

## Appendix 4D

# Cochlear Limited Half Yearly Report As at 31 December 2016

### Results for announcement to the market

		Movement from 31 December 2015		\$A000
<b>Sales Revenue</b>	<b>up</b>	<b>4%</b>	<b>to</b>	<b>604,366</b>
Total Revenue	up	9%	to	609,164
Earnings before interest and taxes (EBIT)	up	19%	to	156,397
<b>Net profit for the period attributable to members</b>	<b>up</b>	<b>19%</b>	<b>to</b>	<b>111,367</b>
Basic earnings per share (cents)	up	18%	to	194.2
Dividend (dollars)	up	18%	to	\$1.30
Net tangible assets per share at 31 December 2016 (cents)	up	52%	to	480.0
Net tangible assets per share at 31 December 2015 (cents)				315.9

<b>Dividends</b>	Amount per security	Franked amount per security	Conduit foreign income per security
Interim dividend per share (dollars)	\$1.30	\$1.30	\$0.00
Previous corresponding period (dollars)	\$1.10	\$1.10	\$0.00
Record date for determining entitlements to the dividend	16 March 2017		
Dividend payment date	6 April 2017		
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 2016**

**Cochlear Limited and its controlled entities**  
**Directors' Report**  
**For the half year ended 31 December 2016**

The directors present their report, together with the consolidated interim financial report of the Consolidated Entity (Cochlear), being Cochlear Limited (the Company) and its controlled entities, for the half year ended 31 December 2016 and the auditors' review report thereon.

**Directors**

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

<b>Name</b>	<b>Period of directorship</b>
<i>Non-executive directors</i>	
Mr Rick Holliday-Smith, <i>Chairman</i>	Director since March 2005
Mrs Yasmin Allen	Director since August 2010
Mr Glen Boreham, AM	Director since January 2015
Professor Edward Byrne, AC	Director since July 2002
Ms Alison Deans	Director since January 2015
Mr Andrew Denver	Director since February 2007
Mr Donal O'Dwyer	Director since August 2005
Professor Bruce Robinson	Director since December 2016
<i>Executive director</i>	
Mr Chris Smith, <i>Chief Executive Officer &amp; President</i>	Director since September 2015

**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 half year ended 31 December 2016 and the results of those operations are set out below.

**Review of operations**

The following provides a summary of Cochlear's performance for the half year ended 31 December 2016.

	31 Dec 2016	31 Dec 2015
	\$000	\$000
<b>Total Revenue</b>	<b>609,164</b>	<b>558,088</b>
Sales revenue	604,366	581,720
Earnings before interest and tax (EBIT)	156,397	130,967
<b>Profit attributable to members</b>	<b>111,367</b>	<b>94,033</b>
Basic earnings per share (cents)	194.2	164.7
Diluted earnings per share (cents)	193.9	164.4
Interim dividend per share (dollars)	\$1.30	\$1.10

**Product and service highlights**

	31 Dec 2016	31 Dec 2015	% Change	Constant Currency
	\$000	\$000		
Cochlear implants (units)	16,234	14,748	↑10%	
<i>Sales revenue</i>				
Cochlear implants	377,071	362,709	↑ 4%	↑ 8%
Services (sound processor upgrades and accessories)	144,814	146,298	↓ 1%	↑ 3%
Acoustics (bone conduction and acoustic implants)	82,481	72,713	↑13%	↑20%
<b>Total Sales revenue</b>	<b>604,366</b>	<b>581,720</b>	<b>↑ 4%</b>	<b>↑ 8%</b>

# **Cochlear Limited and its controlled entities**

## **Directors' Report**

### **For the half year ended 31 December 2016**

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#### ***Cochlear implants – 62% of sales revenue***

Cochlear implant revenue grew 4% in Australian dollars (8% in constant currency) and unit sales grew 10% (16% excluding the benefit of Chinese Central Government tender units) with around 10% growth across both developed and emerging markets.

Developed markets grew around 10% with highlights including continued strong performances from the United States (US) and Western Europe with Korea and Japan also performing well. Emerging markets grew strongly with continuing strong growth in India and China Other with solid improvements in Latin America and Central & Eastern Europe.

There has been a strong uptake of the Nucleus Profile implants since release in FY15. During the half, the electrode portfolio was expanded with a full market release of the new Slim Modiolar electrode (CI532) in Europe, the US and Canada.

Kanso was released during the half as a sound processor option for new implant systems in the US and Europe, with sales contributing to second quarter revenue. Kanso is a discrete, easy-to-use, off-the-ear sound processor that delivers the same hearing performance as the Nucleus 6 Sound Processor. Uptake has exceeded expectations and contributed to market share gains during the half.

The increase in sales revenue also reflects continued investments in market growth initiatives including direct-to-consumer activities and field expansion across many markets. These initiatives help build awareness of implantable hearing solutions and support further penetration into the adult segment.

#### ***Services (sound processor upgrades and accessories) – 24% of sales revenue***

Services sales revenue declined by 1% in Australian dollars (an increase of 3% in constant currency). Constant currency sales growth of around 6% was delivered across both the Americas and EMEA driven by the continuing uptake of the Nucleus 6 Sound Processor.

As part of the commitment to increase recipient engagement and provide recipients with great customer experience, the business continued to rollout a number of service-oriented programs. These programs include the recipient membership program, Cochlear Family, and MyCochlear.com, a personalised online portal to connect recipients directly with Cochlear.

Cochlear Family membership is growing rapidly, with membership almost doubling over the past six months. Recruitment continues to be a priority with Cochlear Family members upgrading their sound processors at a significantly higher rate than that of non-members.

#### ***Acoustics (bone conduction and acoustic implants) – 14% of sales revenue***

Acoustics, which includes bone conduction and acoustic implant sales revenue, grew 13% in Australian dollars (20% in constant currency) with solid performances across all regions.

Sales growth was driven by the strong uptake of the Baha 5 Power and Baha 5 SuperPower sound processors which were released during FY16.

The Baha 5 System provides the widest range of sound processors, including the industry's smallest, smartest and most powerful head-worn bone conduction solutions for those with single-sided deafness or who have conductive or mixed hearing loss. The Baha 5 System is also the only hearing implant system with MFi (made for iPhone) capabilities, allowing direct streaming between the sound processor and iPhones.

**Cochlear Limited and its controlled entities**  
**Directors' Report**  
**For the half year ended 31 December 2016**

**Regional review**

Sales revenue	31 Dec 2016 \$000	31 Dec 2015 \$000	% Change	Constant Currency
Americas	285,146	264,081	↑ 8%	↑ 12%
EMEA (Europe, Middle East and Africa)	207,912	210,420	↓ 1%	↑ 6%
Asia Pacific	111,308	107,219	↑ 4%	↑ 4%
<b>Total Sales revenue</b>	<b>604,366</b>	<b>581,720</b>	<b>↑ 4%</b>	<b>↑ 8%</b>

**Americas (US, Canada & Latin America) – 48% of sales revenue**

Sales revenue increased by 8% in Australian dollars (12% in constant currency). The highlight was the growth in the US with cochlear implant unit sales up around 10%. Growth overall has been driven by new product introductions and growing services revenue, supported by awareness building initiatives which continue to drive overall market growth rates. The success of Kanso, released in October, contributed to momentum during the second quarter.

The expanded field sales organisation, direct-to-consumer marketing and new customer relationship management system (Salesforce.com) have also supported continuing strong market growth rates.

Overall Latin American unit growth and sales revenue have recovered well after declining in FY16.

**EMEA (Europe, Middle East and Africa) – 34% of sales revenue**

Sales revenue declined by 1% in Australian dollars (an increase of 6% in constant currency) with solid performances across the region.

Unit growth across Western Europe was around 10% with the highlight being strong growth in the UK and Spain. Investments in market growth initiatives and the positive reception to Kanso, CI532 and the Baha 5 Power and SuperPower sound processors drove both market share and market growth across many markets.

Central and Eastern Europe also performed well. The region is benefiting from Cochlear's expanding presence, new indications for cochlear implantation as well as multi-year efforts in building neonatal screening.

**Asia Pacific (Australasia & Asia) – 18% of sales revenue**

Sales revenue increased by 4% in Australian dollars (4% in constant currency) with solid growth experienced across many markets including Japan, Korea, China Other and India.

China Other performed well, boosted by the expansion of Cochlear's field sales presence. The result includes 1,100 Chinese Central Government tender units, which compares to around 1,700 units in HY16.

India represents a small but rapidly growing market. The growing number of clinics, expansion of the field force and improvements in reimbursement all contributed to double-digit unit growth.

**Cochlear Limited and its controlled entities**  
**Directors' Report**  
**For the half year ended 31 December 2016**

**Financial review**

**Major expenses**

	31 Dec 2016	31 Dec 2015	Change
	\$000	\$000	\$000
Costs of goods sold	176,218	171,278	4,940
<i>% of sales revenue</i>	29.2%	29.4%	(0.2) pts
Selling and general expenses	165,166	154,339	10,827
Administration expenses	44,252	38,142	6,110
Research and development expenses	72,207	71,299	908
<i>% of sales revenue</i>	11.9%	12.3%	(0.4) pts
Other income	(5,076)	(7,937)	2,861
EBIT	156,397	130,967	25,430
<i>% of total revenue</i>	25.7%	23.5%	2.2 pts

EBIT increased by \$25.4 million, up 19%, to \$156.4 million, with the operating margin (EBIT to total revenue) increasing by 2.2 points to 25.7%.

Cost of goods sold (COGS) increased \$4.9 million to \$176.2 million, primarily as a result of growing volumes. COGS as a percentage of sales revenue decreased by 0.2% to 29.2%, reflecting the impact of changes in foreign exchange (FX) rates and product and geographic sales mix.

Selling and general expenses increased by \$10.8 million to \$165.2 million. The 7% increase reflects the increased investment in the sales force and marketing activities.

Investment in research and development (R&D) increased 1% to \$72.2 million, representing 11.9% of sales revenue, and is down 0.4 points on HY16.

Other income decreased by \$2.9 million to \$5.1 million. Other income primarily reflects FX gains on asset translation.

**Foreign currency (FX) impacts on income statement**

Income statement impacts	\$000
Reported FX contract gains/(losses) on hedged sales (transaction impact)	
- FX gains – HY17	4,798
- FX losses – HY16	(23,632)
	28,430
Sales revenue and expenses (translation impact) <sup>1</sup>	
- Sales revenue	(24,259)
- Total expenses including tax	12,634
	(11,625)
Asset translation (translation impact)	
- FX gain on asset translation – HY17	2,635
- FX gain on asset translation – HY16	5,836
	(3,201)

1. HY17 actual v HY16 at HY17 rates

**Cochlear Limited and its controlled entities**  
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**For the half year ended 31 December 2016**

*Transaction impacts*

Cochlear utilises currency hedging to provide some certainty around near-term cash flow. Over 90% of revenue and around 50% of costs are denominated in foreign currency. Most of the cash that is generated is repatriated to Australia to fund operating and investing activities, including R&D and dividends. In order to provide some certainty around near-term cash flow, expected cash flows are hedged back to Australian dollars (AUD).

In HY17, the AUD appreciated against most of the major currencies compared to HY16 rates. FX gains on hedged sales were \$4.8 million as FX contracts roll off. This compared to FX losses on hedged sales of \$23.6 million in HY16.

*Translation impacts*

The key translation impacts from translating foreign sales, expenses and assets into AUD include:

- a net reduction to sales revenue of \$24.3 million;
- a net reduction in expenses of \$12.6 million; and
- a net benefit to net profit of \$2.6 million from the translation of assets, primarily trade receivables. This compares to a \$5.8 million net benefit in HY16.

**Capital employed**

	31 Dec 2016	30 Jun 2016	Change
	\$000	\$000	\$000
Trade receivables	280,007	268,538	11,469
Inventories	154,547	154,103	444
Less: Trade and other payables	(109,589)	(110,354)	765
Working capital	324,965	312,287	12,678
<i>Debtor days</i>	84	85	(1)
<i>Inventory days</i>	168	169	(1)
Property, plant and equipment	91,820	86,878	4,942
Intangible assets	212,049	224,338	(12,289)
Other net liabilities	(47,621)	(57,125)	9,504
<b>Capital employed</b>	<b>581,213</b>	<b>566,378</b>	<b>14,835</b>

Capital employed increased by \$14.8 million to \$581.2 million since 30 June 2016 primarily as a result of an increase in working capital.

Working capital increased by \$12.7 million to \$325.0 million largely reflecting increased sales.

Trade receivables increased \$11.5 million to \$280.0 million. Debtors days reduced by one day to 84 days.

Net property, plant and equipment remained largely unchanged.

Intangible assets decreased by \$12.3 million to \$212.0 million, largely a result of revaluation to period end FX rates. All intangible assets are tested for impairment on an annual basis. There were no impairments or write-downs of intangible assets in HY17.

Other net liabilities decreased by \$9.5 million, largely reflecting timing of tax payments.

**Cochlear Limited and its controlled entities**  
**Directors' Report**  
**For the half year ended 31 December 2016**

**Cash flow**

	31 Dec 2016	31 Dec 2015	Change
	\$000	\$000	\$000
EBIT	156,397	130,967	25,430
Depreciation and amortisation	15,941	16,328	(387)
Changes in working capital and other	(29,077)	(19,374)	(9,703)
Net interest paid	(3,304)	(6,262)	2,958
Income taxes paid	(37,670)	(48,119)	10,449
<b>Operating cash flow</b>	<b>102,287</b>	<b>73,540</b>	<b>28,747</b>
Capital expenditure	(15,011)	(13,427)	(1,584)
Other investments	(2,176)	(3,334)	1,158
<b>Free cash flow</b>	<b>85,100</b>	<b>56,779</b>	<b>28,321</b>

The business generated strong cash flows with free cash flow increasing by 50% to \$85.1 million, driven primarily by increased earnings and timing of tax paid.

An increase in EBIT of \$25.4 million was partially offset by a net \$9.7 million investment in working capital and other to fund business growth.

Income taxes paid reduced by \$10.4 million to \$37.7 million with taxes paid broadly in line with taxation expense for the half.

During the half, the Australian Federal Government reduced the R&D tax concession rate from 40.0% to 38.5%, effective from 30 June 2016. In FY16, Cochlear had approximately \$100 million in qualifying R&D investments which had delivered a full year benefit to net profit of around \$10 million. The change in legislation will reduce the tax benefit to around \$8.5 million, a \$1.5 million reduction in FY17 compared to FY16.

**Net debt**

	31 Dec 2016	30 Jun 2016	Change
	\$000	\$000	\$000
Loans and borrowings:			
Current	3,539	3,978	(439)
Non-current	169,397	189,260	(19,863)
Total debt	172,936	193,238	(20,302)
Cash and cash equivalents	(79,408)	(75,417)	(3,991)
<b>Net debt</b>	<b>93,528</b>	<b>117,821</b>	<b>(24,293)</b>
Total loan facilities	350,000	350,000	
Unused portion of debt facilities	175,000	155,000	

Net debt reduced by \$24.3 million to \$93.5 million since 30 June 2016.

At 31 December 2016, there was \$350.0 million in total loan facilities and the unused portion of the bank facility was \$175.0 million.



**Cochlear Limited and its controlled entities**  
**Directors' Report**  
**For the half year ended 31 December 2016**

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**Dividends**

	31 Dec 2016	31 Dec 2015	% Change
Interim ordinary dividends (dollars)	\$1.30	\$1.10	18%
Payout ratio %	67%	67%	
Franking %	100%	100%	

Strong free cash flow and the continued strength of the balance sheet have supported the payment of an interim dividend of \$1.30 per share, franked at 100%, representing a payout of 67% of first half net profit.

The record date for determining dividend entitlements is 16 March 2017 and the interim dividend will be paid on 6 April 2017.

**2017 Financial outlook**

For FY17, Cochlear continues to expect net profit to be within a range of \$210-225 million, an increase of around 10-20% on FY16. Cochlear continues to experience positive momentum across the business with investments made in product development and market growth initiatives expected to underpin growth in the second half. The balance sheet position and free cash flow generation remain strong and Cochlear continues to target a dividend payout ratio of around 70% of net profit.

Key guidance considerations for the second half of FY17:

- continued strong momentum in unit growth;
- Chinese Central Government tender units now expected to be below FY16 levels with the next tender expected during the third quarter;
- expect R&D expenditure for FY17 to be similar to FY16;
- an approximate \$1.5 million full year net profit impact from the reduction in R&D tax concession rate from 40% to 38.5%, announced in September 2016 by the Australian Federal Government and effective from 30 June 2016; and
- forecasting a weighted average AUD/USD FX rate of 75 cents for FY17 versus 73 cents in FY16.

**Non-IFRS financial measures**

Given the significance of 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:

- Constant currency: restatement of IFRS financial measures in comparative years using HY17 FX rates.

The above non-IFRS financial measures have not been subject to review or audit. However, KPMG has 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 half year ended 31 December 2016**

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**Forward looking statements**

Cochlear advises that this document contains forward looking statements which may be subject to significant uncertainties outside of Cochlear's control.

No representation is made as to the accuracy or reliability of forward looking statements or the assumptions on which they are based.

Actual future events may vary from these forward looking statements and it is cautioned that undue reliance not be placed on any forward looking statement.

**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 \$1.20 per share, franked to 100% with Class C (100%)  
franking credits, in respect of the year ended 30 June 2016, paid on 29 September 2016. 68,883

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 2016. Since the end of the financial half-year, the directors declared an interim dividend of \$1.30 100% franked amounting to a total of \$74.7m.

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

The lead auditor's independence declaration is set out on page 11 and forms part of the Directors' Report for the half year ended 31 December 2016.

**Rounding off**

The Company is of a kind referred to in Australian Securities and Investments Commission (ASIC) (Rounding in Financial/Directors' Reports) Instrument 2016/191 (Rounding instrument) dated 24 March 2016 and in accordance with that Instrument, amounts in the Directors' Report and Financial Report have been rounded off to the nearest one thousand dollars unless otherwise indicated.

Dated at Sydney this 14<sup>th</sup> day of February 2017.

Signed in accordance with a resolution of the directors:



Director



Director



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

To: the directors of Cochlear Limited

I declare that, to the best of my knowledge and belief, in relation to the review for the half-year ended 31 December 2016 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

Cameron Slapp, *Partner*

Sydney, 14 February 2017

**Cochlear Limited and its controlled entities**  
**Interim Income Statement**  
**For the half year ended 31 December 2016**

	Note	31 Dec 2016 \$000	31 Dec 2015 \$000
Revenue	2.2	609,164	558,088
Cost of sales	2.3	(176,218)	(171,278)
<b>Gross profit</b>		<b>432,946</b>	<b>386,810</b>
Selling and general expenses		(165,166)	(154,339)
Administration expenses		(44,252)	(38,142)
Research and development expenses		(72,207)	(71,299)
Other income	2.4	5,076	7,937
<b>Results from operating activities</b>		<b>156,397</b>	<b>130,967</b>
Finance income - interest		272	130
Finance expense - interest		(3,689)	(4,814)
<b>Net finance expense</b>		<b>(3,417)</b>	<b>(4,684)</b>
<b>Profit before income tax</b>		<b>152,980</b>	<b>126,283</b>
Income tax expense	3	(41,613)	(32,250)
<b>Net profit</b>		<b>111,367</b>	<b>94,033</b>
Basic earnings per share (cents)	2.5	194.2	164.7
Diluted earnings per share (cents)	2.5	193.9	164.4

The notes on pages 17 to 24 are an integral part of these consolidated interim financial statements.

**Cochlear Limited and its controlled entities**  
**Interim Statement of Comprehensive Income**  
**For the half year ended 31 December 2016**

	31 Dec 2016	31 Dec 2015
	\$000	\$000
<b>Net profit</b>	<b>111,367</b>	<b>94,033</b>
<b><i>Other comprehensive income</i></b>		
Items that may be reclassified subsequently to profit or loss:		
Foreign currency translation differences	(15,672)	8,192
Effective portion of changes in fair value of cash flow hedges, net of tax	3,613	(12,660)
Net change in fair value of cash flow hedges transferred to the income statement, net of tax	(3,359)	16,542
Total items that may be reclassified to profit or loss	(15,418)	12,074
<b>Other comprehensive (loss) / income for the period, net of tax</b>	<b>(15,418)</b>	<b>12,074</b>
<b>Total comprehensive income for the period</b>	<b>95,949</b>	<b>106,107</b>

The notes on pages 17 to 24 are an integral part of these consolidated interim financial statements.

**Cochlear Limited and its controlled entities**  
**Interim Balance Sheet**  
**For the half year ended 31 December 2016**

	Note	31 Dec 2016 \$000	30 Jun 2016 \$000
<b>Assets</b>			
Cash and cash equivalents		79,408	75,417
Trade and other receivables		297,898	281,925
Forward exchange contracts		14,045	11,454
Inventories		154,547	154,103
Current tax assets		6,552	6,208
Prepayments		19,255	13,921
<b>Total current assets</b>		<b>571,705</b>	<b>543,028</b>
Other receivables		1,230	1,507
Forward exchange contracts		7,978	10,713
Property, plant and equipment		91,820	86,878
Intangible assets		212,049	224,338
Investments		13,755	13,755
Deferred tax assets		85,127	77,144
<b>Total non-current assets</b>		<b>411,959</b>	<b>414,335</b>
<b>Total assets</b>		<b>983,664</b>	<b>957,363</b>
<b>Liabilities</b>			
Trade and other payables		109,589	110,354
Foreign exchange contracts		10,729	12,643
Loans and borrowings	5.1	3,539	3,978
Current tax liabilities		25,441	13,701
Employee benefit liabilities		42,547	45,485
Provisions		33,191	33,675
Deferred revenue		25,401	31,264
<b>Total current liabilities</b>		<b>250,437</b>	<b>251,100</b>
Foreign exchange contracts		4,953	3,547
Loans and borrowings	5.1	169,397	189,260
Employee benefit liabilities		13,716	13,750
Provisions	4.1	46,500	44,027
Deferred tax liabilities		10,976	7,122
<b>Total non-current liabilities</b>		<b>245,542</b>	<b>257,706</b>
<b>Total liabilities</b>		<b>495,979</b>	<b>508,806</b>
<b>Net assets</b>		<b>487,685</b>	<b>448,557</b>
<b>Equity</b>			
Share capital		169,333	158,940
Reserves		(28,411)	(14,662)
Retained earnings		346,763	304,279
<b>Total equity</b>		<b>487,685</b>	<b>448,557</b>

The notes on pages 17 to 24 are an integral part of these consolidated interim financial statements.

**Cochlear Limited and its controlled entities**  
**Interim Statement of Changes in Equity**  
**For the half year ended 31 December 2016**

Amounts \$000	Issued capital	Treasury reserve	Translation reserve	Hedging reserve	Share based payment reserve	Retained earnings	Total equity
Balance at 1 July 2015	152,599	(8,463)	(32,541)	(20,547)	26,887	237,451	355,386
<i>Total comprehensive income</i>							
Net profit	-	-	-	-	-	94,033	94,033
<i>Other comprehensive income</i>							
Foreign currency translation differences	-	-	8,192	-	-	-	8,192
Effective portion of changes in fair value of cash flow hedges, net of tax	-	-	-	(12,660)	-	-	(12,660)
Net change in fair value of cash flow hedges transferred to the income statement, net of tax	-	-	-	16,542	-	-	16,542
<b>Total other comprehensive income</b>	-	-	<b>8,192</b>	<b>3,882</b>	-	-	<b>12,074</b>
<b>Total comprehensive income</b>	-	-	<b>8,192</b>	<b>3,882</b>	-	<b>94,033</b>	<b>106,107</b>
<b>Transactions with owners, recorded directly in equity</b>							
Performance shares vested	-	2,068	-	-	(2,068)	-	-
Share options exercised	5,435	5,541	-	-	(3,438)	-	7,538
Share based payment transactions	-	-	-	-	5,059	-	5,059
Deferred tax recognised in equity	-	-	-	-	(1,577)	-	(1,577)
Dividends to shareholders	-	-	-	-	-	(57,168)	(57,168)
<b>Balance at 31 December 2015</b>	<b>158,034</b>	<b>(854)</b>	<b>(24,349)</b>	<b>(16,665)</b>	<b>24,863</b>	<b>274,316</b>	<b>415,345</b>
Balance at 1 July 2016	159,303	(363)	(48,373)	4,189	29,522	304,279	448,557
<i>Total comprehensive income</i>							
Net profit	-	-	-	-	-	111,367	111,367
<i>Other comprehensive income</i>							
Foreign currency translation differences	-	-	(15,672)	-	-	-	(15,672)
Effective portion of changes in fair value of cash flow hedges, net of tax	-	-	-	3,613	-	-	3,613
Net change in fair value of cash flow hedges transferred to the income statement, net of tax	-	-	-	(3,359)	-	-	(3,359)
<b>Total other comprehensive (loss)/income</b>	-	-	<b>(15,672)</b>	<b>254</b>	-	-	<b>(15,418)</b>
<b>Total comprehensive (loss)/income</b>	-	-	<b>(15,672)</b>	<b>254</b>	-	<b>111,367</b>	<b>95,949</b>
<b>Transactions with owners, recorded directly in equity</b>							
Share options exercised	10,068	325	-	-	(1,385)	-	9,008
Share based payment transactions	-	-	-	-	4,569	-	4,569
Deferred tax recognised in equity	-	-	-	-	(1,515)	-	(1,515)
Dividends to shareholders	-	-	-	-	-	(68,883)	(68,883)
<b>Balance at 31 December 2016</b>	<b>169,371</b>	<b>(38)</b>	<b>(64,045)</b>	<b>4,443</b>	<b>31,191</b>	<b>346,763</b>	<b>487,685</b>

The notes on pages 17 to 24 are an integral part of these consolidated interim financial statements.

**Cochlear Limited and its controlled entities**  
**Interim Statement of Cash Flows**  
**For the half year ended 31 December 2016**

	31 Dec 2016	31 Dec 2015
	\$000	\$000
<b><i>Cash flows from operating activities</i></b>		
Cash receipts from customers	583,430	544,572
Cash paid to suppliers and employees	(442,610)	(418,752)
Grant and other income received	2,441	2,101
Interest received	272	113
Interest paid	(3,576)	(6,375)
Income taxes paid	(37,670)	(48,119)
<b>Net cash from operating activities</b>	<b>102,287</b>	<b>73,540</b>
<b><i>Cash flows from investing activities</i></b>		
Acquisition of property, plant and equipment	(15,011)	(13,427)
Acquisition of enterprise resource planning system	(2,176)	(3,334)
<b>Net cash used in investing activities</b>	<b>(17,187)</b>	<b>(16,761)</b>
<b><i>Cash flows from financing activities</i></b>		
Repayment of borrowings	(128,000)	(57,110)
Proceeds from borrowings	108,000	57,110
Proceeds from exercise of share options, net	9,008	7,538
Dividends paid	(68,883)	(57,168)
<b>Net cash used in financing activities</b>	<b>(79,875)</b>	<b>(49,630)</b>
<b>Net increase in cash and cash equivalents</b>	<b>5,225</b>	<b>7,149</b>
Cash and cash equivalents at 1 July	75,417	72,208
Effect of exchange rate fluctuation on cash held	(1,234)	894
<b>Cash and cash equivalents at 31 December</b>	<b>79,408</b>	<b>80,251</b>

The notes on pages 17 to 24 are an integral part of these consolidated interim financial statements.



# **Cochlear Limited and its controlled entities**

## **Notes to the Interim Financial Statements**

### **For the half year ended 31 December 2016**

#### **1 Basis of preparation**

##### **1.1 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 half year ended 31 December 2016 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 2016 is available upon request from the Company's registered office at 1 University Avenue, Macquarie University NSW 2109, Australia or at [www.cochlear.com](http://www.cochlear.com).

##### **1.2. 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 2016. This report should also be read in conjunction with any public announcements made by Cochlear Limited during the half year ended 31 December 2016 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 14 February 2017.

The Consolidated Entity is of a kind referred to in ASIC Corporations (Rounding in Financial/Directors' Reports) Instrument 2016/191 (Rounding instrument) dated 24 March 2016 and in accordance with that Instrument, all financial information presented in Australian dollars (AUD) has been rounded to the nearest one thousand dollars unless otherwise stated.

##### **1.3 Significant accounting policies**

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 2016.

##### **1.4 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 2016.

**Cochlear Limited and its controlled entities**  
**Notes to the Interim Financial Statements**  
**For the half year ended 31 December 2016**

**2. Performance for the half year**

**2.1 Operating segments**

	Americas		EMEA <sup>(i)</sup>		Asia Pacific		Total	
	2016	2015	2016	2015	2016	2015	2016	2015
	\$000	\$000	\$000	\$000	\$000	\$000	\$000	\$000
Reportable segment revenue	285,146	264,081	207,912	210,420	111,308	107,219	<b>604,366</b>	<b>581,720</b>
Reportable segment EBIT	149,849	144,056	88,921	87,047	35,371	34,334	<b>274,141</b>	<b>265,437</b>

(i) Europe, Middle East and Africa

**Reconciliations of reportable segment revenues and profit or loss**

Revenues	Cochlear implants	Services	Total Cochlear implants	Acoustics	Reportable segment revenue	Foreign exchange gains / (losses) on hedged sales	Consolidated revenue
	\$000	\$000	\$000	\$000	\$000	\$000	\$000
31 Dec 2016	377,071	144,814	<b>521,885</b>	82,481	<b>604,366</b>	4,798	<b>609,164</b>
31 Dec 2015	362,709	146,298	<b>509,007</b>	72,713	<b>581,720</b>	(23,632)	<b>558,088</b>

Profit or loss	Reportable segment EBIT	Corporate and other net expenses	Foreign exchange gains / (losses) on hedged sales	Net finance expense	Consolidated profit before income tax
	\$000	\$000	\$000	\$000	\$000
31 Dec 2016	274,141	(122,542)	4,798	(3,417)	<b>152,980</b>
31 Dec 2015	265,437	(110,838)	(23,632)	(4,684)	<b>126,283</b>

**2.2 Revenue**

	31 Dec 2016	31 Dec 2015
	\$000	\$000
Sale of goods revenue before hedging	598,250	574,795
Foreign exchange gains/(losses) on hedged sales	4,798	(23,632)
<b>Revenue from the sale of goods</b>	<b>603,048</b>	<b>551,163</b>
Rendering of services revenue	6,116	6,925
<b>Total revenue</b>	<b>609,164</b>	<b>558,088</b>

**2.3 Expenses**

	31 Dec 2016	31 Dec 2015
	\$000	\$000
<b>Cost of sales</b>		
Carrying amount of inventories recognised as an expense	168,963	161,579
Write-down in value of inventories	3,174	5,120
Other	4,081	4,579
<b>Total cost of sales</b>	<b>176,218</b>	<b>171,278</b>

**Cochlear Limited and its controlled entities**  
**Notes to the Interim Financial Statements**  
**For the half year ended 31 December 2016**

**2.4 Other income**

	31 Dec 2016	31 Dec 2015
	\$000	\$000
Grant received or due and receivable	985	523
Net foreign exchange gain	2,635	5,836
Other	1,456	1,578
<b>Total other income</b>	<b>5,076</b>	<b>7,937</b>

**2.5 Earnings per share**

**Basic earnings per share**

The calculation of basic EPS has been based on the following net profit attributable to equity holders of the parent entity and weighted average number of ordinary shares of the Company:

	31 Dec 2016	31 Dec 2015
Net profit attributable to equity holders of the parent entity	\$111,367,000	\$94,033,000
<i>Weighted average number of ordinary shares (basic):</i>		
Issued ordinary shares at 1 July (number)	57,199,264	56,957,274
Effect of options and performance shares exercised (number)	146,849	133,123
Effect of shares issued under Employee Share Plan (number)	4,647	7,270
<b>Weighted average number of ordinary shares (basic)</b>	<b>57,350,760</b>	<b>57,097,667</b>
<b>Basic earnings per share (cents)</b>	<b>194.2</b>	<b>164.7</b>

**Diluted earnings per share**

The calculation of diluted EPS has been based on the following net profit attributable to equity holders of the parent entity and weighted average number of shares outstanding after adjustments for the effects of all dilutive potential ordinary shares:

	31 Dec 2016	31 Dec 2015
Net profit attributable to equity holders of the parent entity	\$111,367,000	\$94,033,000
<i>Weighted average number of ordinary shares (diluted):</i>		
Weighted average number of shares (basic) (number)	57,350,760	57,097,667
Effect of options, performance shares and rights unvested (number)	79,882	84,978
<b>Weighted average number of ordinary shares (diluted)</b>	<b>57,430,642</b>	<b>57,182,645</b>
<b>Diluted earnings per share (cents)</b>	<b>193.9</b>	<b>164.4</b>

**Cochlear Limited and its controlled entities**  
**Notes to the Interim Financial Statements**  
**For the half year ended 31 December 2016**

**2.6 Options and performance rights**

The Company has granted options and performance rights to certain employees and key management personnel under the Cochlear Executive Incentive Plan (CEIP). The terms and conditions of the plan are disclosed in the Consolidated Annual Financial Report as at and for the year ended 30 June 2016.

Grants made in the current period to certain employee and key management personnel under the CEIP are set out below.

Grant date	Exercise price per option	Number of options	Number of performance rights	Contractual life
August 2016 <sup>1</sup>	N/A	N/A	32,847	2 years
October 2016 <sup>2</sup>	\$135.84	95,586	24,233	4 years

1. Performance rights offered under deferred short-term incentives.

2. Options and performance rights offered under long-term incentives.

**2.7 Dividends**

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

	Dollars per share	Total amount \$'000	Franked/unfranked	Date of payment
<b>31 December 2016</b>				
Final – ordinary	1.20	68,883	100% Franked	29 September 2016
<b>31 December 2015</b>				
Final – ordinary	1.00	57,168	100% Franked	1 October 2015

***Subsequent event***

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

Interim – ordinary	1.30	74,655	100% Franked	6 April 2017
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The financial effect of these dividends has not been brought to account in the Consolidated Interim Financial Report for the half year ended 31 December 2016 and will be recognised in subsequent financial statements.

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

**Cochlear Limited and its controlled entities**  
**Notes to the Interim Financial Statements**  
**For the half year ended 31 December 2016**

**3. Income taxes**

**Numerical reconciliation between income tax expense and profit before income tax**

	31 Dec 2016	31 Dec 2015
	\$000	\$000
Net profit	111,367	94,033
Income tax expense	41,613	32,250
<b>Profit before income tax</b>	<b>152,980</b>	<b>126,283</b>
Tax at the Australian tax rate of 30% (Dec 2015: 30%)	45,894	37,885
<b>Increase in income tax expense due to:</b>		
Non-deductible expenses	438	653
Effect of tax rate in foreign jurisdictions	31	-
<b>Decrease in income tax expense due to:</b>		
Research and development allowances	(4,384)	(5,435)
Effect of tax rate in foreign jurisdictions	-	(1,091)
	41,979	32,012
Adjustment for prior years	(366)	238
<b>Income tax expense on profit before income tax</b>	<b>41,613</b>	<b>32,250</b>

**4. Operating assets and liabilities**

**4.1 Patent dispute**

In a trial of the patent infringement lawsuit by the Alfred E. Mann Foundation for Scientific Research and Advanced Bionics LLC in January 2014, a Jury found that Cochlear Limited and its US subsidiary Cochlear Americas infringed four claims across two patents, the infringement was “willful” and awarded USD 131,216,325 in damages.

On 1 April 2015, a Judge in the United States District Court in Los Angeles, California held that three of the four patent claims were invalid and Cochlear’s infringement of the remaining claim was not “willful”. The Judge overturned the damages awarded because three of the four claims were held to be invalid. On 21 April 2015, the Court entered Judgment on liability only and stayed a new trial on damages pending the outcome of the appeals by all parties from the Judgment to the United States Court of Appeals for the Federal Circuit.

On 18 November 2016, the Court of Appeals affirmed the Judgment as to infringement, affirmed the Judgment as to invalidity of two claims in one patent and reversed the Judgment of invalidity of one claim in the remaining patent. The Court of Appeals then remanded to the District Court the issue of damages and wilfulness of infringement of two claims in the remaining patent at issue.

As the patents have expired, the trial Judgment and the Court of Appeals decision will not disrupt Cochlear’s business or customers in the United States.

The nature of the above legal process is such that final future outcomes are uncertain. The directors have made judgements and assumptions relating to their best estimate of the outcome of this litigation and actual outcomes may differ from the estimated liability.

A provision was expensed in the half year ended 31 December 2013 in relation to this dispute. For the purpose of determining this provision, Cochlear considered its independent damages expert’s assessment prepared for the trial to estimate the liability that could result from the infringement of four claims. No additional amount has been provided since that initial provision. The provision at 31 December 2016 is \$21.3m (30 June 2016: \$21.3m).

**Cochlear Limited and its controlled entities**  
**Notes to the Interim Financial Statements**  
**For the half year ended 31 December 2016**

**4.2 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/or 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 and lawsuits in various countries including 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.

Cochlear carries product liability insurance and has made claims under the policies. The insurers have agreed to indemnify Cochlear in accordance with the terms and conditions of the policies 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.

**5. Financial and capital structure**

**5.1 Loans and Borrowings**

	31 Dec 2016	30 Jun 2016
	\$000	\$000
Loans and borrowings:		
Current	3,539	3,978
Non-current	169,397	189,260
Total loans and borrowings	172,936	193,238
Less: Cash and cash equivalents	(79,408)	(75,417)
<b>Net debt</b>	<b>93,528</b>	<b>117,821</b>

**Multi-option bank facilities - Secured bank loan**

Cochlear has two bank loan facilities. The first was extended in June 2016 for a further three year period to 14 June 2019 and has a total commitment limit of AUD 250.0 million. The facility has an option to allocate a letter of credit sub-facility limit of up to AUD 30.0 million for the purpose of drawing either letters of credit or bank guarantees. This letter of credit sub-limit currently is AUD 5.0 million.

In June 2013, Cochlear negotiated a second loan facility for a period of five years. The facility has a total commitment limit of AUD 115.0 million, made up of an AUD 100.0 million loan sub-facility limit and incorporates an AUD 15.0 million letter of credit facility that was negotiated in August 2011.

Both facilities are secured by interlocking guarantees provided by certain controlled entities. Interest on the facilities is variable and charged at prevailing market rates.

# **Cochlear Limited and its controlled entities**

## **Notes to the Interim Financial Statements**

### **For the half year ended 31 December 2016**

#### **Other credit facilities**

##### ***Unsecured bank overdrafts***

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

##### ***Secured bank loan***

Cochlear has a Japanese yen (JPY) 450.0 million loan facility. It is secured by a letter of guarantee and reviewed annually. Interest is charged at prevailing market rates.

##### ***Bank guarantees***

As at 31 December 2016, Cochlear had contingent liability facilities denominated in United States dollars (USD), Euros (EUR), Sterling (GBP), Indian rupees and New Zealand dollars totalling AUD 1.9 million (June 2016: AUD 1.6 million).

## **5.2 Financial Instruments**

#### **Fair values**

The carrying amounts and estimated fair value of Cochlear's financial assets and liabilities are materially the same.

The fair value of forward exchange contracts is based upon the listed market price, if available. If a listed market price is not available, the fair value is estimated by discounting the difference between the contractual forward price and the current forward price for the residual maturity of the contract using benchmark bill futures and swap rates. These fair values are provided by independent third parties.

##### ***Valuation of financial assets and liabilities***

For financial asset and liabilities measured and carried at fair value, Cochlear uses the following levels to categorise the valuation methods used:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices); and
- Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

All of Cochlear's forward exchange contracts were valued using observable market inputs (Level 2) and there were no transfers between levels during the half year.

The equity securities classified as available for sale financial assets are valued using unobservable market inputs (Level 3). Unobservable inputs are those not readily available in an active market. These inputs are generally derived from other observable inputs that match the risk profile of the financial instruments and validated against current market assumptions and historical transactions where available.

There are no other financial assets or financial liabilities carried at fair value or valued using a Level 1 valuation method.

**Cochlear Limited and its controlled entities**  
**Notes to the Interim Financial Statements**  
**For the half year ended 31 December 2016**

**6 Other notes**

**6.1 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 2016, see Note 2.7.



**Cochlear Limited and its controlled entities**  
**Directors' Declaration**  
**For the half year ended 31 December 2016**

In the opinion of the directors of Cochlear Limited:

1. The consolidated financial statements and notes set out on pages 12 to 24 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 2016, 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.

Signed in accordance with a resolution of the directors:

Dated at Sydney this 14th day of February 2017.



Director



Director



## Independent auditor's review report

### To the Members of Cochlear Limited

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#### Conclusion

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We have reviewed the accompanying interim financial report of Cochlear Limited.

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:

- i) giving a true and fair view of the Consolidated Entity's financial position as at 31 December 2016 and of its performance for the half-year ended on that date; and
- ii) complying with *Australian Accounting Standard AASB 134 Interim Financial Reporting* and the *Corporations Regulations 2001*.

The interim financial report comprises:

- the consolidated interim balance sheet as at 31 December 2016;
- 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 ended on that date;
- notes 1 to 6.1 comprising a summary of significant accounting policies and other explanatory information; and
- the Directors' Declaration.

The Consolidated Entity comprises Cochlear Limited (the Company) and the entities it controlled at the half-year's end or from time to time during the half-year.

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#### Emphasis of matter

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We draw attention to Note 4.1 to the interim financial statements which describes the uncertainty related to the outcome of the lawsuit filed against the Consolidated Entity for the affirmed patent infringement. Our review report is not modified in respect of this matter.

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#### Responsibilities of the Directors for the half-year financial report

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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.
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## Independent auditor's review report

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### Auditor's responsibility for the review of the half-year financial report

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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 the Consolidated Entity's financial position as at 31 December 2016 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.

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### Independence

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

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KPMG  
Sydney, 14 February 2017

Cameron Slapp, *Partner*