Equipped program up from 75 in 2006.

Cochlear's commitment to training and development of its employees combines on-the-job development and formal training courses. The training provided covers job-specific and technical areas as well as general areas such as communication, time management and self-leadership. The Sydney office alone provided 14,341 hours of training during 2007, up from 12,773 hours last year. A Global Training Delivery Team was formed to help find the most efficient and effective learning solutions to equip our customer facing employees with the knowledge and skills they need to support our customers and to prepare for future product launches.

### Investing in a continuously learning organisation

We have also continued to invest in further Continuous Improvement programs focusing on production, warehouse, purchasing, engineering and facilities employees. We have had 190 successful graduates of the Workplace English Language and Literacy (WELL) program since commencing the program in March 2006. Cochlear was awarded a Quality Award for 2006 from New South Wales Technical and Further Education for its WELL program. A Leadership Development program designed specifically for Cochlear in conjunction with the Macquarie Graduate School of Management is being attended by 34 manufacturing and logistics managers.

During the year, the Women in Leadership network was formed. This network aims to have more women ready for leadership roles within Cochlear and for the Company to be recognised as an employer of choice for women. It also provides professional development opportunities for employees and helps to enhance career growth options for women.

1 2 3

### 1. Mr Tommie CE Bergman

*Chairman*

Age 62. DipEng, Grad DipMarketing, FAICD, FAIM

Appointed Chairman 22 October 2002

Appointed director and Deputy Chairman 1 January 2002

Director of Rinker Group Limited since June 2007. Former director of Smorgon Steel Group Limited (1999 – 2007). Former Chairman (2003 – 2005) and Deputy Chairman (2001 – 2002) of WMC Resources Limited and director of Amcor Limited (1997 – 2003) and Atlas Copco Australia Pty Ltd. Former Chairman and Managing Director of Asea Brown Boveri Australasia Pty Ltd (1991 – 2002). Prior to that held CEO and Chairman positions in the ABB Group in Singapore, India, Portugal and the United States.

Chairman of the Nominations Committee and Technology and Innovation Committee. Member of the Audit Committee and Remuneration Committee.

### 2. Dr Chris G Roberts

*CEO/President*

Age 53. BE (Hons), MBA, PhD, FAICD, FTSE

Appointed 1 February 2004

Chief Executive Officer of Cochlear Limited. Director of ResMed Inc since 1992 and Chairman of Research Australia. Dr Roberts has worked in the medical device industry for more than 30 years in a number of senior management positions.

Member of the Medical Science Committee and Technology and Innovation Committee.

### 3. Mr Paul R Bell

Age 61. BA, MA (Hons)

Appointed 1 August 2005

Director of Bio-Link Partners Limited since 2005 and Biota Holdings Limited since 2006. Former director of GroPep Limited (2003 – 2006). Extensive executive career spanning 30 years with the international pharmaceutical company, Merck & Co Inc (Managing Director – Australia, 1988 – 1997; and President of the Asia Pacific Human Health Division, 1997 – 2002). Member of the Global Merck Management Committee.

Chairman of the Remuneration Committee. Member of the Nominations Committee and Technology and Innovation Committee.

4 5 6 7

### 4. Prof Edward Byrne, AO

Age 55. DSc, MD, MBA, FRCP, FRACP

Appointed 1 July 2002

Executive Dean of the Faculty of Biomedical Sciences University College, London and Head of the Royal Free and University College Medical School. Member of the Advisory Board and former Dean of Faculty of Medicine, Nursing and Health Sciences at Monash University, Melbourne (2003 – 2007), Deputy Chair of Neurosciences Victoria Limited. Former director of Neurosciences Australia Limited, the Baker Medical Research Institute, Burnet Medical Research Institute, Prince Henry's Medical Research Institute, Southern Health and Mental Health Research Institute.

Chairman of the Medical Science Committee. Member of the Nominations Committee and Technology and Innovation Committee.

### 5. Mr Andrew Denver

Age 58. BSc (Hons), MBA, FAICD

Appointed 1 February 2007

Chairman of Universal Biosensor Pty Limited, director of CathRx Limited, Anzon Australia Limited and Principals Funds Management Pty Limited. Former Managing Director of Memtec Limited and President Asia for Pall Corporation.

Member of the Audit Committee, Nominations Committee and Technology and Innovation Committee.

### 6. Mr Rick Holliday-Smith

Age 57. BA (Hons), FAICD

Appointed 1 March 2005

Director of St.George Bank Limited since February 2007, Servcorp Limited since 1999 and ASX Limited since July 2006. Chairman of Snowy Hydro Limited (not listed) since May 2006. Chairman of SFE Corporation Limited since 1999 until de-listing in July 2006. Former director of Exco Resources NL (1999 – 2006), DCA Group Limited (2004 – 2006) and MIA Group Limited (2000 – 2004). Former President of NationsBank-CRT, Chicago and Managing Director of Hong Kong Bank Limited, London.

Chairman of the Audit Committee. Member of the Nominations Committee and Remuneration Committee.

### 7. Mr Donal P O'Dwyer

Age 54. BE Civil, MBA

Appointed 1 August 2005

Chairman of Atcor Medical since 2004 and a director of Sunshine Heart Inc since 2004, Mesoblast Limited since 2004 and Angioblast Systems Inc since 2005. President of Cordis Cardiology (Johnson & Johnson medical device business unit with annual turnover of over USD 2 billion) between 2000 and 2004.

Member of the Audit Committee, Medical Science Committee, Nominations Committee and Technology and Innovation Committee.

1 2 3 4 5 6

### 1. Dr Chris Roberts

***CEO/President***

See "Board of directors" on previous page.

### 2. Richard Brook

***President, European Region***

BSc Management, MBA

Richard is responsible for the development and execution of the strategic direction for all our operations in Europe, the Middle East and Africa. This includes sales in over 60 countries. Operations in Europe include sales, marketing, distribution, service, finance, regulatory and administration across this complex and diverse region.

Before joining Cochlear in 2003, Richard held senior roles in Guidant Corporation and Alaris Medical Systems. He has over 15 years' experience in the medical device industry.

### 3. Dr Bronwyn Evans

***Senior Vice President, Quality and Regulatory***

BE (Hons), PhD

Bronwyn is responsible for ensuring continued high quality of Cochlear's products together with coordinating the regulatory approval processes around the world for its products.

She joined the Company in 2005 after more than 20 years' experience in engineering and management roles in power generation and distribution, engineering education and the medical industry. Most recently, she worked as Asia Service Manager for GE Healthcare, Ultrasound based in Singapore.

### 4. Dig Howitt

***Senior Vice President, Manufacturing and Logistics***

BE (Hons), MBA

Dig is responsible for the leadership of the manufacturing and logistics groups. He and his team are responsible for the manufacture of all Cochlear products and all aspects of the supply chain together with the introduction of new products from research and development into commercial production.

Prior to joining Cochlear in 2000, Dig had gained general management experience at Boral and Sunstate Cement as well as being a consultant for Boston Consulting Group.

### 5. Jan Janssen

***Senior Vice President, Design and Development***

MSc Elec Eng

Jan leads a team of over 200 highly qualified engineers and scientists who implement the research and development strategy. This includes responsibility for identifying and developing cutting-edge technologies and commercial products.

Jan joined Cochlear in 2000 as head of the Cochlear Technology Centre based in Belgium, having previously worked with Philips Electronics where he was involved in research and development in the fields of high technology electronics and cochlear implants. Jan was promoted to Senior Vice President, Design and Development in 2005.

### 6. Michael Kavanagh

***Senior Vice President, Global Marketing***

BSc, MBA (Advanced)

Michael is responsible for the development of global marketing initiatives for Cochlear's product portfolio. This spans the identification of new product development opportunities through to product introduction and lifecycle management. This requires coordination and interpretation of research and then translating this into a relevant product portfolio together with marketing programs to drive disciplined growth.

Michael joined Cochlear in 2003, having held senior sales and marketing positions both locally and internationally in the pharmaceutical industry.

### 7. Anne-Marie Leslie

***Senior Vice President, Human Resources***

BA (Hons), EMHRL

Anne-Marie joined Cochlear in April 2007 and is responsible for global human resources management, focusing on people strategies to meet the demands of a fast growing, global company.

7 8 9 10 11 12

She has over 25 years' experience in local, regional and global human resource management, most recently with Bristol-Myers Squibb in the USA. Earlier experience included quality management at Kodak as winners of the Australian Quality Prize and as an evaluator with Business Excellence Awards in Australia and the USA.

### 8. Neville Mitchell

***Chief Financial Officer and Company Secretary***

BComm, CA (SA), CA

Neville is responsible for accounting, corporate finance, treasury and audit, together with investor relations, company secretarial and the corporate legal function for Cochlear.

He joined the Company in 1990 and has been Chief Financial Officer since listing in 1995. Prior to joining Cochlear, he was a senior manager with KPMG in Johannesburg.

### 9. David Morris

***President, Bone Anchored Solutions***

BBus, BAppSc

David is responsible for the Bone Anchored Solutions Division, which is based in Gothenburg Sweden. This Division includes marketing, research, product design and development, quality and regulatory, manufacturing, distribution and administration for all the Baha and Vistafix products.

He was appointed as President, Bone Anchored Solutions in 2005, having joined the Company in 2002 as Senior Vice President, Business Development. David is the Chairman of the Australian Medical Device Industry Action Agenda and has extensive international and Australian experience in strategy and operational consulting.

### 10. Jim Patrick

***Senior Vice President, Chief Scientist***

MSc

Jim is responsible for the global research portfolio of projects that feed into the commercial development stream. In addition, Jim is responsible for clinical trials around the globe.

One of the original researchers involved with the cochlear implant program in Melbourne from 1975, Jim has worked in a number of senior managerial positions at Cochlear since its inception in 1981. Jim is an Associate Professor at the Department of Otolaryngology at the University of Melbourne.

### 11. Mark Salmon

***President, Asia Pacific Region***

MBA (Executive)

Mark is responsible for the development and execution of the strategic direction for all our operations in Australia, Asia and the South Pacific. This high growth region has complex regulatory sales and marketing drivers which require coordination of sales, marketing, third party distribution, regulatory and clinical infastructure development activities.

He joined Cochlear in 2004, after more than 20 years' experience in the medical industry, most recently as President and CEO of Asia Growth Markets and Australia, New Zealand and South East Asia for GE Medical Systems.

### 12. Chris Smith

***President, Americas Region***

BSc

Chris is responsible for the development and execution of the strategic direction for our operations in the Americas region, comprising North America, Central America and South America. Operations in the Americas include sales, marketing, distribution, service, finance, regulatory and administration across this fast growing region.

He joined Cochlear in 2004, after more than 20 years' experience in the medical device industry specifically and healthcare in general in the United States including Warburg Pincus, and as Group President for Gyrus Group (ENT and Surgical Divisions).

Dr Chris Roberts reports to the Board of directors and all other members of the senior executive team report to Dr Chris Roberts.

# Cochlear is committed to ensuring that its policies and practices reflect good corporate governance and that there is compliance with all corporate governance requirements applicable to Australian listed companies.

This Corporate Governance Report sets out the key governance principles and practices of Cochlear in the order of the ASX Corporate Governance Council's Principles of Good Corporate Governance and Best Practice Recommendations (March 2003) (Guidelines). A checklist of the recommendations made in the Guidelines is set out at the end of this report. References to recommendations are made throughout this report in order to indicate how Cochlear complies with the recommendations. All policies and terms of reference referred to in this report are published on the Company's website www.cochlear.com in the Corporate Governance section.

Cochlear continues to refine and update its corporate governance policies and procedures. Cochlear will make any changes necessary as a result of the ASX Corporate Governance Council's revised version of the Guidelines prior to the revised Guidelines becoming effective in January 2008.

**Principle 1: Lay solid foundations for management and oversight**

The Board is responsible to Cochlear's shareholders and other stakeholders for the Company's overall business performance.

The Board operates under a Board Charter that details its functions and the matters specifically reserved to it for decision (Rec 1.1). The Charter is published in the Corporate Governance section of the Cochlear website.

The Board is responsible for adopting Cochlear's directional strategies and for monitoring management's implementation of those strategies. The Board considers and sets the Company's goals and performance targets, appoints and removes the CEO/President, oversees succession plans and approves the accounts, budgets, Risk Management Policy (including internal control and compliance), Code of Business Conduct and major capital management and expenditure decisions.

There is a clear distinction between the role and responsibilities of the Board and the role and responsibilities of the CEO/President (Rec 1.1). The balance of responsibilities between the Board and the CEO/President is reviewed on a regular basis so as to ensure that the division of functions remains appropriate to the needs of the Company.

The Chairman is responsible for leading the Board in the performance of its duties. The Board's prime objectives are to improve shareholder returns and to achieve disciplined and sustainable growth. The full Board meets for at least eight regular meetings each year.

Other meetings are called as deemed necessary. A summary of meeting attendance (including committee meeting attendance) for the 2007 financial year is set out in the Directors' Report at page 44 (Recs 2.5, 4.5 and 9.5). At each Board meeting, the non-executive directors meet for a period without management or any executive directors present. Throughout the year, the Board has regular scheduled discussions on various aspects of the Company's strategy.

The CEO/President is responsible for the efficient and effective operation of Cochlear on a day-to-day basis. The CEO/President oversees the implementation of the strategies approved by the Board and is accountable to the Board for all authority delegated to the senior executive team. Notwithstanding these delegations by the Board, the CEO/President must consult the Chairman on matters that are sensitive, extraordinary or of a strategic nature. The CEO/President must bring all material matters to the Board's attention. The senior executive team briefs the Board regularly so as to keep the Board up to date and assist the directors with monitoring the results of operations. Each month, directors receive operating reports prepared by senior management, covering each region and function. Directors also regularly visit and inspect operations in Australia and overseas.

**Principle 2: Structure the board to add value**

***Composition of the Board***

As at 30 June 2007, the Board comprised six non-executive directors, including the Chairman, and one executive director, the CEO/President. The directors consider that, between them, they possess the necessary skills, knowledge and experience to allow the Board to perform its duties appropriately. Between them, the directors bring to the Board scientific, medical, technical and financial expertise, as well as international business experience.

Summaries of the relevant skills, experience and expertise of each director are set out on pages 30 to 31 (Rec 2.5).

Mr Peter North, AM and Mr Justus Veeneklaas retired from the Board with effect from 24 October 2006 Annual General Meeting. Mr North, AM and Mr Veeneklaas had served on the Board since February 1997 and March 1998 respectively.

Dr John Parker retired as an Executive Director and Chief Technology Officer of the Company with effect from 31 March 2007. Dr Parker was appointed as a director in March 2002.

Mr Andrew Denver was appointed to the Board with effect from 1 February 2007 following an appointment process established and controlled by the Nominations Committee.

The policy for appointment of directors and the selection process are outlined in the Nominations Committee Terms of Reference, which are published in the Corporate Governance section of the Company website (Rec 2.5). The Nominations Committee assesses the necessary and desirable competencies of candidates for directorship. The selection process includes obtaining advice from an external consultant to assist in identifying suitable candidates who meet the required specifications. Upon appointment of a new director, the key terms and conditions and the Company's expectations of the appointee are set out in a letter to the new director.

New non-executive directors are provided with an induction program specifically tailored to the needs of individual appointees. That program includes product training, one-on-one meetings with members of the senior executive team and visits to key functional areas. Directors participate in continuous improvement and education programs from time to time, as considered appropriate.

The Company's Constitution requires one third of the directors to retire from office at the AGM each year. Retiring directors are eligible for re-election. The CEO/President is excluded from this requirement. Prof Edward Byrne, AO and Mr Donal O'Dwyer will retire at the 2007 AGM and will stand for re-election at that meeting.

When the Board fills a vacancy during a year, the new director must stand for election at the next AGM. Accordingly, Mr Andrew Denver will stand for re-election at the 2007 AGM.

Mr Tommie Bergman, the Chairman of the Company, is an independent non-executive director (Rec 2.2). Mr Bergman is not and has not previously been the CEO of the Company (Rec 2.3). Details of the division of responsibility between the Chairperson and the CEO/President are set out above under Principle 1: Lay solid foundations for management and oversight.

***Independence***

The Board has assessed the independence of the non-executive directors in light of their interests and relationships and considers that all of the non-executive directors are independent (Rec 2.5). A majority of the Board is therefore independent (Rec 2.1). Independent non-executive directors are independent of management and free of any business or other relationship with Cochlear that could materially interfere with the exercise of objective, unfettered or independent judgement by the director or the director's ability to act in the best interests of the Company. The Nominations Committee Terms of Reference outline criteria used to determine the independence of the directors. The criteria used follow the criteria set out in the Guidelines.

The Board regularly assesses the independence of the non-executive directors in the light of the interests and circumstances disclosed by them. Any loss of independence by a non-executive director will immediately be disclosed to the market.

None of the non-executive directors has any business relationship with Cochlear. The total number of shares owned by Cochlear non-executive directors is 21,450. This is considered immaterial.

The Board believes arbitrary limits on tenure may cause loss of experience and expertise that are important contributors to the efficient working of the Board. The Board does not currently believe that any non-executive directors have served on the Board for a period which could, or could reasonably be perceived to, materially interfere with the director's ability to act in the best interests of the Company. The period of office of each director is disclosed at pages 30 to 31. Currently, no director has served longer than six years on the Board.

With the consent of the Chairman, individual directors may seek independent professional advice, at the expense of Cochlear, on any matter connected with their responsibilities (Rec 2.5). No individual directors exercised this right during the year. At each Board meeting, the non-executive directors meet for a period without management or any executive directors present.

***Board committees***

The Board has established five permanent committees to assist in the execution of its responsibilities. Each such committee reports to the Board. Each committee has Terms of Reference under which authority is delegated to it from the Board. The Terms of Reference for each committee can be viewed in the Corporate Governance section of the Cochlear website.

Committee meeting agendas, papers and minutes are made available to all members of the Board. Committee Chairmen are free to use whatever resources they consider necessary to discharge their responsibilities.

The number of committee meetings held during the year and the attendance at these meetings by members are set out in the Directors' Report at page 44 (Recs 2.5, 4.5 and 9.5). With the exception of the Medical Science Committee and the Technology and Innovation Committee, all members of the committees are independent non-executive directors. Executive director, Dr Chris Roberts, is a member of the Medical Science Committee and the Technology and Innovation Committee.

The composition and role of each committee are set out below:

*Audit Committee (Rec 4.2)*

The Audit Committee was established at the time of listing of the Company on the ASX in 1995 and is composed entirely of independent non-executive directors (Rec 4.3). The members meet at least four times a year. The Board considers that the Audit Committee is of a sufficient size and independence and possesses sufficient technical expertise to discharge its mandate effectively. An assessment of technical expertise of the Committee's members occurs on an annual basis.

The Audit Committee consists entirely of independent non-executive directors (Rec 4.3). Mr Rick Holliday-Smith chairs the Committee, with the other members at 30 June 2007 being Mr Tommie Bergman, Prof Edward Byrne, AO, Mr Andrew Denver and Mr Donal O'Dwyer (Recs 4.3 and 4.5). The external and internal auditors, the CEO/President and the Chief Financial Officer (CFO) are invited to the meetings at the discretion of the Committee. At each Committee meeting they attend, the external auditor reports on the outcome of their audit and other work. The Committee meets with the external auditor in the absence of members of management at every meeting that the external auditor attends. Summaries of the Committee members' technical expertise are set out at pages 30 to 31 (Rec 4.5). The Audit Committee Terms of Reference set out the Committee's role and responsibilities, composition, structure and membership requirements. The Audit Committee Terms of Reference can be viewed in the Corporate Governance section of the Cochlear website (Rec 4.5).

The principal role of the Committee is to advise and assist the Board in relation to the reporting of financial information.

The Committee's primary responsibilities include:

- ensuring the Company adopts, maintains and applies appropriate accounting and reporting processes and procedures;
- facilitating the independence of the external audit process and addressing issues arising from the audit process; and
- ensuring the Company maintains effective risk management and internal control systems.

Processes relating to financial reporting are set out below at Principle 4: Safeguard integrity in financial reporting. Processes relating to risk management and internal control are set out below at Principle 7: Recognise and manage risk.

*Remuneration Committee (Recs 9.1 and 9.2)*

The Remuneration Committee was established at the time of listing of the Company on the ASX in 1995 and meets at least three times a year. The Committee is chaired by Mr Paul Bell. As at 30 June 2007, the other members of the Committee were Mr Tommie Bergman and Mr Rick Holliday-Smith. All members of the Remuneration Committee are independent non-executive directors (Rec 9.5). As the need arises, the CEO/President, CFO, Senior Vice President, Human Resources and other executives are invited to meetings at the discretion of the Committee.

The Remuneration Committee Terms of Reference set out the Committee's role and responsibilities, composition, structure and membership requirements. The Remuneration Committee Terms of Reference can be viewed in the Corporate Governance section of the Cochlear website (Rec 9.5).

The Committee is responsible for making recommendations to the Board in relation to Remuneration Policy and the amounts and composition of remuneration for the CEO/President and the senior executive team. This includes long-term performance requirements and incentives. Remuneration levels are set at competitive levels to attract and retain qualified and experienced staff. Independent advice is taken on the appropriateness of remuneration packages.

The Committee's role includes responsibility for the remuneration and incentive policies (including the Performance Appraisal Policy) for Cochlear generally. It also approves the recruitment, retention and termination policies and practices as well as superannuation arrangements and makes recommendations to the Board in accordance with the Cochlear Executive Long Term Incentive Plan (CELTIP).

Further details on Cochlear's remuneration policies and the principles upon which they are based are set out below at Principle 9: Remunerate fairly and responsibly and in the Remuneration Report at pages 47 to 55 (Rec 9.1).

*Nominations Committee (Rec 2.4)*

The Nominations Committee is chaired by Mr Tommie Bergman (the Company Chairman) and is comprised entirely of independent non-executive directors. In addition to the Chairman, the members of the Committee as at 30 June 2007 were Mr Paul Bell, Prof Edward Byrne, AO, Mr Rick Holliday-Smith and Mr Donal O'Dwyer, with Mr Andrew Denver joining the Committee with effect from 1 February 2007 (Rec 2.5).

The Committee was established in July 2003. The Committee's role is to assist the directors in ensuring that the Board is comprised of individuals who are best able to discharge the responsibilities of a director, having regard to the law and the highest standards of governance, by:

- assessing the skills, knowledge, experience and diversity required on the Board and the extent to which each is represented;
- establishing processes for the review of the performance of individual directors and the Board as a whole;
- establishing processes for the identification of suitable candidates for appointment to the Board;
- reviewing skills required to be maintained by existing directors; and
- overseeing succession planning for the Board.

The Nominations Committee Terms of Reference set out the Committee's role and responsibilities, composition, structure and membership requirements. The Nominations Committee Terms of Reference can be viewed in the Corporate Governance section of the Cochlear website (Rec 2.5). The Nominations Committee Terms of Reference include a description of the procedure for the selection and appointment of new directors and the criteria used to determine director independence (Rec 2.5).

As a part of the appointment process, prospective directors must disclose existing and proposed directorships, as well as any other commitments they have. These commitments will be assessed to determine whether the prospective director has adequate time to perform their duties. The Committee assesses the time commitments of the Chairman and all other non-executive directors on an ongoing basis so as to ensure that adequate time is available to discharge Board duties.

The current members of the Board are all considered to have sufficient time available to them in order to discharge their responsibilities to Cochlear.

*Medical Science Committee*

The Medical Science Committee was established during the 2003 financial year and meets at least biannually. The Committee is chaired by Prof Edward Byrne, AO, with the other members being Dr Chris Roberts and Mr Donal O'Dwyer. The Committee may invite any executive to its meetings at its discretion.

The Medical Science Committee Terms of Reference set out the Committee's role and responsibilities, composition, structure and membership requirements. The Medical Science Committee Terms of Reference can be viewed in the Corporate Governance section of the Cochlear website.

The Committee considers any matters relating to medical aspects of Cochlear's businesses and related technologies. This includes a watching brief on medical developments in these fields and the findings of independent medical experts.

*Technology and Innovation Committee*

The Technology and Innovation Committee was established during the 2003 financial year and is chaired by Mr Tommie Bergman. The other members of the Committee are Dr Chris Roberts, Mr Paul Bell, Prof Edward Byrne, AO and Mr Donal O'Dwyer, with Mr Andrew Denver joining the Committee with effect from 1 February 2007. Executives of the Company are invited to meetings at the discretion of the Committee.

The Technology and Innovation Committee Terms of Reference set out the Committee's role and responsibilities, composition, structure and membership requirements. The Technology and Innovation Committee Terms of Reference can be viewed in the Corporate Governance section of the Cochlear website.

The Committee oversees the strategic direction of the Company's technology research and product development programs with an emphasis on priority and resource allocation in line with the Company's agreed corporate strategy.

### Principle 3: Promote ethical and responsible decision making

Directors and the senior executive team are expected to act with the utmost integrity and objectivity, striving at all times to enhance the reputation and performance of Cochlear. Cochlear's values are enunciated in the Code of Business Conduct and are reflected in Cochlear's mission statement and strategic plan (Rec 3.1). The Code guides the directors and the senior executive team as to the practices necessary to maintain confidence in the Company's integrity and as to the responsibility and accountability of individuals for reporting and investigating reports of unethical practices. The Code also guides compliance with legal and other obligations to legitimate stakeholders. The Code can be viewed in the Corporate Governance section of the Cochlear website (Rec 3.3).

Directors and the senior executive team are subject to the Non-Executive Directors and Executives Share Ownership Policy. This Policy specifies minimum levels of shareholdings for directors and the senior executive team. This Policy became effective on 1 July 2007.

All directors, senior executives and employees are subject to Cochlear's Dealing in Securities Policy (Rec 3.2). Under this Policy, directors are required to obtain the consent of the Chairman before dealing in Cochlear securities. The Policy requires direct reports of the CEO/President and other senior employees to seek consent from the Company prior to trading in the Company's securities.

The Policy gives guidance as to the windows of time during which it is most appropriate for directors, senior executives and employees to trade in the Company's securities. Consistent with the Corporations Act 2001, directors, senior executives and employees are prohibited from dealing in the Company's securities whilst in possession of "inside information". Compliance with the Policy is monitored. The Audit Committee receives a report at each of its meetings regarding trading in the Company's securities by those subject to the Policy.

Share dealings by directors are promptly notified to the ASX.

Executives who are granted shares under the CELTIP are provided with recommended share trading periods and guidelines on what constitutes insider trading.

The Cochlear Dealing in Securities Policy can be viewed in the Corporate Governance section of the Cochlear website (Recs 3.2 and 3.3).

**Principle 4: Safeguard integrity in financial reporting**

The directors are committed to the preparation of financial statements that present a balanced and clear assessment of the Company's financial performance, position and prospects.

Accounting and financial control policies and procedures have been established and are monitored by the Audit Committee (Rec 4.2). The Committee approves any new material accounting policies. Compliance with these procedures and policies is subject to review by the external and internal auditors. The Committee provides a link between the external auditor and the Board and monitors compliance with statutory responsibilities. The Committee is responsible for making recommendations on the appointment, evaluation and dismissal of the external auditor, setting fees and ensuring that the external auditor reports to the Committee and the Board. The Committee reviews the performance, independence and objectives of the external auditor on an annual basis. Details relating to the selection and appointment of the Company's external auditors are included in the Audit Committee Terms of Reference (Rec 4.5).

Additional detail relating to the Audit Committee and the Audit Committee Terms of Reference can be found above at Principle 2: Structure the board to add value (Recs 4.4 and 4.5).

Cochlear is committed to auditor independence. The Cochlear audit engagement partner must rotate every five years, with the last rotation occurring in July 2006. To enhance auditor independence, the Committee must approve all non-audit services provided by the Company's external audit firm.

Cochlear has a highly structured six monthly reporting process, culminating in Board sign-off and release of financial results to the market. The CEO/President and the CFO provide a written statement to the Board that the Company's published financial reports present a true and fair view, in all material respects, of the Company's financial condition and that the operational results are in accordance with relevant accounting standards (Rec 4.1).

**Principle 5: Make timely and balanced disclosure**

Cochlear is committed to effective communication with its investors so as to give them equal and timely access to accurate, balanced and understandable information.

Cochlear's Continuous Disclosure Policy and Procedures set out the Company's policies and procedures in relation to disclosure of information (Rec 5.1). The Policy and Procedures aim to ensure full and timely disclosure to the market of all material issues relating to Cochlear and to ensure all stakeholders have an equal opportunity to access that information. The Policy and Procedures are designed to ensure that the disclosure requirements set out in the ASX Listing Rules and the Corporations Act 2001 are complied with and to ensure accountability at a senior management level for that compliance. The Policy and Procedures are reviewed on a regular basis.

The Continuous Disclosure Policy and Procedures can be viewed in the Corporate Governance section of the Company website (Rec 5.2).

**Principle 6: Respect the rights of shareholders**

The shareholders of Cochlear play a key role in the governance of the Company.

The directors recognise that shareholders must receive timely information about the Company in order to play their role effectively. The directors appreciate that information communicated to shareholders needs to be of high quality, relevant, balanced and understandable. The Company's Shareholder Communications Policy is published at the Corporate Governance section of the Cochlear website (Rec 6.1). The Policy is designed to promote effective communications with shareholders and to encourage shareholders to participate in general meetings of the Company.

The principal channels of communication with the Company's shareholders are the provision of the annual and half yearly reports, periodic analyst and media briefings, the distribution of specific material covering major transactions and events, Company announcements and the AGM.

The Board's philosophy is to encourage full participation of shareholders at the AGM to ensure a high level of accountability and identification with Cochlear's strategy and goals. The external auditor attends the AGM and is available to answer questions about the conduct of the audit and the preparation and content of the Audit Report (Rec 6.2).

In addition, shareholders may at any time direct questions or requests for information to the Company Secretary, CEO/President or Chairman. Shareholders can also gain access to information about Cochlear, including the Annual Report, key policies and the Terms of Reference of its Board committees through the Company website.

### Principle 7: Recognise and manage risk

Cochlear views risk management as integral to its objectives of effective management of Company assets and the creation and maintenance of shareholder value. The Board has established a Risk Management Policy that provides a framework to manage the risks associated with Cochear's activities on a continuing basis (Rec 7.1). The Risk Action Plan is designed to provide a comprehensive risk management system which identifies, assesses and appropriately manages Cochlear's material risks (Rec 7.1). Cochlear focuses on effective management of material business, operational, financial, organisational and corporate risks. Within these categories, specific identified risks arise from matters such as actions by competitors, technological developments, government policy changes and exchange rate movements. The Risk Action Plan is compliant with the Australian and New Zealand Standard of Risk Management AS/NZS 4360.

The Board, Audit Committee and senior executive team are together accountable for monitoring risk and implementing the Risk Management Policy.

The Board oversees implementation of the Risk Management Policy and the Risk Action Plan. The Board ensures investors are informed of material changes to the Company's risk profile.

The Audit Committee advises the Board and reports on the status of major risks to the Company through integrated risk management programs.

Day-to-day implementation of the Risk Action Plan is delegated to the Risk Committee. The Risk Committee is made up of senior executives and the Committee reports to the Audit Committee at least twice a year. The Risk Committee is responsible for identification of areas of risk, prioritisation of these risks and adoption of cost effective strategies to manage Cochlear's exposure. Senior executives charged with the responsibility for identifying and managing these risks are required to sign off on them on a quarterly basis.

The Audit Committee advises the Board on risk management and is responsible for reviewing the effectiveness of Cochlear's approach to risk management and the establishment and maintenance of internal compliance and control systems within the risk management framework. This includes the scope of the internal audit function. The Audit Committee is responsible for the appointment and removal of the internal auditor and for ensuring that the internal auditor is independent from the external auditor.

Whilst particular internal audit programs may be outsourced, the internal and external audit functions are separate and independent of each other. The Audit Committee approves the internal audit program for each year and the effectiveness of the function is kept under review. The CEO/President and the CFO are required to state to the Board in writing that the integrity of the financial statements is founded on a sound system of risk management and internal compliance and control which implements policies adopted by the Board and that the system is operating efficiently and effectively in all material respects (Rec 7.2). The Risk Management Policy can be viewed at the Corporate Governance section of the Company website (Rec 7.3).

### Principle 8: Encourage enhanced performance

The Board, its committees, individual directors, the senior executive team and employees are assessed on their performance.

A review of the performance of the Board, its committees and individual directors is performed at least every two years, with the most recent being undertaken in 2006. The Chairman, in agreement with the Nominations Committee, undertook individual interviews and questionnaires and subsequently settled evaluations with each individual director as to their performance over the past year (Rec 8.1).

Employees, including key executives, participate in biannual performance reviews with their manager, where achievement of key goals is discussed and assessed and future goals are agreed upon.

The Performance Evaluation Process Overview gives details of performance evaluation for the Board, its committees, individual directors and key executives (Rec 8.1). The Performance Evaluation Process Overview is published in the Corporate Governance section of the Company website. Further detail in relation to the Nominations Committee and performance evaluation can be found above at Principle 2: Structure the board to add value.

**Principle 9: Remunerate fairly and responsibly**

Cochlear's Remuneration Policy and practices are designed to attract, motivate and retain high quality people. The structure of non-executive directors' remuneration is clearly distinguished from that of executives.

The Policy is built around principles that:

- remuneration be linked to Cochlear's performance and the creation of shareholder value;
- directors' remuneration be competitive and reflect good corporate governance;
- executive and employee rewards be competitive in the markets in which Cochlear operates;
- executive and relevant employee remuneration be an appropriate balance of fixed and variable reward;
- variable remuneration for senior management be comprised of short and long-term components; and
- a significant proportion of executive and employee reward be dependent upon performance assessed against key business measures, both financial and non-financial (Recs 9.1 and 9.5).

Details of the 2007 financial year remuneration of the directors (including retirement benefits), the five highest paid executive officers of the Consolidated Entity and Company and specified executives are included in the Remuneration Report on pages 47 to 55 (Rec 9.5). Further disclosure in relation to the remuneration philosophy is included in the Remuneration Report.

***Non-executive directors' remuneration policy (Recs 9.1 and 9.3)***

Fees for non-executive directors are based on the nature of their work and their responsibilities. In determining levels of fees, survey data on comparable companies is considered. Non-executive directors' fees are recommended by the Remuneration Committee and determined by the Board within the aggregate amount approved by shareholders at the 2004 AGM of $1,000,000 a year.

Non-executive directors do not receive any options, performance shares or other performance related remuneration. All non-executive directors now receive the statutory superannuation awards only. Any amounts due under the closed directors retirement scheme have been frozen and are indexed by reference to the bank bill rate.

***Senior executives' remuneration policy (Recs 9.1 and 9.3)***

Remuneration for Cochlear executives includes both fixed and variable incentive components. Equity based executive remuneration is made in accordance with the thresholds set out in the CELTIP. The CELTIP was approved by shareholders at the 2003 Annual General Meeting (Rec 9.4).

***Remuneration Committee***

The Board has established a Remuneration Committee to focus on appropriate remuneration policies which are designed to enhance corporate and individual performance. The Remuneration Committee Terms of Reference (published in the Corporate Governance section of the Company website) set out the Committee's role and responsibilities, composition, structure and membership requirements (Rec 9.5). Detail relating to the Remuneration Committee can be found above at Principle 2: Structure the board to add value (Rec 9.1).

**Principle 10: Recognise the legitimate interests of stakeholders**

The Company provides a forum to address individual shareholders' questions at each AGM. The Board and senior executive team are committed to formulating and implementing Company strategy in a manner that continually increases value for shareholders.

As well as its responsibility to shareholders, the Company is aware of its responsibilities to employees, customers and the community.

The Company has documented policies on equal opportunity, occupational health and safety and standards of workplace behaviour, which are communicated to employees at the time of employment. These policies are reinforced by continuous performance management and employee training programs. For further information regarding the Company's employees, refer to pages 28 to 29.

The Company's substantial marketing, design and development and regional teams are focused on meeting and exceeding the needs and expectations of Cochlear's customers and sustaining excellence in customer service.

The Company requires all employees, consultants and agents performing work for Cochlear to comply with the Code of Business Conduct. The Code of Business Conduct can be viewed in the Corporate Governance section of the Company website (Rec 10.1). This Code requires strict compliance with high standards of honesty, integrity and fairness in all conduct relating to Cochlear and its products. The Code outlines formal procedures relating to anti-corruption, confidentiality/privacy, trade practices, documentation management, workplace and other compliance issues for the purpose of ensuring that the Company meets best practice in these areas. The Code also provides for clear and confidential reporting mechanisms concerning any potential breach. In 2006, the Company introduced a whistleblower policy to ensure that the confidentiality, investigation and reporting of any allegations relating to improper conduct are properly maintained.

Cochlear engages across the world in philanthropic and educational activities which benefit its implant recipients, the advance of medical treatment and the wider community. In 2006, the Cochlear Foundation was formed primarily to provide financial assistance in relation to research, education and community activities for the benefit of the hearing impaired.

For further information regarding Cochlear's community involvement, please refer to the Cochlear website.

## ASX Corporate Governance Council's principles and recommendations checklist

| Number | Requirement | Compliant |
|---|---|---|
| **Pr 1** | **Lay solid foundations for management and oversight** | |
| Rec 1.1 | Formalise and disclose the functions reserved to the board and those delegated to management. | ✓ |
| **Pr 2** | **Structure the board to add value** | |
| Rec 2.1 | A majority of the board should be independent directors. | ✓ |
| Rec 2.2 | The chairperson should be an independent director. | ✓ |
| Rec 2.3 | The roles of chairperson and chief executive officer should not be exercised by the same individual. | ✓ |
| Rec 2.4 | The board should establish a nomination committee. | ✓ |
| Rec 2.5 | Provide the information indicated in Guide to reporting on Principle 2. | ✓ |
| **Pr 3** | **Promote ethical and responsible decision making** | |
| Rec 3.1 | Establish a code of conduct to guide the directors, the chief executive officer (or equivalent), the chief financial officer (or equivalent) and any other key executives as to:<br>• the practices necessary to maintain confidence in the company's integrity; and<br>• the responsibility and accountability of individuals for reporting and investigating reports of unethical practices. | ✓ |
| Rec 3.2 | Disclose the policy concerning trading in company securities by directors, officers and employees. | ✓ |
| Rec 3.3 | Provide the information indicated in Guide to reporting on Principle 3. | ✓ |
| **Pr 4** | **Safeguard integrity in financial reporting** | |
| Rec 4.1 | Require the chief executive officer (or equivalent) and the chief financial officer (or equivalent) to state in writing to the board that the company's financial reports present a true and fair view, in all material respects, of the company's financial condition and operational results and are in accordance with relevant accounting standards. | ✓ |
| Rec 4.2 | The board should establish an audit committee. | ✓ |
| Rec 4.3 | Structure the audit committee so that it consists of:<br>• only non-executive directors;<br>• a majority of independent directors;<br>• an independent chairperson, who is not chairperson of the board; and<br>• at least three members. | ✓ |
| Rec 4.4 | The audit committee should have a formal charter. | ✓ |
| Rec 4.5 | Provide the information indicated in Guide to reporting on Principle 4. | ✓ |
| **Pr 5** | **Make timely and balanced disclosure** | |
| Rec 5.1 | Establish written policies and procedures designed to ensure compliance with ASX Listing Rule disclosure requirements and to ensure accountability at a senior management level for that compliance. | ✓ |
| Rec 5.2 | Provide the information indicated in Guide to reporting on Principle 5. | ✓ |
| **Pr 6** | **Respect the rights of shareholders** | |
| Rec 6.1 | Design and disclose a communications strategy to promote effective communication with shareholders and encourage effective participation at general meetings. | ✓ |
| Rec 6.2 | Request the external auditor to attend the annual general meeting and be available to answer shareholder questions about the conduct of the audit and the preparation and content of the auditor's report. | ✓ |
| **Pr 7** | **Recognise and manage risk** | |
| Rec 7.1 | The board or appropriate board committee should establish policies on risk oversight and management. | ✓ |
| Rec 7.2 | The chief executive officer (or equivalent) and the chief financial officer (or equivalent) should state to the board in writing that:<br>• the statement given in accordance with best practice recommendation 4.1 (the integrity of financial statements) is founded on a sound system of risk management and internal compliance and control which implements the policies adopted by the board; and<br>• the company's risk management and internal compliance and control system is operating efficiently and effectively in all material respects. | ✓ |
| Rec 7.3 | Provide the information indicated in Guide to reporting on Principle 7. | ✓ |
| **Pr 8** | **Encourage enhanced performance** | |
| Rec 8.1 | Disclose the process for performance evaluation of the board, its committees and individual directors, and key executives. | ✓ |
| **Pr 9** | **Remunerate fairly and responsibly** | |
| Rec 9.1 | Provide disclosure in relation to the company's remuneration policies to enable investors to understand (i) the costs and benefits of those policies and (ii) the link between remuneration paid to directors and key executives and corporate performance. | ✓ |
| Rec 9.2 | The board should establish a remuneration committee. | ✓ |
| Rec 9.3 | Clearly distinguish the structure of non-executive directors' remuneration from that of executives. | ✓ |
| Rec 9.4 | Ensure that payment of equity based executive remuneration is made in accordance with thresholds set in plans approved by shareholders. | ✓ |
| Rec 9.5 | Provide the information indicated in Guide to reporting on Principle 9. | ✓ |
| **Pr 10** | **Recognise the legitimate interests of stakeholders** | |
| Rec 10.1 | Establish and disclose a code of conduct to guide compliance with legal and other obligations to legitimate stakeholders. | ✓ |

**Seraphine Schütz (girl on right)**
Hearing loss in left ear at birth

**First implant**

| | |
|---|---|
| Year | 2006 |
| Age at implantation | 12 |
| Device | Baha Divino |

# FINANCIAL REPORT

Cochlear Limited and its controlled entities financial report for the year ended 30 June 2007

## Contents



I used to have to ask people constantly to repeat themselves,

but now with my Baha this is no longer a problem.

Seraphine Schütz
Basel, Switzerland Age 13

The directors present their report, together with the Financial Report of Cochlear Limited (Company) and the Consolidated Financial Report of the Consolidated Entity (Cochlear), being the Company and its controlled entities, for the year ended 30 June 2007, and the Auditors' Report thereon.

## Directors

The directors of the Company in office at any time during the financial year were Mr PR Bell, Mr TCE Bergman, Prof E Byrne, AO, Mr A Denver, Mr R Holliday-Smith, Mr PJ North, AM, Mr DP O'Dwyer, Dr JL Parker, Dr CG Roberts and Mr JH Veeneklaas. Information on the directors is presented on page 30 of the Annual Report.

### Directors' meetings

The number of directors' meetings (including meetings of committees of directors) and number of meetings attended by each of the directors of the Company during the financial year are:

| | Board of directors | | Audit Committee | | Medical Science Committee | | Nominations Committee | | Remuneration Committee | | Technology and Innovation Committee | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Held(i) | Attended(ii) | Held(i) | Attended(ii) | Held(i) | Attended(ii) | Held(i) | Attended(ii) | Held(i) | Attended(ii) | Held(i) | Attended(ii) |
| Mr TCE Bergman | 9 | 9 | 6 | 6 | - | - | 4 | 4 | 6 | 5 | 3 | 3 |
| Mr PR Bell | 9 | 9 | - | - | - | - | 4 | 4 | 6 | 6 | 3 | 3 |
| Prof E Byrne, AO | 9 | 9 | 6 | 6 | 2 | 2 | 4 | 4 | - | - | 3 | 3 |
| Mr A Denver(iii) | 4 | 4 | 2 | 2 | - | - | 1 | 1 | - | - | 1 | 1 |
| Mr R Holliday-Smith | 9 | 8 | 6 | 6 | - | - | 4 | 4 | 6 | 6 | - | - |
| Mr PJ North, AM(iv) | 3 | 3 | 3 | 2 | - | - | 2 | 2 | - | - | 1 | 1 |
| Mr DP O'Dwyer | 9 | 9 | 6 | 6 | 2 | 2 | 4 | 4 | - | - | 3 | 2 |
| Dr JL Parker(v) | 8 | 5 | - | - | - | - | - | - | - | - | 3 | 1 |
| Dr CG Roberts | 9 | 9 | - | - | 2 | 2 | - | - | - | - | 3 | 3 |
| Mr JH Veeneklaas(vi) | 3 | 3 | - | - | - | - | 2 | 2 | 3 | 3 | 1 | 1 |

(i) Number of meetings held while in office.
(ii) Number of meetings attended.
(iii) Mr A Denver was appointed on 1 February 2007.
(iv) Mr PJ North, AM, retired on 24 October 2006.
(v) Dr JL Parker retired on 31 March 2007.
(vi) Mr JH Veeneklaas retired on 24 October 2006.

## Principal activities and review of operations and results

The principal activities and a review of the operations of the Consolidated Entity during the year ended 30 June 2007, and the results of these operations are set out in the CEO/President's Report and the Financial discussion and analysis.

Other than as discussed in the CEO/President's Report and the Financial discussion and analysis, there were no significant changes in the nature of those activities during the year ended 30 June 2007 and the results of those operations are set out in the abovementioned reports.

### Consolidated results

The consolidated results for the financial year are:

| | 2007 $000 | 2006 $000 |
|---|---|---|
| Revenue | 559,412 | 452,260 |
| Profit before tax | 143,481 | 108,835 |
| Net profit attributable to equity holders of the parent | 100,131 | 80,032 |
| Basic earnings per share (cents) | 182.9 | 146.8 |
| Diluted earnings per share (cents) | 180.1 | 145.2 |

### Dividends

Dividends paid or declared by the Company to members since the end of the previous financial year are:

| Type | Cents per share | Total amount $000 | Date of payment | Tax rate for franking credit |
|---|---|---|---|---|
| In respect of the previous financial year: | | | | |
| Final – ordinary shares | 55.0 | 30,175 | 21 September 2006 | 30% |
| In respect of the current financial year: | | | | |
| Interim – ordinary shares | 55.0 | 30,208 | 20 March 2007 | 30% |

All the dividends paid or declared by the Company since the end of the previous financial year were 100% franked.

The final dividend in respect of the current financial year has not been provided for in the Financial Report as it was not declared until after 30 June 2007. Since the end of the financial year, the directors declared a final 70.0 cents per share dividend 100% franked at the tax rate of 30% amounting to a total of $38,446,205.

### Environmental regulations

The Consolidated Entity's operations are not subject to any significant environmental regulations under either Commonwealth of Australia or State/Territory legislation. However, the Board believes that the Consolidated Entity has adequate systems in place to manage its environmental obligations and is not aware of any breach of those environmental requirements as they apply to the Consolidated Entity.

### Non-audit services

During the year, KPMG, the Company's auditor, has performed certain other services in addition to its statutory duties. The Board has considered the non-audit services provided during the year by the auditor and in accordance with written advice provided by resolution of the Audit Committee, and is satisfied that the provision of those non-audit services during the year by the auditor is compatible with, and did not compromise, the auditor independence requirements of the Corporations Act 2001 for the following reasons:

- all non-audit services were subject to the corporate governance procedures adopted by the Company and have been reviewed by the Audit Committee to ensure that they do not impact the integrity and objectivity of the auditor; and
- the non-audit services provided do not undermine the general principles relating to auditor independence.

A copy of the auditor's independence declaration as required under section 307C of the Corporations Act 2001 is included in this Report.

| | Consolidated 2007 $ | Consolidated 2006 $ |
|---|---|---|
| **Auditors' remuneration** | | |
| **Audit services** | | |
| Auditors of the Company: | | |
| KPMG Australia: | | |
| - audit and review of financial reports | 428,000 | 350,000 |
| - other regulatory audit services | 21,500 | 6,400 |
| Overseas KPMG firms: | | |
| - audit and review of financial reports | 591,762 | 443,796 |
| - other regulatory audit services | 51,855 | - |
| **Total audit services** | **1,093,117** | **800,196** |
| **Other services** | | |
| Auditors of the Company: | | |
| KPMG Australia: | | |
| - taxation services | 355,760 | 185,698 |
| - international taxation services | 783,394 | 423,792 |
| - other assurance services | 19,500 | 17,250 |
| Overseas KPMG firms: | | |
| - taxation services | 334,027 | 218,217 |
| - international taxation services | 108,467 | 118,717 |
| - other assurance services | 52,827 | 9,700 |
| **Total other services** | **1,653,975** | **973,374** |

**State of affairs**

The significant changes to the state of affairs of the Consolidated Entity during the financial year were as follows:

- on 2 January 2007, the Company acquired the manufacturing operations and assets of Crystalaid Manufacture Pty Limited for $19.1 million. Details of the acquisition are disclosed in Note 27 to the financial statements; and
- on 30 April 2007, the Consolidated Entity increased its shareholding in its subsidiary Cochlear Acoustics Limited (CAL) to 100% by acquiring the remaining 25% of shares in CAL from Phonak AG (Phonak) for a consideration of $7.5 million. This resulted in goodwill being recognised of $8.0 million. The Consolidated Entity sold certain assets to Phonak for consideration of $8.5 million. The Consolidated Entity also received $7.2 million from Phonak in reimbursement of research and development expenditure incurred in return for equal access to the intellectual property generated by CAL since its inception. These transactions gave rise to a net gain before tax of $6.9 million ($4.8 million after tax) to the Consolidated Entity.

**Likely developments**

Further information as to likely developments in the operations of the Consolidated Entity and the expected results of those operations in subsequent financial years has not been included in this Directors' Report because the directors believe, on reasonable grounds, that to include such information would be likely to result in unreasonable prejudice to the Consolidated Entity.

# Remuneration Report

## Remuneration Committee

The Remuneration Committee operates under delegated authority of the Board. The Remuneration Committee approves the Remuneration Policy and structure for executives and executive directors (senior executives) and makes recommendations to the Board on the total remuneration packages of each senior executive.

External advice on remuneration matters is obtained and is made available for the Remuneration Committee.

## Remuneration policies – audited

The Board recognises that Cochlear's performance is dependent on the quality of its people. To successfully achieve its financial and operating objectives in a complex and global environment, Cochlear must be able to attract, motivate and retain highly skilled senior executives who are dedicated to the interests of shareholders. Cochlear adopts a total remuneration approach for senior executives. The key principles that underpin Cochlear's Remuneration Policy include:

- a competitive Total Remuneration Strategy provided to attract, motivate and retain senior executive talent;
- a significant proportion (up to 50% of total fixed remuneration) of total senior executive remuneration linked to financial performance and business objectives, under the Cochlear Management Short Term Incentive Plan (CMSTIP); and
- a significant proportion (up to 50% of total fixed remuneration) of total senior executive remuneration linked to the creation of long-term value for shareholders under the Cochlear Executive Long Term Incentive Plan (CELTIP).

The Remuneration Policy assists Cochlear to achieve its business strategy and objectives. The Remuneration Committee recognises that, while remuneration is a key factor in recruiting the right people, it is not the only factor. Cochlear's corporate reputation, its ethical culture and values and its ability to provide interesting and challenging career opportunities, also play an important role.

## Remuneration structure

***Senior executives – audited***

Remuneration of the senior executives is based on policies and programs under the following categories:

- total fixed remuneration made up of base salary and superannuation, retirement benefits and other incidental benefits; and
- variable remuneration made up of an annual short-term incentive plan and long-term incentives.

The remuneration structure is designed to strike a balance between fixed and variable remuneration. Variable remuneration is tied to performance and is at risk.

***Service contracts – audited***

Cochlear does not enter into service contracts for senior executives, other than the CEO/President. Senior executives operate under standard termination and redundancy conditions with the following exceptions:

- the President, Asia Pacific Region has a notice period of three months and the President, European Region has a notice period of six months; and
- the President, European Region will receive a maximum of CHF 30,000 for repatriation costs in the case of termination or resignation.

The CEO/President's conditions are set out separately in this Remuneration Report.

***Base salary and benefits – audited***

Base salaries are determined by reference to appropriate benchmark information, taking into account an individual's responsibilities, performance, qualifications, experience and geographical location.

In addition to base salary, selected overseas based executives receive additional benefits including health insurance, a car allowance and a relocation allowance. In Australia, retirement benefits are paid in line with the statutory Superannuation Guarantee legislation levels. In July 2005, members of the legacy defined benefit plan (Plan) were given the opportunity to transfer to the accumulation fund. Ongoing contributions are based on the estimated required Company contributions, using the Plan actuarial assessments to ensure that employees are not adversely prejudiced by the move. The transfer of all members was completed in the first half of the 2006 financial year.

Globally, retirement benefits are paid in line with local legislation and practice.

***Variable remuneration – unaudited***

The Board believes that well designed and managed short-term and long-term incentive plans are important elements of employee remuneration, providing tangible incentives for senior executives to achieve Cochlear's short-term and long-term performance goals. Participation in these plans encourages greater involvement by senior executives to share in the future growth, prosperity and profitability of Cochlear in a way that gives them a community of interest with shareholders.

The proportions of variable remuneration opportunity vary for senior executives within Cochlear, reflecting an individual's responsibilities, performance and experience.

***Cochlear Management Short Term Incentive Plan – audited***

Short-term incentives for senior executives are determined under the CMSTIP. The short-term incentive is structured in such a way that a significant part of the senior executive's package depends upon achievement of individual performance goals linked to the business objectives and the financial performance of Cochlear. Financial measures include revenue and earnings before interest and taxes targets. Short-term incentives are paid on both the half and full year results.

The percentage of total remuneration that is allocated to short-term incentives varies according to the senior executive's position and the range is 30% – 50% of total fixed remuneration for achieving all budgeted targets. In years of exceptional performance, the short-term incentives could increase to 100% of total fixed remuneration.

The process of determining relevant performance measures and whether they are met is as follows:

- at the beginning of the financial year, the Remuneration Committee recommends to the Board the targets for the CEO/President and the other senior executives. These are dependent on financial objectives and agreement between the CEO/President and the senior executive on individual performance goals; and
- the CEO/President and the other senior executives and then the CEO/President and Chairman assess progress towards the financial and individual performance goals. The Remuneration Committee reviews, and the Board approves, these assessments prior to any payment.

The Remuneration Committee also evaluates the proposed short-term incentive awards in aggregate and determines their appropriateness having regard to Cochlear's overall financial results. After this assessment, the Remuneration Committee makes its recommendation to the Board for payment.

Once approved by the Board, the short-term incentive awards are paid to participants. This occurs on a half and full year basis.

***Cochlear Executive Long Term Incentive Plan – audited***

The CELTIP was approved by shareholders at the 2003 Annual General Meeting (AGM). The CELTIP is designed to reward senior executives for achieving long-term growth in shareholder value.

Senior executives are offered a mixture of options (being options to acquire ordinary shares in Cochlear Limited) and performance shares (being fully paid ordinary shares in Cochlear Limited).

The number of options and performance shares offered to a senior executive depends on their fixed remuneration and Cochlear's target remuneration package for the senior executive's position. The mixture of options and performance shares is determined at the discretion of the Board.

The exercise price of the options is based on the weighted average price of Cochlear Limited's shares traded during the five business days following the date of the provision of the final preliminary report to the Australian Securities Exchange (ASX) in August each year. All options refer to options over ordinary shares of Cochlear Limited. Each option is convertible to one ordinary share. All performance shares are ordinary shares of Cochlear Limited. Each performance share equates to one ordinary share.

Both the options and performance shares are subject to performance hurdles and vesting restrictions, which will ultimately determine the final number of options that will be exercisable and the number of performance shares receivable by a senior executive. The relevant performance hurdles and vesting restrictions are:

- a three year vesting period – during which time the senior executive must remain in employment and will be unable to exercise the options or trade the performance shares; and
- the performance of Cochlear over the vesting period – measured by using growth in earnings per share (EPS) and total shareholder return (TSR) as measured against the S&P/ASX 100 comparator group. Half the offer will be assessed against EPS growth and the other half using TSR growth as follows:

| Compound annual growth rate of EPS over a three year period | | Ranking of TSR growth rate against S&P/ASX 100 comparator group over a three year period | |
|---|---|---|---|
| Performance | % of options and performance shares vesting | Performance | % of options and performance shares vesting |
| <10% | 0% | <50th percentile | 0% |
| 10% to 20% | 50% to 100% pro-rata | 50th to 75th percentile | 50% to 100% pro-rata |
| >20% | 100% | >75th percentile | 100% |

Options and performance shares only vest if the performance hurdles and time qualifications are met.

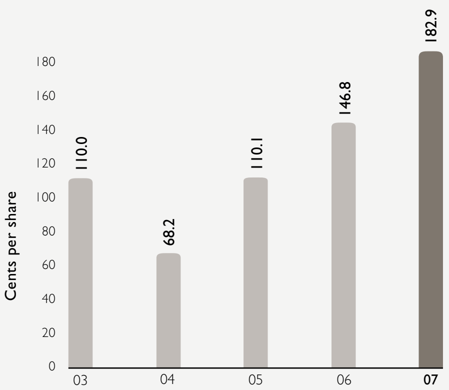
There are no voting or dividend rights attached to options. There are no voting rights attached to the unvested ordinary shares. Voting rights will be attached to the unissued ordinary shares when the options have been exercised. Performance shares are held in trust for the senior executives. Dividends paid to the trust are subsequently paid to the relevant senior executives. Voting rights are not transferred. Voting rights are attached to the performance shares once ownership is transferred. Dividends are no longer payable once shares are forfeited.

The following factors and assumptions were used in determining the fair value of options on grant date:

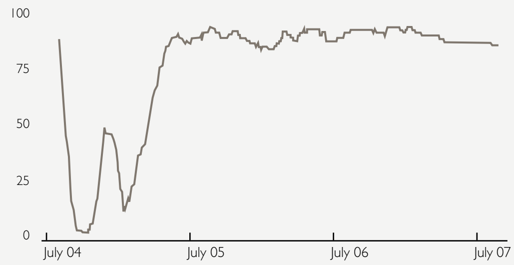
| Grant date | Option life | Fair value per option | Exercise price | Price of shares on grant date | Expected volatility | Risk free interest rate | Dividend yield |
|---|---|---|---|---|---|---|---|
| 21 August 2006 | 3 – 5 years | $6.22 | $49.43 | $50.89 | 30% | 5.845% | 2.2% |
| 22 August 2005 | 3 – 5 years | $4.71 | $39.93 | $41.40 | 25% | 5.080% | 1.9% |

**Performance of Cochlear in current CELTIP cycle – unaudited**

Depicted in the charts below is a comparison of basic EPS for financial years 2003 to 2007 and the TSR performance of Cochlear relative to the S&P/ASX 100 for financial years 2005 to 2007:




Comparison of Cochlear Limited's basic EPS performance




Percentile ranking of Cochlear's TSR performance from 1 July 2004 to 30 June 2007

Financial amounts for 2005 to 2007 are in accordance with AIFRS.
Financial amounts for 2003 and 2004 are in accordance with previous GAAP.

For the year ended 30 June 2007, the growth in basic EPS was 25% and the total return to Cochlear Limited shareholders (as measured from the change in share price plus dividends paid) was 14%.

In considering Cochlear's performance and growth in shareholder value, the remuneration policies have regard to the following amounts in respect of the current financial year and the previous four financial years:

| Amounts $ | 2007 | 2006 | 2005 | 2004 | 2003 |
|---|---|---|---|---|---|
| Net profit attributable to equity holders of the parent (million) | 100.1 | 80.0 | 59.6 | 36.8 | 58.2 |
| Dividends paid (million) | 60.4 | 49.1 | 42.8 | 42.3 | 33.3 |
| Share price | 61.00 | 54.63 | 39.20 | 22.72 | 32.30 |

Net profit amounts for 2003 and 2004 were calculated in accordance with previous Australian Generally Accepted Accounting Principles (previous GAAP). Net profit for 2005 to 2007 has been calculated in accordance with Australian equivalents to International Financial Reporting Standards (AIFRS).

**Executive directors – audited**

At the date of this Remuneration Report, there is one executive director in office, Dr CG Roberts.

Dr CG Roberts was appointed to the Board on 1 February 2004 at the time of his appointment as CEO/President.

Dr CG Roberts was appointed for a fixed term of three years from the commencement date of 1 February 2004. Effective 1 February 2007, Dr CG Roberts' appointment was continued. In line with best market practice, Dr CG Roberts' appointment was continued with no fixed term and a notice period of six months. If Cochlear terminates Dr CG Roberts' employment without cause, he will be entitled to receive an amount equivalent to 12 months of his total fixed remuneration plus the amount of benefits under the CMSTIP pro-rated to the date of termination.

Dr CG Roberts participates in the CMSTIP at a value equal to 50% of total fixed remuneration.

Dr CG Roberts participates to a value equal to 50% of total fixed remuneration under the CELTIP. The proportion of CELTIP that is provided between options and performance shares is determined by the Board.

**Non-executive directors – audited**

Fees for non-executive directors are based on the nature of the directors' work and their responsibilities. The remuneration rates reflect the complexity of Cochlear and the extent of the geographical regions in which Cochlear operates. In determining the level of fees, survey data on comparable companies is considered. Non-executive directors' fees are recommended by the Remuneration Committee and determined by the Board. Shareholders approve the aggregate amount of non-executive director fees.

Fees are within the aggregate amount approved by shareholders at the AGM in October 2004 of $1,000,000 a year.

The Chairman of Cochlear is Mr TCE Bergman. His director's fees are set at three times the base fee for non-executive directors. He does not receive any additional fees for serving on committees of the Board.

From 2003, no new non-executive director was entitled to join the Cochlear Limited directors' retirement scheme. Non-executive directors appointed prior to this were members of the scheme, which provided directors with more than five years' service, retirement benefits of up to three times their annual remuneration over the previous three years.

On 23 October 2006, the Board determined that it should implement changes to non-executive director remuneration consistent with developing market practice and guidelines by discontinuing the ongoing accrual of benefits under the existing retirement scheme once the remaining members of the scheme reached their five year service period. The benefits accrued to that date will be indexed by reference to the bank bill rate. At 30 June 2007, all directors had transitioned from the retirement scheme.

Non-executive directors do not receive any performance related remuneration, options or performance shares.

There are no commitments to non-executive directors arising from non-cancellable contracts with the Company.

### Directors' and senior executives' remuneration details – audited

The following table provides the details of all directors and the executives of Cochlear with the greatest authority (key management personnel), and each of the five named officers of the Company and Consolidated Entity receiving the highest remuneration.

Details of the nature and amount of each major element of remuneration are:

| | Year | Short-term | | | | Post-employment | | | Other long-term | Equity compensation[i], [iv] | | | Total | Performance related remuneration as proportion of total % | Value of equity compensation as proportion of remuneration % |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Amounts $ | | Salary and fees | Bonuses[i] | Non-monetary benefits[ii] | Total | Superannuation benefits | Leaving benefits[iii] | Total | Long service leave | Value of options | Value of performance shares | Total | | | |
| **Directors** | | | | | | | | | | | | | | | |
| ***Non-executive*** | | | | | | | | | | | | | | | |
| Mr TCE Bergman<br>Chairman | 2007 | 320,423 | - | - | 320,423 | 13,205 | 97,380 | 110,585 | - | - | - | - | 431,008 | - | - |
| | 2006 | 252,000 | - | - | 252,000 | 12,139 | 257,365 | 269,504 | - | - | - | - | 521,504 | - | - |
| Mr PR Bell<br>(appointed 1 August 2005) | 2007 | 134,865 | - | - | 134,865 | 12,050 | - | 12,050 | - | - | - | - | 146,915 | - | - |
| | 2006 | 115,073 | - | - | 115,073 | 10,356 | - | 10,356 | - | - | - | - | 125,429 | - | - |
| Prof E Byrne, AO | 2007 | 114,711 | - | - | 114,711 | 10,324 | 83,541 | 93,865 | - | - | - | - | 208,576 | - | - |
| | 2006 | 100,000 | - | - | 100,000 | 9,000 | 65,561 | 74,561 | - | - | - | - | 174,561 | - | - |
| Mr A Denver<br>(appointed 1 February 2007) | 2007 | 50,769 | - | - | 50,769 | 4,569 | - | 4,569 | - | - | - | - | 55,338 | - | - |
| Mr R Holliday-Smith | 2007 | 149,577 | - | - | 149,577 | 13,037 | - | 13,037 | - | - | - | - | 162,614 | - | - |
| | 2006 | 128,000 | - | - | 128,000 | 11,520 | - | 11,520 | - | - | - | - | 139,520 | - | - |
| Mr PJ North, AM<br>(retired 24 October 2006) | 2007 | 37,142 | - | - | 37,142 | 3,343 | 9,353 | 12,696 | - | - | - | - | 49,838 | - | - |
| | 2006 | 109,000 | - | - | 109,000 | 9,810 | 24,000 | 33,810 | - | - | - | - | 142,810 | - | - |
| Mr DP O'Dwyer<br>(appointed 1 August 2005) | 2007 | 139,634 | - | - | 139,634 | 12,379 | - | 12,379 | - | - | - | - | 152,013 | - | - |
| | 2006 | 109,365 | - | - | 109,365 | 9,843 | - | 9,843 | - | - | - | - | 119,208 | - | - |
| Mr JH Veeneklaas<br>(retired 24 October 2006) | 2007 | 35,038 | - | - | 35,038 | 3,153 | 9,596 | 12,749 | - | - | - | - | 47,787 | - | - |
| | 2006 | 100,000 | - | - | 100,000 | 9,000 | 26,500 | 35,500 | - | - | - | - | 135,500 | - | - |
| Prof BDO Anderson, AO (retired 20 October 2005) | 2006 | 32,308 | - | - | 32,308 | 2,908 | 8,492 | 11,400 | - | - | - | - | 43,708 | - | - |
| ***Executive*** | | | | | | | | | | | | | | | |
| Dr CG Roberts<br>CEO/President | 2007 | 863,363 | 475,816 | - | 1,339,179 | 12,636 | - | 12,636 | 13,208 | 323,425 | 71,925 | 395,350 | 1,760,373 | 49.5% | 22.5% |
| | 2006 | 750,750 | 403,155 | - | 1,153,905 | 12,139 | - | 12,139 | 8,842 | 186,988 | 62,699 | 249,687 | 1,424,573 | 45.8% | 17.5% |
| Dr JL Parker<br>(retired 31 March 2007) | 2007 | 288,602 | 46,365 | 87,079 | 422,046 | 9,739 | 372,652 | 382,391 | 39,578 | 95,100 | 22,190 | 117,290 | 961,305 | 17.0% | 12.2% |
| | 2006 | 346,653 | 117,421 | 181,992 | 646,066 | 12,139 | - | 12,139 | 11,660 | 66,441 | 28,383 | 94,824 | 764,689 | 27.8% | 12.4% |
| **Total directors** | **2007** | **2,134,124** | **522,181** | **87,079** | **2,743,384** | **94,435** | **572,522** | **666,957** | **52,786** | **418,525** | **94,115** | **512,640** | **3,975,767** | | |
| | **2006** | **2,043,149** | **520,576** | **181,992** | **2,745,717** | **98,854** | **381,918** | **480,772** | **20,502** | **253,429** | **91,082** | **344,511** | **3,591,502** | | |

| | Year | Short-term | | | | Post-employment | | | Other long-term | Equity compensation[i, iv] | | | Total | Performance related remuneration as proportion of total % | Value of equity compensation as proportion of remuneration % |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Amounts $ | | Salary and fees | Bonuses[i] | Non-monetary benefits[ii] | Total | Super-annuation benefits | Leaving benefits[iii] | Total | Long service leave | Value of options | Value of perform-ance shares | Total | | | |
| **Executives** | | | | | | | | | | | | | | | |
| ***Consolidated Entity*** | | | | | | | | | | | | | | | |
| Mr R Brook[v, vi, vii] President, European Region | 2007 | 355,517 | 147,148 | 67,516 | 570,181 | 22,291 | - | 22,291 | - | 120,458 | 28,450 | 148,908 | 741,380 | 39.9% | 20.1% |
| | 2006 | 328,512 | 128,896 | 66,482 | 523,890 | 17,370 | - | 17,370 | - | 85,124 | 36,267 | 121,391 | 662,651 | 37.8% | 18.3% |
| Mr NJ Mitchell[v, vi, viii] Chief Financial Officer and Company Secretary | 2007 | 326,832 | 127,062 | - | 453,894 | 87,088 | - | 87,088 | 13,371 | 92,497 | 21,265 | 113,762 | 668,115 | 36.0% | 17.0% |
| | 2006 | 301,433 | 115,364 | - | 416,797 | 67,280 | - | 67,280 | 11,887 | 63,010 | 26,767 | 89,777 | 585,741 | 35.0% | 15.3% |
| Mr DN Morris[v, viii] President, Bone Anchored Solutions | 2007 | 319,118 | 109,164 | - | 428,282 | 13,662 | - | 13,662 | 6,768 | 81,203 | 18,897 | 100,100 | 548,812 | 38.1% | 18.2% |
| | 2006 | 276,007 | 93,939 | - | 369,946 | 12,139 | - | 12,139 | 5,483 | 56,152 | 23,442 | 79,594 | 467,162 | 37.1% | 17.0% |
| Mr MD Salmon[v, vi, viii] President, Asia Pacific Region | 2007 | 367,576 | 110,679 | - | 478,255 | 13,662 | - | 13,662 | 3,882 | 90,593 | 20,907 | 111,500 | 607,299 | 36.6% | 18.4% |
| | 2006 | 333,397 | 108,719 | - | 442,116 | 12,139 | - | 12,139 | 3,119 | 52,744 | 17,753 | 70,497 | 527,871 | 34.0% | 13.4% |
| Mr CM Smith[v, vi, vii] President, Americas Region | 2007 | 460,251 | 197,783 | 19,673 | 677,707 | 13,692 | - | 13,692 | - | 191,023 | 13,303 | 204,326 | 895,725 | 44.9% | 22.8% |
| | 2006 | 442,478 | 172,289 | 22,804 | 637,571 | 17,431 | - | 17,431 | - | 136,451 | 9,977 | 146,428 | 801,430 | 39.8% | 18.3% |
| Mr H Yoshikawa[vii, ix] General Manager and Representative Director, Japan | 2006 | 290,292 | 90,559 | 21,941 | 402,792 | 40,416 | - | 40,416 | - | 12,285 | 11,111 | 23,396 | 466,604 | 24.4% | 5.0% |
| ***Company*** | | | | | | | | | | | | | | | |
| Mr J Janssen[v, vi, x] Senior Vice President, Design and Development | 2007 | 310,876 | 108,448 | - | 419,324 | 13,662 | - | 13,662 | - | 55,741 | 11,112 | 66,853 | 499,839 | 35.1% | 13.4% |
| Mr MC Kavanagh[v] Senior Vice President, Global Marketing | 2007 | 295,699 | 100,635 | - | 396,334 | 13,662 | - | 13,662 | 5,321 | 76,356 | 17,885 | 94,241 | 509,558 | 38.2% | 18.5% |
| | 2006 | 276,961 | 92,127 | - | 369,088 | 12,139 | - | 12,139 | 7,154 | 54,287 | 23,484 | 77,771 | 466,152 | 36.4% | 16.7% |
| Mr JF Patrick[xi] Senior Vice President, Chief Scientist | 2006 | 246,840 | 89,467 | - | 336,307 | 38,549 | - | 38,549 | - | 53,457 | 23,057 | 76,514 | 451,370 | 36.8% | 17.0% |
| **Total executives** | **2007** | **2,435,869** | **900,919** | **87,189** | **3,423,977** | **177,719** | **-** | **177,719** | **29,342** | **707,871** | **131,819** | **839,690** | **4,470,728** | | |
| | **2006** | **2,495,920** | **891,360** | **111,227** | **3,498,507** | **217,463** | **-** | **217,463** | **27,643** | **513,510** | **171,858** | **685,368** | **4,428,981** | | |

(i) Short-term and long-term incentive bonuses are granted annually. The grant date is tied to the performance appraisal, which, for the current year was completed by 30 June 2007. The service and performance criteria are set out in this report.

(ii) Benefits include the provision of car allowances, health insurance and relocation costs.

(iii) Amounts accrued during the financial year to the directors' retirement scheme.

(iv) The value disclosed above is the proportion of the fair value of the options and performance shares allocated to the reporting period. The ability to exercise the options and performance shares is conditional on Cochlear achieving certain performance hurdles. The estimated value of options for the current financial year is calculated at the date of grant using the Black-Scholes model applying a 30% volatility, as reflected in the historical volatility. Further details of options granted during the financial year are set out below. The value of performance shares for the current financial year is calculated as the share price at the date of issue discounted for vesting probabilities.

(v) Executive is included as one of the five named Company executives or Consolidated Entity executives who received the highest remuneration in the current financial year in accordance with section 300A of the Corporations Act 2001.

(vi) Executive is included as a key management person in accordance with AASB 124 Related Party Disclosures.

(vii) Denotes overseas based executive.

(viii) Denotes Consolidated Entity and Company executives.

(ix) Not included in Consolidated Entity top five executives in 2007.

(x) Not included in Company top five executives in 2006.

(xi) Not included in Company top five executives in 2007.

### Exercise of options granted as remuneration – audited

During the reporting period, the following shares were issued on the exercise of options previously granted as compensation:

| | Number of shares | Amount paid $/share |
|---|---|---|
| **Executive director** | | |
| Dr JL Parker (retired 31 March 2007) | 11,445 | 34.19 |
| **Executives** | | |
| Mr R Brook | 14,482 | 34.19 |
| Mr MC Kavanagh | 9,917 | 34.19 |
| Mr NJ Mitchell | 10,542 | 34.19 |
| Mr DN Morris | 8,674 | 34.19 |

During the previous financial year, 80,000 options were exercised. There are no amounts unpaid on the shares issued as a result of the exercise of the options in prior years.

### Analysis of bonuses included in remuneration – unaudited

Details of the vesting profile of the short-term incentive bonuses awarded as remuneration to each executive director of the Company and each of the five named Company executives and relevant Consolidated Entity executives are detailed below:

| | Short-term incentive bonus | | |
|---|---|---|---|
| Amounts $ | Included in remuneration | % vested in the financial year(i) | % forfeited during the financial year(ii) |
| **Executive directors** | | | |
| Dr CG Roberts | 475,816 | 108.6% | - |
| Dr JL Parker (retired 31 March 2007) | 46,365 | 98.8% | 1.2% |
| **Executives** | | | |
| ***Consolidated Entity*** | | | |
| Mr R Brook | 147,148 | 102.4% | - |
| Mr NJ Mitchell | 127,062 | 107.6% | - |
| Mr DN Morris | 109,164 | 108.6% | - |
| Mr MD Salmon | 110,679 | 82.8% | 17.2% |
| Mr CM Smith | 197,783 | 121.5% | - |
| ***Company*** | | | |
| Mr J Janssen | 108,448 | 107.6% | - |
| Mr MC Kavanagh | 100,635 | 107.8% | - |

(i) Amounts included in vested short-term incentives for the financial year represent the amounts that vested in the financial year based on achievement of personal goals and specified financial goals. Amounts exceeding 100% indicate performance above target. No amounts vest in future financial years in respect of the CMSTIP for the financial year.

(ii) The amounts forfeited in short-term incentive bonuses are due to personal and financial goals not being met in the financial year.

**Analysis of share based payments granted as remuneration – unaudited**

Details of the vesting profile of the options and performance shares granted as remuneration to each director of the Company and each of the five named Company executives and relevant Consolidated Entity executives are below:

| | | | Options | | | | | Performance shares | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Date of grant | Financial years in which grant vests | Number granted | % vested in financial year | % forfeited in financial year[i] | Value yet to vest Min[ii]$ | Value yet to vest Max[iii]$ | Number granted | % vested in financial year | % forfeited in financial year[i] | Value yet to vest Min[ii]$ | Value yet to vest Max[iii]$ |
| **Executive directors** | | | | | | | | | | | | |
| Dr CG Roberts | 23 August 2004 | 30 June 2008 | 164,321 | - | - | nil | 723,874 | 10,595 | - | - | nil | 209,206 |
| | 22 August 2005 | 30 June 2009 | 79,468 | - | - | nil | 374,238 | 5,923 | - | - | nil | 128,722 |
| | 21 August 2006 | 30 June 2010 | 70,422 | - | - | nil | 438,025 | - | - | - | - | - |
| Dr JL Parker | 1 December 2003 | 30 June 2007 | 20,584 | 56% | 44% | nil | nil | 2,648 | 56% | 44% | nil | nil |
| (retired 31 March 2007) | 23 August 2004 | 30 June 2008 | 42,149 | - | - | nil | 185,677 | 2,717 | - | - | nil | 53,649 |
| | 22 August 2005 | 30 June 2009 | 28,447 | - | - | nil | 133,965 | 2,120 | - | - | nil | 46,073 |
| | 21 August 2006 | 30 June 2010 | 18,862 | - | - | nil | 117,322 | - | - | - | - | - |
| **Executives** | | | | | | | | | | | | |
| ***Consolidated Entity*** | | | | | | | | | | | | |
| Mr R Brook | 1 December 2003 | 30 June 2007 | 26,046 | 56% | 44% | nil | nil | 3,350 | 56% | 44% | nil | nil |
| | 23 August 2004 | 30 June 2008 | 54,736 | - | - | nil | 241,126 | 3,529 | - | - | nil | 69,683 |
| | 22 August 2005 | 30 June 2009 | 36,138 | - | - | nil | 170,210 | 2,694 | - | - | nil | 58,541 |
| | 21 August 2006 | 30 June 2010 | 23,239 | - | - | nil | 144,547 | - | - | - | - | - |
| Mr NJ Mitchell | 1 December 2003 | 30 June 2007 | 18,961 | 56% | 44% | nil | nil | 2,439 | 56% | 44% | nil | nil |
| | 23 August 2004 | 30 June 2008 | 38,886 | - | - | nil | 171,303 | 2,507 | - | - | nil | 49,569 |
| | 22 August 2005 | 30 June 2009 | 27,949 | - | - | nil | 131,620 | 2,083 | - | - | nil | 45,269 |
| | 21 August 2006 | 30 June 2010 | 18,980 | - | - | nil | 118,057 | - | - | - | - | - |
| Mr DN Morris | 1 December 2003 | 30 June 2007 | 15,600 | 56% | 44% | nil | nil | 2,007 | 56% | 44% | nil | nil |
| | 23 August 2004 | 30 June 2008 | 30,269 | - | - | nil | 133,328 | 2,507 | - | - | nil | 49,513 |
| | 22 August 2005 | 30 June 2009 | 22,843 | - | - | nil | 107,591 | 1,703 | - | - | nil | 37,006 |
| | 21 August 2006 | 30 June 2010 | 16,157 | - | - | nil | 100,497 | - | - | - | - | - |
| Mr MD Salmon | 23 August 2004 | 30 June 2008 | 38,904 | - | - | nil | 171,382 | 2,508 | - | - | nil | 49,522 |
| | 22 August 2005 | 30 June 2009 | 27,174 | - | - | nil | 127,990 | 2,025 | - | - | nil | 44,003 |
| | 21 August 2006 | 30 June 2010 | 18,422 | - | - | nil | 114,585 | - | - | - | - | - |
| Mr CM Smith | 23 August 2004 | 30 June 2008 | 165,830 | - | - | nil | 730,522 | - | - | - | - | - |
| | 22 August 2005 | 30 June 2009 | 28,646 | - | - | nil | 134,923 | 2,135 | - | - | nil | 46,394 |
| | 21 August 2006 | 30 June 2010 | 28,849 | - | - | nil | 179,441 | - | - | - | - | - |
| ***Company*** | | | | | | | | | | | | |
| Mr J Janssen | 1 December 2003 | 30 June 2007 | - | - | - | - | - | 1,000 | 56% | 44% | nil | nil |
| | 23 August 2004 | 30 June 2008 | - | - | - | - | - | 1,000 | - | - | nil | 19,746 |
| | 22 August 2005 | 30 June 2009 | 16,814 | - | - | nil | 79,193 | 1,253 | - | - | nil | 27,228 |
| | 21 August 2006 | 30 June 2010 | 21,217 | - | - | nil | 131,969 | - | - | - | - | - |
| Mr MC Kavanagh | 1 December 2003 | 30 June 2007 | 17,836 | 56% | 44% | nil | nil | 2,294 | 56% | 44% | nil | nil |
| | 23 August 2004 | 30 June 2008 | 34,605 | - | - | nil | 152,443 | 2,231 | - | - | nil | 44,053 |
| | 22 August 2005 | 30 June 2009 | 22,635 | - | - | nil | 106,595 | 1,687 | - | - | nil | 36,663 |
| | 21 August 2006 | 30 June 2010 | 15,005 | - | - | nil | 93,331 | - | - | - | - | - |

(i) The percentage forfeited in the financial year represents the reduction from the maximum number of options and performance shares available to vest due to EPS, TSR or employee service periods not being met.
(ii) The minimum value of options and performance shares yet to vest is nil as the performance criteria may not be met and consequently the options and performance shares may not vest.
(iii) The maximum value of options and performance shares yet to vest is not determinable as it depends on the market price of shares of the Company on the ASX at the date the option and performance shares vest. The maximum values disclosed above are based on the valuations as per this report.

### Analysis of movements in options – unaudited

The movement of values during the reporting period of options over ordinary shares of Cochlear Limited held by each Company director and each of the five named Company executives and relevant Consolidated Entity executives is detailed below:

| | Value of options | | | |
|---|---|---|---|---|
| Amounts $ | Granted in year(i) | Exercised in year(ii) | Forfeited in year(ii) | Total option value in year |
| **Executive directors** | | | | |
| Dr CG Roberts | 438,025 | - | - | 438,025 |
| Dr JL Parker (retired 31 March 2007) | 117,322 | 169,611 | 130,783 | 417,716 |
| **Executives** | | | | |
| ***Consolidated Entity*** | | | | |
| Mr R Brook | 144,547 | 323,518 | 165,487 | 633,552 |
| Mr NJ Mitchell | 118,057 | 176,057 | 120,471 | 414,585 |
| Mr DN Morris | 100,497 | 154,477 | 99,117 | 354,091 |
| Mr MD Salmon | 114,585 | - | - | 114,585 |
| Mr CM Smith | 179,441 | - | - | 179,441 |
| ***Company*** | | | | |
| Mr J Janssen | 131,969 | - | - | 131,969 |
| Mr MC Kavanagh | 93,331 | 165,611 | 113,324 | 372,266 |

(i) The value of options granted in the year is the fair value of options calculated at grant date using a Black-Scholes model. The total value of the options granted is included in the table above. This amount is allocated to remuneration over the vesting period (i.e. in years 30 June 2007 to 30 June 2010).

(ii) The value of options exercised and forfeited during the year is calculated as the market price of shares of the Company on the ASX as at close of trading on the date the options were exercised or forfeited after deducting the price paid or payable to exercise the option.

## Other items – unaudited

### Unissued shares under option

As at the date of this report, unissued ordinary shares of the Company under options are:

| Number of options | Plan | Exercise price per share | Exercise period |
|---|---|---|---|
| 715,540 | CELTIP | $18.97 | August 2007 – September 2009 |
| 714,257 | CELTIP | $39.93 | August 2008 – September 2010 |
| 518,894 | CELTIP | $49.43 | August 2009 – September 2011 |

The closing share price at 30 June 2007 was $61.00.

During the financial year, the Company granted 537,381 options over ordinary shares to employees under the CELTIP. The options are exercisable in the two years following lodgement with the ASX of the Company's preliminary financial report for the year ending 30 June 2009. The number of options which will be exercisable is dependent on the performance measures and retention requirements set out in this Remuneration Report.

During the year, 115,719 options granted by the Company were forfeited.

### Directors' interests

The relevant interest of each director in the share capital of the Company, as notified by the directors to the ASX in accordance with section 205G(1) of the Corporations Act 2001, at the date of this report is as follows:

| | Cochlear Limited ordinary shares | Options over ordinary shares |
|---|---|---|
| Mr PR Bell | 2,500 | - |
| Mr TCE Bergman | 12,000 | - |
| Prof E Byrne, AO | 1,000 | - |
| Mr A Denver | 500 | - |
| Mr R Holliday-Smith | 2,500 | - |
| Mr DP O'Dwyer | 2,950 | - |
| Dr CG Roberts | 422,018 | 314,211 |

### Indemnification of officers

Under the terms of Article 35 of the Company's Constitution, and to the extent permitted by law, the Company has indemnified the directors of the Company named in this Directors' Report, the Company Secretary, Mr NJ Mitchell, and other persons concerned in or taking part in the management of the Consolidated Entity. The indemnity applies when persons are acting in their capacity as officers of the Company in respect of:

- liability to third parties (other than the Company or related bodies corporate), if the relevant officer has acted in good faith; and
- cost and expenses of successfully defending legal proceedings in which relief under the Corporations Act 2001 is granted to the relevant officer.

### Insurance for directors and officers

During the financial year, the Company paid a premium for a Directors' and Officers' Liability Insurance policy and a Supplementary Legal Expenses Insurance policy. The insurance provides cover for the directors named in this Directors' Report, the Company Secretary, and officers and former directors and officers of the Company. The insurance also provides cover for present and former directors and officers of other companies in the Consolidated Entity. The directors have not included details of the nature of the liabilities covered and the amount of the premium paid in respect of the Directors' and Officers' Liability and Supplementary Legal Expenses Insurance policies, as such disclosure is prohibited under the terms of the contract.

### Events subsequent to reporting date

Other than the matter noted below, there has not arisen in the interval between the end of the financial year and the date of this Directors' Report, any item, transaction or event of a material and unusual nature likely, in the opinion of the directors of the Company, to affect significantly the operations of the Consolidated Entity, the results of those operations, or the state of affairs of the Consolidated Entity in future financial years.

***Dividends***

For dividends declared after 30 June 2007, see Note 8 to the financial statements.

### Rounding off

The Company is of a kind referred to in Australian Securities and Investments Commission (ASIC) Class Order 98/100 dated 10 July 1998 and in accordance with that Class Order, amounts in the Financial Report and Directors' Report have been rounded off to the nearest one thousand dollars, unless otherwise indicated.

Dated at Sydney this 14th day of August 2007.

Signed in accordance with a resolution of the directors:

Director

Director

**Lead auditor's independence declaration under section 307C of the Corporation Act 2001**

I declare that, to the best of my knowledge and belief, in relation to the audit for the year ended 30 June 2007 there have been:

(i) no contraventions of the auditor independence requirements as set out in the Corporations Act 2001 in relation to the audit; and

(ii) no contraventions of any applicable code of professional conduct in relation to the audit.

KPMG

KPMG

Sydney, 14 August 2007

Kevin Leighton, Partner

| | | Consolidated | | Company | |
|---|---|---|---|---|---|
| | | 2007 | 2006 | 2007 | 2006 |
| | Note | $000 | $000 | $000 | $000 |
| Revenue | 4(a) | 559,412 | 452,260 | 403,182 | 285,653 |
| Cost of sales | 4(b) | (161,334) | (130,962) | (183,561) | (110,771) |
| **Gross profit** | | **398,078** | **321,298** | **219,621** | **174,882** |
| Other income | 4(c) | 1,133 | 884 | 1,980 | 379 |
| Selling and general expenses | | (141,046) | (124,808) | (21,993) | (25,706) |
| Administration expenses | | (38,635) | (29,951) | (30,664) | (23,314) |
| Research and development expenses | 4(b) | (65,949) | (58,926) | (53,138) | (42,798) |
| **Results from operating activities** | | **153,581** | **108,497** | **115,806** | **83,443** |
| Financial income | 5 | 2,199 | 6,729 | 3,181 | 10,454 |
| Financial expense | 5 | (12,299) | (6,391) | (4,937) | (16) |
| **Net financing (expense)/income** | | **(10,100)** | **338** | **(1,756)** | **10,438** |
| Profit before tax | | 143,481 | 108,835 | 114,050 | 93,881 |
| Income tax expense | 7 | (45,805) | (30,610) | (29,363) | (26,522) |
| **Net profit (including minority interest)** | | **97,676** | **78,225** | **84,687** | **67,359** |
| Attributable to: | | | | | |
| **Equity holders of the parent** | | **100,131** | **80,032** | **84,687** | **67,359** |
| Minority interest | | (2,455) | (1,807) | - | - |
| Net profit (including minority interest) | | 97,676 | 78,225 | 84,687 | 67,359 |
| Basic earnings per share (cents) | | | | | |
| Ordinary shares | 10 | 182.9 | 146.8 | | |
| Diluted earnings per share (cents) | | | | | |
| Ordinary shares | 10 | 180.1 | 145.2 | | |

The income statements are to be read in conjunction with the notes to the financial statements set out on pages 62 to 101.

| | Consolidated | | Company | |
|---|---|---|---|---|
| | 2007 $000 | 2006 $000 | 2007 $000 | 2006 $000 |
| Foreign exchange translation differences | (5,072) | 2,638 | 420 | (391) |
| Cash flow hedges: | | | | |
| Effective portion of changes in fair value | 23,428 | (1,021) | 23,428 | (1,021) |
| Gain transferred to the income statement | (11,568) | (14,485) | (11,568) | (14,485) |
| **Net income recognised directly in equity** | **6,788** | **(12,868)** | **12,280** | **(15,897)** |
| Net profit (including minority interest) | 97,676 | 78,225 | 84,687 | 67,359 |
| **Total recognised income and expense for the period** | **104,464** | **65,357** | **96,967** | **51,462** |
| Attributable to: | | | | |
| Equity holders of the parent | 106,705 | 67,857 | 96,967 | 51,462 |
| Minority interest | (2,241) | (2,500) | - | - |
| **Total recognised income and expense for the period** | **104,464** | **65,357** | **96,967** | **51,462** |

Other movements in equity arising from transactions with equity participants as equity participants are set out in Note 25. The statements of recognised income and expense are to be read in conjunction with the notes to the financial statements set out on pages 62 to 101.

| | | Consolidated | | Company | |
|---|---|---|---|---|---|
| | | 2007 | 2006 | 2007 | 2006 |
| | Note | $000 | $000 | $000 | $000 |
| **Current assets** | | | | | |
| Cash and cash equivalents | 26(a) | 83,382 | 87,073 | 43,917 | 27,458 |
| Receivables | 11 | 143,076 | 109,388 | 99,275 | 109,770 |
| Inventories | 12 | 91,890 | 76,822 | 58,425 | 47,209 |
| Other | 13 | 5,390 | 5,920 | 2,787 | 2,349 |
| **Total current assets** | | **323,738** | **279,203** | **204,404** | **186,786** |
| **Non-current assets** | | | | | |
| Receivables | 11 | 6,178 | - | 6,178 | - |
| Other financial assets | 14 | 477 | 383 | 64,116 | 33,994 |
| Property, plant and equipment | 15 | 40,565 | 30,833 | 31,879 | 21,381 |
| Intangible assets | 16 | 196,268 | 205,238 | 13,533 | 4,126 |
| Deferred tax assets | 17 | 18,511 | 30,267 | 770 | 5,072 |
| **Total non-current assets** | | **261,999** | **266,721** | **116,476** | **64,573** |
| **Total assets** | | **585,737** | **545,924** | **320,880** | **251,359** |
| **Current liabilities** | | | | | |
| Trade and other payables | 18 | 61,923 | 57,345 | 33,381 | 28,337 |
| Loans and borrowings | 20 | 161,337 | 70,547 | 30,223 | - |
| Current tax liabilities | | 7,997 | 24,981 | 1,165 | 14,407 |
| Provisions | 22 | 30,953 | 27,058 | 20,872 | 15,642 |
| Other | 19 | 17,338 | 23,525 | 848 | 857 |
| **Total current liabilities** | | **279,548** | **203,456** | **86,489** | **59,243** |
| **Non-current liabilities** | | | | | |
| Loans and borrowings | 20 | 37,552 | 125,493 | - | - |
| Provisions | 22 | 7,828 | 6,433 | 6,399 | 5,655 |
| Other | 19 | - | 764 | - | 764 |
| **Total non-current liabilities** | | **45,380** | **132,690** | **6,399** | **6,419** |
| **Total liabilities** | | **324,928** | **336,146** | **92,888** | **65,662** |
| **Net assets** | | **260,809** | **209,778** | **227,992** | **185,697** |
| **Equity** | | | | | |
| Share capital | 24 | 69,998 | 66,663 | 69,998 | 66,663 |
| Reserves | 25 | 9,584 | 3,010 | 15,357 | 3,077 |
| Retained earnings | 25 | 181,227 | 137,864 | 142,637 | 115,957 |
| **Total equity attributable to equity holders of the parent** | | **260,809** | **207,537** | **227,992** | **185,697** |
| Minority interest | 25 | - | 2,241 | - | - |
| **Total equity** | 25 | **260,809** | **209,778** | **227,992** | **185,697** |

The balance sheets are to be read in conjunction with the notes to the financial statements set out on pages 62 to 101.

# STATEMENTS OF CASH FLOWS Cochlear Limited and its controlled entities for the year ended 30 June 2007

| | | Consolidated | | Company | |
|---|---|---|---|---|---|
| | | 2007 | 2006 | 2007 | 2006 |
| | Note | $000 | $000 | $000 | $000 |
| **Cash flows from operating activities** | | | | | |
| Cash receipts from customers | | 506,589 | 432,838 | 407,018 | 234,073 |
| Cash payments to suppliers and employees | | (367,238) | (352,164) | (263,108) | (209,038) |
| Dividends received | | - | - | 1,608 | - |
| Grant and other income received | | 151 | 884 | 151 | 379 |
| Interest received | | 2,353 | 3,816 | 3,204 | 5,896 |
| Interest paid | | (8,892) | (6,391) | (802) | (16) |
| Income taxes paid | | (56,127) | (27,428) | (43,397) | (19,358) |
| **Net cash provided by operating activities** | 26(b) | **76,836** | **51,555** | **104,674** | **11,936** |
| **Cash flows from investing activities** | | | | | |
| Payment for property, plant and equipment | | (18,596) | (14,329) | (13,506) | (6,968) |
| Payment for enterprise resource planning system | | (7,805) | (706) | (7,805) | - |
| Proceeds from sale of non-current assets | | 7,574 | 572 | 292 | 197 |
| Investment in controlled entities | | (7,953) | - | (30,000) | (15,380) |
| Payment for acquisition of manufacturing business | 27(b) | (9,972) | - | (9,972) | - |
| Development expenditure | | (375) | (179) | (375) | (179) |
| **Net cash used in investing activites** | | **(37,127)** | **(14,642)** | **(61,366)** | **(22,330)** |
| **Cash flows from financing activities** | | | | | |
| Repayment of borrowings | | (38,487) | (29,787) | (5,000) | (1,273) |
| Proceeds from borrowings | | 57,822 | 3,678 | 35,000 | - |
| Proceeds from issue of shares | | 3,335 | 17,288 | 3,335 | 17,288 |
| Dividends paid by the parent | | (60,383) | (49,096) | (60,383) | (49,096) |
| **Net cash used in financing activities** | | **(37,713)** | **(57,917)** | **(27,048)** | **(33,081)** |
| **Net increase/(decrease) in cash and cash equivalents** | | **1,996** | **(21,004)** | **16,260** | **(43,475)** |
| Cash and cash equivalents at 1 July | | 85,326 | 103,627 | 27,458 | 70,918 |
| Effects of exchange fluctuation on the balances of cash held in foreign currencies | | (5,585) | 2,703 | (24) | 15 |
| **Cash and cash equivalents at 30 June** | 26(a) | **81,737** | **85,326** | **43,694** | **27,458** |

The statements of cash flows are to be read in conjunction with the notes to the financial statements set out on pages 62 to 101.

## 1. Reporting entity

Cochlear Limited is a company domiciled in Australia. The consolidated financial statements of the Company as at and for the year ended 30 June 2007 comprise the Company and its subsidiaries. The Consolidated Entity operates in the implantable hearing device industry.

## 2. Basis of preparation

### (a) Statement of compliance

The financial report is a general purpose financial report which has been prepared in accordance with Australian Accounting Standards (AASBs) and the Corporations Act 2001. The financial report also complies with International Financial Reporting Standards and Interpretations adopted by the International Accounting Standards Board.

The financial statements were approved by the Board of directors on 14 August 2007.

### (b) Basis of measurement

The consolidated financial statements have been prepared on the historical cost basis except for derivative financial instruments which are measured at fair value. The methods used to measure fair values are discussed further in Note 3.

### (c) Functional and presentation currency

These consolidated financial statements are presented in Australian dollars, which is the Company's functional currency.

The Company is of a kind referred to in ASIC Class Order 98/100 dated 10 July 1998 and in accordance with that Class Order, all financial information presented in Australian dollars has been rounded to the nearest thousand unless otherwise stated.

### (d) Use of estimates and judgements

The preparation of a financial report requires management to make judgements, estimates and assumptions that affect the application of accounting policies and reported amounts of assets, liabilities, income and expenses. Actual results may differ from these estimates.

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected.

In particular, information about significant areas of estimation, uncertainty and critical judgements in applying accounting policies that have the most significant effect on the amount recognised in the financial statements is described in Note 3.

## 3. Significant accounting policies

Accounting policies have been applied consistently to all periods represented in these consolidated financial statements and have been applied consistently by all entities in the Consolidated Entity.

The entity has elected to early adopt the following accounting standards and amendments:
• AASB 101 Presentation of Financial Statements (October 2006).

In the prior financial year, the Consolidated Entity adopted AASB 132 Financial Instruments: Presentation and AASB 139 Financial Instruments: Recognition and Measurement in accordance with the transitional rules of AASB 1 First-time Adoption of Australian Equivalents to International Financial Reporting Standards. This change has been accounted for by adjusting the opening balance of reserves at 1 July 2005, as disclosed in Note 25.

Certain comparative amounts have been reclassified to conform with the current year's presentation.

### (a) Basis of consolidation

*Controlled entities*

Controlled entities are entities controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable or convertible are taken into account. The financial statements of controlled entities are included in the consolidated financial statements from the date that control commences until the date that control ceases.

Acquisitions of minority interest in a controlled entity is treated as a transaction with owners. Consequently, the difference between the purchase consideration and the carrying amount of the net assets of the subsidiary is treated as goodwill.

Investments in controlled entities are carried at their cost of acquisition in the Company's financial statements.

*Transactions eliminated on consolidation*

Intra-group balances and any unrealised gains and losses or income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

### (b) Income recognition

Revenues are recognised at fair value of the consideration received net of the amount of goods and services tax (GST).

***Sales revenue***

Sales revenue comprises revenue earned (net of returns, discounts and allowances) from the provision of products or services. Revenue from the sale of goods is recognised in the income statement when the significant risks and rewards of ownership have been transferred to the buyer. No revenue is recognised if there are significant uncertainties regarding recovery of the consideration due or if there is a risk of return of goods or there is continuing management involvement with the goods. Revenue from the sale of services is recognised when the service has been provided to the customer and where there are no continuing unfulfilled service obligations.

The accounting policy for foreign exchange gains/losses arising from hedges of forecast sales transactions is set out in accounting policy (f).

***Other income***

Other income, including government grants, is recognised on a systematic basis over the periods necessary to match it with the related costs for which it is intended to compensate or, if the costs have already been incurred, in the period in which it becomes receivable which is when the entitlement is confirmed. Dividend income from subsidiaries is recognised by the parent when the dividends are declared by the subsidiary.

### (c) Goods and services tax

Revenue, expenses and assets are recognised net of the amount of GST, except where the amount of GST incurred is not recoverable from the taxation authority. In these circumstances, the GST is recognised as part of the cost of acquisition of the asset or as part of the expense.

Receivables and payables are stated with the amount of GST included. The net amount of GST recoverable from, or payable to, the relevant taxation authority is included as a current asset or liability in the balance sheet.

Cash flows are included in the statement of cash flows on a gross basis. The GST components of cash flows arising from investing and financing activities which are recoverable from, or payable to, the relevant taxation authority are classified as operating cash flows.

### (d) Foreign currency

***Foreign currency transactions***

Transactions in foreign currencies are translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at reporting date are translated to Australian dollars at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement. Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to Australian dollars at foreign exchange rates ruling at the dates the fair values were determined.

***Financial statements of foreign operations***

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on consolidation, generally are translated to Australian dollars at foreign exchange rates ruling at balance date. The revenues and expenses of foreign operations are translated to Australian dollars at rates approximating the foreign exchange rates ruling at the dates of transactions.

***Net investment in foreign operations***

Exchange differences arising from the translation of the net investment in foreign operations, and of related hedges are taken to the foreign currency translation reserve. They are released into the income statement upon disposal.

### (e) Derivative financial instruments

The Consolidated Entity uses derivative financial instruments to hedge its exposure to foreign exchange arising from operating, investing and financing activities. In accordance with its treasury policy, the Consolidated Entity does not hold or issue derivative financial instruments for trading purposes. However, derivatives that do not qualify for hedge accounting are accounted for as trading instruments.

Derivative financial instruments are recognised initially at fair value. Subsequent to initial recognition, derivative financial instruments are stated at fair value. The gain or loss on remeasurement to fair value is recognised immediately in the income statement. However, where derivatives qualify for hedge accounting, recognition of any resultant gain or loss depends on the nature of the item being hedged (see accounting policy (f)).

### (f) Hedges

***Cash flow hedges***

Where a derivative financial instrument is designated as a hedge of the variability in cash flows of a recognised asset or liability, or a highly probable forecast transaction, the effective part of any gain or loss on the derivative financial instrument is recognised directly in equity. When the forecast transaction subsequently results in the recognition of a non-financial asset or non-financial liability, the associated cumulative gain or loss is removed from equity and included in the initial cost or other carrying amount of the non-financial asset or liability. If a hedge of a forecast transaction subsequently results in the recognition of a financial asset or a financial liability, then the associated gains and losses that were recognised directly in equity are reclassified into the income statement in the same period or periods during which the asset acquired or liability assumed affects the income statement.

For cash flow hedges, other than those covered by the preceding statement, the associated cumulative gain or loss is removed from equity and recognised in the income statement in the same period or periods during which the hedged forecast transaction affects the income statement and on the same line item as that hedged forecast transaction. The ineffective part of any gain or loss is recognised immediately in the income statement.

When a hedging instrument expires or is sold, terminated or exercised, or the Company revokes designation of the hedge relationship but the hedged forecast transaction still is expected to occur, the cumulative gain or loss at that point remains in equity and is recognised in accordance with the above policy when the transaction occurs. If the hedged transaction is no longer expected to take place, then the cumulative unrealised gain or loss recognised in equity is recognised immediately in the income statement.

*Hedge of monetary assets and liabilities*

When a derivative financial instrument is used to hedge economically the foreign exchange exposure of a recognised monetary asset or liability, hedge accounting is not applied and any gain or loss on the hedging instrument is recognised in the income statement.

*Hedge of net investment in foreign operations*

The portion of the gain or loss on an instrument used to hedge a net investment in a foreign operation that is determined to be an effective hedge is recognised directly in equity. The ineffective portion is recognised immediately in the income statement. When the hedged net investment is disposed of, the cumulative gain transferred to equity is transferred to the income statement.

### (g) Cash and cash equivalents

Cash and cash equivalents comprise cash balances and call deposits with an original maturity of three months or less. Bank overdrafts that are repayable on demand and form an integral part of the Consolidated Entity's cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

### (h) Provisions

A provision is recognised in the balance sheet when the Consolidated Entity has a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation.

*Warranties*

Provisions for warranty claims are made for claims in relation to sales made prior to the reporting date, based on historical claim rates and respective product populations. The provision is determined on a discounted cash flow basis. Warranty periods on hardware products extend for three to 10 years. The Consolidated Entity is expected to incur the majority of the liability over the next three to 10 years.

*Restructuring, employee termination benefits and surplus lease space*

Provisions for restructuring or termination benefits are only recognised when a detailed plan has been approved and the restructuring or termination has either commenced or been publicly announced, or firm contracts related to the restructuring or termination benefits have been entered into. Costs related to ongoing activities are not provided for. The liabilities for termination benefits that will be paid as a result of these restructurings have been included in the provision for employee benefits.

Provision is made for non-cancellable operating lease rentals payable on surplus leased premises when it is determined that no substantive future benefit will be obtained from their occupancy and sub-lease rentals are less than the lease rentals paid. The estimate is calculated based on discounted net future cash flows, using the interest rate implicit in the lease or an estimate thereof.

*Self-insurance*

The Company self-insures to manage certain risks associated with operating in its line of business. Outstanding claims are recognised when an incident occurs that may give rise to a claim and are measured at the cost that the entity expects to incur in settling the claims, discounted using a rate that reflects current market assessments of the time value of money and the risks specific to the liability.

*Make good lease costs*

The Consolidated Entity has a number of operating leases over its offices that require the asset to be returned to the lessor in its original condition. The operating lease payments do not include an element for the repairs/overhauls.

A provision for make good lease costs is recognised at the time it is determined that it is probable that such costs will be incurred in a future period, measured at the expected cost of returning the asset to the lessor in its original condition. The Consolidated Entity is expected to incur the liability within the next 11 years. An offsetting asset of the same value is also recognised and is classified in property, plant and equipment. This asset is amortised to the income statement over the life of the lease.

### (i) Intangible assets

*Goodwill*

All business combinations are accounted for by applying the purchase method. Goodwill represents the difference between the cost of the acquisition and the fair value of the net identifiable assets acquired.

Goodwill is stated at cost less any accumulated impairment losses. Goodwill is allocated to cash generating units and is tested annually for impairment (see accounting policy (j)). Negative goodwill arising on an acquisition is recognised directly in the income statement.

*Enterprise resource planning system*

The external expenditure incurred on hardware and software and the external costs necessary for the implementation of the system are recognised as an intangible asset, to the extent that the Consolidated Entity controls future economic benefits as a result of the costs incurred, and is stated at cost less accumulated amortisation. All internal development, licence and support costs attributable to feasibility, alternative approach assessment and implementation are expensed as incurred.

*Research and development expenditure*

Expenditure on research activities, undertaken with the prospect of gaining new scientific or technical knowledge and understanding, is recognised in the income statement as an expense as incurred.

Expenditure on development activities, whereby research findings are applied to a plan or design for the production of new or substantially improved products and processes, is capitalised if the product or process is technically and commercially feasible and the Consolidated Entity has sufficient resources to complete development.

The expenditure capitalised includes the cost of materials, direct labour and an appropriate proportion of overheads. Other development expenditure is recognised in the income statement as an expense as incurred. Capitalised development expenditure is stated at cost less accumulated amortisation (see below) and impairment losses (see accounting policy (j)).

*Other intangible assets*

Other intangible assets, principally comprising of technology acquired, customer relationships and intellectual property, are acquired individually or through business combinations and are stated at cost less accumulated amortisation (see below) and impairment losses (see accounting policy (j)).

Expenditure on internally generated goodwill and brands is recognised in the income statement as an expense as incurred.

*Subsequent expenditure*

Subsequent expenditure on capitalised intangible assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

*Amortisation*

Amortisation is charged to the income statement on a straight-line basis over the estimated useful lives of the intangible assets unless such lives are indefinite. Goodwill and intangible assets with an indefinite useful life are systematically tested for impairment annually. Other intangible assets are amortised from the date that they are available for use. The estimated useful lives for the current and comparative periods are as follows:

| | |
|---|---|
| Acquired technology | 4 years |
| Enterprise resource planning system | 2.5 – 4 years |
| Customer relationships | 4 years |
| Intellectual property | 3 years |
| Capitalised development expenditure | 1 – 3 years. |

### (j) Impairment

The carrying amounts of the Consolidated Entity's assets, other than inventories (see accounting policy (l)), employee benefit assets (see accounting policy (m)), and deferred tax assets (see accounting policy (o)), are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated (see below).

For goodwill, assets that have an indefinite useful life and intangible assets that are not yet available for use, the recoverable amount is estimated at each balance sheet date.

An impairment loss is recognised whenever the carrying amount of an asset or its cash generating unit exceeds its recoverable amount. Impairment losses are recognised in the income statement unless the asset has previously been revalued, in which case the impairment loss is recognised as a reversal to the extent of that previous revaluation with any excess recognised through the income statement.

Impairment losses recognised in respect of cash generating units are allocated first to reduce the carrying amount of any goodwill allocated to the cash generating unit or a group of units and then, to reduce the carrying amount of the other assets in the unit or a group of units on a pro-rata basis.

*Calculation of recoverable amount*

*Receivables*

The recoverable amount of the Consolidated Entity's investments in held-to-maturity receivables carried at amortised cost is calculated as the present value of estimated future cash flows, discounted at the original effective interest rate (i.e. the effective interest rate computed at initial recognition of these financial assets). Receivables with a short duration are not discounted.

Impairment of receivables is not recognised until objective evidence is available that a loss event has occurred. Significant receivables are individually assessed for impairment. Impairment testing of significant receivables that are not assessed as impaired individually is performed by placing them into portfolios of significant receivables with similar risk profiles and undertaking a collective assessment of impairment. Non-significant receivables are not individually assessed. Instead, impairment testing is performed by placing non-significant receivables in portfolios of similar risk profiles, based on objective evidence from historical experience adjusted for any effects of conditions existing at each balance date.

The allowance for impairment is calculated with reference to the profile of debtors in the Consolidated Entity's sales and marketing regions.

*Other assets*

The recoverable amount of other assets is the greater of their fair value less costs to sell, and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash generating unit to which the asset belongs.

***Reversals of impairment***

An impairment loss in respect of a receivable carried at amortised cost is reversed if the subsequent increase in recoverable amount can be related objectively to an event occurring after the impairment loss was recognised.

An impairment loss in respect of goodwill is not reversed.

In respect of other assets, an impairment loss is reversed when there is an indication that the impairment loss may no longer exist and there has been a change in the estimates used to determine the recoverable amount.

An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

### (k) Property, plant and equipment

***Owned assets***

Items of property, plant and equipment are stated at cost less accumulated depreciation (see below) and impairment losses (see accounting policy (j)). An asset's cost is determined as consideration provided plus incidental costs directly attributable to the acquisition.

The cost of self-constructed assets includes the cost of material and direct labour, an appropriate proportion of fixed and variable overheads, and capitalised interest.

Subsequent costs in relation to replacing a part of property, plant and equipment are recognised in the carrying amount if it is possible that future economic benefits embodied within the item will flow to the Consolidated Entity and the cost of the item can be measured reliably. All other costs are recognised in the income statement as incurred.

***Leased assets***

*Operating leases*

Payments made under operating leases are expensed on a straight-line basis over the term of the lease, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased property. Minimum lease payments include fixed rate step-ups.

***Depreciation***

Items of property, plant and equipment, including leasehold assets, are depreciated using the straight-line method over their estimated useful lives, taking into account estimated residual values. Assets are depreciated from the date of acquisition or, in respect of internally constructed assets, from the time an asset is completed and held ready for use.

Depreciation rates and methods and residual values are reviewed annually for appropriateness. When changes are made, adjustments are reflected prospectively in current and future financial periods only.

The estimated useful lives in the current and comparative periods are as follows:

| | |
|---|---|
| Leasehold improvements | 5 – 9 years |
| Plant and equipment | 3 – 8 years. |

### (l) Inventories

Inventories are carried at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business less estimated costs of completion and selling, marketing and distribution expenses.

Cost is based on the first-in-first-out principle and includes expenditure incurred in acquiring the inventories and bringing them to their existing condition and location. In the case of manufactured inventories and work in progress, cost includes an appropriate share of both variable and fixed overhead costs. Fixed overhead costs are allocated on the basis of normal operating capacity.

### (m) Employee benefits

***Defined contribution plans***

Obligations for contributions to defined contribution plans are recognised as an expense in the income statement as incurred.

***Defined benefit plans***

A liability or asset in respect of defined benefit plans is recognised in the balance sheet, and is measured as the present value of the defined benefit obligation as at the reporting date plus unrecognised actuarial gains or losses less the fair value of the plan's assets at that date and any unrecognised past service cost. The present value of the defined benefit obligation is based on expected future payments which arise from membership of the plan to the reporting date, calculated annually by independent actuaries using the projected unit credit method.

When the calculation results in plan assets exceeding liabilities to the Consolidated Entity, the recognised asset is limited to the net total of any unrecognised actuarial losses and past service costs and the present value of any future refunds from the plan or reductions in future contributions to the plan.

Past service cost is the increase in the present value of the defined benefit obligation for employee services in prior periods, resulting in the current period from the introduction of, or changes to, post-employment benefits or other long-term employee benefits. Past service costs may either be positive (where benefits are introduced or improved) or negative (where existing benefits are reduced).

Expected future payments are discounted using market yields at the reporting date on national government bonds with terms to maturity and currency that match the estimated future cash flows.

When the benefits of a plan are improved, the portion of the increased benefit relating to past service by employees is recognised as an expense in the income statement on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits vest immediately, the expense is recognised immediately in the income statement.

The full amount of actuarial gains and losses that arise subsequent to transition date will be recognised directly in retained earnings.

***Wages, salaries and annual leave***

Liabilities for employee benefits for wages, salaries and annual leave expected to settle within 12 months of the year end represent present obligations resulting from employees' services provided up to reporting date, calculated at undiscounted amounts based on remuneration wage and salary rates that the Consolidated Entity expects to pay as at reporting date including related on-costs, such as workers' compensation insurance and payroll tax.

***Long service leave***

The provision for employee benefits to long service leave represents the present value of the estimated future cash outflows to be made by the employer resulting from employees' services provided up to reporting date.

The provision is calculated using expected future increases in remuneration rates, including related on-costs and expected settlement dates based on turnover history, and is discounted using the rates attaching to national government securities at reporting date, which most closely match the terms of maturity of the related liabilities. The unwinding of the discount is treated as a long service leave expense.

***Equity based transactions***

The Company has granted options and performance shares to certain employees under the Cochlear Executive Long Term Incentive Plan (CELTIP).

The fair value of options and shares granted is recognised as an employee benefits expense with a corresponding increase in equity. The fair value is measured at the date the options or shares are granted taking into account market and non-market based criteria and expensed over the vesting period after which the employees become unconditionally entitled to the options and shares. The fair value of the options granted is measured using the Black-Scholes method, taking into account the terms and conditions attached to the options. The fair value of the performance shares granted is measured using the weighted average share price of ordinary shares in the Company, taking into account the terms and conditions attached to the shares. The amount recognised as an expense is adjusted to reflect the actual number of options and shares that vest except where forfeiture is due to market related conditions.

***Treasury shares***

The Company operates the Cochlear Executive Long Term Incentive Plan (Performance Shares) Trust (Trust). The main purpose of the Trust is to hold unvested performance shares as part of the CELTIP. Under AIFRS, the Trust qualifies as an equity compensation plan special purpose entity and its results are included in those for the Company and the Consolidated Entity.

Any shares held by the Trust are accounted for as treasury shares and treated as a reduction in the share capital of the Company and the Consolidated Entity.

### (n) Receivables

Trade and other receivables are stated at amortised cost less impairment losses (see accounting policy (j)).

### (o) Taxation

Income tax in the income statement for the periods presented comprises current and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantially enacted at reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The following temporary differences are not provided for: the initial recognition of goodwill and other assets or liabilities that affect neither accounting nor taxable profit, and differences relating to investments in subsidiaries to the extent that they will probably not reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at reporting date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

### (p) Payables

Trade and other payables are stated at amortised cost.

### (q) Loans and borrowings

Loans and borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, loans and borrowings are stated at amortised cost with any difference between amortised cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest rate basis.

### (r) Net financing (expense)/income

Financial costs include interest and finance charges in respect of finance leases. Debt establishment costs are capitalised and recognised as a reduction in loans and borrowings. They are calculated based on the effective interest rate method and are amortised over the period of the loan. Interest income is recognised as it accrues. Foreign exchange differences net of the effect of hedges on borrowings are recognised in net financing (expense)/income.

### (s) Earnings per share

Basic earnings per share (EPS) is calculated by dividing the net profit attributable to equity holders of the parent for the financial period, after excluding any costs of servicing equity (other than ordinary shares) by the weighted average number of ordinary shares of the Company, adjusted for any bonus issue.

Diluted EPS is calculated by dividing the basic EPS earnings, adjusted by the after-tax effect of financing costs associated with the dilutive potential ordinary shares and the effect on revenues and expenses of conversion to ordinary shares associated with dilutive potential ordinary shares, by the weighted average number of ordinary shares and dilutive potential ordinary shares of the Company adjusted for any bonus issue.

### (t) Segment reporting

A segment is a distinguishable component of the Consolidated Entity that is engaged either in providing products or services within a particular economic environment (geographical segment), or in providing products or services (business segment), which is subject to risks and rewards that are different from those of other segments.

### (u) Accounting estimates and judgements

Management discussed with the Audit Committee the development, selection and disclosure of the Consolidated Entity's critical accounting policies and estimates and the application of these policies and estimates.

***Key sources of estimation uncertainty***

*Office of Inspector General inquiry*
Cochlear Americas, a wholly-owned subsidiary of the Company, is subject to an inquiry being handled by the Office of Inspector General. For further details, refer to Note 23.

### (v) Share capital

***Ordinary shares***

Incremental costs directly attributable to issue of ordinary shares and share options are recognised as a deduction from equity, net of any income tax benefit.

***Repurchase of share capital***

When share capital recognised as equity is repurchased, the amount of the consideration paid, including directly attributable costs, is recognised as a deduction from equity.

***Dividends***

A liability for dividends payable is recognised in the financial period in which the dividends are declared.

### (w) New standards and interpretations not yet adopted

The following standards, amendments to standards and interpretations have been identified as those which may impact the entity in the period of initial application. They are available for early adoption at 30 June 2007, but have not been applied in preparing this financial report:

- AASB 7 Financial Instruments: Disclosures;
- AASB 2005-10 Amendments to Australian Accounting Standards; and
- AASB 8 Operating Segments.

The impact of these standards is yet to be determined but they will be applied by the Consolidated Entity on the relevant application date.

| | Consolidated | | Company | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| | $000 | $000 | $000 | $000 |
| **4. Revenue and expenses** | | | | |
| **(a) Revenue** | | | | |
| Sale of goods revenue before hedging | 539,711 | 428,516 | 386,414 | 264,802 |
| Foreign exchange gains on hedged sales | 16,526 | 20,693 | 16,526 | 20,693 |
| **Revenue from the sale of goods** | **556,237** | **449,209** | **402,940** | **285,495** |
| Rendering of services revenue | 3,175 | 3,051 | 242 | 158 |
| **Total revenue** | **559,412** | **452,260** | **403,182** | **285,653** |
| **(b) Expenses** | | | | |
| Cost of sales: | | | | |
| Carrying amount of inventories recognised as an expense | 156,045 | 128,028 | 143,785 | 110,665 |
| Other | 3,415 | 2,681 | 38,744 | 106 |
| Write-down in value of inventories | 1,874 | 253 | 1,032 | - |
| **Total cost of sales** | **161,334** | **130,962** | **183,561** | **110,771** |
| Research and development expenses: | | | | |
| Research and development expenditure | 63,753 | 56,703 | 50,942 | 40,575 |
| Development expenditure capitalised | (375) | (179) | (375) | (179) |
| Capitalised development expenditure – amortisation expense | 2,571 | 2,402 | 2,571 | 2,402 |
| **Total research and development expenses** | **65,949** | **58,926** | **53,138** | **42,798** |
| **(c) Other income** | | | | |
| Grant received or due and receivable | 151 | 233 | 151 | 233 |
| Dividend from controlled entity | - | - | 1,608 | - |
| Other income | 982 | 651 | 221 | 146 |
| **Total other income** | **1,133** | **884** | **1,980** | **379** |
| **(d) Employee benefits expense** | | | | |
| Wages and salaries | 125,466 | 103,554 | 65,165 | 52,403 |
| Contributions to superannuation funds | 7,366 | 5,959 | 4,782 | 4,509 |
| Increase in leave liabilities | 3,367 | 2,632 | 2,579 | 1,053 |
| Equity settled transactions | 3,615 | 2,466 | 2,376 | 1,673 |
| **Total employee benefits expense** | **139,814** | **114,611** | **74,902** | **59,638** |
| **(e) Other expenses** | | | | |
| Costs resulting from integration of acquired entity | 573 | 1,524 | - | - |
| **Total other expenses** | **573** | **1,524** | **-** | **-** |
| **(f) Profit before tax has been arrived at after charging/(crediting) the following items:** | | | | |
| Operating lease rental expense | 7,611 | 6,647 | 3,510 | 2,687 |
| Decrease in provisions | (171) | (2,003) | (137) | (2,496) |
| Loss/(gain) on disposal of property, plant and equipment | 1,125 | 20 | (27) | (177) |

| | Consolidated | | Company | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| | $000 | $000 | $000 | $000 |
| **5. Net financing (expense)/income** | | | | |
| Interest income | 2,199 | 3,683 | 3,181 | 5,762 |
| Net foreign exchange gain | - | 3,046 | - | 4,692 |
| **Financial income** | **2,199** | **6,729** | **3,181** | **10,454** |
| Interest expense | (8,892) | (6,391) | (887) | (16) |
| Net foreign exchange loss | (3,407) | - | (4,050) | - |
| **Financial expenses** | **(12,299)** | **(6,391)** | **(4,937)** | **(16)** |
| **Net financing (expense)/income** | **(10,100)** | **338** | **(1,756)** | **10,438** |

| | Consolidated | | Company | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| | $ | $ | $ | $ |
| **6. Auditors' remuneration** | | | | |
| **Audit services** | | | | |
| Auditors of the Company: | | | | |
| KPMG Australia: | | | | |
| - audit and review of financial reports | 428,000 | 350,000 | 428,000 | 335,500 |
| - other regulatory audit services | 21,500 | 6,400 | 21,500 | 6,400 |
| Overseas KPMG firms: | | | | |
| - audit and review of financial reports | 591,762 | 443,796 | - | 25,876 |
| - other regulatory audit services | 51,855 | - | 35,472 | - |
| **Total audit services** | **1,093,117** | **800,196** | **484,972** | **367,776** |
| **Other services** | | | | |
| Auditors of the Company: | | | | |
| KPMG Australia: | | | | |
| - taxation services | 355,760 | 185,698 | 355,760 | 150,962 |
| - international taxation services | 783,394 | 423,792 | 783,394 | 387,720 |
| - other assurance services | 19,500 | 17,250 | 19,500 | 17,250 |
| Overseas KPMG firms: | | | | |
| - taxation services | 334,027 | 218,217 | 21,319 | 16,350 |
| - international taxation services | 108,467 | 118,717 | 100,077 | 7,580 |
| - other assurance services | 52,827 | 9,700 | 52,827 | - |
| **Total other services** | **1,653,975** | **973,374** | **1,332,877** | **579,862** |

| | | Consolidated | | Company | |
|---|---|---|---|---|---|
| | Note | 2007 $000 | 2006 $000 | 2007 $000 | 2006 $000 |

## 7. Income tax expense

| | Note | 2007 $000 | 2006 $000 | 2007 $000 | 2006 $000 |
|---|---|---|---|---|---|
| Recognised in the income statement | | | | | |
| Current tax expense | | | | | |
| Current year | | 37,669 | 40,237 | 31,275 | 25,792 |
| Under/(over) provided in prior years | | 1,463 | (283) | (1,131) | (406) |
| | | **39,132** | **39,954** | **30,144** | **25,386** |
| Deferred tax expense/(benefits) | | | | | |
| Origination and reversal of temporary differences | | 4,062 | (5,777) | (781) | 1,136 |
| Benefits of tax losses | | 2,611 | (3,567) | - | - |
| | 17 | 6,673 | (9,344) | (781) | 1,136 |
| **Total income tax expense in the income statement** | | **45,805** | **30,610** | **29,363** | **26,522** |
| **Numerical reconciliation between income tax expense and profit before tax** | | | | | |
| Profit before tax | | 143,481 | 108,835 | 114,050 | 93,881 |
| Income tax expense using the domestic corporate rate of 30% (2006: 30%) | | 43,044 | 32,651 | 34,215 | 28,164 |
| Increase in income tax expense due to: | | | | | |
| Non-deductible expenses | | 4,080 | 764 | 685 | 617 |
| Effect of tax rate in foreign jurisdictions | | 1,949 | - | 807 | 151 |
| Decrease in income tax expense due to: | | | | | |
| Research and development allowance | | (4,731) | (2,004) | (4,731) | (2,004) |
| Non-assessable dividends from controlled entities | | - | - | (482) | - |
| Effect of tax rate in foreign jurisdictions | | - | (518) | - | - |
| | | **44,342** | **30,893** | **30,494** | **26,928** |
| Under/(over) provided in prior years | | 1,463 | (283) | (1,131) | (406) |
| **Income tax expense on profit before tax** | | **45,805** | **30,610** | **29,363** | **26,522** |
| Deferred tax recognised directly in equity | | | | | |
| Relating to derivative financial instruments | 17 | 5,083 | (6,645) | 5,083 | (6,645) |

## 8. Dividends

Dividends recognised in the current financial year by the Company are:

| | Cents per share | Total amount $000 | Franked/unfranked | Date of payment |
|---|---|---|---|---|
| **2007** | | | | |
| Interim 2007 ordinary | 55.0 | 30,208 | Franked | 20 Mar 2007 |
| Final 2006 ordinary | 55.0 | 30,175 | Franked | 21 Sep 2006 |
| **Total amount** | | **60,383** | | |
| **2006** | | | | |
| Interim 2006 ordinary | 45.0 | 24,666 | Franked | 14 Mar 2006 |
| Final 2005 ordinary | 45.0 | 24,430 | Franked | 22 Sep 2005 |
| **Total amount** | | **49,096** | | |

Franked dividends declared or paid during the financial year were franked at the tax rate of 30%.

**Subsequent events**

Since the end of the financial year, the directors declared the following dividends:

| | Cents per share | Total amount $000 | Franked/unfranked | Date of payment |
|---|---|---|---|---|
| Final 2007 ordinary | 70.0 | 38,446 | Franked | 27 Sep 2007 |
| **Total amount** | | **38,446** | | |

The financial effect of the 2007 final dividend has not been brought to account in the financial statements for the year ended 30 June 2007 and will be recognised in the subsequent financial period.

There are no further tax consequences as a result of paying dividends other than a reduction in the franking account as shown below:

| | Company | |
|---|---|---|
| | 2007 $000 | 2006 $000 |
| **Dividend franking account** | | |
| 30% franking credits available to shareholders of Cochlear Limited for subsequent financial periods | 17,173 | 13,352 |

The above amounts are based on the balance of the dividend franking account at year end adjusted for:

- franking credits that will arise from the payment of the current tax liability;
- franking debits that will arise from the payment of dividends recognised as a liability at the year end; and
- franking credits that the Company may be prevented from distributing in subsequent financial years.

The ability to utilise the franking credits is dependent upon there being sufficient available profits to declare dividends. The impact on the dividend franking account of dividends proposed after balance sheet date but not recorded as a liability is to reduce it by $16,476,945 (2006: $12,932,223).

No additional current tax liability will arise to the extent that franking credits are available with which to pay appropriately franked dividends. Dividends in excess of the balance of the dividend franking account will either be unfranked or result in franking deficit tax liability payable by the Company to the extent that franking credits are provided that do not exist. The Company's policy is not to pay dividends with franking credits that will result in a franking deficit tax liability.

## 9. Segment reporting

Inter-segment pricing is on an arms length basis and is determined in accordance with transfer pricing arrangements.

Segment results, assets and liabilities include items directly attributable to a segment, as well as those that can be allocated on a reasonable basis. Unallocated items mainly comprise corporate expenses and assets associated with the manufacturing process.

In presenting information on the basis of geographical segments, segment revenue is based on the geographical location of customers. Segment assets are based on the geographical location of the assets.

The Consolidated Entity's geographical segments as follows:

| | Americas | | Europe | | Asia Pacific | | Eliminations | | Consolidated | |
|---|---|---|---|---|---|---|---|---|---|---|
| | 2007 $000 | 2006 $000 | 2007 $000 | 2006 $000 | 2007 $000 | 2006 $000 | 2007 $000 | 2006 $000 | 2007 $000 | 2006 $000 |
| **Revenue** | | | | | | | | | | |
| Revenue outside the Consolidated Entity | 249,768 | 198,188 | 212,992 | 173,722 | 80,126 | 59,657 | - | - | 542,886 | 431,567 |
| Inter-segment sales revenue | - | - | - | - | 328,888 | 229,657 | (328,888) | (229,657) | - | - |
| Total segment revenue | 249,768 | 198,188 | 212,992 | 173,722 | 409,014 | 289,314 | (328,888) | (229,657) | 542,886 | 431,567 |
| Foreign exchange gains on hedged sales | | | | | | | | | 16,526 | 20,693 |
| **Total revenue** | | | | | | | | | **559,412** | **452,260** |
| Segment result | 77,201 | 52,065 | 63,407 | 45,721 | 20,298 | 12,048 | - | - | 160,906 | 109,834 |
| Unallocated net expenses | | | | | | | | | (7,325) | (1,337) |
| Net financing (expense)/income | | | | | | | | | (10,100) | 338 |
| Profit before tax | | | | | | | | | 143,481 | 108,835 |
| Income tax expense | | | | | | | | | (45,805) | (30,610) |
| **Net profit (including minority interest)** | | | | | | | | | **97,676** | **78,225** |
| Segment depreciation and amortisation | 4,257 | 4,953 | 2,663 | 2,954 | 902 | 892 | - | - | 7,822 | 8,799 |
| Unallocated depreciation and amortisation | | | | | | | | | 9,283 | 7,276 |
| **Total depreciation and amortisation** | | | | | | | | | **17,105** | **16,075** |
| Segment non-cash expenses other than depreciation and amortisation | (131) | 1,775 | 2,598 | 479 | 717 | 278 | - | - | 3,184 | 2,532 |
| Unallocated non-cash expenses other than depreciation and amortisation | | | | | | | | | 2,045 | (812) |
| **Total non-cash expenses other than depreciation and amortisation** | | | | | | | | | **5,229** | **1,720** |
| **Inventory write-down** | **900** | **203** | **842** | **15** | **132** | **35** | **-** | **-** | **1,874** | **253** |
| Segment assets | 154,392 | 164,697 | 258,181 | 231,758 | 38,748 | 40,560 | (89,220) | (57,840) | 362,101 | 379,175 |
| Unallocated assets | | | | | | | | | 223,636 | 166,749 |
| **Total assets** | | | | | | | | | **585,737** | **545,924** |
| Segment liabilities | 78,269 | 85,570 | 63,995 | 66,116 | 9,535 | 9,699 | (64,014) | (89,226) | 87,785 | 72,159 |
| Unallocated liabilities | | | | | | | | | 237,143 | 263,987 |
| **Total liabilities** | | | | | | | | | **324,928** | **336,146** |
| Segment acquisition of non-current assets | 1,870 | 2,129 | 6,449 | 5,444 | 999 | 360 | - | - | 9,318 | 7,933 |
| Unallocated acquisition of non-current assets | | | | | | | | | 17,083 | 7,102 |
| **Total acquisition of non-current assets** | | | | | | | | | **26,401** | **15,035** |

**Secondary reporting**

The Consolidated Entity operates in a single business segment, being the implantable hearing device industry.

| | Consolidated | |
|---|---|---|
| | 2007 | 2006 |
| **10. Earnings per share** | | |
| **Basic earnings per share** | | |
| The calculation of basic earnings per share for the year ended 30 June 2007 was based on net profit attributable to equity holders of the parent of $100,131,000 (2006: $80,032,000) and a weighted average number of ordinary shares outstanding during the year ended 30 June 2007 of 54,742,745 (2006: 54,530,299) calculated as follows: | | |
| Net profit attributable to equity holders of the parent | $100,131,000 | $80,032,000 |
| Weighted average number of ordinary shares: | | |
| Issued ordinary shares at 1 July | 54,636,995 | 54,169,325 |
| Effect of shares due to exercise of options and performance shares | 96,795 | 350,376 |
| Effect of shares issued relating to employee shares granted | 8,955 | 10,598 |
| **Weighted average number of ordinary shares (basic)** | **54,742,745** | **54,530,299** |
| **Diluted earnings per share** | | |
| The calculation of diluted earnings per share for the year ended 30 June 2007 was based on net profit attributable to equity holders of the parent of $100,131,000 (2006: $80,032,000) and a weighted average number of ordinary shares outstanding during the year ended 30 June 2007 of 55,582,822 (2006: 55,122,283) calculated as follows: | | |
| Net profit attributable to equity holders of the parent | $100,131,000 | $80,032,000 |
| Weighted average number of ordinary shares (diluted): | | |
| Weighted average number of shares (basic) | 54,742,745 | 54,530,299 |
| Effect of options and performance shares | 840,077 | 591,984 |
| **Weighted average number of ordinary shares (diluted)** | **55,582,822** | **55,122,283** |

| | | Consolidated | | Company | |
|---|---|---|---|---|---|
| | | 2007 | 2006 | 2007 | 2006 |
| | Note | $000 | $000 | $000 | $000 |
| **11. Receivables** | | | | | |
| **Current** | | | | | |
| Trade receivables net of allowance for impairment loss | | 116,897 | 96,060 | 13,359 | 10,987 |
| Other receivables | | 10,277 | 7,427 | 6,043 | 4,100 |
| Amount receivable from controlled entities | 30 | - | - | 63,971 | 88,782 |
| Forward exchange contracts | | 15,902 | 5,901 | 15,902 | 5,901 |
| **Total current receivables** | | **143,076** | **109,388** | **99,275** | **109,770** |
| **Non-current** | | | | | |
| Forward exchange contracts | | 6,178 | - | 6,178 | - |
| **Total non-current receivables** | | **6,178** | **-** | **6,178** | **-** |
| **12. Inventories** | | | | | |
| Raw materials and stores | | 38,372 | 28,975 | 35,259 | 26,900 |
| Work in progress | | 7,271 | 7,835 | 4,922 | 6,578 |
| Finished goods | | 46,247 | 40,012 | 18,244 | 13,731 |
| **Total inventories** | | **91,890** | **76,822** | **58,425** | **47,209** |
| **13. Other assets** | | | | | |
| **Prepayments** | | **5,390** | **5,920** | **2,787** | **2,349** |
| **14. Other financial assets** | | | | | |
| Shares in controlled entities, unlisted, at cost | 27 | - | - | 63,989 | 33,868 |
| Other amounts receivable | | 477 | 383 | 127 | 126 |
| **Total other financial assets** | | **477** | **383** | **64,116** | **33,994** |

| | Consolidated | | Company | |
|---|---|---|---|---|
| | 2007 $000 | 2006 $000 | 2007 $000 | 2006 $000 |
| **15. Property, plant and equipment** | | | | |
| **Leasehold improvements** | | | | |
| At cost | 24,537 | 21,973 | 22,218 | 19,572 |
| Accumulated amortisation | (13,324) | (10,309) | (12,797) | (9,757) |
| | **11,213** | **11,664** | **9,421** | **9,815** |
| **Plant and equipment** | | | | |
| At cost | 65,038 | 50,716 | 48,303 | 33,087 |
| Accumulated depreciation | (35,686) | (31,547) | (25,845) | (21,521) |
| | **29,352** | **19,169** | **22,458** | **11,566** |
| **Total property, plant and equipment, at net book value** | **40,565** | **30,833** | **31,879** | **21,381** |
| **Reconciliations** | | | | |
| Reconciliations of the carrying amounts of each class of property, plant and equipment are set out below: | | | | |
| **Leasehold improvements** | | | | |
| Carrying amount at beginning of financial year | 11,664 | 12,949 | 9,815 | 11,797 |
| Additions | 1,764 | 1,796 | 1,488 | 684 |
| Disposals | (10) | (323) | - | - |
| Amortisation | (3,445) | (2,782) | (3,122) | (2,670) |
| Acquisitions through business combinations | 1,166 | - | 1,166 | - |
| Effect of movements in foreign exchange | 74 | 24 | 74 | 4 |
| **Carrying amount at end of financial year** | **11,213** | **11,664** | **9,421** | **9,815** |
| **Plant and equipment** | | | | |
| Carrying amount at beginning of financial year | 19,169 | 11,675 | 11,566 | 8,087 |
| Additions | 16,832 | 12,533 | 12,018 | 6,284 |
| Disposals | (2,415) | (269) | (265) | (20) |
| Depreciation | (7,284) | (5,245) | (4,854) | (2,938) |
| Acquisitions through business combinations | 3,824 | - | 3,824 | - |
| Effect of movements in foreign exchange | (774) | 475 | 169 | 153 |
| **Carrying amount at end of financial year** | **29,352** | **19,169** | **22,458** | **11,566** |

| | Consolidated | | Company | |
|---|---|---|---|---|
| | 2007 $000 | 2006 $000 | 2007 $000 | 2006 $000 |
| **16. Intangible assets** | | | | |
| **Goodwill, at cost** | **182,401** | **185,352** | **4,146** | **-** |
| **Acquired technology** | | | | |
| At cost | 3,398 | 3,702 | - | - |
| Accumulated amortisation | (1,982) | (1,234) | - | - |
| | **1,416** | **2,468** | **-** | **-** |
| **Enterprise resource planning system** | | | | |
| At cost | 20,366 | 13,091 | 16,984 | 9,179 |
| Accumulated amortisation | (12,005) | (10,545) | (9,441) | (9,093) |
| | **8,361** | **2,546** | **7,543** | **86** |
| **Customer relationships** | | | | |
| At cost | 4,801 | 5,433 | - | - |
| Accumulated amortisation | (2,838) | (1,826) | - | - |
| | **1,963** | **3,607** | **-** | **-** |
| **Intellectual property capitalised, at cost**[(i)] | **-** | **6,788** | **-** | **-** |
| **Capitalised development expenditure** | | | | |
| At cost | 7,759 | 7,385 | 7,759 | 7,385 |
| Accumulated amortisation | (5,915) | (3,345) | (5,915) | (3,345) |
| | **1,844** | **4,040** | **1,844** | **4,040** |
| **Other intangible assets** | | | | |
| At cost | 496 | 583 | - | - |
| Accumulated amortisation | (213) | (146) | - | - |
| | **283** | **437** | **-** | **-** |
| **Total intangible assets** | **196,268** | **205,238** | **13,533** | **4,126** |

(i) Intellectual property is not amortised on the basis that it has not yet reached the condition necessary for it to be capable of operating in the manner intended by the Consolidated Entity.

| | Consolidated | | Company | |
|---|---|---|---|---|
| | 2007 $000 | 2006 $000 | 2007 $000 | 2006 $000 |
| **Reconciliations** | | | | |
| Reconciliations of the carrying amounts of each class of intangible assets are set out below: | | | | |
| **Goodwill** | | | | |
| Carrying amount at beginning of financial year | 185,352 | 168,002 | - | - |
| Acquisitions through business combinations | 12,099 | - | 4,146 | - |
| Effect of movements in foreign exchange | (15,050) | 17,350 | - | - |
| **Carrying amount at end of financial year** | **182,401** | **185,352** | **4,146** | **-** |
| **Acquired technology** | | | | |
| Carrying amount at beginning of financial year | 2,468 | 3,056 | - | - |
| Amortisation | (850) | (926) | - | - |
| Effects of movements in foreign exchange | (202) | 338 | - | - |
| **Carrying amount at end of financial year** | **1,416** | **2,468** | **-** | **-** |
| **Enterprise resource planning system** | | | | |
| Carrying amount at beginning of financial year | 2,546 | 5,039 | 86 | 2,000 |
| Acquisitions | 7,805 | 706 | 7,805 | - |
| Amortisation | (1,659) | (3,366) | (348) | (1,914) |
| Effect of movements in foreign exchange | (331) | 167 | - | - |
| **Carrying amount at end of financial year** | **8,361** | **2,546** | **7,543** | **86** |
| **Customer relationships** | | | | |
| Carrying amount at beginning of financial year | 3,607 | 4,585 | - | - |
| Amortisation | (1,201) | (1,238) | - | - |
| Effect of movements in foreign exchange | (443) | 260 | - | - |
| **Carrying amount at end of financial year** | **1,963** | **3,607** | **-** | **-** |
| **Intellectual property capitalised, at cost** | | | | |
| Carrying amount at beginning of financial year | 6,788 | 6,825 | - | - |
| Disposals | (6,274) | - | - | - |
| Effect of movements in foreign exchange | (514) | (37) | - | - |
| **Carrying amount at end of financial year** | **-** | **6,788** | **-** | **-** |
| **Capitalised development expenditure** | | | | |
| Carrying amount at beginning of financial year | 4,040 | 6,263 | 4,040 | 6,263 |
| Development phase expenditure | 375 | 179 | 375 | 179 |
| Amortisation | (2,571) | (2,402) | (2,571) | (2,402) |
| **Carrying amount at end of financial year** | **1,844** | **4,040** | **1,844** | **4,040** |

| | Consolidated | | Company | |
|---|---|---|---|---|
| | 2007 $000 | 2006 $000 | 2007 $000 | 2006 $000 |
| **Other intangible assets** | | | | |
| Carrying amount at beginning of financial year | 437 | 559 | - | - |
| Amortisation | (95) | (116) | - | - |
| Effect of movements in foreign exchange | (59) | (6) | - | - |
| **Carrying amount at end of financial year** | **283** | **437** | **-** | **-** |

### Amortisation charge

The amortisation charge is recognised in the administration expenses line except for amortisation of capitalised development expenditure which is recognised in the research and development expenses line in the income statement.

### Impairment tests for cash generating units containing goodwill

The following units have significant carrying amounts of goodwill:

| | Consolidated | | Company | |
|---|---|---|---|---|
| | 2007 $000 | 2006 $000 | 2007 $000 | 2006 $000 |
| Americas | 65,437 | 69,721 | 1,940 | - |
| Europe | 109,603 | 109,518 | 1,488 | - |
| Asia Pacific | 7,361 | 6,113 | 718 | - |
| | **182,401** | **185,352** | **4,146** | **-** |

The recoverable amount of each cash generating unit is based on value-in-use calculations. Those calculations use cash flow projections based on actual operating results and the three year business plan. Cash flows for a further two year period are extrapolated using a 3.5% per annum growth rate and are appropriate because the related acquisitions are long-term businesses. This growth rate is consistent with the long-term average growth rate for the industry. A post-tax discount rate of 9.7% per annum has been used in discounting the projected cash flows.

The key assumptions and the approach to determining their value in the current period are:

| Assumption | How determined |
|---|---|
| Discount rate | Based on weighted average cost of capital |
| Sales volume growth rate | Based on a three year forecast taking into account historical growth rates and product lifecycle |
| Terminal value growth rate | Based on a three year forecast taking into account historical growth rates and product lifecycle. |

The recoverable amount of each cash generating unit including unallocated corporate assets is in excess of their carrying amounts and therefore no impairment charge was required. Any adverse change in assumptions could reduce the recoverable amount below the carrying amount.

## 17. Deferred tax assets and liabilities

### Recognised deferred tax assets and liabilities

| | Assets | | Liabilities | | Net | |
|---|---|---|---|---|---|---|
| | 2007 $000 | 2006 $000 | 2007 $000 | 2006 $000 | 2007 $000 | 2006 $000 |
| ***Consolidated*** | | | | | | |
| Property, plant and equipment | - | 1,793 | (183) | - | (183) | 1,793 |
| Intangible assets | - | - | - | (3,072) | - | (3,072) |
| Inventories | 11,790 | 9,682 | - | - | 11,790 | 9,682 |
| Prepayments | - | - | (95) | (101) | (95) | (101) |
| Employee benefits | 538 | 754 | - | - | 538 | 754 |
| Provisions | 8,327 | 8,535 | - | - | 8,327 | 8,535 |
| Deferred revenue | 1,782 | 7,396 | - | - | 1,782 | 7,396 |
| Forward exchange contracts | - | - | (6,635) | (1,541) | (6,635) | (1,541) |
| Other | - | 977 | (369) | (123) | (369) | 854 |
| Tax value of loss carry-forwards recognised | 3,356 | 5,967 | - | - | 3,356 | 5,967 |
| **Net deferred tax assets/(liabilities)** | **25,793** | **35,104** | **(7,282)** | **(4,837)** | **18,511** | **30,267** |
| ***Company*** | | | | | | |
| Property, plant and equipment | - | 1,103 | (285) | - | (285) | 1,103 |
| Intangible assets | - | - | (594) | (1,212) | (594) | (1,212) |
| Inventories | 769 | 854 | - | - | 769 | 854 |
| Provisions | 7,515 | 5,983 | - | - | 7,515 | 5,983 |
| Forward exchange contracts | - | - | (6,635) | (1,541) | (6,635) | (1,541) |
| Other | - | - | - | (115) | - | (115) |
| **Net deferred tax assets/(liabilities)** | **8,284** | **7,940** | **(7,514)** | **(2,868)** | **770** | **5,072** |

At 30 June 2007, a deferred tax liability of $17,402,366 (2006: $14,282,667) relating to an investment in a subsidiary has not been recognised because the Company controls whether the liability will be incurred and it is satisfied that it will not be incurred in the foreseeable future.

### Movement in temporary differences during the year

| Amounts $000 | Consolidated | | | | Company | | | |
|---|---|---|---|---|---|---|---|---|
| | Balance at 1 July | Recognised in income | Recognised in equity | Balance at 30 June | Balance at 1 July | Recognised in income | Recognised in equity | Balance at 30 June |
| **2006** | | | | | | | | |
| Property, plant and equipment | 381 | 1,412 | - | 1,793 | 485 | 618 | - | 1,103 |
| Intangible assets | (4,339) | 1,267 | - | (3,072) | (1,879) | 667 | - | (1,212) |
| Inventories | 5,250 | 4,432 | - | 9,682 | 1,289 | (435) | - | 854 |
| Prepayments | (75) | (26) | - | (101) | - | - | - | - |
| Employee benefits | 777 | (23) | - | 754 | - | - | - | - |
| Provisions | 13,138 | (4,603) | - | 8,535 | 8,055 | (2,072) | - | 5,983 |
| Deferred revenue | 5,404 | 1,992 | - | 7,396 | - | - | - | - |
| Foreign exchange contracts | (8,560) | 374 | 6,645 | (1,541) | (8,290) | 104 | 6,645 | (1,541) |
| Other | (98) | 952 | - | 854 | (97) | (18) | - | (115) |
| Tax value of loss carry-forwards recognised | 2,400 | 3,567 | - | 5,967 | - | - | - | - |
| | **14,278** | **9,344** | **6,645** | **30,267** | **(437)** | **(1,136)** | **6,645** | **5,072** |
| **2007** | | | | | | | | |
| Property, plant and equipment | 1,793 | (1,976) | - | (183) | 1,103 | (1,388) | - | (285) |
| Intangible assets | (3,072) | 3,072 | - | - | (1,212) | 618 | - | (594) |
| Inventories | 9,682 | 2,108 | - | 11,790 | 854 | (85) | - | 769 |
| Prepayments | (101) | 6 | - | (95) | - | - | - | - |
| Employee benefits | 754 | (216) | - | 538 | - | - | - | - |
| Provisions | 8,535 | (208) | - | 8,327 | 5,983 | 1,532 | - | 7,515 |
| Deferred revenue | 7,396 | (5,614) | - | 1,782 | - | - | - | - |
| Foreign exchange contracts | (1,541) | (11) | (5,083) | (6,635) | (1,541) | (11) | (5,083) | (6,635) |
| Other | 854 | (1,223) | - | (369) | (115) | 115 | - | - |
| Tax value of loss carry-forwards recognised | 5,967 | (2,611) | - | 3,356 | - | - | - | - |
| | **30,267** | **(6,673)** | **(5,083)** | **18,511** | **5,072** | **781** | **(5,083)** | **770** |

| | Consolidated | | Company | |
|---|---|---|---|---|
| | 2007 $000 | 2006 $000 | 2007 $000 | 2006 $000 |
| **18. Trade and other payables** | | | | |
| **Trade and other creditors** | **61,923** | **57,345** | **33,381** | **28,337** |
| **19. Other liabilities** | | | | |
| **Current** | | | | |
| Deferred revenue | 17,338 | 23,525 | 848 | 857 |
| **Total current other liabilities** | **17,338** | **23,525** | **848** | **857** |
| **Non-current** | | | | |
| Forward exchange contracts | - | 764 | - | 764 |
| **Total non-current other liabilities** | **-** | **764** | **-** | **764** |
| **20. Loans and borrowings** | | | | |
| **Current** | | | | |
| Bank overdrafts | 1,645 | 1,747 | 223 | - |
| Bank loans, secured | 159,692 | 68,800 | 30,000 | - |
| **Total current loans and borrowings** | **161,337** | **70,547** | **30,223** | **-** |
| **Non-current** | | | | |
| Bank loans, secured | 37,552 | 125,493 | - | - |
| **Total non-current loans and borrowings** | **37,552** | **125,493** | **-** | **-** |
| **Financing arrangements** | | | | |
| The Consolidated Entity has access to the following lines of credit at reporting date: | | | | |
| Bank overdrafts | 4,782 | 3,747 | 2,000 | 2,000 |
| Bank loans | 198,230 | 200,309 | 30,000 | 5,000 |
| Standby letters of credit | 227 | 3,004 | 227 | 227 |
| Bank guarantee facility | 1,100 | 292 | 605 | 280 |
| | **204,339** | **207,352** | **32,832** | **7,507** |
| **Facilities utilised at reporting date** | | | | |
| Bank overdrafts | 1,645 | 1,747 | 223 | - |
| Bank loans | 197,244 | 194,293 | 30,000 | - |
| Standby letters of credit | 191 | 191 | 191 | 191 |
| Bank guarantee facility | 725 | 279 | 604 | 279 |
| | **199,805** | **196,510** | **31,018** | **470** |
| **Facilities not utilised at reporting date** | | | | |
| Bank overdrafts | 3,137 | 2,000 | 1,777 | 2,000 |
| Bank loans | 986 | 6,016 | - | 5,000 |
| Standby letters of credit | 36 | 2,813 | 36 | 36 |
| Bank guarantee facility | 375 | 13 | 1 | 1 |
| | **4,534** | **10,842** | **1,814** | **7,037** |

**Bank overdrafts**

The bank overdrafts are payable on demand and are subject to annual review. Interest on bank overdrafts is variable and is charged at prevailing market rates.

**Bank loans**

The bank loans are secured by a letter of guarantee provided by the Company and are payable within one to five years. Refer to Note 31 for details.

| | Consolidated | | Company | |
|---|---|---|---|---|
| | 2007 $000 | 2006 $000 | 2007 $000 | 2006 $000 |
| **21. Commitments** | | | | |
| **Operating lease commitments** | | | | |
| Future non-cancellable operating lease rentals not provided for in the financial statements are payable as follows: | | | | |
| Not later than one year | 6,953 | 5,886 | 2,919 | 2,323 |
| Later than one year but not later than five years | 23,394 | 12,881 | 3,917 | 5,076 |
| Later than five years | 7,236 | 2,647 | - | - |
| **Total commitments** | **37,583** | **21,414** | **6,836** | **7,399** |
| **Capital expenditure commitments** | | | | |
| Contracted but not provided for and payable: | | | | |
| Not later than one year | 1,790 | 1,294 | 1,507 | 1,294 |
| Later than one year but not later than five years | 1,826 | - | 1,826 | - |
| **Total commitments** | **3,616** | **1,294** | **3,333** | **1,294** |

The Consolidated Entity leases property under non-cancellable operating leases expiring from one to seven years. Leases generally provide the Consolidated Entity with a right of renewal at which time all terms are renegotiated. Lease payments comprise a base amount plus an incremental contingent rental. Contingent rentals are based on movements in the Consumer Price Index.

| | | Consolidated | | Company | |
|---|---|---|---|---|---|
| | | 2007 | 2006 | 2007 | 2006 |
| | Note | $000 | $000 | $000 | $000 |
| **22. Provisions** | | | | | |
| **Current** | | | | | |
| Employee benefits | 29 | 17,267 | 14,633 | 11,027 | 8,020 |
| Warranties | | 8,482 | 7,010 | 8,482 | 6,122 |
| Other and legal | | 5,204 | 5,415 | 1,363 | 1,500 |
| **Total current provisions** | | **30,953** | **27,058** | **20,872** | **15,642** |
| **Non-current** | | | | | |
| Employee benefits | 29 | 3,167 | 2,007 | 1,841 | 1,292 |
| Warranties | | 2,256 | 1,673 | 2,256 | 1,673 |
| Directors' retirement scheme | 29 | 1,069 | 1,457 | 1,069 | 1,457 |
| Make good lease costs | | 1,336 | 1,296 | 1,233 | 1,233 |
| **Total non-current provisions** | | **7,828** | **6,433** | **6,399** | **5,655** |
| **Reconciliations** | | | | | |
| Reconciliations of the carrying amounts of each class of provision, except for the employee benefits provision, are set out below: | | | | | |
| **Warranties** | | | | | |
| Carrying amount at beginning of financial year | | 8,683 | 7,282 | 7,795 | 6,565 |
| Provisions made during financial year | | 11,554 | 7,635 | 12,371 | 7,352 |
| Provisions used during financial year | | (9,428) | (6,312) | (9,428) | (6,122) |
| Effects of movements in foreign exchange | | (71) | 78 | - | - |
| **Carrying amount at end of financial year** | | **10,738** | **8,683** | **10,738** | **7,795** |
| **Other and legal** | | | | | |
| Carrying amount at beginning of financial year | | 5,415 | 7,386 | 1,500 | 3,996 |
| Provisions made during financial year | | 1,741 | 1,505 | 185 | - |
| Provisions used during financial year | | (1,599) | (3,612) | (322) | (2,496) |
| Effects of movements in foreign exchange | | (353) | 136 | - | - |
| **Carrying amount at end of financial year** | | **5,204** | **5,415** | **1,363** | **1,500** |
| **Directors' retirement scheme** | | | | | |
| Carrying amount at beginning of financial year | | 1,457 | 1,327 | 1,457 | 1,327 |
| Provisions made during financial year | | 91 | 216 | 91 | 216 |
| Provisions used during financial year | | (587) | (251) | (587) | (251) |
| Unwind of discount | | 108 | 165 | 108 | 165 |
| **Carrying amount at end of financial year** | | **1,069** | **1,457** | **1,069** | **1,457** |
| **Make good lease costs** | | | | | |
| Carrying amount at beginning of financial year | | 1,296 | 1,328 | 1,233 | 1,233 |
| Provisions made during financial year | | 52 | 63 | - | - |
| Provisions used during financial year | | (12) | (95) | - | - |
| **Carrying amount at end of financial year** | | **1,336** | **1,296** | **1,233** | **1,233** |

### Employee benefits

Employee benefits include entitlements measured at present values of future amounts expected to be paid, based on a 5% per annum projected weighted average increase in remuneration rates over an average period of eight years. Present values are calculated using a weighted average rate of 6% per annum based on national government securities with similar maturity terms.

### Warranties

Refer to Note 3(h) for details of how the provision balance is determined.

### Other and legal

For details of legal costs relating to the Office of Inspector General inquiry, refer to Note 23. For details on the self-insurance provision, refer to Note 3(h).

### Directors' retirement scheme

Non-executive directors appointed prior to 2003 were entitled to retirement benefits of up to three times their annual remuneration over the previous three years once they had more than five years service. The ongoing accrual of benefits under the directors' retirement scheme ceased from 30 June 2007. The benefits accrued to that date are indexed by reference to the bank bill rate.

### Make good lease costs

Refer to Note 3(h) for details of how the provision balance is determined.

## 23. Contingent liabilities

The details and estimated maximum amounts of contingent liabilities are set out below. The directors are of the opinion that provisions are either adequate or are not required in respect of these matters, as it is either not probable that a future sacrifice of economic benefits will be required, or the amount is not capable of reliable measurement.

### Office of Inspector General inquiry

In March 2004, the Company was informed by the US Department of Justice (DOJ) that Cochlear Americas, a wholly-owned subsidiary, is subject to an inquiry under federal healthcare laws in the US that deal with the Medicare and Medicaid programs, including some with potential criminal and civil sanctions.

During the year, the DOJ advised the inquiry was being transferred to the Office of Inspector General (OIG) for administrative processing. The DOJ will no longer proceed with the inquiry and the matter will be handled by the OIG.

Discussions with the OIG are ongoing. The Company is cooperating fully with the inquiry and has engaged a nationally recognised law firm with specialised expertise in US healthcare law.

In prior years, the Company has recorded a provision in respect of estimated costs of responding to the investigation.

Based on the information available at the date of this report, the financial impact of those costs of responding to the investigation has been adequately provided for in the financial statements.

In the directors' opinion, disclosure of any further information of the above matter would be prejudicial to the interests of the Company.

### Guarantees

Cochlear Limited has provided guarantees to Westpac Institutional Bank for loan facilities provided to Cochlear Sweden Holdings, Cochlear Americas and Cochlear Europe Limited, all wholly-owned subsidiaries.

The Cochlear Sweden Holdings facility is a multi currency facility with a limit of euro 73.4 million, or equivalent thereof. The outstanding balance of the loan at reporting date was SEK 678.9 million (euro 73.4 million).

The Cochlear Americas facility is for USD 30.0 million. The outstanding balance of the loan at reporting date was USD 30.0 million.

The Cochlear Europe Limited facility is for GBP 7.5 million. The outstanding balance of the loan at reporting date was GBP 7.1 million.

| | Consolidated | | Company | |
|---|---|---|---|---|
| | 2007 $000 | 2006 $000 | 2007 $000 | 2006 $000 |
| **24. Issued capital** | | | | |
| **Share capital** | | | | |
| 54,769,632 (2006: 54,636,995) ordinary shares fully paid(i) | 69,998 | 66,663 | 69,998 | 66,663 |
| **Issued share capital** | | | | |
| 54,923,151 (2006: 54,812,840) ordinary shares fully paid(i) | | | | |
| **Movements in issued share capital** | | | | |
| Balance at beginning of financial year | 68,034 | 50,746 | 68,034 | 50,746 |
| 12,768 (2006: 14,170) shares issued for nil consideration under the Employee Share Plan(ii) | - | - | - | - |
| 97,543 (2006: 453,500) shares issued from the exercise of options(iii) | 3,335 | 17,288 | 3,335 | 17,288 |
| Nil (2006: 55,693) shares issued for nil consideration under the CELTIP | - | - | - | - |
| **Balance at end of financial year** | **71,369** | **68,034** | **71,369** | **68,034** |
| **Treasury reserve** | | | | |
| 153,519 (2006: 175,845) ordinary shares fully paid(i) | | | | |
| **Movements in treasury reserve** | | | | |
| Balance at beginning of financial year | (1,371) | (1,371) | (1,371) | (1,371) |
| Nil (2006: 55,693) shares issued for nil consideration under the CELTIP | - | - | - | - |
| 22,326 (2006: nil) shares distributed from the Trust for nil consideration | - | - | - | - |
| **Balance at end of financial year** | **(1,371)** | **(1,371)** | **(1,371)** | **(1,371)** |
| **Net share capital** | **69,998** | **66,663** | **69,998** | **66,663** |

(i) Holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at shareholders' meetings. Ordinary shares have no par value.
(ii) On 17 October 2006, the Company issued 12,768 shares to eligible employees of the Consolidated Entity under the Employee Share Plan for nil consideration.
(iii) Between 21 August 2006 and 6 November 2006, the Company issued 97,543 ordinary shares issued from the exercise of options granted under the CELTIP.

## 25. Reconciliation of movement in capital, reserves and retained earnings attributable to equity holders of the parent

| | Consolidated | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Amounts $000 | Issued capital | Treasury reserve | Translation reserve | General reserve | Hedging reserve | Retained earnings | Total | Minority interest | Total equity |
| **2006** | | | | | | | | | |
| Balance as at 1 July 2005 | 50,746 | (1,371) | (3,991) | 74 | - | 104,462 | 149,920 | 4,741 | 154,661 |
| Effect of change in accounting policy | - | - | - | - | 19,102 | - | 19,102 | - | 19,102 |
| Opening balance at 1 July 2005 – restated | 50,746 | (1,371) | (3,991) | 74 | 19,102 | 104,462 | 169,022 | 4,741 | 173,763 |
| Total recognised income and expense | - | - | 3,329 | 2 | (15,506) | 80,032 | 67,857 | (2,500) | 65,357 |
| Shares issued | 17,288 | - | - | - | - | - | 17,288 | - | 17,288 |
| Equity settled transactions | - | - | - | - | - | 2,466 | 2,466 | - | 2,466 |
| Dividends to shareholders | - | - | - | - | - | (49,096) | (49,096) | - | (49,096) |
| **Balance at 30 June 2006** | **68,034** | **(1,371)** | **(662)** | **76** | **3,596** | **137,864** | **207,537** | **2,241** | **209,778** |
| **2007** | | | | | | | | | |
| Balance as at 1 July 2006 | 68,034 | (1,371) | (662) | 76 | 3,596 | 137,864 | 207,537 | 2,241 | 209,778 |
| Total recognised income and expense | - | - | (5,446) | 160 | 11,860 | 100,131 | 106,705 | (2,241) | 104,464 |
| Shares issued | 3,335 | - | - | - | - | - | 3,335 | - | 3,335 |
| Equity settled transactions | - | - | - | - | - | 3,615 | 3,615 | - | 3,615 |
| Dividends to shareholders | - | - | - | - | - | (60,383) | (60,383) | - | (60,383) |
| **Balance at 30 June 2007** | **71,369** | **(1,371)** | **(6,108)** | **236** | **15,456** | **181,227** | **260,809** | **-** | **260,809** |

| | Company | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Amounts $000 | Issued capital | Treasury reserve | Translation reserve | General reserve | Hedging reserve | Retained earnings | Total | Minority interest | Total equity |
| **2006** | | | | | | | | | |
| Balance as at 1 July 2005 | 50,746 | (1,371) | (128) | - | - | 96,021 | 145,268 | - | 145,268 |
| Effect of change in accounting policy | - | - | - | - | 19,102 | - | 19,102 | - | 19,102 |
| Opening balance at 1 July 2005 – restated | 50,746 | (1,371) | (128) | - | 19,102 | 96,021 | 164,370 | - | 164,370 |
| Total recognised income and expense | - | - | (391) | - | (15,506) | 67,359 | 51,462 | - | 51,462 |
| Shares issued | 17,288 | - | - | - | - | - | 17,288 | - | 17,288 |
| Equity settled transactions | - | - | - | - | - | 1,673 | 1,673 | - | 1,673 |
| Dividends to shareholders | - | - | - | - | - | (49,096) | (49,096) | - | (49,096) |
| **Balance at 30 June 2006** | **68,034** | **(1,371)** | **(519)** | **-** | **3,596** | **115,957** | **185,697** | **-** | **185,697** |
| **2007** | | | | | | | | | |
| Balance as at 1 July 2006 | 68,034 | (1,371) | (519) | - | 3,596 | 115,957 | 185,697 | - | 185,697 |
| Total recognised income and expense | - | - | 420 | - | 11,860 | 84,687 | 96,967 | - | 96,967 |
| Shares issued | 3,335 | - | - | - | - | - | 3,335 | - | 3,335 |
| Equity settled transactions | - | - | - | - | - | 2,376 | 2,376 | - | 2,376 |
| Dividends to shareholders | - | - | - | - | - | (60,383) | (60,383) | - | (60,383) |
| **Balance at 30 June 2007** | **71,369** | **(1,371)** | **(99)** | **-** | **15,456** | **142,637** | **227,992** | **-** | **227,992** |

### Treasury reserve

The treasury reserve comprises the cost of shares acquired by the Trust at the date of purchase.

### Foreign currency translation reserve

The foreign currency translation reserve records the foreign currency differences arising from the translation of the financial statements of foreign operations where their functional currency is different to the presentation currency of the reporting entity. Refer to Note 3(d) for further details.

### Hedging reserve

The hedging reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet occurred.

## 26. Notes to the statements of cash flows

### Cash assets

The operating account received an average interest rate of:
- Company 5.6% (2006: 4.8%) per annum; and
- Consolidated 1.4% (2006: 2.4%) per annum.

Cash held on deposit for periods not exceeding 90 days received an average interest rate of:
- Company 6.2% (2006: 5.6%) per annum; and
- Consolidated 6.2% (2006: 5.6%) per annum.

### (a) Reconciliation of cash and cash equivalents

For the purposes of the statements of cash flows, cash includes cash on hand and at bank and term deposits, net of outstanding bank overdrafts. Cash and cash equivalents as at reporting date as shown in the statements of cash flows are reconciled to the related items in the balance sheets as follows:

| | | Consolidated | | Company | |
|---|---|---|---|---|---|
| | | 2007 | 2006 | 2007 | 2006 |
| | Note | $000 | $000 | $000 | $000 |
| Cash on hand | | 41,165 | 62,778 | 1,700 | 3,163 |
| Cash on deposit | | 42,217 | 24,295 | 42,217 | 24,295 |
| | | **83,382** | **87,073** | **43,917** | **27,458** |
| Bank overdrafts | 20 | (1,645) | (1,747) | (223) | - |
| | | **81,737** | **85,326** | **43,694** | **27,458** |
| **(b) Reconciliation of net profit to net cash provided by operating activities** | | | | | |
| Net profit (including minority interest) | | 97,676 | 78,225 | 84,687 | 67,359 |
| **Add items classified as investing activities** | | | | | |
| Loss/(gain) on disposal of non-current assets | | 1,125 | 20 | (27) | (177) |
| **Add non-cash items** | | | | | |
| Amounts set aside to provisions | | 30,054 | 18,681 | 21,807 | 11,179 |
| Depreciation and amortisation | | 17,105 | 16,075 | 10,895 | 9,924 |
| Share based payments | | 3,615 | 2,466 | 2,376 | 1,673 |
| **Net cash provided by operating activities before changes in assets and liabilities** | | **149,575** | **115,467** | **119,738** | **89,958** |
| **Changes in assets and liabilities** | | | | | |
| (Increase)/decrease in receivables | | (23,687) | (29,464) | 20,496 | (61,981) |
| Increase in inventories | | (4,987) | (27,304) | (1,135) | (21,483) |
| Decrease/(increase) in prepayments | | 443 | (1,930) | (553) | (326) |
| Decrease/(increase) in deferred tax assets | | 7,271 | (7,803) | (183) | 2,677 |
| (Decrease)/increase in payables | | (4,575) | 10,806 | (4,109) | 9,423 |
| (Decrease)/increase in current tax liabilities | | (16,984) | 12,526 | (13,242) | 6,027 |
| Decrease in provisions | | (25,231) | (15,840) | (16,300) | (11,414) |
| Decrease in deferred revenue | | (6,187) | (4,521) | (9) | (115) |
| Effects of movements in foreign exchange | | 1,198 | (382) | (29) | (830) |
| **Net cash provided by operating activities** | | **76,836** | **51,555** | **104,674** | **11,936** |

## 27. Controlled entities

### (a) Particulars in relation to controlled entities

| | Note | Interest held 2007 % | Interest held 2006 % | Country of incorporation/ formation |
|---|---|---|---|---|
| ***Company*** | | | | |
| Cochlear Limited | | | | Australia |
| ***Controlled entities*** | | | | |
| Cochlear Executive Long Term Incentive Plan (Performance Shares) Trust | | 100 | 100 | Australia |
| Cochlear Incentive Plan Pty Limited | | 100 | 100 | Australia |
| Cochlear Europe Limited | (i) | 100 | 100 | UK |
| Cochlear Acoustics Limited | (i) | 100 | 75 | UK |
| Cochlear AG | (i) | 100 | 100 | Switzerland |
| Cochlear (UK) Limited | (i), (ii) | 100 | 100 | UK |
| Cochlear GmbH | (i) | 100 | 100 | Germany |
| Cochlear Americas | (i) | 100 | 100 | USA |
| Cochlear (HK) Limited | (i) | 100 | 100 | Hong Kong |
| Nihon Cochlear Co Limited | (i) | 100 | 100 | Japan |
| Neopraxis Pty Limited | (ii) | 100 | 100 | Australia |
| Cochlear Technologies Pty Limited | (ii) | 100 | 100 | Australia |
| Medical Insurance Pte Limited | (i) | 100 | 100 | Singapore |
| Cochlear Holdings NV | (i) | 100 | 100 | Belgium |
| Miaki NV | (i) | 100 | 100 | Belgium |
| Cochlear Benelux NV | (i) | 100 | 100 | Belgium |
| Cochlear Bone Anchored Solutions AB | (i), (iii) | 100 | 100 | Sweden |
| Cochlear France SAS | (i) | 100 | 100 | France |
| Cochlear Holdings France SAS | (i) | 100 | 100 | France |
| Cochlear Italia SRL | (i) | 100 | 100 | Italy |
| Cochlear Sweden Holdings AB | (i) | 100 | 100 | Sweden |
| Cochlear Canada Inc | (i) | 100 | 100 | Canada |
| Cochlear Bone Anchored Solutions France SAS | (i) | 100 | 100 | France |
| Entific Medical Systems Deutschland GmbH | (i), (ii) | 100 | 100 | Germany |
| Entific Australia Pty Limited | (iv) | - | 100 | Australia |
| Cochlear Nordic AB | (i) | 100 | 100 | Sweden |

(i) These entities are audited by other member firms of KPMG.
(ii) Dormant.
(iii) Name changed from Entific Medical Systems AB on 28 September 2006.
(iv) Entity deregistered on 20 April 2007.

### (b) Acquisition of business

On 2 January 2007, the Company acquired the Cochlear related manufacturing operations and assets of Crystalaid Manufacture Pty Limited. Details of the acquisition are as follows:

| | $000 |
|---|---|
| **Consideration** | |
| Total consideration paid to date | 9,972 |
| Further consideration to be paid | 9,153 |
| **Total consideration** | **19,125** |
| **Represented by** | |
| Inventories | 10,081 |
| Property, plant and equipment | 4,990 |
| Other assets | 375 |
| Other provisions | (467) |
| Goodwill on acquisition | 4,146 |
| | **19,125** |

### (c) Acquisition of minority interest in controlled entity

On 30 April 2007, the Consolidated Entity increased its shareholding in its subsidiary Cochlear Acoustics Limited (CAL) to 100% by acquiring the remaining 25% of shares in CAL from Phonak AG (Phonak) for a consideration of $7.5 million. This resulted in goodwill being recognised of $8.0 million. The Consolidated Entity sold certain assets to Phonak for consideration of $8.5 million. The Consolidated Entity also received $7.2 million from Phonak in reimbursement of research and development expenditure incurred in return for equal access to the intellectual property generated by CAL since its inception. These transactions gave rise to a net gain before tax of $6.9 million ($4.8 million after tax) to the Consolidated Entity.

## 28. Key management personnel disclosures

The following were key management personnel of the Consolidated Entity at any time during the reporting period and unless otherwise indicated were key management personnel for the entire period:

**Non-executive directors**

Mr TCE Bergman (Chairman)
Mr PR Bell
Prof E Byrne, AO
Mr A Denver (appointed 1 February 2007)
Mr R Holliday-Smith
Mr PJ North, AM (retired 24 October 2006)
Mr DP O'Dwyer
Mr JH Veeneklaas (retired 24 October 2006)

**Executive directors**

Dr CG Roberts
Dr JL Parker (retired 31 March 2007)

**Executives**

Mr R Brook
Mr J Janssen
Mr NJ Mitchell
Mr MD Salmon
Mr CM Smith.

**Key management personnel disclosures**

The key management personnel compensation is included in employee benefits expense as follows:

| | Consolidated | | Company | |
|---|---|---|---|---|
| | 2007 $000 | 2006 $000 | 2007 $000 | 2006 $000 |
| Short-term employee benefits | 5,343 | 4,766 | 4,094 | 3,572 |
| Post-employment benefits | 817 | 595 | 781 | 549 |
| Other long-term benefits | 70 | 36 | 70 | 36 |
| Equity compensation benefits | 1,158 | 773 | 805 | 505 |
| | **7,388** | **6,170** | **5,750** | **4,662** |

Information regarding individual directors and executives remuneration is provided in the Remuneration Report in the Directors' Report on pages 47 to 55.

### Options and performance shares granted as compensation

The movement during the financial year in the number of options and performance shares over ordinary shares of Cochlear Limited held, directly, indirectly or beneficially, by each key management person, including their personally related entities, is as follows:

| | Held at 1 July 2006 | Granted as remuneration | Vested and exercised | Forfeited | Held at 30 June 2007 | Vested and exercisable at 30 June 2007 |
|---|---|---|---|---|---|---|
| **Option holdings** | | | | | | |
| *Executive directors* | | | | | | |
| Dr CG Roberts | 243,789 | 70,422 | - | - | 314,211 | - |
| Dr JL Parker (retired 31 March 2007) | 91,180 | 18,862 | (11,445) | (9,139) | 89,458(i) | - |
| *Executives* | | | | | | |
| Mr R Brook | 116,920 | 23,239 | (14,482) | (11,564) | 114,113 | - |
| Mr J Janssen | 16,814 | 21,217 | - | - | 38,031 | - |
| Mr NJ Mitchell | 85,796 | 18,980 | (10,542) | (8,419) | 85,815 | - |
| Mr MD Salmon | 66,078 | 18,422 | - | - | 84,500 | - |
| Mr CM Smith | 194,476 | 28,849 | - | - | 223,325 | - |
| **Performance share holdings** | | | | | | |
| *Executive directors* | | | | | | |
| Dr CG Roberts | 16,518 | - | - | - | 16,518 | - |
| Dr JL Parker (retired 31 March 2007) | 7,485 | - | (1,472) | (1,176) | 4,837(i) | - |
| *Executives* | | | | | | |
| Mr R Brook | 9,573 | - | - | (1,487) | 8,086 | - |
| Mr J Janssen | 3,253 | - | - | (444) | 2,809 | - |
| Mr NJ Mitchell | 7,029 | - | (1,356) | (1,083) | 4,590 | - |
| Mr MD Salmon | 4,533 | - | - | - | 4,533 | - |
| Mr CM Smith | 2,135 | - | - | - | 2,135 | - |

(i) Closing position reflects balance at date of retirement.

No options held by key management personnel are vested but not exercisable.

All options and performance shares granted in the 2007 financial year were granted on 21 August 2006 and vest in August 2009. Options have an expiration date of 30 June 2011. No options or performance shares have been granted since the end of the financial year. The options and performance shares were provided at no cost to the recipients.

All options granted during the financial year have an exercise price of $49.43 per share and a fair value of $5.86 per share at grant date for options with performance based conditions and $6.59 per share at grant date for options with market based conditions. The performance shares granted during the financial year had a fair value at grant date of $23.13 per share for performance shares with performance based conditions and $18.06 per share at grant date for performance shares with market based conditions.

| | Held at 1 July 2005 | Granted as remuneration | Vested and exercised | Forfeited | Held at 30 June 2006 | Vested and exercisable at 30 June 2006 |
|---|---|---|---|---|---|---|
| **Option holdings** | | | | | | |
| *Executive directors* | | | | | | |
| Dr CG Roberts | 164,321 | 79,468 | - | - | 243,789 | - |
| Dr JL Parker (retired 31 March 2007) | 112,733 | 28,447 | (25,000) | (25,000) | 91,180 | - |
| *Executives* | | | | | | |
| Mr R Brook | 80,782 | 36,138 | - | - | 116,920 | - |
| Mr NJ Mitchell | 107,847 | 27,949 | (25,000) | (25,000) | 85,796 | - |
| Mr MD Salmon | 38,904 | 27,174 | - | - | 66,078 | - |
| Mr CM Smith | 165,830 | 28,646 | - | - | 194,476 | - |
| **Performance share holdings** | | | | | | |
| *Executive directors* | | | | | | |
| Dr CG Roberts | 10,595 | 5,923 | - | - | 16,518 | - |
| Dr JL Parker (retired 31 March 2007) | 5,365 | 2,120 | - | - | 7,485 | - |
| *Executives* | | | | | | |
| Mr R Brook | 6,879 | 2,694 | - | - | 9,573 | - |
| Mr NJ Mitchell | 4,946 | 2,083 | - | - | 7,029 | - |
| Mr MD Salmon | 2,508 | 2,025 | - | - | 4,533 | - |
| Mr CM Smith | - | 2,135 | - | - | 2,135 | - |

**Movement in shares**

The movement during the financial year in the number of ordinary shares of Cochlear Limited held, directly, indirectly or beneficially, by each key management person, including their personally related entities, is as follows:

| | Held at 1 July 2006 | Purchases | Received on exercise of options and performance shares | Sales | Held at 30 June 2007 |
|---|---|---|---|---|---|
| **Directors** | | | | | |
| ***Non-executive*** | | | | | |
| Mr TCE Bergman | 12,000 | - | - | - | 12,000 |
| Mr PR Bell | 1,500 | 1,000 | - | - | 2,500 |
| Prof E Byrne, AO | 1,000 | - | - | - | 1,000 |
| Mr A Denver(i) | - | 500 | - | - | 500 |
| Mr R Holliday-Smith | 1,000 | 1,500 | - | - | 2,500 |
| Mr PJ North, AM(ii) | 13,000 | - | - | - | 13,000 |
| Mr DP O'Dwyer | 2,450 | 500 | - | - | 2,950 |
| Mr JH Veeneklaas(ii) | 1,000 | - | - | - | 1,000 |
| ***Executive*** | | | | | |
| Dr CG Roberts | 237,000 | 185,018 | - | - | 422,018 |
| Dr JL Parker(iii) | 25,000 | - | 12,917 | (32,917) | 5,000 |
| **Executives** | | | | | |
| Mr R Brook | - | - | 14,482 | (14,482) | - |
| Mr NJ Mitchell | 35,000 | - | 11,898 | (16,898) | 30,000 |
| Mr MD Salmon | 2,457 | - | - | (2,443) | 14 |

| | Held at 1 July 2005 | Purchases | Received on exercise of options and performance shares | Sales | Held at 30 June 2006 |
|---|---|---|---|---|---|
| **Directors** | | | | | |
| ***Non-executive*** | | | | | |
| Mr TCE Bergman | 12,000 | - | - | - | 12,000 |
| Mr PR Bell | - | 1,500 | - | - | 1,500 |
| Prof E Byrne, AO | 1,000 | - | - | - | 1,000 |
| Mr R Holliday-Smith | 1,000 | - | - | - | 1,000 |
| Mr PJ North, AM | 13,000 | - | - | - | 13,000 |
| Mr DP O'Dwyer | - | 2,450 | - | - | 2,450 |
| Mr JH Veeneklaas | 1,000 | - | - | - | 1,000 |
| ***Executive*** | | | | | |
| Dr CG Roberts | 237,000 | - | - | - | 237,000 |
| Dr JL Parker | 25,000 | - | 25,000 | (25,000) | 25,000 |
| **Executives** | | | | | |
| Mr R Brook | - | - | - | - | - |
| Mr NJ Mitchell | 35,000 | - | 25,000 | (25,000) | 35,000 |
| Mr MD Salmon | 1,457 | 1,000 | - | - | 2,457 |

(i) Appointed director on 1 February 2007.
(ii) Director retired on 24 October 2006. Closing position reflects balance at date of retirement.
(iii) Director retired on 31 March 2007. Closing position reflects balance at date of retirement.

| | | Consolidated | | Company | |
|---|---|---|---|---|---|
| | | 2007 | 2006 | 2007 | 2006 |
| | Note | $000 | $000 | $000 | $000 |
| **29. Employee benefits** | | | | | |
| **Current** | | | | | |
| Liability for long service leave | | 2,433 | 2,586 | 2,354 | 1,731 |
| Liability for annual leave | | 8,683 | 6,565 | 5,972 | 4,346 |
| Liability for short-term incentives | | 6,151 | 5,482 | 2,701 | 1,943 |
| | 22 | **17,267** | **14,633** | **11,027** | **8,020** |
| Salary and wages accrued | | 2,638 | 2,664 | 1,296 | 1,122 |
| **Total current employee benefits** | | **19,905** | **17,297** | **12,323** | **9,142** |
| **Non-current** | | | | | |
| Liability for long service leave | 22 | 3,167 | 2,007 | 1,841 | 1,292 |
| Directors' retirement scheme | 22 | 1,069 | 1,457 | 1,069 | 1,457 |
| **Total non-current employee benefits** | | **4,236** | **3,464** | **2,910** | **2,749** |
| **Total employee benefits** | | **24,141** | **20,761** | **15,233** | **11,891** |

The Company and the Consolidated Entity have defined benefit plans that provide pension benefits to employees upon retirement. These defined benefit plans cover, in aggregate, 64 employees. The Consolidated Entity contributed $591,656 to defined benefit plans in the year ended 30 June 2007 and expects to contribute $624,289 in the year ending 30 June 2008. The net liability of the plans at 30 June 2007 was $141,999.

**(a) Defined contribution superannuation plans**

The Consolidated Entity makes contributions to defined contribution plans. The amount recognised as expense was $7,146,537 for the year ended 30 June 2007 (2006: $5,607,060).

**(b) Share based payments**

The Company's Employee Share Plan (Plan) was approved by special resolution at the Annual General Meeting held on 19 October 1999. Under the Plan, the directors can at their discretion, allocate at nil consideration up to a maximum of $2,000 worth of shares per eligible employee in any one year. The fair value of shares issued during the reporting period is the market price of the Company's shares on the ASX as at the start of trading on the issue date. Shares under the Plan vest with the employee immediately but are non-transferable for a period of up to three years.

The CELTIP was approved and adopted at the Annual General Meeting on 20 October 2003 and replaced the Executive Share Option Plan. The CELTIP offers a mixture of options over unissued shares and performance shares. Both the options and the performance shares are subject to a three year vesting period. The number of options and shares exercisable by the executives will depend on the performance of the Consolidated Entity over the vesting period. Half of the offer will be assessed against the compound annual growth rate of the earnings per share (EPS) achieved by the Consolidated Entity, and the other half against the total shareholder return (TSR) as measured against the S&P/ASX 100. If the minimum compound annual growth rate in EPS of 10% is not achieved, 50% of shares will not be issued or released to the executives. If the Consolidated Entity is below the 50th percentile against the S&P/ASX 100 over the three years, the remaining 50% of shares will not be issued or released.

To achieve a 100% allocation of options and shares, compound annual growth rate in EPS of 20% must be achieved and the TSR of the Consolidated Entity must be in at least the 75th percentile against the S&P/ASX 100.

At the date of this report, unissued ordinary shares of the Company under option and issued shares held in the Trust are:

| Grant date | Number of instruments | Conditions for minimum vesting | Contractual life of options |
|---|---|---|---|
| Option grant in December 2003 | 5,137 | Three years of service, a minimum compound annual growth rate in EPS of 10%. | 5 years |
| | 4,496 | The Consolidated Entity is above the 50th percentile against the S&P/ASX 100 over three years. | 5 years |
| Option grant in August 2004 | 357,770 | Three years of service, a minimum compound annual growth rate in EPS of 10%. | 5 years |
| | 357,770 | The Consolidated Entity is above the 50th percentile against the S&P/ASX 100 over three years. | 5 years |
| Option grant in August 2005 | 357,128 | Three years of service, a minimum compound annual growth rate in EPS of 10%. | 5 years |
| | 357,129 | The Consolidated Entity is above the 50th percentile against the S&P/ASX 100 over three years. | 5 years |
| Option grant in August 2006 | 254,322 | Three years of service, a minimum compound annual growth rate in EPS of 10%. | 5 years |
| | 254,322 | The Consolidated Entity is above the 50th percentile against the S&P/ASX 100 over three years. | 5 years |
| **Total options** | **1,948,074** | | |

| Issue date | Number of instruments | Conditions for minimum vesting | Contractual life of shares in the Trust |
|---|---|---|---|
| Performance shares issued in December 2003 | 2,692 | Three years of service, a minimum compound annual growth rate in EPS of 10%. | 5 years |
| | 2,356 | The Consolidated Entity is above the 50th percentile against the S&P/ASX 100 over three years. | 5 years |
| Performance shares issued in August 2004 | 30,219 | Three years of service, a minimum compound annual growth rate in EPS of 10%. | 5 years |
| | 30,220 | The Consolidated Entity is above the 50th percentile against the S&P/ASX 100 over three years. | 5 years |
| Performance shares issued in August 2005 | 30,415 | Three years of service, a minimum compound annual growth rate in EPS of 10%. | 5 years |
| | 30,415 | The Consolidated Entity is above the 50th percentile against the S&P/ASX 100 over three years. | 5 years |
| Performance shares issued in August 2006 | 8,529 | Three years of service, a minimum compound annual growth rate in EPS of 10%. | 5 years |
| | 8,530 | The Consolidated Entity is above the 50th percentile against the S&P/ASX 100 over three years. | 5 years |
| **Total performance shares** | **143,376** | | |

| | Weighted average exercise price $ | Number of options | Weighted average exercise price $ | Number of options |
|---|---|---|---|---|
| | 2007 | 2007 | 2006 | 2006 |
| Outstanding at beginning of financial year | 30.10 | 1,634,204 | 30.27 | 1,898,251 |
| Forfeited during financial year | 38.20 | (125,968) | 18.97 | (22,950) |
| Exercised/forfeited during financial year(i) | 34.19 | (97,543) | 38.12 | (967,000) |
| Granted during financial year | 49.43 | 537,381 | 39.93 | 725,903 |
| Outstanding at end of financial year | 34.69 | 1,948,074 | 30.10 | 1,634,204 |
| Exercisable at end of financial year | 18.97 | 715,540 | 34.19 | 192,761 |

(i) Weighted average share price at date of exercise was $51.81.

The estimated value of options for the current financial year is calculated at the date of grant using the Black-Scholes model, applying a 30% volatility, as reflected in the historical volatility.

For options outstanding at the end of the year, 715,540 options have an exercise price of $18.97 with the remaining balance falling within the range of $34.19 – $49.43 (2006: 715,540 options at $18.97 and the remainder falling within the range of $34.19 – $39.93). The weighted average remaining contractual life of options outstanding at the end of the year is three years (2006: three years).

## 30. Related parties

### Controlled entity related parties

The Company engages in purchases and sales of goods with its controlled entities and pays a licence fee for the use of intellectual property. These transactions are in the ordinary course of business on a transfer pricing basis and 45 day terms apply.

| | Company | |
|---|---|---|
| | 2007 $000 | 2006 $000 |
| The aggregate amounts included in the profit before tax for the Company that resulted from transactions with non-director related parties are: | | |
| Revenue from the sale of goods | 328,888 | 229,657 |
| Interest income | 1,673 | 3,126 |
| Dividends from controlled entities | 1,608 | - |
| Interest expense | 499 | 365 |
| The aggregate amounts receivable from wholly-owned controlled entities by the Company at reporting date are: | | |
| Current receivables | 63,971 | 88,782 |

## 31. Financial instruments

Exposure to credit, foreign exchange and interest rate risks arises in the normal course of the Consolidated Entity's business. Derivative financial instruments are used to hedge exposure to fluctuations in foreign exchange rates.

### Credit risk

At the balance sheet date, there was no significant concentrations of credit risk. The maximum exposure to credit risk is represented by the carrying amount of each financial asset, including derivative financial instruments, in the balance sheet.

### Foreign exchange risk

The Consolidated Entity and the Company are exposed to changes in foreign exchange rates from their activities. It is the Consolidated Entity's and the Company's policy to use forward exchange contracts to hedge these risks. The Consolidated Entity and the Company do not enter, hold or issue derivative financial instruments for trading purposes.

The Company enters into forward exchange contracts to hedge anticipated sales and purchases in US dollars, euro, Japanese yen and Swedish kroner.

The amounts of forward cover taken are in accordance with approved policy and internal forecasts.

The following table sets out the gross value to be received under forward exchange contracts and the weighted average contracted exchange rates of outstanding contracts:

| | Foreign exchange rates | | Company and Consolidated | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007<br>$000 | 2006<br>$000 |
| **Sell United States dollar** | | | | |
| Not later than one year | | | 135,043 | 95,937 |
| Later than one year but not later than two years | | | 72,287 | 45,802 |
| Later than two years but not later than three years | | | 8,640 | 5,956 |
| Weighted average exchange rates contracted | 0.78 | 0.72 | | |
| **Sell euro** | | | | |
| Not later than one year | | | 118,250 | 104,656 |
| Later than one year but not later than two years | | | 61,289 | 56,251 |
| Later than two years but not later than three years | | | 6,750 | 6,070 |
| Weighted average exchange rates contracted | 0.59 | 0.57 | | |
| **Sell Japanese yen** | | | | |
| Not later than one year | | | 9,396 | 8,962 |
| Later than one year but not later than two years | | | 3,771 | 3,893 |
| Later than two years but not later than three years | | | 1,287 | 503 |
| Weighted average exchange rates contracted | 82.99 | 68.43 | | |
| **Buy Sweden kroner** | | | | |
| Not later than one year | | | 36,600 | 24,986 |
| Later than one year but not later than two years | | | - | 36,056 |
| Weighted average exchange rates contracted | 5.29 | 5.29 | | |

### Forecast transactions

The Consolidated Entity classifies its forward exchange contracts hedging forecast transactions as cash flow hedges and states them at fair value. The fair value of forward exchange contracts at 1 July 2005 was adjusted against the opening balance of the hedging reserve at that date.

The net fair value of forward exchange contracts used as hedges of forecast transactions at 30 June 2007 was $22.1 million (2006: $5.1 million).

### Interest rate risk

***Effective interest rates, repayment and repricing analysis***

In respect of interest bearing financial liabilities, the following table indicates their effective interest rates at the reporting date. As the liabilities are subject to variable interest rates, they reprice within six months. The repayment schedule is as follows:

| Consolidated | 2007 | | | | | | 2006 | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Amounts $000 | Effective interest rate per annum | 12 months or less | 1 – 2 years | 2 – 5 years | More than 5 years | Total | Effective interest rate per annum | 12 months or less | 1 – 2 years | 2 – 5 years | More than 5 years | Total |
| Secured bank loans: | | | | | | | | | | | | |
| GBP floating rate loan | 5.8% | 16,565 | - | - | - | 16,565 | 5.1% | 17,511 | - | - | - | 17,511 |
| SEK floating rate loan | 4.6% | 77,795 | - | 37,552 | - | 115,347 | 3.2% | 34,902 | 34,902 | 90,591 | - | 160,395 |
| USD floating rate loan | 5.8% | 35,332 | - | - | - | 35,332 | 5.7% | 16,387 | - | - | - | 16,387 |
| AUD floating rate loan | 7.0% | 30,000 | - | - | - | 30,000 | - | - | - | - | - | - |
| JPY bank overdraft | 2.0% | 1,422 | - | - | - | 1,422 | 1.7% | 1,747 | - | - | - | 1,747 |
| AUD bank overdraft | 9.5% | 223 | - | - | - | 223 | - | - | - | - | - | - |
| | | **161,337** | **-** | **37,552** | **-** | **198,889** | | **70,547** | **34,902** | **90,591** | **-** | **196,040** |

| Company | 2007 | | | | | | 2006 | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Amounts $000 | Effective interest rate per annum | 12 months or less | 1 – 2 years | 2 – 5 years | More than 5 years | Total | Effective interest rate per annum | 12 months or less | 1 – 2 years | 2 – 5 years | More than 5 years | Total |
| AUD floating rate loan | 7.0% | 30,000 | - | - | - | 30,000 | - | - | - | - | - | - |
| AUD bank overdraft | 9.5% | 223 | - | - | - | 223 | - | - | - | - | - | - |

Trade receivables and trade payables are not interest bearing and the related cash flows are not subject to interest rate risk.

***Sensitivity analysis***

In managing interest rate and currency risks, the Consolidated Entity aims to reduce the impact of short-term fluctuations on the Consolidated Entity's earnings. Over the longer term, however, permanent changes in foreign exchange and interest rates will have an impact on profit.

For the year ended 30 June 2007, it is estimated that a general increase of one percentage point in interest rates would have decreased the Consolidated Entity's profit after income tax by approximately $1.3 million.

It is estimated that a general increase of one percentage point in the value of the Australian dollar against other foreign currencies would have decreased the Consolidated Entity's profit after income tax by approximately $0.8 million for the year ended 30 June 2007, including hedging results.

### Fair values

The fair values of financial assets and liabilities, together with carrying amounts shown in the balance sheet, are as follows:

| | | Consolidated | | | |
|---|---|---|---|---|---|
| | | 2007 | | 2006 | |
| | Note | Carrying amount $000 | Fair value $000 | Carrying amount $000 | Fair value $000 |
| Cash and cash equivalents | | 83,382 | 83,382 | 87,073 | 87,073 |
| Receivables – current | 11 | 143,076 | 143,076 | 109,388 | 109,388 |
| Receivables – non-current | 11 | 6,178 | 6,178 | - | - |
| Other financial assets | 14 | 477 | 477 | 383 | 383 |
| Trade and other payables | 18 | (61,923) | (61,923) | (57,345) | (57,345) |
| Forward exchange contracts | 19 | - | - | (764) | (764) |
| Bank overdrafts | 20 | (1,645) | (1,645) | (1,747) | (1,747) |
| Secured bank loans – current | 20 | (159,692) | (159,692) | (68,800) | (68,800) |
| Secured bank loans – non-current | 20 | (37,552) | (37,552) | (125,493) | (125,493) |
| | | **(27,699)** | **(27,699)** | **(57,305)** | **(57,305)** |

| | | Company | | | |
|---|---|---|---|---|---|
| | | 2007 | | 2006 | |
| | Note | Carrying amount $000 | Fair value $000 | Carrying amount $000 | Fair value $000 |
| Cash and cash equivalents | | 43,917 | 43,917 | 27,458 | 27,458 |
| Receivables – current | 11 | 99,275 | 99,275 | 109,770 | 109,770 |
| Receivables – non-current | 11 | 6,178 | 6,178 | - | - |
| Other financial assets | 14 | 64,116 | 64,116 | 33,994 | 33,994 |
| Trade and other payables | 18 | (33,381) | (33,381) | (28,337) | (28,337) |
| Forward exchange contracts | 19 | - | - | (764) | (764) |
| Bank overdrafts | 20 | (223) | (223) | - | - |
| Secured bank loans – current | 20 | (30,000) | (30,000) | - | - |
| | | **149,882** | **149,882** | **142,121** | **142,121** |

## 32. Events subsequent to reporting date

Other than the matters noted below, there has not arisen in the interval between reporting date and the date of this Financial Report, any item, transaction or event of a material and unusual nature likely, in the opinion of the directors of the Company, to affect significantly the operations of the Consolidated Entity, the results of those operations, or the state of affairs of the Consolidated Entity in future financial years:

### Dividends

For dividends declared after 30 June 2007, see Note 8.

In the opinion of the directors of Cochlear Limited:

(a) the financial statements, notes, and the remuneration disclosures contained in the Remuneration Report in the Directors' Report, as set out on pages 47 to 101, are in accordance with the Corporations Act 2001, including:

(i) giving a true and fair view of the financial position of the Company and Consolidated Entity as at 30 June 2007 and of their performance, as represented by the results of their operations and their cash flows, for the financial year ended on that date; and

(ii) complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the Corporations Regulations 2001;

(b) the Financial Report also complies with International Financial Reporting Standards as disclosed in Note 2(a);

(c) there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable;

(d) the remuneration disclosures that are contained in sections of the Remuneration Report in the Directors' Report comply with AASB 124 Related Party Disclosures; and

(e) the directors have been given the declarations required by section 295A of the Corporations Act 2001 from the Chief Executive Officer and the Chief Financial Officer for the year ended 30 June 2007.

Dated at Sydney this 14th day of August 2007.

Signed in accordance with a resolution of the directors:

Director

Director

**Report on the Financial Report and AASB 124 remuneration disclosures contained in the Directors' Report**

We have audited the accompanying Financial Report of Cochlear Limited (the Company), which comprises the balance sheets as at 30 June 2007, and the income statements, statements of recognised income and expense and cash flow statements for the year ended on that date, a description of significant accounting policies and other explanatory Notes 1 to 32 and the Directors' Declaration of the Consolidated Entity comprising the Company and the entities it controlled at the year's end or from time to time during the financial year.

As permitted by the Corporations Regulations 2001, the Company has disclosed information about the remuneration of directors and executives (remuneration disclosures), required by Australian Accounting Standard AASB 124 Related Party Disclosures, under the heading "Remuneration Report" in the Directors' Report and not in the Financial Report. We have audited these remuneration disclosures.

***Directors' responsibility for the Financial Report and the AASB 124 remuneration disclosures contained in the Directors' Report***

The directors of the Company are responsible for the preparation and fair presentation of the Financial Report in accordance with Australian Accounting Standards (including the Australian Accounting Interpretations) and the Corporations Act 2001. This responsibility includes establishing and maintaining internal control relevant to the preparation and fair presentation of the Financial Report that is free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances. In Note 2(a), the directors also state, in accordance with Australian Accounting Standard AASB 101 Presentation of Financial Statements, that the Financial Report, comprising the financial statements and notes, complies with International Financial Reporting Standards.

The directors of the Company are also responsible for the remuneration disclosures contained in the Directors' Report.

***Auditor's responsibility***

Our responsibility is to express an opinion on the Financial Report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. These Auditing Standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the Financial Report is free from material misstatement. Our responsibility is also to express an opinion on the remuneration disclosures contained in the Directors' Report based on our audit.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the Financial Report and the remuneration disclosures contained in the Directors' Report. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the Financial Report and the remuneration disclosures contained in the Directors' Report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the Financial Report and the remuneration disclosures contained in the Directors' Report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the Financial Report and the remuneration disclosures contained in the Directors' Report.

We performed the procedures to assess whether in all material respects the Financial Report presents fairly, in accordance with the Corporations Act 2001 and Australian Accounting Standards (including the Australian Accounting Interpretations), a view which is consistent with our understanding of the Company's and the Consolidated Entity's financial position and of their performance and whether the remuneration disclosures are in accordance with Australian Accounting Standard AASB 124.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

***Auditor's opinion on the Financial Report***

In our opinion:

(a) the Financial Report of Cochlear Limited is in accordance with the Corporations Act 2001, including:

  (i) giving a true and fair view of the Company's and the Consolidated Entity's financial position as at 30 June 2007 and of their performance for the year ended on that date; and

  (ii) complying with Australian Accounting Standards (including the Australian Accounting Interpretations) and the Corporations Regulations 2001; and

(b) the Financial Report also complies with International Financial Reporting Standards as disclosed in Note 2(a).

***Auditor's opinion on AASB 124 remuneration disclosures contained in the Directors' Report***

In our opinion, the remuneration disclosures that are contained in the Directors' Report comply with Australian Accounting Standard AASB 124 Related Party Disclosures.

KPMG

KPMG
Sydney, 14 August 2007

Kevin Leighton, Partner

Additional information required by Australian Securities Exchange Listing Rules and not disclosed elsewhere in this report – the information presented is as at 3 August 2007:

## Shareholdings

### *Substantial shareholders*

| Name | Number of ordinary shares held | % |
|---|---|---|
| Fidelity (Institutional Group) | 4,787,486 | 8.72 |
| Commonwealth Bank (Institutional Group) | 3,294,765 | 6.00 |
| **Total** | **8,082,251** | **14.72** |

### *Distribution of shareholders*

| Number of shares held | Number of ordinary shareholders |
|---|---|
| 1 – 1,000 | 16,704 |
| 1,001 – 5,000 | 3,206 |
| 5,001 – 10,000 | 215 |
| 10,001 – 100,000 | 131 |
| 100,001 – over | 26 |
| **Total** | **20,282** |

Non-marketable parcels – 46 shareholders held less than a marketable parcel.

### *Twenty largest shareholders*

| Name | Number of ordinary shares held | % |
|---|---|---|
| HSBC Custody Nominees (Australia) Limited | 12,006,546 | 21.86 |
| JPMorgan Nominees Australia Limited | 8,520,153 | 15.51 |
| National Nominees Limited | 5,018,978 | 9.14 |
| ANZ Nominees Limited (Cash Income a/c) | 2,375,250 | 4.32 |
| Citicorp Nominees Pty Limited | 1,801,318 | 3.28 |
| Cogent Nominees Pty Limited | 1,093,945 | 1.99 |
| Queensland Investment Corporation | 636,556 | 1.16 |
| Citicorp Nominees Pty Limited (CFS WSLE Imputation Fund a/c) | 592,896 | 1.08 |
| Citicorp Nominees Pty Limited (CFS WSLE Geared Share Fund a/c) | 511,691 | 0.93 |
| Dr Christopher Graham Roberts | 410,018 | 0.75 |
| Australian Reward Investment Alliance | 404,303 | 0.74 |
| Citicorp Nominees Pty Limited (CFS Imputation Fund a/c) | 398,408 | 0.73 |
| UBS Wealth Management Australia Nominees Pty Ltd | 299,703 | 0.55 |
| Citicorp Nominees Pty Limited (CFS WSLE Industrial Share a/c) | 277,556 | 0.51 |
| Citicorp Nominees Pty Limited (Cwlth Bank Off Super a/c) | 272,743 | 0.50 |
| Citicorp Nominees Pty Limited (CFS WSLE Aust Share Fund a/c) | 272,512 | 0.50 |
| Cogent Nominees Pty Limited (SMP accounts) | 266,175 | 0.48 |
| Woodross Nominees Pty Limited. | 245,915 | 0.45 |
| AMP Life Limited | 245,023 | 0.45 |
| Citicorp Nominees Pty Limited (CFSIL Cwlth Aust SHS 19 a/c) | 233,317 | 0.42 |
| | | **65.35** |

The 20 largest shareholders held 65.35% of the ordinary shares of the Company.

## On market buy-back

There is no current on market buy-back.

## Other information

Cochlear Limited, incorporated and domiciled in Australia, is a publicly listed company limited by shares.

## Glossary

**AIFRS** Australian equivalents to International Financial Reporting Standards.

**AGM** Annual General Meeting.

**ASIC** Australian Securities and Investments Commission.

**ASX** Australian Securities Exchange.

**Binaural hearing** Hearing with both ears.

**BTE** Behind-the-ear speech processor.

**Channel/Multi-channel** Pairs of electrodes that stimulate the cochlea. A multi-channel implant that has multiple pairs of electrodes that give implant recipients more options for choosing the most responsive hearing nerve fibres, providing richer pitch information and improving hearing in noisy environments.

**DACS** Direct acoustic cochlear stimulator.

**EAS** Electro-accoustic stimulation.

**ERP** Enterprise resource planning.

**F05** Financial Year 2005: 1 July 2004 to 30 June 2005.

**F06** Financial Year 2006: 1 July 2005 to 30 June 2006.

**F07** Financial Year 2007: 1 July 2006 to 30 June 2007.

**F08** Financial Year 2008: 1 July 2007 to 30 June 2008.

**MAP** The term used to describe an individual's "listening program". It is stored in the memory of the speech processor and tells the implant how to activate electrodes in the array depending on the incoming signal.

**Previous GAAP** Previous Australian Generally Accepted Accounting Principles.

**Processor/speech processor** The externally worn part of the cochlear implant system.

**R&D** Research and development.

**SmartSound** Set of sound processing algorithms which enhance hearing performance.

**TSR** Total shareholder return.

## Company ASX announcement record

**13 FEBRUARY 2007** *Record financial results for half year ended 31 December 2006 and Board change*
Cochlear Limited announced record revenue for the six months of $276.1 million, a 25% increase over the 31 December 2005 half year and core earnings of $52.8 million, an increase of 12% over the 31 December 2005 half year. Dr John Parker had also decided to retire on 31 March 2007.

**19 DECEMBER 2006** *Acquisition of key supplier's operations*
Cochlear Limited announced that it had acquired Cochlear related manufacturing operations and assets worth approximately $19 million from Brisbane based company, Crystalaid Manufacture Pty Limited. The transaction was expected to close on 2 January 2007.

**15 DECEMBER 2006** *Appointment of director*
Cochlear Limited Chairman, Mr Tommie Bergman, announced the appointment of Mr Andrew Denver to the Cochlear Board, effective 1 February 2007.

**24 OCTOBER 2006** *Chairman's address*
Cochlear Limited Chairman, Mr Tommie Bergman, addresses shareholders at the Annual General Meeting.

**15 AUGUST 2006** *Record financial results for year ended 30 June 2006*
Cochlear Limited announces total revenue for the year of $452.3 million, a 30% increase over the prior financial year, and core earnings of $86.4 million, an increase of 42% over the prior financial year. The final dividend was 55 cents per share fully franked.

**17 JULY 2006** *Board changes*
Cochlear Limited Chairman, Mr Tommie Bergman, announced that Mr Peter North, AM and Mr Justus Veeneklaas had decided to retire as directors at the October 2006 AGM.

## Company information

**Stock exchange listing**
Australian Securities Exchange
ASX code COH

**Share registrar**
Computershare Investor Services Pty Limited
60 Carrington Street
Sydney NSW 2000, Australia
Tel: +61 2 8234 5000

**Solicitors**
Clayton Utz

**Auditors**
KPMG Chartered Accountants

**Bankers**
**Australia** Westpac Banking Corporation
**Japan** The Bank of Tokyo-Mitsubishi UFJ, Limited
**Sweden** Skandinaviska Enskilda Banken AB (publ)
**United Kingdom** NatWest Bank
**United States** Wells Fargo Bank West, NA

**Annual General Meeting**
The Annual General Meeting will be held at 2pm on Tuesday 23 October 2007 at The Menzies Sydney Hotel, 14 Carrington Street, Sydney. A Notice of Meeting and Proxy Form are enclosed with this Annual Report.

**Financial calendar**
**2007**

| | |
|---|---|
| Dividend record date | 6 September |
| Payment of final dividend | 27 September |
| Annual General Meeting | 23 October |

**2008**

| | |
|---|---|
| Interim profit announcement | 12 February |
| Interim dividend record date | 29 February* |
| Payment of interim dividend | 18 March* |
| Final profit announcement | 12 August |
| Annual General Meeting | 21 October |

* Indicative dates only.

Nucleus is a registered trademark of Cochlear Limited. Baha is a registered trademark of Cochlear Bone Anchored Solutions AB, a Cochlear group company. Cochlear, the elliptical logo, Freedom, Contour, Contour Advance, SmartSound, Softip, Custom Sound, SPrint, Whisper and ESPrit are trademarks of Cochlear Limited. Baha Divino, Baha Intenso and Vistafix are trademarks of Cochlear Bone Anchored Solutions AB, a Cochlear group company.

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Cochlear™


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## Cover image

**Jack McLeod, bilateral recipient (boy in centre)**
Born profoundly deaf

**First implant**

| | |
|---|---|
| Year | 1997 |
| Age at implantation | 1 |
| Implant | Nucleus 24 |
| Processor | SPrint |

**Processor upgrade**

| | |
|---|---|
| Year | 2002 |
| Age at upgrade | 5 |
| Processor | ESPrit 3G |

**Second implant and processor upgrade**

| | |
|---|---|
| Year | 2007 |
| Age at implantation | 10 |
| Implant | Nucleus Freedom |
| Processor | Nucleus Freedom x 2 |


N32523 ISS1 AUG07