

Appendix 4D

Cochlear Limited Half Yearly Report As at 31 December 2012

Results for announcement to the market

| | | Movement | | \$A000 |
|---|-----------|-------------|-----------|----------------|
| Revenue | up | 1% | to | 391,699 |
| Earnings before interest, taxes and product recall costs (EBIT) | down | 0% | to | 108,301 |
| Net profit after tax but before product recall costs | down | 3% | to | 77,665 |
| Net profit for the period attributable to members | up | 481% | to | 77,665 |
| Basic EPS (cents) | up | 481% | to | 136.6 |
| Dividend (cents) | up | 4% | to | 125.0 |

| | | | | |
|---|------|-----|----|-------|
| Net tangible assets per share at 31 December 2012 (cents) | down | 14% | to | 300.3 |
| Net tangible assets per share at 31 December 2011 (cents) | | | | 350.5 |

| Dividends | Amount per security | Franked amount per security | Conduit foreign income per security |
|---|---------------------|-----------------------------|-------------------------------------|
| Interim dividend per share (cents) | 125.0c | 50.0c | 38.0c |
| Previous corresponding period (cents) | 120.0c | 72.0c | 48.0c |
| Record date for determining entitlements to the dividend | 27 February 2013 | | |
| Dividend payment date | 12 March 2013 | | |
| No dividend reinvestment plans were in operation during or since the half-year. | | | |

Refer to the attached Directors' Report for an explanation of the above movements.

Cochlear Limited and its controlled entities

ACN 002 618 073

Interim Financial Report

31 December 2012

Cochlear Limited and its controlled entities
Directors' Report
For the six months ended 31 December 2012

The directors present their report, together with the consolidated interim financial report for Cochlear Limited (the Company) and its controlled entities for the six months ended 31 December 2012 and the auditors' review report thereon.

Directors

The directors of the Company during or since the end of the interim period are:

| Name | Period of directorship |
|---|-------------------------------|
| <i>Non-executive directors</i> | |
| Mr Rick Holliday-Smith, <i>Chairman</i> | Director since March 2005 |
| Mrs Yasmin Allen | Director since August 2010 |
| Mr Paul Bell | Director since August 2005 |
| Professor Edward Byrne, AO | Director since July 2002 |
| Mr Andrew Denver | Director since February 2007 |
| Mr Donal O'Dwyer | Director since August 2005 |
| <i>Executive director</i> | |
| Dr Chris Roberts, <i>CEO/President</i> | Director since February 2004 |

Principal activities and review of operations and results

Other than as discussed in this report, there were no significant changes in the nature of operating activities during the six months ended 31 December 2012 and the results of those operations are set out below.

Financial overview

The consolidated results for the six months attributable to the members of the Company are:

| | 2012 | 2011 |
|---|----------------|-----------------|
| | \$000 | \$000 |
| Revenue | 391,699 | 387,491 |
| Earnings before interest and taxes and product recall costs (EBIT)* | 108,301 | 108,674 |
| Profit before income tax and product recall costs* | 105,471 | 106,291 |
| Net profit after tax but before product recall costs* | 77,665 | 80,147 |
| Product recall costs, net of tax* | - | (100,536) |
| Net (loss)/profit attributable to members | 77,665 | (20,389) |
| Basic earnings per share (cents) | 136.6 | (35.9) |
| Diluted earnings per share (cents) | 136.1 | (35.8) |
| Dividend per share (cents) | 125.0 | 120.0 |

* The product recall costs were nil for the six months ended 31 December 2012, and \$138,835,000 before tax and \$100,536,000 after tax for the six months ended 31 December 2011.

Cochlear Limited and its controlled entities

Directors' Report

For the six months ended 31 December 2012

Financial Performance

Total revenues for H1 F13 were \$391.7 million, up 1% on H1 F12. Sales, excluding FX contracts, were \$368.2 million, up 5%. In constant currency (that is restating H1 F12 at H1 F13 FX rates), H1 F13 sales were up 9%.

Cochlear implant sales, which included accessories and sound processor upgrades, were \$329.7 million, up 6% in reported currency and up 10% in constant currency.

Cochlear implant unit sales were 13,672, up 27%.

Bone Anchored Solutions sales of \$38.5 million were down 3% in reported currency and unchanged in constant currency.

Regional performance:

- Americas sales of \$150.4 million grew 1% in constant currency (up 1% in reported currency).
- EMEA (Europe, Middle East and Africa) sales of \$140.1 million were up 7% in constant currency (down 2% in reported currency).
- Asia Pacific sales of \$77.7 million were up 33% in constant currency (30% in reported currency).

Cost of goods sold (COGS) of \$104.8 million gave a COGS/sales margin of 28.5% compared with 28.8% for the previous financial year. This was despite the appreciating AUD, for example, the AUD appreciated 9% against the Euro.

Selling, General and Administration expenses of \$118.9 million were down 2% in reported currency and unchanged in constant currency. No addition has been made to the recall provision in H1 F13 and the CI500 implant failure rate continues to fall.

Investment in research and development of \$59.9 million was up 3% in reported currency and 5% in constant currency.

EBIT to Revenue was 27.6%; the same as for F12 despite FX contracts down \$12.8 million for the half.

Trade receivables of \$171.4 million grew 18% from June 2012 and debtors' days were 81 days (June 2012, 73). Inventory grew 14% to \$115.7 million over the June 2012 position.

Working Capital to sales of 26% compares with our longer term average of 25%.

Net debt was \$72.5 million at 31st December 2012. At 31st December 2012, the unused portion of the facility was \$60.3 million (June 2012, \$128.0 million).

Given the significance of the product recall and fx movements the directors believe the presentation of non-IFRS financial measures is useful for the users of this document as they reflect the underlying financial performance of the business.

The non-IFRS financial measures included in this document have been calculated on the following basis:

- Excluding recall costs: IFRS measures adjusted for the costs of the product recall
- Constant currency: restatement of IFRS financial measures in comparative years using F13 FX rates
- Free cash flow: IFRS cash flow from operating and investing activities excluding interest and tax paid related to non-operating activities.

The above non-IFRS financial measures have not been subject to review or audit. However, KPMG have separately undertaken a set of procedures to agree the non-IFRS financial measures disclosed to the books and records of the consolidated entity.

**Cochlear Limited and its controlled entities
Directors' Report
For the six months ended 31 December 2012**

Dividends

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

| | \$000 |
|---|---------------|
| In respect of the previous year: | |
| A final ordinary dividend of 125.0 cents per share, franked to 35% with Class C (30%) franking credits, in respect of the year ended 30 June 2012, paid on 20 September 2012. | <u>71,216</u> |

The interim dividend in respect of the current financial year has not been provided for in this financial report as it was not declared until after 31 December 2012. Since the end of the financial half-year, the directors declared an interim dividend of 125.0 cents franked at 40% amounting to a total of \$71,283,000.

Lead Auditor's Independence Declaration under Section 307C of the Corporations Act

The lead auditor's independence declaration is set out on page 4 and forms part of the Directors' Report for the six months ended 31 December 2012.

Rounding off

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

Dated at Sydney this 5th day of February 2013.

Signed in accordance with a resolution of the directors:



Director



Director

**Cochlear Limited and its controlled entities
Directors' Report
For the six months ended 31 December 2012**

Lead Auditor's Independence Declaration under Section 307C of the Corporations Act 2001

I declare that, to the best of my knowledge and belief, in relation to the review for the financial half year ended 31 December 2012 there have been:

- (i) no contraventions of the auditor independence requirements as set out in the Corporations Act 2001 in relation to the review; and
- (ii) no contraventions of any applicable code of professional conduct in relation to the review.



KPMG

Sydney, 5 February 2013



Bruce Phillips, Partner

Cochlear Limited and its controlled entities
Interim Income Statement
For the six months ended 31 December 2012

| | Note | 31 Dec 2012 \$000 | 31 Dec 2011 \$000 |
|--|------|----------------------|----------------------|
| Revenue | 5(a) | 391,699 | 387,491 |
| Cost of sales | 5(b) | (104,842) | (100,280) |
| Cost of sales – product recall | 14 | - | (138,835) |
| Gross profit | | 286,857 | 148,376 |
| Selling and general expenses | | (97,536) | (98,573) |
| Administration expenses | | (21,319) | (22,249) |
| Research and development expenses | | (59,901) | (57,862) |
| Other income | 5(c) | 898 | 728 |
| Other expenses | 5(d) | (698) | (581) |
| Results from operating activities | | 108,301 | (30,161) |
| Finance income | 5(e) | 293 | 445 |
| Finance expense | 5(e) | (3,123) | (2,828) |
| Net finance expense | 5(e) | (2,830) | (2,383) |
| Profit / (loss) before income tax | | 105,471 | (32,544) |
| Income tax (expense) / benefit | 6 | (27,806) | 12,155 |
| Net profit / (loss) | | 77,665 | (20,389) |
| <hr/> | | | |
| Earnings per share | | | |
| Basic earnings per share (cents) | 9 | 136.6 | (35.9) |
| Diluted earnings per share (cents) | 9 | 136.1 | (35.8) |

The notes on pages 11 to 19 are an integral part of these consolidated interim financial statements.

**Cochlear Limited and its controlled entities
Interim Statement of Comprehensive Income
For the six months ended 31 December 2012**

| | 31 Dec 2012 | 31 Dec 2011 |
|---|----------------|-----------------|
| | \$000 | \$000 |
| Net profit / (loss) | 77,665 | (20,389) |
| Other comprehensive income – items that may be reclassified subsequently to profit or loss | | |
| Foreign exchange translation differences | 7,216 | (12,843) |
| Effective portion of changes in fair value of cash flow hedges | 8,116 | 13,883 |
| Net change in fair value of cash flow hedges transferred to the income statement | (16,456) | (25,398) |
| | <hr/> | <hr/> |
| Other comprehensive loss for the period, net of income tax | (1,124) | (24,358) |
| | <hr/> | <hr/> |
| Total comprehensive income / (loss) for the period | 76,541 | (44,747) |

The notes on pages 11 to 19 are an integral part of these consolidated interim financial statements.

Cochlear Limited and its controlled entities
Interim Balance Sheet
As at 31 December 2012

| | Note | 31 Dec 2012 \$000 | 30 Jun 2012 \$000 |
|--------------------------------------|------|----------------------|----------------------|
| Current assets | | | |
| Cash and cash equivalents | | 69,796 | 68,486 |
| Trade and other receivables | | 200,047 | 189,085 |
| Inventories | | 115,715 | 101,298 |
| Current tax receivables | | 7,713 | 5,763 |
| Prepayments | | 7,001 | 9,249 |
| Total current assets | | 400,272 | 373,881 |
| Non-current assets | | | |
| Trade and other receivables | | 17,748 | 11,840 |
| Property, plant and equipment | | 62,262 | 59,611 |
| Goodwill | 11 | 158,275 | 151,066 |
| Other intangible assets | | 61,571 | 55,649 |
| Deferred tax assets | | 42,233 | 50,495 |
| Total non-current assets | | 342,089 | 328,661 |
| Total assets | | 742,361 | 702,542 |
| Current liabilities | | | |
| Trade and other payables | | 80,931 | 100,218 |
| Loans and borrowings | 12 | 78,372 | 45,744 |
| Current tax liabilities | | 6,246 | 19,526 |
| Provisions | | 66,391 | 78,366 |
| Deferred revenue | | 18,525 | 18,089 |
| Total current liabilities | | 250,465 | 261,943 |
| Non-current liabilities | | | |
| Trade and other payables | | 583 | 735 |
| Loans and borrowings | 12 | 63,947 | 19,928 |
| Provisions | | 36,276 | 35,056 |
| Total non-current liabilities | | 100,806 | 55,719 |
| Total liabilities | | 351,271 | 317,662 |
| Net assets | | 391,090 | 384,880 |
| Equity | | | |
| Share capital | | 118,446 | 121,136 |
| Reserves | | (14,311) | (16,762) |
| Retained earnings | | 286,955 | 280,506 |
| Total equity | | 391,090 | 384,880 |

The notes on pages 11 to 19 are an integral part of these consolidated interim financial statements.

Cochlear Limited and its controlled entities
Interim Statement of Changes in Equity
For the six months ended 31 December 2012

| | Issued capital | Treasury reserve | Translation reserve | Hedging reserve | Share based payment reserve | Retained earnings | Total equity |
|--|----------------|------------------|---------------------|-----------------|-----------------------------|-------------------|-----------------|
| | \$000 | \$000 | \$000 | \$000 | \$000 | \$000 | \$000 |
| Balance at 1 July 2012 | 125,865 | (4,729) | (84,153) | 30,910 | 36,481 | 280,506 | 384,880 |
| Total comprehensive income | | | | | | | |
| Net profit | - | - | - | - | - | 77,665 | 77,665 |
| Other comprehensive income | | | | | | | |
| Foreign exchange translation differences | - | - | 7,216 | - | - | - | 7,216 |
| Effective portion of changes in fair value of cash flow hedges | - | - | - | 8,116 | - | - | 8,116 |
| Net change in fair value of cash flow hedges transferred to the income statement | - | - | - | (16,456) | - | - | (16,456) |
| Total other comprehensive loss | - | - | 7,216 | (8,340) | - | - | (1,124) |
| Total comprehensive income for the period | - | - | 7,216 | (8,340) | - | 77,665 | 76,541 |
| Transactions with owners, recorded directly in equity | | | | | | | |
| Shares issued | 1,989 | (4,679) | - | - | - | - | (2,690) |
| Share based payments | - | - | - | - | 3,575 | - | 3,575 |
| Dividends to shareholders | - | - | - | - | - | (71,216) | (71,216) |
| Total transactions with owners | 1,989 | (4,679) | - | - | 3,575 | (71,216) | (70,331) |
| Balance at 31 December 2012 | 127,854 | (9,408) | (76,937) | 22,570 | 40,056 | 286,955 | 391,090 |

The notes on pages 11 to 19 are an integral part of these consolidated interim financial statements.

Cochlear Limited and its controlled entities
Interim Statement of Changes in Equity
For the six months ended 31 December 2012

| | Issued capital | Treasury reserve | Translation reserve | Hedging reserve | Share based payment reserve | Retained earnings | Total equity |
|--|----------------|------------------|---------------------|-----------------|-----------------------------|-------------------|-----------------|
| | \$000 | \$000 | \$000 | \$000 | \$000 | \$000 | \$000 |
| Balance at 1 July 2011 | 123,226 | (3,489) | (65,849) | 56,379 | 32,827 | 360,189 | 503,283 |
| Total comprehensive income | | | | | | | |
| Net loss | - | - | - | - | - | (20,389) | (20,389) |
| Other comprehensive income | | | | | | | |
| Foreign exchange translation differences | - | - | (12,843) | - | - | - | (12,843) |
| Effective portion of changes in fair value of cash flow hedges | - | - | - | 13,883 | - | - | 13,883 |
| Net change in fair value of cash flow hedges transferred to the income statement | - | - | - | (25,398) | - | - | (25,398) |
| Total other comprehensive loss | - | - | (12,843) | (11,515) | - | - | (24,358) |
| Total comprehensive loss for the period | - | - | (12,843) | (11,515) | - | (20,389) | (44,747) |
| Transactions with owners, recorded directly in equity | | | | | | | |
| Shares issued | 2,773 | (1,239) | - | - | - | - | 1,534 |
| Share based payments | - | - | - | - | 3,349 | - | 3,349 |
| Dividends to shareholders | - | - | - | - | - | (68,171) | (68,171) |
| Total transactions with owners | 2,773 | (1,239) | - | - | 3,349 | (68,171) | (63,288) |
| Balance at 31 December 2011 | 125,999 | (4,728) | (78,692) | 44,864 | 36,176 | 271,629 | 395,248 |

The notes on pages 11 to 19 are an integral part of these consolidated interim financial statements.

Cochlear Limited and its controlled entities
Interim Statement of Cash Flows
For the six months ended 31 December 2012

| | Note | 31 Dec 2012 | 31 Dec 2011 |
|---|------|-----------------|-----------------|
| | | \$000 | \$000 |
| Cash flows from operating activities | | | |
| Cash receipts from customers | | 341,712 | 367,841 |
| Cash payments to suppliers and employees | | (280,399) | (273,793) |
| Grant and other income received | | 898 | 728 |
| Interest received | | 307 | 415 |
| Interest paid | | (3,248) | (2,787) |
| Income taxes paid | | (30,755) | (25,039) |
| Net cash from operating activities | | 28,515 | 67,365 |
| Cash flows from investing activities | | | |
| Acquisition of property, plant and equipment | | (9,624) | (9,683) |
| Acquisition of enterprise resource planning system | | (7,572) | (3,833) |
| Acquisition of intangible assets | | (13,305) | (3,752) |
| Net cash used in investing activities | | (30,501) | (17,268) |
| Cash flows from financing activities | | | |
| Repayment of borrowings | 12 | (5,000) | (30,000) |
| Proceeds from borrowings | 12 | 82,000 | 50,000 |
| Payments for repurchase of issued capital, net | | (2,690) | 1,534 |
| Dividends paid by the parent | | (71,216) | (68,171) |
| Net cash from / (used in) financing activities | | 3,094 | (46,637) |
| Net increase in cash and cash equivalents | | 1,108 | 3,460 |
| Cash and cash equivalents at 1 July | | 68,486 | 72,423 |
| Effect of exchange rate fluctuation on cash held | | 202 | (935) |
| Cash and cash equivalents at 31 December | | 69,796 | 74,948 |

The notes on pages 11 to 19 are an integral part of these consolidated interim financial statements.

Cochlear Limited and its controlled entities
Notes to the interim financial statements
For the six months ended 31 December 2012

1. Reporting entity

Cochlear Limited (the Company) is a company domiciled in Australia. The Consolidated Interim Financial Report of the Company as at and for the six months ended 31 December 2012 comprises the Company and its subsidiaries (together referred to as Cochlear or the Consolidated Entity). Cochlear's Consolidated Annual Financial Report as at and for the year ended 30 June 2012 is available upon request from the Company's registered office at 1 University Avenue, Macquarie University NSW 2109, Australia or at www.cochlear.com.

2. Statement of compliance

The Consolidated Interim Financial Report is a general purpose financial report which has been prepared in accordance with AASB134 *Interim Financial Reporting* and the *Corporations Act 2001*, and with IAS 34 *Interim Financial Reporting*.

The Consolidated Interim Financial Report does not include all of the information required for a full annual financial report, and should be read in conjunction with Cochlear's Consolidated Annual Financial Report as at and for the year ended 30 June 2012. This report should also be read in conjunction with any public announcements made by Cochlear Limited during the six months ended 31 December 2012 in accordance with continuous disclosure obligations arising under the Corporations Act 2001.

The Consolidated Interim Financial Report was approved by the Board of Directors on 5th February 2013.

The Consolidated Entity is of a kind referred to in ASIC Class Order 98/100 dated 10 July 1998 and in accordance with the Class Order, amounts in the Consolidated Interim Financial Report have been rounded off to the nearest thousand dollars, unless otherwise stated.

3. Significant accounting policies

Except as described below, the accounting policies applied by the Consolidated Entity in this Consolidated Interim Financial Report are the same as those applied by the Consolidated Entity in the Consolidated Annual Financial Report as at and for the year ended 30 June 2012. The following change in accounting policy is expected to be reflected in the Consolidated Entity's consolidated financial statements as at and for the year ended 30 June 2013.

Changes in accounting policies

Presentation of transactions recognised in other comprehensive income

From 1 July 2012 the Consolidated Entity applied amendments to AASB 134 Interim Financial Reporting outlined in AASB 2011-9 Amendments to Australian Accounting Standards – Presentation of Items of Other Comprehensive Income. The change in accounting policy only relates to disclosures and has had no impact on consolidated earnings per share or net income. The changes have been applied retrospectively and require the Consolidated Entity to separately present those items of other comprehensive income that may be reclassified to profit or loss in the future from those that will never be reclassified to profit or loss.

4. Estimates

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

In preparing this Consolidated Interim Financial Report, the significant judgments made by management in applying Cochlear's accounting policies and the key sources of estimation uncertainty were the same as those that applied to the Consolidated Annual Financial Report as at and for the year ended 30 June 2012.

Cochlear Limited and its controlled entities
Notes to the interim financial statements
For the six months ended 31 December 2012

| | Note | 31 Dec 2012 \$000 | 31 Dec 2011 \$000 |
|---|------|----------------------|----------------------|
| 5. Revenue and expenses | | | |
| (a) Revenue | | | |
| Sale of goods revenue before hedging | | 364,913 | 348,088 |
| Foreign exchange gains on hedged sales | | 23,508 | 36,283 |
| Revenue from the sale of goods | | 388,421 | 384,371 |
| Rendering of services revenue | | 3,278 | 3,120 |
| Total revenue | | 391,699 | 387,491 |
| (b) Expenses | | | |
| Cost of sales | | | |
| Carrying amount of inventories recognised as an expense | | 102,347 | 96,449 |
| Other | | 1,904 | 2,151 |
| Write-down in value of inventories | | 591 | 1,680 |
| Total cost of sales (excluding the product recall) | | 104,842 | 100,280 |
| (c) Other Income | | | |
| Grant received or due and receivable | | 349 | 339 |
| Other | | 549 | 389 |
| Total other income | | 898 | 728 |
| (d) Other Expenses | | | |
| Net foreign exchange loss | | (698) | (581) |
| Total other expenses | | (698) | (581) |
| (e) Net finance expense | | | |
| Interest income | | 293 | 445 |
| Interest expense | | (3,123) | (2,828) |
| Net finance expense | | (2,830) | (2,383) |

Cochlear Limited and its controlled entities
Notes to the interim financial statements
For the six months ended 31 December 2012

6. Income tax expense

| | 31 Dec 2012 | 31 Dec 2011 | 31 Dec 2011 | 31 Dec 2011 |
|---|----------------|-----------------|------------------|----------------|
| | Reported | Reported | Product | Total |
| | \$000 | \$000 | recall | adjusted |
| | | | \$000 | \$000 |
| Numerical reconciliation between income tax expense and profit before income tax | | | | |
| Net profit / (loss) | 77,665 | (20,389) | (100,536) | 80,147 |
| Income tax expense / (benefit) | 27,806 | (12,155) | (38,299) | 26,144 |
| Profit / (loss) before income tax | 105,471 | (32,544) | (138,835) | 106,291 |
| Income tax expense / (benefit) using the Company's domestic tax rate of 30% (2011: 30%) | 31,641 | (9,763) | (41,651) | 31,888 |
| Increase in income tax expense due to: | | | | |
| Non-deductible expenses | 644 | 4,338 | 4,152 | 186 |
| Effect of tax rate in foreign jurisdictions | 1,907 | - | - | - |
| Decrease in income tax expense due to: | | | | |
| Research and development allowances | (5,823) | (4,586) | (800) | (3,786) |
| Share based payment deductions | (335) | (326) | - | (326) |
| Effect of tax rate in foreign jurisdictions | - | (673) | - | (673) |
| | 28,034 | (11,010) | (38,299) | 27,289 |
| Adjustment for prior years | (228) | (1,145) | - | (1,145) |
| Income tax expense / (benefit) on profit before income tax | 27,806 | (12,155) | (38,299) | 26,144 |

Cochlear Limited and its controlled entities
Notes to the interim financial statements
For the six months ended 31 December 2012

7. Segment reporting

| | Americas \$000 | Europe \$000 | Asia Pacific \$000 | Total \$000 |
|--|-------------------|-----------------|-----------------------|----------------|
| Information about reportable segments | | | | |
| Six months ended 31 December 2012 | | | | |
| External revenue | 150,398 | 140,134 | 77,659 | 368,191 |
| Reportable segment profit or loss | 77,100 | 66,499 | 30,883 | 174,482 |
| Six months ended 31 December 2011 | | | | |
| External revenue | 149,001 | 142,534 | 59,673 | 351,208 |
| Reportable segment profit or loss | 72,267 | 68,308 | 19,767 | 160,342 |

| | 31 Dec 2012 \$000 | 31 Dec 2011 \$000 |
|---|----------------------|----------------------|
| Reconciliation of reportable segment revenue | | |
| External revenue | 368,191 | 351,208 |
| Foreign exchange gains on hedged sales | 23,508 | 36,283 |
| Total revenue | <u>391,699</u> | <u>387,491</u> |

Reconciliation of reportable segment profit or loss

| | | |
|--|----------------|-----------------|
| Total profit or loss for reportable segments | 174,482 | 160,342 |
| Corporate and other net expenses | (66,181) | (51,668) |
| Cost of sales - product recall | - | (138,835) |
| Net finance expense | <u>(2,830)</u> | <u>(2,383)</u> |
| Profit / (loss) before income tax | <u>105,471</u> | <u>(32,544)</u> |

Cochlear Limited and its controlled entities
Notes to the interim financial statements
For the six months ended 31 December 2012

8. Options and performance shares

The Company has granted options and performance shares to certain employees and key management personnel under the Cochlear Executive Long Term Incentive Plan (CELTIP). The terms and conditions of the plan are disclosed in the Consolidated Annual Financial Report as at and for the year ended 30 June 2012. In August 2012 a further grant on similar terms was made to certain employees and key management personnel.

Details of the grant made in the current period are set out below.

| | Exercise price per option | Exercise period | Number of options | Number of performance shares |
|--|--------------------------------------|----------------------------|------------------------------|---|
| Options & performance shares issued in August and October 2012 | \$62.78 | Aug 2015 - 17 | 759,828 | 79,660 |

9. Earnings per share

Basic earnings per share

The calculation of basic earnings per share for the six months ended 31 December 2012 was based on net profit attributable to equity holders of the parent and a weighted average number of ordinary shares outstanding during the six months ended 31 December 2012 calculated as follows:

| | | |
|--|--------------------|--------------------|
| | 31 Dec 2012 | 31 Dec 2011 |
| Net profit / (loss) attributable to equity holders of the parent | \$77,665,000 | (\$20,389,000) |
| Weighted average number of ordinary shares: | | |
| Issued ordinary shares at 1 July (number) | 56,865,878 | 56,680,142 |
| Effect of shares issued during the period (number) | 4,074 | 99,761 |
| Weighted average number of ordinary shares | 56,869,952 | 56,779,903 |
| Basic earnings per share (cents) | 136.6 | (35.9) |

Diluted earnings per share

The calculation of diluted earnings per share for the six months ended 31 December 2012 was based on net profit attributable to equity holders of the parent and a weighted average number of ordinary shares outstanding during the six months ended 31 December 2012 calculated as follows:

| | | |
|--|-------------------|-------------------|
| Net profit / (loss) attributable to equity holders of the parent | \$77,665,000 | (\$20,389,000) |
| Weighted average number of ordinary shares (diluted): | | |
| Weighted average number of shares (basic) | 56,869,952 | 56,779,903 |
| Effect of options and performance shares | 182,217 | 127,783 |
| Weighted average number of ordinary shares (diluted) | 57,052,169 | 56,907,686 |
| Diluted earnings per share (cents) | 136.1 | (35.8) |

Cochlear Limited and its controlled entities
Notes to the interim financial statements
For the six months ended 31 December 2012

10. Dividends

Dividends recognised in the current financial period by Cochlear Limited are:

| | Cents per share | Total amount \$'000 | Franked/ unfranked | Date of payment |
|-------------------------|--------------------|------------------------|-----------------------|----------------------|
| 31 December 2012 | | | | |
| Final – ordinary | 125.0 | 71,216 | 35% Franked | 20 September 2012 |
| 31 December 2011 | | | | |
| Final – ordinary | 120.0 | 68,171 | 70% Franked | 22 September 2011 |

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

Subsequent events

Since the end of the reporting period, the directors declared the following dividend:

| | Cents per share | Total amount \$'000 | Franked/ unfranked | Date of payment |
|--------------------|--------------------|------------------------|-----------------------|--------------------|
| Interim – ordinary | 125.0 | 71,283 | 40% Franked | 12 March 2013 |

The financial effect of these dividends has not been brought to account in the Consolidated Interim Financial Report for the six months ended 31 December 2012 and will be recognised in subsequent financial statements.

11. Goodwill

| | |
|--|----------------|
| | \$000 |
| Carrying amount at 1 January 2012 | 153,810 |
| Effect of movements in foreign exchange | (2,744) |
| Carrying amount at 30 June 2012 | 151,066 |
| Carrying amount at 1 July 2012 | 151,066 |
| Effect of movements in foreign exchange | 7,209 |
| Carrying amount at 31 December 2012 | 158,275 |

Cochlear Limited and its controlled entities
Notes to the interim financial statements
For the six months ended 31 December 2012

12. Loans and Borrowings

| | 31 Dec 2012 | 30 Jun 2012 |
|---|--------------------|--------------------|
| | \$000 | \$000 |
| Current | | |
| Secured bank loans | 78,372 | 45,744 |
| Total current loans and borrowings | 78,372 | 45,744 |
| Non-Current | | |
| Secured bank loan | 63,947 | 19,928 |
| Total non-current loans and borrowings | 63,947 | 19,928 |

Unsecured bank overdrafts

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

Secured bank loans

On the 22 August 2012 Cochlear increased its JPY300 million bank facility to JPY450 million, which is reviewed every 365 days. The next review date is 1 March 2013. The facility is secured by a letter of guarantee which expires 13 August 2017. Interest is charged at prevailing market rates.

Secured bank loans – multi-option credit facility

Cochlear's corporate debt facility was amended and restated in April 2011. The facility has two tranches. Tranche A is a \$75.0 million loan facility which may be extended for periods of 12 months, up until 20 April 2014. Tranche B has a total limit of \$125.0 million maturing 20 April 2014. Tranche B provides Cochlear with the option to reallocate a sub-limit of up to \$30.0 million for the purpose of drawing either bank guarantees or letters of credit. The facility is secured by interlocking guarantees provided by certain controlled entities. Interest on the facility is variable and is charged at prevailing market rates.

Secured bank loans – bank guarantee facility

In December 2009, Cochlear secured a GBP1.0 million bank guarantee line which is supported by corporate indemnities and guarantee of up to GBP2.0 million.

In May 2012, Cochlear secured a standalone bank guarantee facility for New Zealand dollars (NZD) 0.1 million.

Unsecured bank loans – bank guarantee facility

In August 2011, Cochlear established a multi-currency bank guarantee and letter of credit facility to be used for general corporate purposes. The facility limit is \$15.0 million.

Cochlear Limited and its controlled entities
Notes to the interim financial statements
For the six months ended 31 December 2012

13. Contingent liabilities

The details 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.

Product liability claims

Cochlear is currently and is likely from time to time to be involved in claims and lawsuits incidental to the ordinary course of business, including claims for damages relating to its products and services.

In addition, Cochlear has received legal claims in various countries and law suits in the United States by recipients who have had Cochlear implant CI500 series devices stop functioning for the reason that led to the September 2011 voluntary recall of unimplanted CI500 series devices. The claims are being negotiated and the law suits defended by Cochlear.

Cochlear carries product liability insurance and has made claims under the policy. The insurers have agreed to indemnify Cochlear in accordance with the terms and conditions of the policy including deductibles and exclusions. In the opinion of the directors, the details of the product liability insurance policies are commercially sensitive and any disclosure of these details may be prejudicial to the interests of Cochlear.

Patent infringement complaints

During the year ended 30 June 2008, the Company was served with a complaint for patent infringement by the Alfred E. Mann Foundation for Scientific Research (Mann Foundation).

The complaint, filed in the US District Court of California, alleges that two patents have been infringed.

The Company believes the Mann Foundation's allegations are without merit and is vigorously defending the complaint.

At the date of this report, the litigation process is ongoing. No provision has been established against settlement because the probability of a significant outflow is considered unlikely.

Guarantees - Operations

Cochlear amended and restated its multi-option credit facility in April 2011. The facility now has two tranches with a total facility limit of \$200.0 million and provides Cochlear with a loan sub-facility limit, which may not exceed \$30.0 million for the purpose of drawing either bank guarantees or letters of credit. The loan sub-facility limit forms part of Tranche B of the facility, which matures 20 April 2014.

In December 2009, Cochlear secured a GBP1.0 million bank guarantee line which is supported by corporate indemnities and guarantee of up to GBP2.0 million.

Cochlear established a revolving guarantee facility in August 2011 with a limit of \$15.0 million; under this facility, letters of credit and bank guarantees can be drawn to support Cochlear's global activities.

In May 2012, Cochlear secured a standalone bank guarantee facility for NZD0.1 million.

Cochlear Limited and its controlled entities
Notes to the interim financial statements
For the six months ended 31 December 2012

14. Product recall

On 11 September 2011, the Company initiated a worldwide voluntary recall of its unimplanted Nucleus CI500 cochlear implant range. The Company had identified a recent increase in the number of Nucleus CI512 implant failures. In the event of a Nucleus CI500 series implant failure recipients may be re-implanted with the Nucleus CI24RE implant range which remains available and continues to be sold with Nucleus 5 externals.

Relevant healthcare professionals and regulatory authorities were advised of this action and management continues to work with these authorities.

On 20 December 2011, the Company announced to healthcare professionals and the Australian Securities Exchange that it had identified the root cause of the failures and continued to work on resolving the problem.

An amount of \$138.8 million was recognised in the Interim Financial Statements for the six months ended 31 December 2011. The charge represented management's best estimate of probable costs based upon data available at each reporting date. This took into account inventory write-downs, property, plant & equipment, intangible asset impairments, and warranty and other costs which include factors such as estimated return rates for the affected units, unit replacement costs, and consulting, logistical and administrative expenses directly associated with the recall.

Management has made judgments, estimates and assumptions related to probable costs arising from the recall which affects the reported amounts of assets and liabilities, income and expenses. Actual outcomes may differ from these estimates as further information is identified.

A provision of \$44.6 million is included in current and non-current provisions related to the costs associated with the recall that are still to be incurred as at 31 December 2012.

An analysis of the recall costs charged to cost of sales and the tax impact included in the tax charge / (benefit) is set out below:

| | 6 months ended December 2012 | 12 months ended 30 June 2012 | 6 months ended December 2011 |
|--|---|---|---|
| | \$000 | \$000 | \$000 |
| Product Recall | | | |
| Write-down of inventories | - | 34,859 | 34,427 |
| Impairment of property, plant and equipment | - | 14,006 | 14,006 |
| Impairment of intangible assets | - | 13,840 | 13,840 |
| Provision for warranty and other costs | - | 76,130 | 76,562 |
| Total cost of sales – product recall before interest and tax | - | 138,835 | 138,835 |
| Income tax benefit | - | (37,499) | (38,299) |
| Total product recall cost after tax | - | 101,336 | 100,536 |

15. Events subsequent to reporting date

Other than reported below, there has not arisen in the interval between the 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 Cochlear, the results of those operations, or the state of affairs of Cochlear in future financial years.

Dividends

For dividends declared after 31 December 2012, see Note 10.

Cochlear Limited and its controlled entities
Directors' Declaration
For the six months ended 31 December 2012

In the opinion of the directors of Cochlear Limited:

1. The financial statements and notes set out on pages 5 to 19 are in accordance with the Corporations Act 2001, including:
 - a. giving a true and fair view of the Consolidated Entity's financial position as at 31 December 2012, and of its performance, for the six month period ended on that date; and
 - b. complying with Australian Accounting Standard AASB 134 *Interim Financial Reporting* and the Corporations Regulations 2001; and
2. There are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

Dated at Sydney this 5th day of February 2013.

Signed in accordance with a resolution of the directors:



Director



Director

Cochlear Limited and its controlled entities
Independent auditor's review report to the members of Cochlear Limited
For the six months ended 31 December 2012

We have reviewed the accompanying interim financial report of Cochlear Limited, which comprises the consolidated interim balance sheet as at 31 December 2012, consolidated interim income statement, consolidated interim statement of comprehensive income, consolidated interim statement of changes in equity and consolidated interim statement of cash flows for the half-year period ended on that date, notes 1 to 15 comprising a summary of significant accounting policies and other explanatory information and the directors' declaration of the Consolidated Entity comprising the company and the entities it controlled at the half-year's end or from time to time during the half-year.

Directors' responsibility for the interim financial report

The directors of the company are responsible for the preparation of the interim financial report that gives a true and fair view in accordance with Australian Accounting Standards and the *Corporations Act 2001* and for such internal control as the directors determine is necessary to enable the preparation of the interim financial report that is free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express a conclusion on the interim financial report based on our review. We conducted our review in accordance with Auditing Standard on Review Engagements ASRE 2410 *Review of a Financial Report Performed by the Independent Auditor of the Entity*, in order to state whether, on the basis of the procedures described, we have become aware of any matter that makes us believe that the interim financial report is not in accordance with the *Corporations Act 2001* including: giving a true and fair view of Consolidated Entity's financial position as at 31 December 2012 and its performance for the half-year ended on that date; and complying with Australian Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Regulations 2001*. As auditor of Cochlear Limited, ASRE 2410 requires that we comply with the ethical requirements relevant to the audit of the annual financial report.

A review of an interim financial report consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with Australian Auditing Standards and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Independence

In conducting our review, we have complied with the independence requirements of the *Corporations Act 2001*.

Conclusion

Based on our review, which is not an audit, we have not become aware of any matter that makes us believe that the interim financial report of Cochlear Limited is not in accordance with the *Corporations Act 2001*, including:

- (a) giving a true and fair view of the Consolidated Entity's financial position as at 31 December 2012 and of its performance for the half-year ended on that date; and
- (b) complying with Australian Accounting Standard AASB 134 *Interim Financial Reporting* and the *Corporations Regulations 2001*.



KPMG
Sydney, 5 February 2013



Bruce Phillips, Partner