

Cochlear Limited and its controlled entities
ACN 002 618 073
Financial statements and reports
for the half year ended 31 December 2004

COCHLEAR LIMITED AND ITS CONTROLLED ENTITIES
DIRECTORS' REPORT
For the half-year ended 31 December 2004

The Directors present their report, together with the financial statements of Cochlear Limited (the "Company") and the consolidated financial statements of the Consolidated Entity, being the Company and its controlled entities, for the half year ended 31 December 2004, and the Auditors' review report thereon.

Directors

The Directors of the Company during or since the end of the half-year are:

Mr Tommie CE Bergman, ° + *

Chairman

Age 59 DipEng, Grad Dip Marketing, FAICD, FAIM
Chairman since October 2002.

Dr Chris Roberts, ^ #

CEO/President

Age. 51. BE (Hons), MBA, PhD, FAICD, FTSE
CEO/President since February 2004

Prof Brian DO Anderson, AO, ^ ° #

Age 63. BSc, BE, PhD, FRS, FTSE, FAA, Hon FIE Aust, FIEEE
Director since October 1995

Professor Edward Byrne, ^ ° #

Age 52. DSc, MD, FRCP, FRACP
Director since July 2002

Ms E Carol Holley, * ° +

Age 55. FCA, FAICD
Director until October 2004

Mr Peter J. North, AM, # * °

Age 70. BE, MBA, FAIM, FAICD, FTSE
Director since February 1997

Dr John Parker, #

Age 42. BSc (Hons), PhD, DOC
Director since March 2002

Mr Justus H. Veeneklaas, ° + #

Age 62. B. Laws
Director since March 1998

* Member of Audit Committee

+ Member of Remuneration Committee

Member of Technology & Innovation Committee

^ Member of Medical Science Committee

° Member of Nominations Committee

E C Holley retired as Director and Chair of the Audit Committee on 19 October 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 half year ended 31 December 2004 and the results of those operations are set out below.

Financial overview

The consolidated results for the half year attributable to the members of the Company are:

	2004 \$000	2003 \$000
Sales revenue	163,615	139,208
Operating profit before tax	40,010	36,351
Profit after tax (PAT) attributable to members of the parent entity	<u>29,465</u>	<u>26,880</u>
Earnings per share (cents)	54.3c	50.1c

Results

Regional Performance

Americas Region

Revenue in the Americas region was US\$47.4 million, up 22% on the previous corresponding period (2003: US\$38.7 million). Because of continued strengthening of the AUD against the USD the increase in AUD terms was 16%.

The Americas region result was impacted by flat sales in South and Central America (these sales are traditionally variable over accounting periods), and sales growth in the USA was higher than the regional growth.

Market share gains were made in the first half and it is estimated that Cochlear's market share in the Americas at the end of 2004 was 60 - 65%.

A competitor was unable to sell product due to a product recall lasting 41 days in the first half. Cochlear estimates this provided a one off Group benefit of \$2.5 million of sales during this recall period, the great majority coming from the Americas region. Late in the half year, another competitor received a warning letter from FDA along with an import ban but had enough stock in the USA to continue selling, so the impact during the half on Cochlear's sales was minimal.

In March 2004, the United States Department of Justice (DOJ) issued a request for information to Cochlear's wholly owned American subsidiary Cochlear Americas Inc. This request for information relates to an investigation into certain Federal Healthcare regulations. The DOJ has made no specific allegations and Cochlear Americas Inc is cooperating fully. There is nothing further to report since Cochlear last updated the market at the AGM in October 2004. It is not known when the DOJ will complete its investigation.

One important development in the USA during the first half was an improvement in Government reimbursement for Medicare and Medicaid patients. The funding was raised by a further 12% this year. This increased reimbursement does not come to Cochlear, but relates to the reimbursement the hospital receives to offset its expenses. In addition, the USA Centers for Medicare and Medicaid Services (CMS), is seeking public comment on its recommendation that the hearing test score eligibility criterion be increased thereby potentially expanding the Medicare patients eligible for a cochlear implant.

These changes are very positive for the many thousands of severely hearing impaired patients whose lives could be transformed by this well-proven, cost-effective and now routine cochlear implant intervention. The increasing acceptance of cochlear implants is very positive for Cochlear and its long term growth plans in key markets like the USA.

European Region

European revenue for the half year was Euro 33.4 million, a 34% increase on the previous corresponding period (2003: Euro 24.9 million) and market share increased from 60% to 60-65%. In AUD the sales were up 44% (to \$59.3 million).

Approximately A\$2.5 million (or 14% of the increased revenue) was attributable to Cochlear's direct presence in Belgium, The Netherlands and France. Cochlear finalised the purchase of its distributors' ongoing businesses in Belgium, The Netherlands and France and entered these markets directly from 1 July 2004 for Belgium and The Netherlands and 1 November 2004 for France. These acquisitions were funded from internal cash reserves. Cochlear's strategy to increase its direct presence in key markets has progressed well and the integration of these operations has been successfully completed.

Cochlear has given notice to its Italian distributor that it intends to enter the Italian market directly at the conclusion of its contract in May 2005. There are substantial start up costs associated with establishing Cochlear Italia that will be incurred in the second half, however Italy is an important European market where Cochlear's direct presence is important.

Asia Pacific

Growth in Australia and Northern Asia remains robust, however Asia Pacific's revenue of \$26.7 million only increased 2% on the previous year (2003: \$25.8 million). The flat sales were because sales to China were below last year's levels. The China sales were negatively impacted by a Chinese Customs Department investigation into the tax exempt importation of cochlear implants by distributors. Cochlear has excellent relationships with various Chinese Government bodies involved in the development of the cochlear implant industry in China and we remain confident in the future of the China market for cochlear implants.

Foreign Currency Impact

Cochlear earns more than 95% of its sales revenue in currencies other than the Australian Dollar. More than 50% of expenditure is also in foreign currencies. To manage the currency variations, Cochlear undertakes forward cover positions on a sliding scale up to 3 years out. The gains and losses from these positions are disclosed in the revenue from ordinary activities line of the accounts in accordance with generally accepted accounting principles.

In the current half, foreign exchange gains including gains on hedged sales were \$13.9 million, down 8% from the December 2003 half (2003: \$15.1 million).

Dividends

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

	A\$'000
In respect of the previous year:	
A final ordinary dividend of 44 cents per share, franked to 100% with Class C (30%) franking credits, in respect of the year ended 30 June 2004, paid on 23 September 2004.	<u>23,831</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 2004. Since the end of the financial half-year, the Directors declared an interim dividend of 35 cents fully franked at a tax rate of 30% amounting to a total of \$19,001,316.

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

The lead auditor's independence declaration is set out on page 6 and forms part of the directors' report for the half-year ended 31 December 2004.

Rounding Off

The Company is of a kind referred to in ASIC Class Order 98/ 100 dated 10 July, 1998, and in accordance with that Class Order, amounts in this Report and the accompanying financial statements have been rounded off to the nearest one thousand dollars, unless otherwise indicated.

Dated at Sydney this 15th day of February 2005.

Signed in accordance with a resolution of the Directors:

.....

.....

Tommie CE Bergman
Director

Chris G Roberts
Director



Lead Auditor's Independence Declaration under Section 307C of the Corporation 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 2004 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

KPMG

John Wigglesworth

Partner

Sydney

15 February, 2005



Directors' Declaration

In the opinion of the Directors of Cochlear Limited:

1. The financial statements and notes set out on pages 9 to 24 are in accordance with the Corporations Act 2001, including:
 - a. giving a true and fair view of the financial position of the Consolidated Entity as at 31 December 2004, and of its performance, as represented by the results of its operations and cash flows for the half-year ended on that date; and
 - b. complying with Accounting Standards AASB 1029 "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 15th day of February 2005.

Signed in accordance with a resolution of the Directors:

T.C.E. Bergman
Director

C. G. Roberts
Director

Appendix 4D

Cochlear Limited Half Yearly Report As at 31 December 2004

Results for announcement to the market

	Movement			\$A'000
Sales Units	up	12%	to	5,014
Total Revenue	up	18%	to	163,615
Profit from ordinary activities after tax attributable to members	up	10%	to	29,465
Net profit for the period attributable to members	up	10%	to	29,465

Net Tangible assets per share 2004	down	21%	to	198.4
Net Tangible assets per share 2003				252.0

Cash after borrowings	up	11%	to	42,978
-----------------------	----	-----	----	--------

Dividends	Amount per security	Franked amount per security
Interim dividend	35.0c	35.0c
Previous corresponding period	35.0c	35.0c
Record date for determining entitlements to the dividend	25 February 2005	
Dividend payment date	15 March 2005	
* 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
Statement of Financial Performance

For the half-year ended 31 December 2004

		Consolidated	
	Note	31 December 2004 \$'000	31 December 2003 \$'000
Revenue from ordinary activities	2	163,615	139,208
Total Expenses	2	123,152	102,462
Borrowing costs	2	453	395
Profit from ordinary activities before related income tax expense		40,010	36,351
Income tax expense relating to ordinary activities	3	10,994	9,705
Net profit		29,016	26,646
Net loss attributable to outside equity interests		449	234
Net profit attributable to members of the parent entity	6	29,465	26,880
Non owner transaction changes in equity			
Net exchange difference relating to self-sustaining foreign operations		(1,402)	(3,044)
Total changes in equity from non-owner related transactions attributable to the members of the parent entity	8	28,063	23,836
<hr/>			
Basic earnings per share (cents)			
- Ordinary shares		54.3	50.1
Diluted earnings per share (cents)			
- Ordinary shares		54.3	50.1

The statement of financial performance is to be read in conjunction with the notes to the half-year financial statements set out on pages 12 to 24.

Cochlear Limited and its Controlled Entities

Statement of Financial Position

As at 31 December 2004

		Consolidated	
	Note	31 December 2004 \$'000	30 June 2004 \$'000
Current assets			
Cash assets		71,419	75,946
Trade receivables		55,538	53,992
Deferred foreign exchange receivable		19,387	12,664
Inventories		40,748	44,837
Income tax receivable		269	807
Other		13,957	12,156
Total current assets		201,318	200,402
Non-current assets			
Deferred foreign exchange receivable		11,175	9,458
Intangibles		21,742	7,190
Plant and equipment		27,793	29,523
Deferred tax assets		19,466	17,791
Other		-	175
Total non-current assets		80,176	64,137
Total assets		281,494	264,539
Current liabilities			
Payables		37,456	31,657
Interest bearing liabilities		28,441	25,867
Current tax liabilities		5,407	4,781
Provisions		19,947	22,352
Deferred revenue		9,163	8,975
Deferred foreign exchange gain		19,387	12,664
Total current liabilities		119,801	106,296
Non-current liabilities			
Provisions		1,604	3,256
Deferred foreign exchange gain		11,175	9,458
Total non-current liabilities		12,779	12,714
Total liabilities		132,580	119,010
Net assets		148,914	145,529
Equity			
Contributed equity	5	50,746	50,746
Reserves		(1,394)	(995)
Retained profits	6	93,898	89,267
Total parent entity interest		143,250	139,018
Outside equity interests		5,664	6,511
Total equity	8	148,914	145,529

The statement of financial position is to be read in conjunction with the notes to the half-year financial statements set out on pages 12 to 24.

Cochlear Limited and its Controlled Entities
Statement of Cash Flows

For the half-year ended 31 December 2004

		Consolidated	
		31 December	31 December
		2004	2003
	Note	\$'000	\$'000
Cash flows from Operating activities			
Cash receipts in the course of operations		156,791	140,342
Cash payments in the course of operations		(111,332)	(115,481)
Grants received		161	108
Interest received		900	995
Interest paid		(396)	(292)
Income taxes paid		(11,429)	(12,710)
Net cash provided by operating activities		34,695	12,962
Cash flows from Investing activities			
Payment for plant and equipment		(3,232)	(8,406)
Payment for investments		(838)	-
Payment for controlled entities (net of cash acquired)	9	(15,910)	-
Net Cash used in investing activities		(19,980)	(8,406)
Cash flows From Financing activities			
Dividends paid		(23,831)	(23,355)
Proceeds from borrowings		4,262	17,996
Repayment of borrowings		-	(4,383)
Issue of shares		-	27,657
Net cash (used in) / provided by financing activities		(19,569)	17,915
Net increase in cash held		(4,854)	22,471
Cash at beginning of financial period		74,091	42,018
Effects of exchange fluctuations on the balances of cash held in foreign currencies		460	(854)
Cash at the end of the financial period		69,697	63,635

The statement of cash flows is to be read in conjunction with the notes to the half-year financial statements set out on pages 12 to 24.

Cochlear Limited and its Controlled Entities

Notes to the financial statements

For the half-year ended 31 December 2004

1. Statement of significant accounting policies

(a) Basis of preparation of half-year financial report

The half-year consolidated financial report is a general purpose financial report which has been prepared in accordance with Accounting Standard AASB 1029 "Interim Financial Reporting", the recognition and measurement requirements of applicable AASB standards, Urgent Issues Group Consensus Views, other authoritative pronouncements of the Australian Accounting Standards Board and the Corporations Act 2001. This half-year financial report is to be read in conjunction with the 30 June 2004 Annual Financial Report and any public announcements by Cochlear Limited and its Controlled Entities during the half-year in accordance with continuous disclosure obligations arising under the Corporations Act 2001. It has been prepared on the basis of historical costs and, except where stated, does not take into account changing money values or fair values of non-current assets.

These accounting policies have been consistently applied by each entity in the Consolidated Entity and are consistent with those applied in the 30 June 2004 Annual Financial Report. Certain comparative balances have been reclassified to conform with current period presentation.

The half-year report does not include full note disclosures of the type normally included in an annual financial report.

(b) Goodwill

Goodwill represents the excess of the purchase consideration plus incidental costs over the fair value of the identifiable net assets acquired. Goodwill is amortised from the date of acquisition using the straight-line method over a period of 20 years. The amortisation period is reviewed annually for appropriateness.

	Consolidated	
	31 December 2004	31 December 2003
	\$'000	\$'000
2. Revenue and expenses from ordinary activities		
(a) Revenue		
Operating activities		
Revenue from sale of goods before hedging	146,922	121,838
Foreign exchange gains on hedged sales	11,854	14,767
Revenue from the sale of goods	158,776	136,605
Revenue from rendering of services	1,626	980
	160,402	137,585
Other revenue		
Foreign exchange gains	2,012	347
Other income	161	108
Interest received or due and receivable from other persons	1,040	1,168
	163,615	139,208

Cochlear Limited and its Controlled Entities
Notes to the financial statements

For the half-year ended 31 December 2004

	Consolidated	
	31 December	31 December
	2004	2003
	\$'000	\$'000
(b) Expenses		
Cost of sales		
- Cost of goods sold	40,804	32,790
- Warranty	2,955	3,336
- Write down in value of inventory	2,232	333
	45,991	36,459
Distribution, marketing and field clinical support	46,057	39,541
Research and development	20,911	19,737
Administration and system development	10,193	6,725
	123,152	102,462
Borrowing costs	453	395
3. Income tax		
Prima facie income tax expense calculated at 30% (2003: 30%) on the profit from ordinary activities	12,003	10,905
Increase in income tax due to :		
Net higher overseas tax rate	157	295
Other non-allowable permanent differences	269	256
Decrease in income tax expense due to:		
Research and development allowance	(1,124)	(1,051)
Employee share distribution	(198)	(207)
Other allowable permanent differences	-	(130)
	11,107	10,068
Income tax (over)/under provided in prior years	(113)	(363)
Total income tax expense attributable to operating profit	10,994	9,705

Cochlear Limited and its Controlled Entities
Notes to the financial statements

For the half-year ended 31 December 2004

Asia Pacific		Europe		Americas		Unallocated		Eliminations		Consolidated	
2004	2003	2004	2003	2004	2003	2004	2003	2004	2003	2004	2003
A\$'000	A\$'000	A\$'000	A\$'000	A\$'000	A\$'000	A\$'000	A\$'000	A\$'000	A\$'000	A\$'000	A\$'000

4. Segment reporting

Revenue

Revenue outside the Consolidated Entity	26,789	26,191	59,294	41,136	64,638	55,946	11,854	14,767	-	-	162,575	138,040
Intersegment revenue	87,374	70,325	-	-	-	-	-	-	(87,374)	(70,325)	-	-

Profit

Operating profit/(loss) before interest & tax	4,277	6,317	18,657	7,856	12,933	11,326	3,556	10,079	-	-	39,423	35,578
Net interest revenue/(expense)											587	773
Operating profit before tax											40,010	36,351
Income tax expense attributable to operating profit											(10,994)	(9,705)
Operating profit after tax											29,016	26,646

Industry segment

The Consolidated Entity operates in the cochlear implant industry.

Cochlear Limited and its Controlled Entities

Notes to the financial statements

For the half-year ended 31 December 2004

	Consolidated	
	31 December 2004 \$'000	30 June 2004 \$'000
5. Contributed equity		
Issued and paid-up capital		
54,289,477 (June 2004: 54,161,690) ordinary shares, fully paid	50,746	50,746
Movements in ordinary share capital		
Balance at beginning of financial period	50,746	23,089
Shares issued:		
72,870 (2003: 43,140) shares issued on 24 September 2004 for nil consideration under the Employee Share Plan	-	-
Nil (2003: 539,000) shares issued from the exercise of options	-	27,657
54,917 (2003: nil) shares issued on 30 September 2004 for nil consideration under the Cochlear Executive Long Term Incentive Plan (CELTIP)	-	-
Balance at end of financial period	50,746	50,746

Options and performance shares

At the date of this report, unissued ordinary shares of the Company under option are:

	Exercise Price Per Share	Exercise Period	Number of Options	Number of Performance Shares
Options issued in September 2002 (i)	\$38.12	Aug-Sept 2005	990,000	-
Options & performance shares issued in November 2003 (ii)	\$34.19	Aug 2006-08	192,761	54,234
Options & performance shares issued in September 2004 (ii)	\$18.97	Aug 2007-09	738,490	65,918

Cochlear Limited and its Controlled Entities

Notes to the financial statements

For the half-year ended 31 December 2004

- (i) The Company has an Executive Share Option Plan (ESOP) originally approved and adopted at the annual general meeting on 20 October 1995 and subsequently amended 20 October 1997. All options expire on the earlier of their expiry date or termination of the employee's employment. Options do not vest until three years after granting and thereafter the number of options exercisable depends on the compound annual growth rate of earnings per ordinary share achieved by the Consolidated Entity over a three year period from the date of issue. The number of options which will be exercisable by the executives under the plan will depend upon the compound annual growth rate of the earnings per share achieved by the Consolidated Entity. Three different levels of growth rate have been set which will determine the number of options exercisable by the executives in any particular year. If the minimum compound growth rate of 10% per annum is not achieved, no shares will be issued. To achieve a 100% allocation, an annual compound growth rate of 18% over the three-year period must be achieved. During the financial period, no options were exercised and 966,000 options expired / lapsed.
- (ii) The Cochlear Executive Long Term Incentive Plan (CELTIP) was approved and adopted at the annual general meeting on 21 October 2003 and replaced the ESOP Plan. The CELTIP offers a mixture of options over unissued shares and performance shares. Both the options and the performance shares are subject to a three-year vesting period. The number of options and shares exercisable by the executives will depend on the performance of the Consolidated Entity over the vesting period. Half of the offer will be assessed against the compound annual growth rate of the earnings per share achieved by the Consolidated Entity, and the other half against the total shareholder return (TSR) as measured against the S&P ASX 100. If the minimum compound growth rate in earnings per share of 10% is not achieved and the Consolidated Entity is below the 50th percentile against the S&P ASX 100 over three years, no shares will be issued. To achieve a 100% allocation, an annual compound growth rate in earnings per share of 20% must be achieved and the Consolidated Entity must be in at least the 75th percentile against the S&P ASX 100. During the financial period 50,535 options expired / lapsed and 11,001 performance shares were forfeited.

	Consolidated	
	31 December	31 December
	2004	2003
	\$'000	\$'000
6. Retained profits		
Retained profits at the beginning of the half-year	89,267	95,410
Net profit attributable to members of the parent entity	29,465	26,880
Crystallisation of foreign currency translation reserve following dividend paid by controlled entity	(1,003)	(592)
Dividends recognised during the half-year	(23,831)	(23,355)
Retained profits at the end of the half-year	93,898	98,343

Cochlear Limited and its Controlled Entities

Notes to the financial statements

For the half-year ended 31 December 2004

7. 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 2004				
Final - ordinary	44.0	23,831	Franked	23 September 2004
31 December 2003				
Final - ordinary	44.0	23,355	Franked	23 September 2003

Franked dividends declared or paid during the financial year were fully 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	35.0	19,001	Franked	15 March 2005

The financial effect of these dividends has not been brought to account in the Consolidated Entity financial statements for the half-year ended 31 December 2004 and will be recognised in subsequent financial reports.

Dividend Franking Account

	Company	
	31 December 2004	31 December 2003
	\$'000	\$'000
30% franking credits available to shareholders of Cochlear Limited for subsequent financial periods	3,576	11,924

Cochlear Limited and its Controlled Entities
Notes to the financial statements

For the half-year ended 31 December 2004

	Consolidated	
	31 December	31 December
	2004	2003
	\$'000	\$'000
8. Total equity reconciliation		
Total equity at beginning of the half-year	145,529	119,687
Total changes in parent entity interest in equity recognised in Statement of Financial Performance	28,063	23,836
Transactions with owners as owners:		
Movement in contributed equity	-	27,657
Dividends paid	(23,831)	(23,355)
Total changes in outside equity interest	(847)	6,577
Total equity at end of the half-year	148,914	154,402

9. Acquisition of controlled entities

On 1 July 2004 the Consolidated Entity purchased 100% of the voting shares of Miaki NV a company incorporated in Belgium. At the time of acquisition Miaki NV owned 100% of the voting shares of Newmedic NV, which was subsequently renamed to Cochlear Benelux NV. Details of the acquisition are as follows:

	Consolidated
	31 December
	2004
	\$'000
Consideration	11,797
Cash acquired	2,008
Outflow of cash	9,789

Cochlear Limited and its Controlled Entities

Notes to the financial statements

For the half-year ended 31 December 2004

	Consolidated
	31 December
	2004
	\$'000
Fair value of assets acquired	
Fixed assets	62
Inventory	286
Trade debtors	2,347
Other debtors	96
Trade creditors	(1,802)
Accruals	(86)
Bank loans - secured	(313)
Other loans - unsecured	(5)
	<hr/> 585
Goodwill on acquisition	<hr/> 9,204
Consideration (cash)	<hr/> <hr/> 9,789

On 1 November 2004 the Consolidated Entity purchased 100% of the voting shares of Newmedic International SAS a company incorporated in France. Newmedic International SAS was subsequently renamed to Cochlear France SAS. Details of the acquisition are as follows:

	Consolidated
	31 December
	2004
	\$'000
Consideration	6,815
Cash acquired	694
Outflow of cash	<hr/> 6,121
Fair value of assets acquired	
Fixed assets	128
Inventory	361
Trade debtors	1,400
Prepayments and other debtors	3,253
Trade creditors	(3,651)
Accruals	(149)
	<hr/> 1,342
Goodwill on acquisition	<hr/> 4,779
Consideration (cash)	<hr/> <hr/> 6,121

Cochlear Limited and its Controlled Entities
Notes to the financial statements

For the half-year ended 31 December 2004

	Interest Held		Country of Incorporation
	31 December	30 June	
	2004	2004	
	%	%	
10. Particulars in relation to controlled entities			
The Company			
Cochlear Limited			Australia
Controlled entities			
Cochlear Europe Limited	100	100	United Kingdom
Cochlear Acoustics Limited	75	75	United Kingdom
Cochlear AG	100	100	Switzerland
Cochlear (UK) Limited	100	100	United Kingdom
Cochlear GmbH	100	100	Germany
Cochlear Americas	100	100	United States of America
Cochlear (HK) Limited	100	100	Hong Kong
Nihon Cochlear Co Limited	100	100	Japan
Neopraxis Pty Limited	100	100	Australia
Cochlear Technologies Pty Limited	100	100	Australia
Medical Insurance Pte Limited	100	100	Singapore
Cochlear Holdings NV (a)	100	-	Belgium
Miaki NV (b)	100	-	Belgium
Cochlear Benelux NV (c)	100	-	Belgium
Cochlear France Holdings SAS (d)	100	-	France
Cochlear France SAS (e)	100	-	France
Cochlear Italia SRL (f)	100	-	Italy

(a) Incorporated 13 August 2004

(b) Acquired 1 July 2004

(c) Acquired 1 July 2004

(d) Incorporated 1 November 2004

(e) Acquired 1 November 2004

(f) Incorporated 1 December 2004

Cochlear Limited and its Controlled Entities

Notes to the financial statements

For the half-year ended 31 December 2004

11. Contingent liabilities

The detail and estimated maximum amounts of contingent liabilities that may become payable is set out below. The Directors are not aware of any circumstance or information which would lead them to believe that these liabilities will crystallise and consequently no provisions are included in the financial statements in respect of these matters.

US Department of Justice Inquiry

In March 2004, the Company was informed by the United States Department of Justice that Cochlear Americas Limited, a wholly-owned subsidiary, is subject to an inquiry under federal healthcare laws in the USA that deal with the Medicare and Medicaid programs, including some with potential criminal sanctions. The Department of Justice has made no specific allegations. The Company is cooperating fully with the inquiry and has engaged a nationally recognised law firm with specialised expertise in US healthcare law. Legal costs incurred as a result of managing the information request have been provided for the current period. It is not possible to estimate the financial impact of this investigation. There has been no change in the status of this matter during the financial period.

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

Assessment from the Tokyo Regional Tax Bureau (TRTB) relating to transfer pricing matters

On 23 May 2003 Nihon Cochlear Co Limited (NCC), a wholly-owned subsidiary of Cochlear Limited received a notice of assessment of \$3,282,850 from the TRTB. The assessment resulted from a transfer pricing audit conducted by the TRTB. The Company vigorously disputes the assessment and the matter is currently in Mutual Agreement proceedings between the Australian Taxation Office and the Japan National Tax Authority.

NCC has paid the full amount owing under the assessment. This payment has been recognised as an asset on the Statement of Financial Position, included within other assets.

In the Directors' opinions, disclosure of any further information about the above matter would be prejudicial to the interests of the Company.

There are no contingent liabilities for termination benefits under service agreements with Directors or persons who take part in the management of the Company.

Cochlear Limited and its Controlled Entities

Notes to the financial statements

For the half-year ended 31 December 2004

12. Events subsequent to reporting date

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 the Consolidated Entity, the results of those operations, or the state of affairs of the Consolidated Entity in future financial years.

International Financial Reporting Standards

The Company will be required to prepare financial statements using Australian Standards that comply with International Financial Reporting Standards (IFRS), beginning with the half-year ended 31 December 2005.

The Company has established a formal project monitored by a steering committee to achieve transition to IFRS. The Company's implementation project consists of three phases as described below.

Assessment and planning phase

This phase aims to identify the key conversion impacts on the financial statements, policies and procedures, systems and processes and staff.

This phase includes:

- Identification of the key differences in accounting policies and disclosures expected to arrive from adopting IFRS
- Assessment of new requirements for capturing information in our systems
- Impact on staff, including training
- Identification of the likely impact on financial statements as a result of adopting IFRS

The Company considers this phase to be complete at 31 December 2004.

Design phase

This phase aims to effect the changes required to existing accounting policies and procedures and systems in order to transition to IFRS.

This phase includes:

- Preparing new accounting policies and procedures for compliance with IFRS requirements
- Designing business processes and accounting systems to support the capture of information required to conform with IFRS disclosures
- Updating disclosures to comply with IFRS
- Educating staff on new requirements

Cochlear Limited and its Controlled Entities

Notes to the financial statements

For the half-year ended 31 December 2004

The design phase is in progress and work is continuing on the above areas. This phase is expected to be complete during the 2005 financial year.

Implementation phase

This phase will include implementation of those changes to business procedures and accounting systems identified. This phase will also include operational training for staff.

The Company has commenced this phase and expects this to be substantially complete by 30 June 2005.

Significant Differences Between Australian Accounting Standards and IFRS

This financial report has been prepared in accordance with Australian Accounting Standards and other financial reporting requirements (Australian GAAP). The differences between Australian GAAP and IFRS identified to date as potentially having a significant effect on the Consolidated Entities' financial performance and financial position are summarised below:

Hedge accounting

All derivatives financial instruments used to hedge foreign exchange risk will be carried at fair value on the Consolidated Entity's Statement of Financial Position. IFRS recognise fair value hedge accounting, which can only be considered where effectiveness tests are met. To the extent that hedges are considered ineffective, differences between the fair value of the hedge and cost must be taken to the Statement of Financial Performance.

Cost of employment benefits

The Consolidated Entity does not currently recognise the net position of its defined benefit superannuation plans on the Statement of Financial Position by using the Projected Unit Credit method to value the defined benefit obligation, but rather recognises the net position on a funding basis. IFRS require that this net position be recognised on the Statement of Financial Position. An initial adjustment will be made against retained earnings at 1 July 2004, based on plan valuations at that date. Future movements in the net position of the plans will be recognised in the Statement of Changes in Equity.

Research and development costs

The Consolidated Entity currently expenses all development expenditures as incurred through the Statement of Financial Performance. IFRS require that development costs be capitalised to the Statement of Financial Position to the extent they meet certain recognition criteria including the ability to demonstrate that the technical feasibility of developing an asset so that it will be available for use or sale and whether the development costs will generate probable economic benefits.

An initial adjustment will be made against retained earnings at 1 July 2004 for development costs which satisfy the requirements for deferral. After the transitional adjustment, development costs that satisfy the criteria for deferral will be capitalised to the Statement of Financial Position and amortised to net profit and loss over the period that the benefits are expected to be realised.

Cochlear Limited and its Controlled Entities

Notes to the financial statements

For the half-year ended 31 December 2004

The Consolidated Entity expects earnings volatility to be impacted only to the extent that development costs capitalised in a given period are higher or lower than those costs capitalised in the preceding financial years.

Options and share based payments

The Consolidated Entity does not currently recognise an expense for options issued to executives or shares issued under the employee share plan.

On adoption of IFRS, the Consolidated Entity will recognise the cost of all options and share based payments as an expense over the relevant vesting period. This treatment will result in an increase in expenses on the Statement of Financial Performance.

Share based payments, whether purchased on open market or issued, are held in the name of the Cochlear Executive Long Term Incentive Plan (CELTIP) Trust until such time as they vest with employees. The Trust does not currently form part of the Consolidated Entity as it is not controlled by the Company. Under IFRS, the Trust will form part of the Consolidated Entity and as such, the shares held by the Trust will need to be accounted for as treasury stock and as a reduction in share capital. The fair value of performance shares will be recognised as an expense on a straight-line basis over the vesting period.

Income tax

The Consolidated Entity currently applies the “income statement” approach to account for income tax. Under IFRS, a “balance sheet” approach will be adopted, whereby deferred tax balances are recognised in the Statement of Financial Position when there is a difference between the carrying value of an asset or liability and its tax cost base. This treatment will likely result in higher levels of deferred tax balances on the Statement of Financial Position. The impact on earnings is not expected to be material.



Independent review report to the members of Cochlear Limited

Scope

The financial report and directors' responsibility

The financial report comprises the statement of financial position, statement of financial performance, statement of cash flows, accompanying notes to the financial statements, and the directors' declaration for the Cochlear Limited Consolidated Entity ("the Consolidated Entity"), for the half-year ended 31 December 2004. The Consolidated Entity comprises Cochlear Limited ("the Company") and the entities it controlled during that half-year.

The directors of the Company are responsible for the preparation and true and fair presentation of the financial report in accordance with the Corporations Act 2001. This includes responsibility for the maintenance of adequate accounting records and internal controls that are designed to prevent and detect fraud and error, and for the accounting policies and accounting estimates inherent in the financial report.

Review approach

We conducted an independent review in order for the Company to lodge the financial report with the Australian Securities and Investments Commission. Our review was conducted in accordance with Australian Auditing Standards applicable to review engagements.

We performed procedures in order to state whether on the basis of the procedures described anything has come to our attention that would indicate the financial report does not present fairly, in accordance with the Corporations Act 2001, Australian Accounting Standard AASB 1029 "Interim Financial Reporting" and other mandatory financial reporting requirements in Australia, a view which is consistent with our understanding of the Consolidated Entity's financial position, and of its performance as represented by the results of its operations and cash flows.

We formed our statement on the basis of the review procedures performed, which were limited primarily to:

- enquiries of company personnel; and
- analytical procedures applied to the financial data.

While we considered the effectiveness of management's internal controls over financial reporting when determining the nature and extent of our procedures, our review was not designed to provide assurance on internal controls.

The procedures do not provide all the evidence that would be required in an audit, thus the level of assurance is less than given in an audit. We have not performed an audit and, accordingly, we do not express an audit opinion.

A review cannot guarantee that all material misstatements have been detected.





Independence

In conducting our review, we followed applicable independence requirements of Australian professional ethical pronouncements and the Corporations Act 2001.

Statement

Based on our review, which is not an audit, we have not become aware of any matter that makes us believe the half-year financial report of Cochlear Limited is not in accordance with:

- a) the Corporations Act 2001, including:
 - i. giving a true and fair view of the Consolidated Entity's financial position as at 31 December 2004 and of its performance for the half-year ended on that date; and
 - ii. complying with Australian Accounting Standard AASB 1029 "Interim Financial Reporting" and the Corporations Regulations 2001; and
- b) other mandatory financial reporting requirements in Australia.

KPMG

John Wigglesworth

Partner

Sydney

15 February, 2005

