



# A hearing life

Hear now. And always





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## Directors' Report Cochlear Limited for the year ended 30 June 2014

The directors present their report, together with the Consolidated Financial Report of the Consolidated Entity (Cochlear), being Cochlear Limited (the Company) and its controlled entities, for the year ended 30 June 2014, and the Auditor's Report thereon.

### Directors

The directors of the Company at any time during or since the end of the financial year were Mr R Holliday-Smith, Mrs YA Allen, Mr PR Bell, Prof E Byrne, AC, Mr A Denver, Mr DP O'Dwyer and Dr CG Roberts.

Information on the directors is presented in the Annual Report. This information includes the qualifications, experience and special responsibilities of each director. It also gives details of the directors' other directorships. Information on the Company Secretary including his qualifications and experience is presented in the Annual Report.

### Directors' meetings

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

	Board of directors		Audit Committee		Medical Science Committee		Nomination Committee		Human Resources Committee		Technology and Innovation Committee	
	Held	Attended	Held	Attended	Held	Attended	Held	Attended	Held	Attended	Held	Attended
Mr R Holliday-Smith	10	10	6	6	-	-	2	2	4	4	-	-
Mrs YA Allen	10	10	6	6	-	-	2	2	4	4	-	-
Mr PR Bell	10	9	-	-	-	-	2	2	4	4	-	-
Prof E Byrne, AC	10	10	-	-	2	2	2	2	-	-	3	3
Mr A Denver	10	10	6	6	2	2	2	2	-	-	3	3
Mr DP O'Dwyer	10	10	6	6	2	2	2	2	-	-	3	3
Dr CG Roberts	10	10	-	-	2	2	-	-	-	-	3	3

## Principal activities and review of operations and results

### Operations

#### Business model

Cochlear's mission is:

"We help people hear and be heard. We empower people to connect with others and live a full life. We transform the way people understand and treat hearing loss. We innovate and bring to market a range of implantable hearing solutions that deliver a lifetime of hearing outcomes."

Cochlear's strategy is focused on customer experience, operational excellence, product innovation, people engagement and value creation.

Cochlear's customer experience strategy is to actively grow the market for implantable hearing solutions. Part of this strategy is increasing Cochlear's support for the market. This is being done through directed programs including greater direct to consumer connection, and increased consumer awareness. Cochlear invested an additional approximate \$10 million during the financial year ended 30 June 2014 (F14) in focused Strategic Growth Initiatives to grow and support the market.

Cochlear's product innovation strategy is to create and bring to market an extensive segmented portfolio of innovative and quality products. Cochlear offers a range of advanced solutions to address different types of hearing loss such as:

- cochlear implants, designed to help those people with moderate to profound sensorineural hearing loss;
- bone conduction implants, designed to help those people with conductive hearing loss, mixed hearing loss or single-sided deafness; and
- acoustic implants, designed to help those people with moderate to severe sensorineural or mixed hearing loss.

Cochlear's implant systems comprise an implant which is inserted during surgery and an external sound processor. This external sound processor can be upgraded with new technology as it becomes available.

For F14, 88% of Cochlear's sales revenue was from cochlear implant (Nucleus) products and 12% from bone conduction (Baha) products. Sound processor upgrade sales revenue accounted for 13% of total sales revenue (15% of the cochlear implant products sales).

The barriers to increasing the penetration of the candidate base include:

- awareness of implantable solutions as a viable option;
- patient motivation;

## Directors' Report Cochlear Limited for the year ended 30 June 2014

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- lack of clear referral paths;
- affordability and funding availability; and
- clinic capacity.

Cochlear operates in a global environment. Each of the over 100 countries that Cochlear sells into has differing penetration rates and reasons for that level of penetration owing to differing cultural and economic situations.

Cochlear estimates that hundreds of thousands of people have been implanted with one of its implants. Cochlear's business model includes supporting these customers with innovative and compatible products, through the sale of sound processor upgrades and accessories and ongoing product support. In F14, the launch of the Nucleus 6 Sound Processor into major markets in the second quarter (Q2) led to an increase in upgrade sales in the second half (H2) as customers upgraded to the new technology.

Cochlear aims to remain the market leader in implantable hearing solutions. There is no independent published market share data but Cochlear estimates it has a market leading share of implantable hearing solutions.

Cochlear's global headquarters is based on the Macquarie University campus in Sydney, Australia. At this location are the corporate offices, manufacturing, research and development as well as the Asia Pacific regional headquarters.

Cochlear manages its sales and distribution through three geographical regions. There are several principal regional head offices plus many local offices:

- Americas, which includes the United States of America (US), Canada and Latin America;
- EMEA, which includes Europe, Middle East and Africa; and
- Asia Pacific, which includes Australasia and Asia.

Cochlear has a deep geographical reach, selling in over 100 countries. Cochlear has a direct presence in approximately 20 countries and uses distributors and agents in other areas.

Manufacturing for the cochlear implant product range is based in Australia, at three sites: Lane Cove and Macquarie University, in Sydney, and Brisbane. Lane Cove continues to manufacture Cochlear's legacy products. New implant ranges will be manufactured at Cochlear's Macquarie University headquarters including the Nucleus Profile implant recently launched. The Brisbane site is responsible for manufacturing non-implant components.

The bone conduction implant product range is manufactured in Sweden.

The acoustic implant product range is manufactured across sites in Australia, the US and Belgium.

Cochlear's supply chain operates with product being distributed from its manufacturing sites in Australia and Sweden to its regional distribution centres in the US, the United Kingdom (UK) and Panama. The product is then further distributed to the end customer.

The proportion of Cochlear's sales revenue to end customers by region is approximately: Americas 39%, EMEA 44% and Asia Pacific 17%.

Foreign exchange has a significant impact on Cochlear's consolidated results. Cochlear has a partial natural hedge with over 90% of sales in foreign currency and over 50% of costs in foreign currency. To help manage the portion not covered by the natural hedge, foreign exchange contracts on foreign currency cash flows back to Australia are taken out. These contracts cover a three year period at a declining level of cover. The Australian dollar (AUD) strengthened during the year against the Japanese yen (JPY) but has weakened against the United States dollar (USD) and the Euro (EUR). These are hedged currencies.

### Operating result F14

#### Revenue

F14 was an important year for Cochlear as new products were launched and progress made on growth initiatives.

The year commenced without regulatory approvals for key new products, but with the market anticipating imminent launches. This had the result of a slowdown of sales in Q1 F14 ahead of new product launches. As the year progressed, regulatory approvals came through for a range of new and innovative products. By the end of the year, Cochlear had launched the largest number of new products in a single year. These included:

- Nucleus 6 Sound Processor
  - a fully featured Nucleus 6 Sound Processor was launched in key European markets in Q1. While not all features on Nucleus 6 Sound Processor were approved in the US, the sound processor started being sold in that region in Q2. Further approvals for the remaining features are being received on a progressive basis;
- Nucleus Profile Implant Series
  - the world's thinnest cochlear implant (Nucleus CI512) was launched in Europe and Asia in Q4 and is awaiting approval in other markets;

## Directors' Report Cochlear Limited for the year ended 30 June 2014

- Hybrid System
  - the Hybrid System was launched in the US in Q4;
- Baha 4 and Baha Attract Systems
  - since being launched in Q2, these bone conduction products have been well received;
- Aqua+ Accessory
  - the Aqua+ Accessory was launched in the US in Q3 and is pending approval in Europe; and
- Codacs System
  - the Codacs System, part of the acoustics range, received European regulatory approval during F14. Cochlear believes this segment remains an important part of its product offering and will further broaden the indications for new candidates.

As anticipated, sales in Q2 recovered and were up over 30% from Q1 following approval and the launch of the new products. This momentum continued in H2.

Sales of cochlear implant units were down 3% to 25,997 for the year. H2 F14 unit sales were up 22% on H1 F14 and up 10% on H2 F13.

Sales revenue was up 15% from that for last year to \$820.9 million. In constant currency terms (i.e. restating F13 at F14 foreign exchange rates), sales revenue was up 3%. The tale of two halves was evident with H2 F14 sales revenue up 18% on H1 F14 and up 28% on H2 F13. In constant currency, H2 F14 sales revenue was up 16% on H2 F13.

Cochlear implant sales revenue, which included sound processor upgrades, was up 13% to \$720.8 million, and up 2% in constant currency.

Revenue from sound processor upgrades (i.e. sales of new sound processors to existing recipients) can be cyclical.

In F14, sound processor upgrade sales were up 27% to \$108.0 million from those for the prior year, up 14% in constant currency. Sound processor upgrade sales increased in H2 F14 following the release of new products.

Sales of bone anchored solutions (including acoustic implant sales) of \$100.1 million were up 27% from those for last year and up 13% in constant currency. Again, the launch of new products in H1 F14 positively impacted sales growth and H2 F14 sales revenue was up 18% on H1 F14 and up 35% (up 21% in constant currency) on H2 F13.

The AUD depreciated against most of Cochlear's major currencies during the year which benefited sales revenue in AUD. From a translation perspective, Cochlear benefited by net \$82.1 million i.e. AUD sales revenue was \$82.1 million higher when translated at F14 foreign exchange rates than when translated at F13 foreign exchange rates. Offsetting this was a reduction in profit from foreign currency contracts. Hedges taken out in prior years and used in line with policy were at higher rates than the average spot foreign exchange rates applicable during the year on exercise of the foreign currency contracts. This resulted in a loss of \$16.0 million compared to a profit of \$37.7 million last year.

Future foreign exchange contracts are detailed in Note 22 to the financial statements and indicate future foreign exchange contract rates closer to the current spot rates for the USD and EUR.

### *Regional sales*

- Americas sales revenue of \$320.8 million increased 13% (up 2% in constant currency). The launch of the Nucleus 6 together with the positive impact of the launched Aqua+ Accessory and the regulatory approval of the Hybrid System in April 2014 meant that H2 F14 sales revenue was up 14% on H1 F14 and up 27% (up 16% in constant currency) on H2 F13.

In Q4 F13, the US business introduced a Future Technology Exchange Program (FTEP) where new implant recipients could exchange their sound processors for new technology at no additional cost once the new technology is approved for sale. In F13, revenue on cochlear implant system sales of \$4.6 million was deferred under the FTEP and was recognised in F14 when the new sound processors were delivered to customers. There is no remaining FTEP deferred revenue at 30 June 2014.

- EMEA sales revenue of \$358.5 million increased 27% (increased 10% in constant currency). EMEA revenue growth continues to reflect the portfolio of geographies in the region, with varying growth rates in different countries. The launch of Nucleus 6 and Baha 4 and Baha Attract positively impacted sales and H2 F14 sales revenue was up 12% on H1 F14 and up 32% (up 17% in constant currency) on H2 F13.

In Q4 F13, the EMEA business introduced an FTEP in selected countries. In F13, revenue on cochlear implant system sales of \$1.8 million was deferred under the FTEP and was recognised in F14 when the Nucleus 6 Sound Processors were delivered to customers. There is no remaining FTEP deferred revenue at 30 June 2014.

- Asia Pacific sales revenue of \$141.6 million decreased 4% (decreased 9% in constant currency). Asia Pacific revenue growth continues to reflect the portfolio of geographies in the region, with varying growth rates in different countries.

A Central Government tender sale into China of approximately 1,800 units was recognised in H2 F14 (down from 2,800 units in F13). In F14, the decrease in sales revenue was a consequence of the lower tender sales in China.

## Directors' Report Cochlear Limited for the year ended 30 June 2014

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Australia again achieved double digit cochlear implant unit sales growth. This demonstrates that there continues to be solid growth prospects for the other regions as they are well below the Australian penetration rates. For example, sales in the UK are approximately those in Australia, but the UK population is nearly three times the size of that of Australia. There are no statistically different demographics applicable to hearing impairment in the two countries.

### *Product sales*

As well as a portfolio of geographies, there is also a comprehensive portfolio of products driving Cochlear's revenue growth:

- cochlear implant sales revenue increased 13% (increased 2% in constant currency) to \$720.8 million, with H2 F14 being up 18% on H1 F14 and up 27% (up 15% in constant currency) on H2 F13.

Sound processor upgrade sales revenue for F14 increased 27% (increased 14% in constant currency) to \$108.0 million following the release of Cochlear's Nucleus 6 Sound Processor in H1 F14; and

- bone conduction and acoustic implant sales revenue grew 27% (increased 13% in constant currency) to \$100.1 million. Cochlear introduced its Baha 4 and Baha Attract during F14 and this biased growth to H2 which was up 18% on H1 F14 and up 35% (up 21% in constant currency) on H2 F13.

### *Profit*

Net profit after tax (NPAT) in H2 F14 was \$72.7 million. This was in line with guidance provided in February 2014 and up 32% on H2 F13. Full year NPAT for F14 was \$93.7 million.

Cochlear's cost of sales to sales revenue of 30.2% is above that for last year of 29.1%. Lower manufacturing volumes in the first half of F14 adversely impacted manufacturing variances. By H2, volumes had recovered and margins were improved. The cost of sales to sales revenue margin was 32.8% for H1 F14, but in H2 F14 had returned to historical levels and was 28.1%.

Selling, general and administration (SG&A) expenses were up 16% but up 6% in constant currency. This followed a disciplined approach to expenditure. Cochlear invested approximately an additional \$10 million during F14 in focused Strategic Growth Initiatives aimed at growing the market. Excluding foreign exchange movements and additional investment in Strategic Growth Initiatives, SG&A expenses increased 3%. The SG&A expense increase covered product launch costs as well as cost increases flagged last year such as the USA Medical Device Excise Tax and amortisation of enterprise resource planning system upgrades that had been completed late in F13.

Research and development (R&D) expenses of \$127.6 million increased 2% but decreased 2% in constant currency. This reflects the deliberate strategy to hold the R&D expenditure at F13 levels. As detailed earlier, a number of new products were released in F14. The regulatory and reimbursement regimen differ in the various countries Cochlear sells into and launch timing is governed by these approvals.

A provision of USD 20 million (\$22.5 million) was expensed in H1 F14 in relation to the patent dispute lawsuit by the Alfred E. Mann Foundation for Scientific Research (AMF) and Advanced Bionics LLC (AB) in the US. The directors are of the opinion that the facts and the law do not support the jury's findings and Cochlear has applied to overturn the verdict in post-trial motions filed with the District Court. The directors will appeal any significant adverse judgment to the United States Court of Appeals for the Federal Circuit.

Full year earnings before interest and tax (EBIT) of \$127.1 million was 29% lower than that for the prior year. Excluding the patent dispute provision in H1 F14, EBIT was \$149.6 million and the EBIT to sales revenue of 18.2% was below that for last year of 25.0%.

The H2 profit growth benefited from the higher sales and H2 F14 EBIT was \$100.2 million, up 42% on H2 F13. H2 F14 EBIT was up 103% on H1 F14 EBIT, excluding the patent dispute provision.

Net interest expense increased \$3.8 million to \$10.0 million due to higher borrowings. Interest cover was 13 times (2013: 29 times).

The effective tax rate of 20.0% decreased by 3.2 percentage points. Excluding the patent dispute provision, the effective tax rate of 21.6% decreased by 1.6 percentage points, as the R&D tax concession benefit remained largely unchanged at \$11.2 million reflecting the continued investment in R&D in Australia.

NPAT decreased 29% to \$93.7 million.

Excluding the patent dispute provision, NPAT was \$109.5 million, again heavily biased to H2.

Overall, NPAT was negatively impacted by \$12.5 million due to both translation and transaction movements in foreign exchange rates during the year.

### **Financial position**

Inventories of \$128.6 million at 30 June 2014 were down 2% from 30 June 2013 (\$131.6 million). Inventory days decreased to 189 days (30 June 2013: 231 days). This reflects the strong sales in H2 F14 and careful inventory management.

Trade receivables of \$201.3 million were up 7% from 30 June 2013 (\$187.6 million), reflecting the strong sales in H2 F14. In constant currency, trade receivables were up 6%. Debtor days decreased to 74 days (30 June 2013: 80 days). Debtor days decreased in all regions following a concerted effort to improve collections.

## Directors' Report Cochlear Limited for the year ended 30 June 2014

The product recall provision was utilised by a net \$15.0 million, with \$21.6 million remaining at 30 June 2014. No further amount has been recognised as a charge or released as a credit in F14.

Intangible assets of \$234.1 million (30 June 2013: \$235.8 million) are a significant proportion of Cochlear's total assets. Foreign exchange movements accounted for \$0.7 million of the decrease. Some \$170.3 million of the asset total relates to goodwill arising from the earlier acquisitions of businesses, principally the Entific (Baha) business in 2005. All intangible assets are tested for impairment on an annual basis. There were no impairments or write-downs of intangible assets in F14.

The final dividend of \$1.27 per share brought the full year dividend to \$2.54 per share, up 1%. This is in line with guidance provided at the F13 Annual General Meeting, held in October 2013.

The Board anticipates the F15 dividend will return to a more historical payout ratio of approximately 70% of NPAT.

Net debt was \$181.3 million at 30 June 2014 (30 June 2013: \$117.8 million). The increase in net debt was driven by:

- profit generated of \$93.7 million, with free cash flow of \$79.5 million; used by
- payment of dividends of \$144.9 million; and
- movements in working capital as discussed above.

Free cash flow was \$79.5 million for the year, up from \$20.2 million for F13. The free cash flow for F14 was heavily biased to H2, with \$65.1 million being generated in H2 F14.

At 30 June 2014, debt facilities of \$350 million were in place with remaining terms of two and four years. At 30 June 2014, the unused portion of the facilities was \$110.0 million. All bank covenants were met at year end.

### Outlook

There continue to be more people in the world diagnosed with hearing loss who could benefit from Cochlear's products than are treated each year. There remains a significant, unmet and addressable clinical need which will continue to underpin long-term sustainable growth.

The clinical and business environments in which Cochlear operates are dynamic and evolving. Cochlear is committed to identifying and supporting the clinical trends as they will shape its future operating environment. A good example of this is the ongoing trend for bilateral implantation.

The impact of recently launched products as well as the impact of new products to be launched in F15 will continue to underpin demand and sales growth for the business.

Cochlear's latest generation sound processor, Nucleus 6, has now been launched in its major markets and will continue to be launched in the remaining markets as local regulatory approvals are received.

Baha 4 and Baha Attract have also been launched in major markets and will continue to roll out to other markets as approvals are received.

Cochlear benefits from a geographic portfolio effect, selling into a range of countries. In any year, some countries experience strong growth, some remain flat and some experience a slowdown. Overall, the trend is for long-term sustainable growth.

Cochlear's strong relationships with its customers and professionals will continue to underpin demand and sales growth for the business.

Several of the emerging markets are heavily biased to tender sales, including the Central Government of China's tenders. Cochlear reviews these tenders carefully and participates at a level that makes commercial sense. In F14, the Chinese tender of approximately 1,800 units was delivered in H2. The future outcome of tender sales is uncertain.

Cochlear remains committed to funding market growth initiatives. These include candidate identification and support; reimbursement and government policy aimed at enhancing cochlear implantation; referral path initiatives; and geographic expansion. These will remain a focus in F15 and will augment overall market growth.

At 30 June 2014, Cochlear had foreign currency equivalent of \$431.9 million in foreign exchange contracts. In F15, the average exchange rate for the USD contracts is 0.93 and the average for EUR contracts is 0.72. At rates applicable on 30 June 2014, a net loss on foreign exchange contracts in F15 is forecast.

### Business risks

Cochlear's principal business risks are outlined below. These are significant risks that may adversely affect Cochlear's business strategy, financial position or future performance. It is not possible to identify every risk that could affect Cochlear's business, and the actions taken to mitigate the risks described below cannot provide absolute assurance that a risk will not materialise.

#### • *Product innovation and competition*

Cochlear is exposed to the risk of failing to develop and produce innovative products for customers. Increased competition exposes Cochlear to the risk of losing market share as well as a decrease in average selling prices in the industry. Cochlear is also exposed to the risk of medical, biological and/or technological advancement by third parties where alternative products or treatments are developed and commercialised that render Cochlear's products obsolete. This could result in a loss of business.

## Directors' Report Cochlear Limited for the year ended 30 June 2014

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In F14, Cochlear invested 16% of revenue in R&D. Cochlear also works with over 100 external research partners. The creation of new intellectual property and the protection of new and existing intellectual property are a key focus for Cochlear. Cochlear currently has patents over a range of features of its technologies.

- ***Infringement litigation***

Cochlear operates in an industry that has substantial intellectual property and patents, designs and trademarks protecting that intellectual property. Cochlear is exposed to the risk that it will be litigated against for claims of infringement. This could result in Cochlear paying royalties to be able to continue to manufacture product, or injunctions preventing Cochlear selling products it had developed. In F14, a provision of USD 20 million (\$22.5 million) was expensed in relation to a patent infringement lawsuit by AMF and AB in the US. The directors are of the opinion that the facts and the law do not support the jury's findings and Cochlear has applied to overturn the verdict in post-trial motions filed with the District Court. The directors will appeal any significant adverse Judgment to the United States Court of Appeals for the Federal Circuit.

- ***Misappropriation of know-how and intellectual property***

Cochlear is exposed to the risk of its know-how and intellectual property being misappropriated either through hacking of its systems or by employees, consultants and others who from time to time have access to Cochlear's know-how and intellectual property. This could result in competitors using this information and increasing their competitiveness. Cochlear could lose market share as a result of this.

Cochlear monitors its systems and has appropriate safeguards and processes in place. Confidentiality agreements are in place with key employees and third parties that are exposed to Cochlear's know-how and intellectual property.

- ***Regulation***

Cochlear operates in a highly regulated industry. Medical devices are subject to strict regulations, including data security, of regulatory bodies in the US, Europe, Asia and Australia as well as many other local bodies in countries where Cochlear's products are sold. If Cochlear or a third-party supplier fails to satisfy regulatory requirements or the regulations change and amendments are not made, this could result in the imposition of sanctions. Delays in achieving regulatory approval can impact Cochlear's ability to sell its latest technology. These risks could result in Cochlear's products being subject to recall and/or the loss of sales and reputational harm.

Cochlear has a worldwide quality assurance system in place.

- ***Reimbursement***

The majority of Cochlear's customers rely on a level of reimbursement from insurers and government health authorities to fund their purchases. There is increasing pressure on healthcare budgets globally. Cochlear is also subject to healthcare related taxes imposed by government agencies and this could negatively impact the ability of candidates to access Cochlear's products (e.g. the Medical Device Excise Tax in the US). Government reimbursement for Baha products in the US is currently under review by the Centers for Medicare and Medicaid Services (CMS).

Cochlear continues to work with reimbursement and government agencies throughout the world to emphasise the benefits and cost effectiveness of the intervention.

- ***Product liability***

The manufacturing, testing, marketing and sale of Cochlear's products involve product liability risk. As the developer, manufacturer, marketer and distributor of certain products, Cochlear may be held liable for damages arising from use of its products during development or after the product has been approved for sale.

Cochlear maintains product liability insurance and operates a worldwide quality assurance system related to the design, testing and manufacture of its products.

- ***Interruption to product supply***

Cochlear relies on third-party companies for the supply of key materials and services. This carries the risk of delays and disruptions in supplies. Certain materials are available from a single source only and regulatory requirements make substitution costly, time-consuming or commercially unviable. Lifetime and strategic purchases of certain inventory items are made.

Cochlear manufactures its cochlear implant products from two sites in Sydney. The latest generation products are manufactured at Cochlear's Macquarie University headquarters and legacy products at a manufacturing site in Lane Cove. Cochlear manufactures its bone conduction implant products in Sweden. The acoustic implant product range is manufactured across sites in Australia, the US and Belgium.

There is the potential risk of disruption to sales should a manufacturing facility be unable to operate. Any new manufacturing facility will require regulatory approval prior to being able to produce and sell product from it. This approval could take many months.

Cochlear monitors its suppliers and identifies second-source supply where possible. Inventories are managed and purchased in sufficient quantities for continued product supply in the short term. Where appropriate, lifetime buys and strategic raw materials purchases are made. Cochlear also regularly reviews its disaster recovery plans for its manufacturing sites. Two discreet approved manufacturing sites for implants will be maintained.



## Directors' Report Cochlear Limited for the year ended 30 June 2014

### • *Political or social instability*

Cochlear sells in over 100 countries. Regional political or social instability could negatively impact sales and the receipt of payment for sales.

Cochlear assesses the countries it sells into and does not have a significant concentration of sales in countries impacted by political or social instability.

### • *Foreign exchange rates*

Cochlear is exposed to currency risk on sales and purchases that are denominated in a currency other than the respective functional currencies of the legal entities. The currencies in which these transactions primarily are denominated are AUD, USD, EUR, JPY, Sterling (GBP), Swedish kroner (SEK) and Swiss francs (CHF). Over 90% of Cochlear's revenues and over 50% of costs are denominated in currencies other than AUD.

Currency risk is hedged in accordance with the Board approved treasury risk policy. The treasury risk policy aims to manage the impact of short-term fluctuations on Cochlear's earnings. Over the longer term, permanent changes in market rates will have an impact on earnings. Derivative financial instruments (forward exchange contracts) are used to hedge exposure to fluctuations in foreign exchange rates in a declining ratio of coverage out to three years.

### • *Credit*

Cochlear's exposure to credit risk is influenced by the geographical location and characteristics of individual customers. Cochlear does not have a significant concentration of credit risk with a single customer. The majority of debtors are government supported clinics or major hospital chains.

Policies and procedures for credit management and administration of receivables are established and executed at a regional level. Individual regions deliver reports to management and the Board on debtor ageing and collection activities on a monthly basis.

In monitoring customer credit risk, the ageing profile of total receivables balances and individually significant debtors is reported by geographic region to the Board on a monthly basis. Regional management is responsible for identifying high risk customers and placing restrictions on future trading, including suspending future shipments and administering dispatches on a prepayment basis.

In addition, absolute country limits are in place and Chief Financial Officer approval is required to increase a limit. These limits are periodically reviewed by the Audit Committee.

### • *Interest rates*

Cochlear is exposed to interest rate risks in Australia.

Interest rate risk is hedged on a case-by-case basis by assessing the term of borrowings and the purpose for which the funds are obtained. Hedging against interest rate risk is achieved by entering into interest rate swaps. At 30 June 2014, no hedging had been entered into.

Note: Given the significance of the patent dispute and foreign exchange movements, the directors believe the presentation of non-International Financial Reporting Standards (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 measures in comparative years using F14 foreign exchange rates;
- free cash flow: IFRS cash flow from operating and investing activities excluding interest and tax paid related to non-operating activities; and
- excluding patent dispute provision: IFRS measures adjusted for the expense of the patent dispute provision.

These 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.

### Consolidated results

The consolidated results for the financial year are:

	2014 \$000	2013 \$000
Revenue	804,936	752,721
Profit before income tax	117,114	172,637
Net profit after tax but before patent dispute provision*	109,490	132,563
Patent dispute provision, net of tax*	15,781	-
Net profit	93,709	132,563
Basic earnings per share (cents)	164.6	233.0
Diluted earnings per share (cents)	164.2	232.4

\* The patent dispute provision was \$22,545,000 before tax and \$15,781,000 after tax.

## Directors' Report Cochlear Limited for the year ended 30 June 2014

### Dividends

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

Type	Cents per share	Total amount \$000	Date of payment	% franked	Tax rate for franking credit
In respect of the previous financial year: Final – ordinary shares	127.0	72,442	19 September 2013	30%	30%
In respect of the current financial year: Interim – ordinary shares	127.0	72,469	27 March 2014	0%	30%

The final dividend in respect of the current financial year has not been provided for in the Financial Report as it was not declared until after 30 June 2014. Since the end of the financial year, the directors declared a final 127 cents per share dividend, 20% franked at the tax rate of 30%, amounting to a total of \$72,468,765.

### Environmental regulations

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

### Non-audit services

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

- all non-audit services were subject to the corporate governance procedures adopted by the Company and have been reviewed by the Audit Committee to ensure that they do not impact the integrity and objectivity of the auditor; and
- the non-audit services provided do not undermine the general principles relating to auditor independence as set out in APES 110 Code of Ethics for Professional Accountants, as they did not involve reviewing or auditing the auditor's own work, acting in a management or decision-making capacity for the Company, acting as an advocate for the Company or jointly sharing risks and rewards.

Details of the amounts paid to the auditor of the Company, KPMG, and its related practices for audit and non-audit services during the year are set out below:

	Consolidated	
	2014 \$	2013 \$
<b>Audit services</b>		
<i>Auditors of the Company:</i>		
KPMG:		
– audit and review of financial reports	1,422,391	1,336,981
– other regulatory compliance services	42,875	58,925
<b>Total audit services</b>	<b>1,465,266</b>	<b>1,395,906</b>
<b>Non-audit services</b>		
<i>Auditors of the Company:</i>		
KPMG:		
– taxation compliance services	818,282	1,211,162
<b>Total non-audit services</b>	<b>818,282</b>	<b>1,211,162</b>

### State of affairs

There were no significant changes to the state of affairs of Cochlear during the financial year.

## Directors' Report Cochlear Limited for the year ended 30 June 2014

### Remuneration Report

#### Contents

Section	Title	Description
1.0	Introduction	Describes the scope of the Remuneration Report and the individuals whose remuneration details are disclosed.
2.0	Remuneration governance	Describes the role of the Board and the Human Resources Committee, and the use of remuneration consultants when making remuneration decisions.
3.0	Non-executive director remuneration	Provides details regarding the fees paid to non-executive directors.
4.0	Executive remuneration	Outlines the principles applied to executive remuneration decisions and the framework used to deliver the various components of remuneration, including explanation of the performance and remuneration linkages.
5.0	Employee share scheme and other share information	Provides details regarding Cochlear's employee equity plans including that information required by the <i>Corporations Act 2001</i> and applicable accounting standards.
6.0	Service contracts and employment agreements	Provides details regarding the contractual arrangements between Cochlear and the executives whose remuneration details are disclosed.

#### 1.0 Introduction

Cochlear is a geographically diverse business, subject to rapid and changing competitive forces, including currency variations, and with a long history of growth. The Board remains committed to a strong growth focus and designs its executive remuneration strategies to direct behaviours towards achieving sustainable growth in shareholder value over the long term. However, as noted last year, these policies must be flexible enough to enable Cochlear to attract, motivate and retain high performing executives in many locations in a dynamic environment.

The Board's philosophy and approach to executive remuneration have always been to balance fair remuneration for skills and expertise with a risk and reward framework that supports longer-term growth of Cochlear as a global business. The comprehensive review of executive remuneration during the financial year ended 30 June 2013 (F13) was implemented in F14.

Following last year's review, a number of changes were adopted in respect of Cochlear's executive key management personnel (KMP) remuneration policies. As a reminder to shareholders, specific changes adopted are summarised as follows:

1. the Remuneration Report was reformatted with improved disclosure principles adopted;
2. the use of performance shares for long-term incentives (LTI) was suspended;
3. performance rights for executive KMP LTI were introduced;
4. changes in the eligibility criteria for participation in the LTI resulted in fewer executive participants;
5. the remuneration mix for the Chief Executive Officer (CEO)/President and other executive KMP was reweighted;
6. the short-term incentive (STI) opportunity for selected executives was increased;
7. the deferral of STI into performance rights has been introduced effective from 1 July 2013 equivalent to 30% of STI cash earned. The first allocation of rights under the deferred STI program occurred in August 2014;
8. the use of options for selected executive KMP LTI was retained because options are consistent with Cochlear's objective to be a growth company. The use of options as an LTI alternative remains under constant review;
9. the LTI allocation methodology (including the option valuation for LTI dollar value) was changed to 'gross contract value' of the option at the calculation date, before any discounts for performance or service;
10. the performance conditions to apply to the F14 LTI were reviewed. The earnings per share (EPS) hurdle rates remained unchanged at the high end of market expectations. The total shareholder return (TSR) hurdle rate has been modified after consideration of shareholder feedback. These settings remain for the F15 LTI program. See section 4.4.2;



## Directors' Report Cochlear Limited for the year ended 30 June 2014

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11. selected Board and executive KMP remuneration was independently benchmarked to ensure the remuneration of these key roles meets external expectations. This remains an ongoing process;
12. director fees remained unchanged in F14, apart from a minor increase in Chairman fees for the Audit Committee and Human Resources Committee (HRC) to reflect the additional responsibilities and time commitments required; and
13. the remuneration mix for all executive KMP was reviewed to ensure it met external benchmark standards. Changes adopted have been explained in the Remuneration Report.

The changes adopted in F14 are reviewed annually. At this stage, no material Board or executive KMP remuneration strategy changes are under consideration for F15.

The Board believes Cochlear's approach to Board and executive KMP remuneration is a balanced, fair and equitable approach designed to reward and motivate a successful and experienced executive team to deliver ongoing business growth which meets the expectations of shareholders over the long term.

The Board will continue to welcome feedback from shareholders on Cochlear's remuneration practices or on the communication of remuneration matters in the F14 Remuneration Report and beyond.

### 1.1 Scope

This Remuneration Report sets out, in accordance with the relevant *Corporations Act 2001* (Corporations Act) and accounting standard requirements, the remuneration arrangements in place for KMP of Cochlear during F14.

### 1.2 Key management personnel

Key management personnel have authority and responsibility for planning, directing and controlling the activities of Cochlear and comprise the non-executive directors, and executive KMP (being the executive director and other senior executives named in this report). Details of the KMP as at year end are set out in the table below:

## Directors' Report Cochlear Limited for the year ended 30 June 2014

	Title (at year end)	Change in F14
<b>Non-executive directors</b>		
Rick Holliday-Smith	Chairman Member, Audit Committee Member, Human Resources Committee Chairman, Nomination Committee	Changed committee membership from 1 July 2013
Yasmin Allen	Director Chairman, Audit Committee Member, Human Resources Committee Member, Nomination Committee	Changed committee membership from 1 July 2013
Paul Bell	Director Chairman, Human Resources Committee Member, Nomination Committee	Changed committee membership from 1 July 2013
Edward Byrne, AC	Director Chairman, Medical Science Committee Member, Nomination Committee Member, Technology and Innovation Committee	No change. Full year
Andrew Denver	Director Member, Audit Committee Member, Medical Science Committee Member, Nomination Committee Chairman, Technology and Innovation Committee	Changed committee membership from 1 July 2013
Donal O'Dwyer	Director Member, Audit Committee Member, Medical Science Committee Member, Nomination Committee Member, Technology and Innovation Committee	Changed committee membership from 1 July 2013
<b>Executive director</b>		
Chris Roberts	CEO/President Member, Medical Science Committee Member, Technology and Innovation Committee	No change. Full year
<b>Other executive KMP</b>		
Richard Brook	President, European Region	No change. Full year
Jan Janssen	Senior Vice President, Design and Development, Clinical and Regulatory	No change. Full year
Neville Mitchell	Chief Financial Officer and Company Secretary	No change. Full year
Mark Salmon	President, Asia Pacific Region	No change. Full year
Chris Smith	President, Americas Region	No change. Full year

There were no key management personnel departures during F14.

## Directors' Report Cochlear Limited for the year ended 30 June 2014

### 2.0 Remuneration governance

This section of the Remuneration Report describes the role of the Board and the HRC, and the use of remuneration consultants when making remuneration decisions.

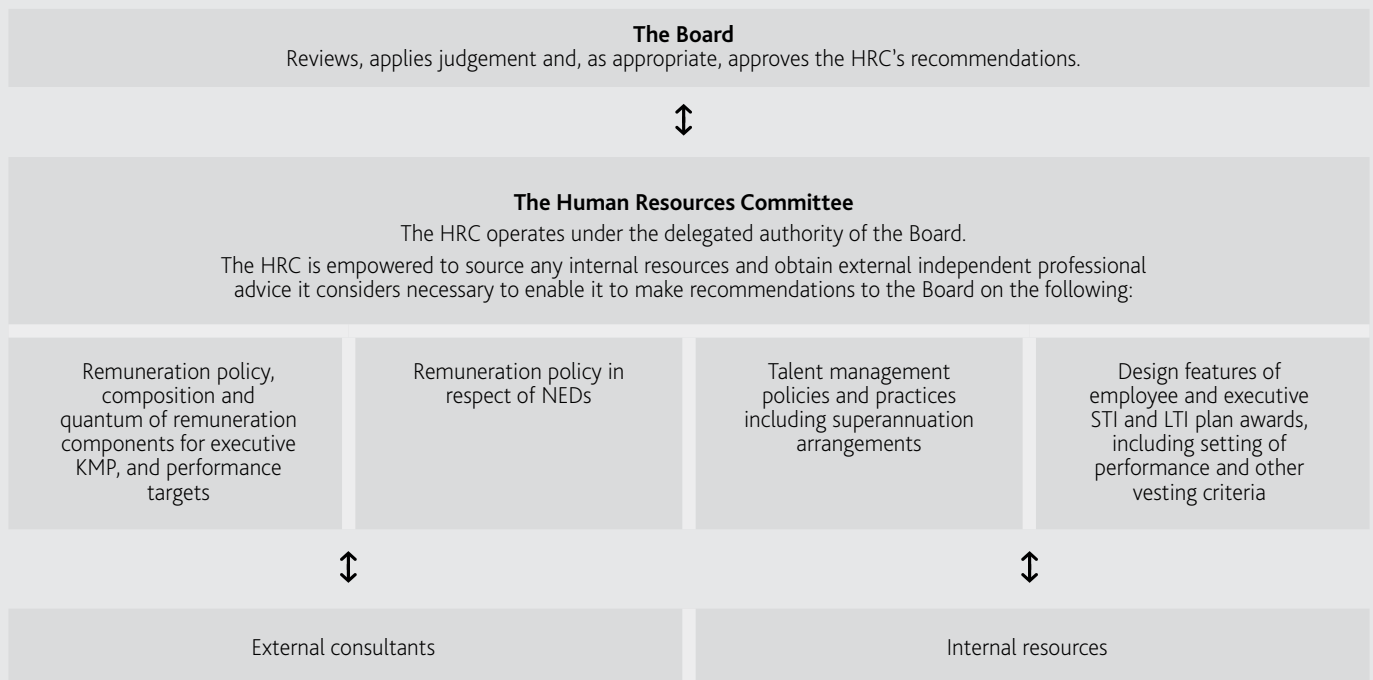
#### 2.1 Role of the Board and the Human Resources Committee

The Board is responsible for Cochlear's remuneration strategy and policy. Consistent with this responsibility, the Board has established the HRC which comprises solely independent non-executive directors (NEDs).

The role of the HRC is set out in its Charter, which is reviewed annually and was last revised and approved by the Board in December 2012. In summary, the HRC's role includes:

- ensure that the appropriate procedures exist to assess the remuneration levels of the Chairman, other NEDs, executive directors, direct reports to the CEO/President, Board committees and the Board as a whole;
- ensure that Cochlear meets the requirements of the ASX Corporate Governance Council's gender diversity principles and recommendations, and other relevant guidelines;
- ensure that Cochlear adopts, monitors and applies appropriate remuneration policies and procedures;
- ensure that reporting disclosures related to remuneration meet the Board's disclosure objectives and all relevant legal requirements;
- develop, maintain and monitor appropriate talent management programs including succession planning, recruitment, development; and retention and termination policies and procedures for senior management; and
- develop, maintain and monitor appropriate superannuation and other pension benefit arrangements for Cochlear.

The HRC's role and interaction with Board, internal and external advisors, are further illustrated below:



Further information on the HRC's role, responsibilities and membership is contained in the Corporate Governance Report of this Annual Report. The HRC terms of reference can also be viewed in the Investor Centre, corporate governance section of the Cochlear website, [www.cochlear.com](http://www.cochlear.com).



## Directors' Report Cochlear Limited for the year ended 30 June 2014

### 2.2 Use of remuneration consultants

During F14, remuneration consultancy contracts were entered into by Cochlear and accordingly the disclosures required under section 300A(1)(h) of the Corporations Act are set out as follows:

Advisor/consultant — F14	Services provided	Remuneration consultant for the purpose of the Corporations Act
Ian Crichton, Remuneration Consultant, CRA Plan Managers Pty Limited	Review of F14 Remuneration Report	No

#### Key questions regarding use of remuneration consultants

Did the remuneration consultant provide remuneration recommendations in relation to any of the executive KMP for F14?	No
How much was the remuneration consultant paid by Cochlear for remuneration related and other services?	CRA Plan Managers Pty Limited – remuneration services \$43,070; other services \$33,212.
What arrangements did Cochlear make to ensure that the making of the remuneration recommendations would be free from undue influence by the executive KMP?	Cochlear maintains a protocol which governs the procedure for procuring advice relating to KMP remuneration. The protocol contains a summary of the process for the engagement of the remuneration consultant, the provision of information to the remuneration consultant and the communication of remuneration recommendations.
Is the Board satisfied that the remuneration information provided was free from any such undue influence? What are the reasons for the Board being so satisfied?	Yes, the Board is satisfied. The reasons are as follows: the Chairman of the HRC had oversight of all requests for remuneration information; and the protocol with respect to the procurement of remuneration related advice remains in place.

## Directors' Report Cochlear Limited for the year ended 30 June 2014

### 3.0 Non-executive director remuneration

#### 3.1 NED remuneration

Principle	Comment
Fees are set by reference to key considerations	Fees for NEDs are based on the nature of the NEDs' work and their responsibilities. The remuneration rates reflect the complexity of Cochlear and the extent of the geographical regions in which Cochlear operates. In determining the level of fees, survey data on comparable companies is considered. NEDs' fees are recommended by the HRC and determined by the Board. Shareholders approve the aggregate amount available for the remuneration of NEDs. A minor increase in Audit Committee Chairman and Human Resource Committee fees was introduced in F14.
Remuneration is structured to preserve independence whilst creating alignment (see also section 3.4)	To preserve independence and impartiality, NEDs are not entitled to any form of incentive payments including options and the level of their fees is not set with reference to measures of Cochlear performance. However, to create alignment between directors and shareholders, the Board has adopted guidelines that request NEDs to hold (or have a benefit in) shares in Cochlear equivalent in value to at least one year's base fees. Cochlear does not offer loans to fund share ownership.
Aggregate Board and committee fees are approved by shareholders	The total amount of fees paid to NEDs in F14 is within the aggregate amount approved by shareholders at the AGM in October 2011 of \$2,000,000 per year.

#### 3.2 NED fees and other benefits

Elements	Details		
Board/committee fees per annum – F14	Board Chairman fee <sup>1</sup>		\$438,000
	Board NED base fee		\$146,000
	<b>Committee fees</b>	<b>Committee Chair</b>	<b>Committee member</b>
	Audit	\$40,000	\$20,000
	Human Resources	\$30,000	\$10,000
	Nomination	No fee	No fee
	Medical Science	\$20,000	\$10,000
	Technology and Innovation	\$20,000	\$10,000
<b>Post-employment benefits</b>			
Superannuation	Superannuation contributions have been made at a rate of 9.25% of the base fee (but only up to the Australian Government's prescribed maximum contributions limit) which satisfies the Company's statutory superannuation contributions. The contribution rate increased on 1 July 2014 to 9.5%. Contributions are not included in the base fee.		
Retirement scheme	<p>From 2003, no new NED was entitled to join the Cochlear directors' retirement scheme. NEDs appointed prior to this were members of the scheme, which provided NEDs with more than five years' service, retirement benefits of up to three times their annual remuneration over the previous three years.</p> <p>On 23 October 2006, the Board determined that it should implement changes to NED remuneration consistent with developing market practice and guidelines, by discontinuing the ongoing accrual of benefits under the existing retirement scheme once the remaining members of the scheme reached their five year service period. The benefits accrued to that date are indexed by reference to the bank bill rate.</p> <p>All directors transitioned from the retirement scheme during F07. As at 30 June 2014, Edward Byrne is the only NED entitled to this benefit. The accrued entitlement for Edward Byrne under the Cochlear directors' retirement scheme as at 30 June 2014 was \$421,719.</p>		
<b>Other benefits</b>			
Equity instruments	NEDs do not receive any performance related remuneration, options or performance shares/rights.		
Other fees/benefits	<p>NEDs receive reimbursement for costs directly related to Cochlear business.</p> <p>No payments were made to NEDs during F14 for travel allowances, extra services or special exertions.</p>		

1. Committee fees are not paid to the Chairman of the Board.

## Directors' Report Cochlear Limited for the year ended 30 June 2014

### 3.3 NED total remuneration

Amounts \$	Year	Short-term benefits	Post-employment benefits		Total
		Fees	Termination benefits <sup>1</sup>	Superannuation benefits	
Rick Holliday-Smith (Chairman)	<b>F14</b>	<b>438,000</b>	-	<b>17,775</b>	<b>455,775</b>
	F13	438,000	-	16,470	454,470
Yasmin Allen <sup>2,3</sup>	<b>F14</b>	<b>196,000</b>	-	<b>17,255</b>	<b>213,255</b>
	F13	185,192	-	15,888	201,080
Paul Bell <sup>4</sup>	<b>F14</b>	<b>176,000</b>	-	<b>16,280</b>	<b>192,280</b>
	F13	171,000	-	15,338	186,338
Edward Byrne <sup>3</sup>	<b>F14</b>	<b>176,000</b>	<b>10,902</b>	<b>16,280</b>	<b>203,182</b>
	F13	166,000	12,293	14,940	193,233
Andrew Denver <sup>3</sup>	<b>F14</b>	<b>196,000</b>	-	<b>17,255</b>	<b>213,255</b>
	F13	186,000	-	15,753	201,753
Donal O'Dwyer	<b>F14</b>	<b>186,000</b>	-	<b>16,828</b>	<b>202,828</b>
	F13	186,000	-	15,961	201,961
Total	<b>F14</b>	<b>1,368,000</b>	<b>10,902</b>	<b>101,673</b>	<b>1,480,575</b>
	F13	1,332,192	12,293	94,350	1,438,835

1. Amounts accrued for interest during the financial year relating to the directors' retirement scheme.

2. Increased fee for Chair of Audit Committee.

3. Increases related to serving new Board committee responsibilities for the full year.

4. Increased fee for Chair of Human Resources Committee.

### 3.4 Minimum shareholding guidelines

The Board has approved minimum shareholding guidelines for NEDs, the CEO/President and those executives who report directly to the CEO/President. Under these guidelines, all NEDs are requested to accumulate a minimum shareholding in Cochlear shares equivalent in value to one year's base fees and all executive KMP are requested to accumulate a minimum shareholding in Cochlear shares equivalent to one year's total fixed remuneration, calculated using the prior 365 day average closing share price.

The guidelines were implemented in March 2007. As at 30 June 2014, all executive KMP and NEDs were in compliance with the guidelines.

### 4.0 Executive remuneration

#### 4.1 Executive KMP remuneration

Cochlear's executive remuneration policies are designed to attract, motivate and retain a highly qualified and experienced group of executives employed across diverse geographies. Fixed remuneration components are determined having regard to the specific skills and competencies of the executive KMP with reference to both internal and external relativities, particularly local market conditions. The 'at risk' components of remuneration are strategically directed to encourage management to strive for superior (risk balanced) performance by rewarding the achievement of targets that are challenging, clearly defined, understood and communicated within the ambit of accountability of the relevant executive KMP.



## Directors' Report Cochlear Limited for the year ended 30 June 2014

Executive KMP remuneration objectives are exemplified through three categories of remuneration, as illustrated below:

Executive KMP remuneration objectives			
Attract, motivate and retain executive talent across diverse geographies	The creation of reward differentiation to drive performance values and behaviours components	An appropriate balance of 'fixed' and 'at risk' components	Shareholder value creation through equity components
Total target remuneration (TTR) is set by reference to the relevant geographic market			
Fixed		At risk	
Total fixed remuneration (TFR)	Short-term incentives (STI)	Long-term incentives (LTI)	
TFR is set based on relevant market relativities, reflecting responsibilities, performance, qualifications, experience and geographic location	STI performance criteria are set by reference to Cochlear group and/or regional revenue and EBIT and individual performance targets relevant to the specific position	LTI targets are linked to both Cochlear group internal EPS growth and external relative TSR outperformance measures	
Remuneration will be delivered as:			
Base salary plus any fixed elements related to local markets, including superannuation or equivalents	Part cash and part equity (performance rights). The equity component will be subject to service and deferred for 2 years	Equity in options and/or performance rights. All equity is held subject to service and performance for 3 years from grant date. The equity is at risk until vesting. Performance is tested once at the vesting date	
Strategic intent and market positioning			
TFR will generally be positioned at the median compared to relevant market based data considering expertise and performance in the role	Performance incentive is directed to achieving Board approved targets, reflective of market circumstances. TFR + STI is intended to be positioned in the 3rd quartile of the relevant benchmark comparisons	LTI is intended to reward executive KMP for sustainable long-term growth aligned to shareholders' interests. LTI allocation values are intended to be positioned at the top of the 3rd quartile of the relevant benchmark comparisons	
↕	↕	↕	
Total target remuneration			
TTR is intended to be positioned in the 3rd quartile compared to relevant market benchmark comparisons. 4th quartile TTR may result if outperformance is achieved. The remuneration structure is designed to ensure top quartile executive KMP remuneration is only achieved if Cochlear outperforms			

## Directors' Report Cochlear Limited for the year ended 30 June 2014

### 4.2 Remuneration composition mix and timing of receipt

#### 4.2.1 Current remuneration mix and amendments for F15

Cochlear endeavours to provide an appropriate and competitive mix of remuneration components balanced between fixed and at risk and paid in both cash and deferred equity. The broad remuneration composition mix for executive KMP can be illustrated as follows:

##### Remuneration mix for F14

The review of executive remuneration last year (F13) involved shareholder feedback and market benchmarks to understand context and positioning and detailed analysis of past remuneration outcomes using the new valuation methodology. Following the review of remuneration, the Board decided to reweight the performance based elements of total target remuneration and to introduce a deferred equity component to the STI plan for executive KMP. The effect of this reweighting and application of the new LTI allocation valuation delivered a lower effective LTI value (through lower LTI allocations) offset by a higher STI opportunity and with a component value equivalent to 30% of STI cash deferred into equity with a further two year vesting period. This change was made in response to the detailed remuneration strategy review and to ensure executives are rewarded for sustained performance. The Board believes the new arrangements better reflect contemporary standards and remuneration benchmark comparisons.

Position	TFR (Cash) at target	STI at target	LTI at target
CEO/President	33.4% of TTR	33.3% of TTR	33.3% of TTR
Other executive KMP	At least 45.1% of TTR	Up to 32.3% of TTR	Up to 22.6% of TTR

The mix of remuneration for the CEO/President and other executive KMP will remain unchanged in F15.

##### Total fixed remuneration (TFR)

Cochlear's approach to TFR settings is to aim to position all executives between the median and 75th percentile, but at the lower end of this range where possible to control fixed costs, exchange rate movements notwithstanding. Only modest increases in TFR were approved in F14 to maintain this balanced approach. Cochlear's approach to TFR settings will remain largely unchanged in F15.

##### Short-term incentives (STI)

Cochlear has consistently focused STI on achieving annual revenue and EBIT targets and personal objectives. To support Cochlear's balanced approach to TFR, Cochlear has set STI targets aimed at achieving a market competitive TFR + STI between the median and the 75th percentile when budgets are met. STI opportunity was increased in F14 following an independent assessment comprising a higher STI opportunity and with the introduction of a component value, equivalent to 30% of STI cash earned, deferred into equity for the first time. The LTI value was also reduced primarily as a function of changing the allocation value. The changes adopted in F14 will remain largely unchanged in F15.

##### Long-term incentives (LTI)

As announced last year, the LTI opportunity is now calculated using the 'gross contract value'. The change from 'accounting value' to 'gross contract value' materially reduced the number of equity units available for the designated LTI dollar opportunity. Accordingly, some reweighting of the LTI was adopted in F14. The approach and methodology remain in F15.

##### Total target remuneration (TTR)

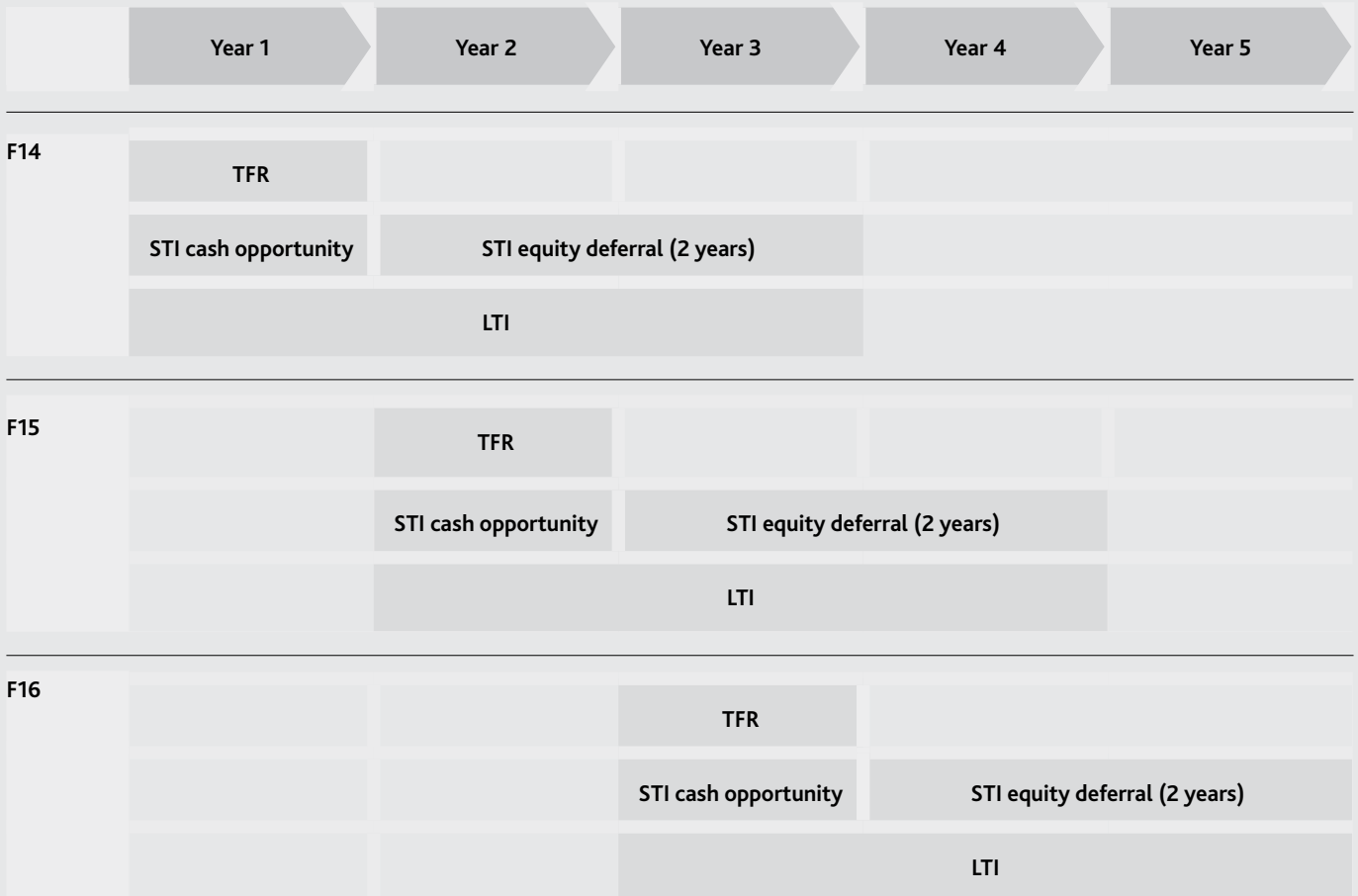
TTR under the remuneration mix adopted will, in the opinion of the Board, deliver an overall risk adjusted reward opportunity which is fair and market competitive.

Shareholders should note that Cochlear has performance hurdles, particularly for LTI that are at the higher end of the market (S&P/ASX 100 companies) in terms of degrees of difficulty. Further, any LTI award will only have value to the executive if the performance hurdles are met to enable vesting to occur, and for option related awards, the equity outcomes are positive in terms of share price movement (i.e. the share price on vesting exceeds the exercise price). In F14, the LTI program delivered a nil outcome and the STI program within a range around 50%.

## Directors' Report Cochlear Limited for the year ended 30 June 2014

### 4.2.2 Remuneration – timing of receipt of the benefit for F15 onwards

The three complementary components of executive KMP remuneration are 'earned' over multiple time ranges. This is illustrated in the following chart:



Note: LTI is awarded in year 1 and earned at the end of year 3 but expensed over the three year service period.

As illustrated, executive KMP remuneration is delivered on a cascading basis, with a material component deferred for two (STI) and three (LTI) years and awarded as equity. This remuneration mix is designed to ensure executive KMP are focused on delivering results over the short, medium and long term if they are to maximise their remuneration opportunity. The Board believes this approach aligns executive KMP remuneration to shareholder interests and expectations.

### 4.3 Total fixed remuneration explained

Total fixed remuneration (TFR) includes all remuneration and benefits paid to an executive KMP calculated on a total employment cost basis. In addition to base salary, selected overseas executives receive benefits that may include health insurance, car allowances and relocation allowances. In Australia, retirement benefits are generally paid in line with the statutory Superannuation Guarantee legislation prevailing. Globally, retirement benefits are generally paid in line with local legislation and practice.

Executive KMP TFR is tested regularly for market competitiveness by reference to appropriate independent and externally sourced comparable benchmark information, including for comparable ASX listed companies, and based on a range of size criteria including market capitalisation, taking into account an executive's responsibilities, performance, qualifications, experience and geographic location.

Job evaluation methodologies are applied to assist with managing internal relativities.

TFR adjustments, if any, are made with reference to individual performance, an increase in job role or responsibility, changing market circumstances as reflected through independent benchmark assessments or through promotion.

Any adjustments to executive KMP remuneration are approved by the Board, based on HRC and CEO/President recommendations.

## Directors' Report Cochlear Limited for the year ended 30 June 2014

### 4.4 Variable (at risk) remuneration explained

As set out in section 4.2, variable remuneration forms a significant portion of the CEO/President and other executive KMP remuneration opportunity. Apart from being market competitive, the purpose of variable remuneration is to direct executives' behaviours towards maximising Cochlear's short, medium and long-term performance. The key aspects are summarised below:

#### 4.4.1 Short-term incentives (STI)

Purpose	<p>The STI arrangements at Cochlear are designed to reward executives for the achievement against annual performance targets set by the Board at the beginning of the performance period. The STI program is reviewed annually by the HRC and approved by the Board.</p> <p>Any STI award in excess of the 100% budget opportunity is individually approved by the HRC. All STI awards to the CEO/President and other executive KMP are approved by the HRC and Board.</p>
Performance targets	<p>The key performance objectives of Cochlear are currently directed to achieving Board approved sales revenue and EBIT targets, and by the achievement of individual performance goals.</p> <p>For the current year, sales revenue and EBIT targets had equal weighting.</p> <p>The weighting between Cochlear group and regional sales revenue and EBIT will depend on the responsibilities and scope of influence of the executive KMP. Individual performance goals account for a 20% weighting for executive KMP based on a range of individual performance objectives including strategic objectives determined each year.</p> <p>80% of STI is based on financial targets set by the Board and having regard to prior year performance, global market conditions, competitive environment, future prospects and the Board approved budgets. The specific targets are not detailed in this report due to their commercial sensitivity.</p> <p>Validation of performance against the measures set for:</p> <ul style="list-style-type: none"> <li>• the CEO/President involves an independent review and endorsement by the Chief Financial Officer (CFO), reviewed and approved by the HRC and Board; and</li> <li>• other executive KMP involves a review by the CEO/President based on inputs from the CFO. Final review is undertaken by the HRC and Board.</li> </ul> <p>Any anomalies or discretionary elements are validated and approved by the Board.</p>
Rewarding performance	<p>The STI performance ratings are determined under a predetermined matrix with the Board determination final.</p>
Mandatory deferral of STI	<p>Effective from 1 July 2013, a mandatory deferral of a portion of STI was introduced to reinforce alignment with shareholder interests. Grants will be calculated at the end of each year based on EBIT, revenue and individual performance outcomes and then held for two years until vesting. This achieves additional retention and alignment of executives with shareholder interests.</p> <p>The deferred STI component for F14 will be calculated based on 30% of the STI cash amount earned and will be delivered as performance rights.</p> <p>The equity component will be independently determined based on the gross contract value using Cochlear's five day volume weighted average price following the announcement of full year results in August 2014, that is, based on a Black-Scholes-Merton pricing model without discounting for service or performance hurdles.</p> <p>Once the STI awarded as performance rights has been granted, there are no further performance measures attached to the performance rights other than continued tenure for the vesting period (two years).</p>

## Directors' Report Cochlear Limited for the year ended 30 June 2014

**Table 1 – Executive KMP STI opportunity and actual F14 STI awarded<sup>1</sup>**

Executive KMP	Position	Target STI as a % of F14 TTR	STI awarded as a % of TTR	Actual cash and deferred STI award in F14 (\$)	Actual STI forfeited in F14 as a % of TTR
Chris Roberts	CEO/President	33.3%	18.1%	760,572	15.2%
Richard Brook	President, European Region <sup>2</sup>	24.5%	21.1%	277,426	3.4%
Jan Janssen	Senior Vice President, Design and Development, Clinical and Regulatory	32.3%	17.7%	198,521	14.6%
Neville Mitchell	CFO and Company Secretary	32.3%	17.7%	244,433	14.6%
Mark Salmon	President, Asia Pacific Region	32.3%	15.9%	204,584	16.4%
Chris Smith	President, Americas Region <sup>2</sup>	31.5%	22.2%	335,718	9.4%

1. Includes the monetary value of STI cash combined with the monetary value of STI deferral.

2. European and US based Regional Presidents' total target remuneration is benchmarked and paid in local currency.

F14 STI payments are similar to those paid in F13 for the KMP. This reflects a number of factors:

- increase in STI target opportunity;
- business performance with EBIT, revenue and individual outcomes resulting in payments within a range between 49.1% – 86.1% of target;
- the patent dispute provision detailed in Note 20 to the financial statements was excluded for the calculation of STI;
- currency fluctuations; and
- momentum built with increased revenues, and careful investment in growth initiatives and cost management and second half guidance met.

### 4.4.2 Long-term incentives (LTI)

The LTI provides an annual opportunity for executive KMP and other selected executives (based on their ability to influence and execute strategy) to receive an equity award deferred for three years, that is intended to align a significant portion of executives' overall remuneration to shareholder value over the longer term. All LTI awards remain at risk and subject to forfeiture or lapse until vesting and must meet or exceed EPS growth rates and/or relative TSR performance hurdles over the vesting period.

Purpose	To align executive KMP remuneration opportunity with shareholder value and provide retention stimulus.			
Types of equity awarded	LTI up to F13 was provided under the Cochlear Executive Long Term Incentive Plan. See section 5.1 for further details. A new plan, the Cochlear Executive Incentive Plan (CEIP), was introduced in July 2013. See section 5.1 for further details. Under the CEIP, selected senior executives are offered options (being an option at a pre-set exercise price to acquire ordinary shares of Cochlear Limited) or performance rights (being a nil exercise price right to fully paid ordinary shares of Cochlear Limited) or a combination of both.			
Time of grant	All equity grants will be made after the AGM each year but based on values determined in August.			
Time restrictions	Equity grants awarded to the CEO/President and other executive KMP are tested against the performance hurdles set, at the end of three financial years. If the performance hurdles are not met at the vesting date, options or performance rights lapse.			
Performance hurdles and vesting schedule	Equity grants to the CEO/President and other executive KMP are in two equal tranches assigned 50% to compound annual growth in EPS and 50% subject to ranking of TSR against the S&P/ASX 100. The performance conditions applying to the latest grant (F14) were as follows:			
	Compound annual growth in EPS (3 years)		Ranking of TSR against S&P/ASX 100 (3 years)	
	Performance	% of equity to vest	Performance	% of equity to vest
	< 10%	0%	< 50th percentile	0%
	10% to 20%	50% to 100% pro-rata	50th to 75th percentile	40% to 100% pro-rata
	> 20%	100%	> 75th percentile	100%

Options and performance rights vest if the time restrictions and relevant performance hurdles are met. The Board must approve any special provisions, in accordance with Company policies, in the event of termination of employment or a change of control. After the three year vesting schedule, any vested options expire after seven months if they have not been exercised.



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Dividends	No dividends are attached to options or performance rights.
Voting rights	There are no voting rights attached to options or performance rights.
Retesting	There is no retesting of performance hurdles under Cochlear LTI.
LTI allocation	<p>The size of individual LTI grants for the CEO/President and other executive KMP is determined in accordance with the Board approved remuneration strategy mix. See section 4.2.</p> <p>The allocation methodology for options and performance rights was changed effective from 1 July 2013. The target LTI dollar value for each executive is converted to options and/or performance rights according to new LTI allocation values and is independently determined based on the gross contract value of the relevant equity instrument and based on a Black-Scholes-Merton pricing model without discounting for service or EPS and TSR performance hurdles:</p> <ul style="list-style-type: none"> <li>• performance option allocation = LTI dollar value/Black-Scholes-Merton value before service or EPS and TSR performance discounts; and/or</li> <li>• performance right allocation = LTI dollar value/Black-Scholes-Merton value before service or EPS and TSR performance discounts.</li> </ul>

**Table 2 – Vesting outcomes (performance shares and options granted F10 to F12)**

### Performance shares

Grant date	Vesting timeframe	EPS 3 year CAGR <sup>1</sup>	% vested <sup>2</sup>	% forfeited	Relative 3 year TSR ranking percentile	% vested <sup>2</sup>	% forfeited	Market price on vesting date
17-Aug-09	Vested June 2012	-24.6%	0.0%	100.0%	65th	79.3%	20.7%	\$64.40
16-Aug-10	Vested June 2013	-5.5%	0.0%	100.0%	28th	0.0%	100.0%	N/A
15-Aug-11	Vested June 2014	-19.7%	0.0%	100.0%	32nd	0.0%	100.0%	N/A

### Options

Grant date	Vesting timeframe	Exercise price	EPS 3 year CAGR <sup>1</sup>	% vested <sup>2</sup>	% forfeited	Relative 3 year TSR ranking percentile	% vested <sup>2</sup>	% forfeited	Net market value at vesting
17-Aug-09	Vested June 2012	\$60.04	-24.6%	0.0%	100.0%	65th	79.3%	20.7%	\$4.36
16-Aug-10	Vested June 2013	\$69.80	-5.5%	0.0%	100.0%	28th	0.0%	100.0%	N/A
15-Aug-11	Vested June 2014	\$68.56	-19.7%	0.0%	100.0%	32nd	0.0%	100.0%	N/A

1. Compound annual growth rate.

2. All plan participants had the same vesting and forfeiture percentage outcome.

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### 4.5 Other remuneration elements and disclosures relevant to executive KMP

#### 4.5.1 Clawback

Cochlear implemented a clawback policy to take effect from 1 July 2014 to ensure compliance with ASX requirements. There have been no circumstances where the policy would have applied.

#### 4.5.2 Hedging and margin lending prohibition

Under the Cochlear Trading Policy and in accordance with the Corporations Act, equity granted under Cochlear equity incentive schemes must remain at risk until vested, or until exercised if options or performance rights. It is a specific condition of grant that no schemes are entered into, by an individual or their associates that specifically protect the unvested value of performance shares, options or performance rights allocated.

Cochlear also prohibits the CEO/President or 'Designated Persons' (including other executive KMP) providing Cochlear securities in connection with a margin loan or similar financing arrangement unless that person has received a specific notice of no objection in compliance with the policy.

Cochlear, in line with good corporate governance, has a formal policy setting down how and when employees of Cochlear may deal in Cochlear securities.

Cochlear's Trading Policy is available on the Cochlear website [www.cochlear.com](http://www.cochlear.com) under Investor Centre, corporate governance.

#### 4.5.3 Cessation of employment provisions

The provisions that apply for STI and LTI awards in the case of cessation of employment are detailed in sections 6.1 (Service contracts) and 6.2 (Employment agreements).

#### 4.5.4 Conditions of LTI grants

The conditions under which LTI (performance rights and options) are granted, and are approved by the Board in accordance with the relevant scheme rules, are as summarised in section 5.

#### 4.5.5 Minimum shareholding guidelines

The purpose of the Cochlear NED and executive share ownership guidelines is to ensure appropriate alignment of the interests of Cochlear's KMP with the financial interests of Cochlear's shareholders.

The guidelines aim to create a share ownership focus and culture and to build long-term commitment to the Company by providing direction to KMP as to minimum levels of share ownership.

Each executive KMP should hold Cochlear Limited shares or vested options to an amount that is equivalent to the prior year's TFR, or one time's base fees for NEDs, based on the 365 day average Cochlear Limited share price for the prior year.

The guidelines were introduced in March 2007 and all executive KMP were expected to acquire the relevant number of shares over three years from implementation of the guidelines. As at 30 June 2014, all executive KMP were in compliance with the guidelines.

### 4.6 Relationship between Cochlear performance and executive KMP remuneration

#### 4.6.1 Cochlear financial performance (F10 to F14)

	F10	F11	F12	F13	F14
Sales revenue (\$million)	696.2	732.2	704.6	715.0	820.9
EBIT (\$million)	220.5	242.7	76.5	178.9	127.1
NPAT (\$million)	155.2	180.1	56.8	132.6	93.7
Basic EPS (cents)	275.7	318.2	100.0	233.0	164.6
Total dividend per share (cents)	200.0	225.0	245.0	252.0	254.0
Share price as at 30 June (\$)	74.32	72.00	65.84	61.71	61.70

For further explanation of details on Cochlear performance, see the Principal activities and review of operations and results section of the Directors' Report on pages 23 to 30.

## Directors' Report Cochlear Limited for the year ended 30 June 2014

### 4.6.2 Cochlear current year performance and relationship to executive KMP remuneration

Cochlear sales grew 15% year on year with second half sales revenue up 28% on the corresponding period last year. New product launches combined with investments in market growth initiatives drove this growth. In F14, a provision of \$22.5 million was expensed in relation to the patent dispute lawsuit. A loss of \$16.0 million (F13 profit of \$37.7 million) was made on foreign exchange contracts. Earnings per share in F14 of 164.6 cents was 29% below F13.

The Board evaluates STI each six months and considers the mix of components and targets to ensure they remain focused but sensitive to market challenges.

The STI payouts to KMP this year ranged from 49.1% to 54.9% of their opportunity, with the exception of the President of the Americas Region and the President of the European Region who earned 70.3% and 86.1% of their opportunity respectively. This reflects the relatively stronger bone anchored solutions and European regional performance in F14 as explained in the Principal activities and review of operations and results section.

The executive KMP again performed at expectations with respect to their personal objectives.

The Board believes that the payout ratios on STI in F14 fairly reflected individual, business and Cochlear performance expectations and that overall executive KMP remuneration remain aligned to Company performance.

### 4.6.3 Cochlear EPS and TSR performance (F10 to F14) and relationship to executive KMP remuneration

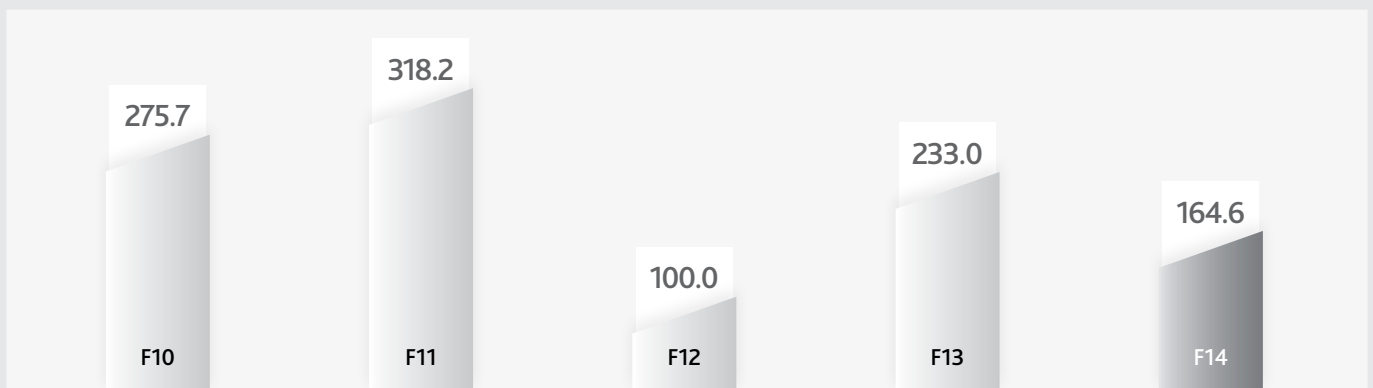
As explained in section 4.1, Cochlear's remuneration framework aims to incentivise executive KMP towards long-term sustainable growth of the business internationally and the creation of shareholder value in the short, medium and long term. This is developed in two ways:

- cash (and equity) STI, whether paid immediately or deferred, depend on revenue and EBIT performance and outcomes for the completed performance year (as explained in section 4.4.1); and
- LTI, in the form of options and performance rights, are linked to compound annual growth in EPS and relative TSR performance (as explained in section 4.4.2).

EPS (internal) and relative TSR (external) are generally accepted proxies for creation of shareholder value. It is the Board's intention to review the suitability of these performance criteria and settings on a regular basis to ensure they best serve shareholders' interests.

#### Earnings per share (EPS)

Cochlear's basic EPS over the last five years is displayed in the graph below:



For more information, see the Directors' Report.

The table below illustrates Cochlear's compound annual growth in basic EPS in respect of performance for grants from F10 to F12:

Grant date	Compound annual EPS growth					EPS vesting performance
	F10	F11	F12	F13	F14	
17-Aug-09	18.0%	16.7%	-24.6%			0.0%
16-Aug-10		15.4%	-39.8%	-5.5%		0.0%
15-Aug-11			-68.6%	-14.4%	-19.7%	0.0%

Refer the Principal activities and review of operations and results section of the Directors' Report on pages 23 to 30 for details on the performance of Cochlear.

As a result of Cochlear underachieving the EPS growth targets set, none of the 2011 equity grants vested.

## Directors' Report Cochlear Limited for the year ended 30 June 2014

### Total shareholder return (TSR) – unaudited

Cochlear's relative TSR performance over the relevant performance periods up to 30 June 2014 in respect of vested equity grants is set out below. This information is unaudited.

Grant date	Relative 3 year TSR percentile ranking	TSR vesting performance
17-Aug-09	65th	79.3%
16-Aug-10	28th	0.0%
15-Aug-11	32nd	0.0%

TSR is a function of share price growth and dividends reinvested. However, Cochlear's performance over time, is affected by a range of variables, including currency volatility, global economic and geopolitical conditions, market growth for its products and other competitive pressures.

Cochlear did not meet the minimum threshold of TSR performance for the 2011 equity grants, so none of the 2011 equity grants vested.

### 4.7 Executive remuneration table – audited statutory disclosure (accounting cost to Cochlear)

	Year	Fixed remuneration				Variable remuneration				Total		Proportion of total remuneration		
		Short-term		Other employment costs		Short-term <sup>2</sup>		Long-term <sup>4,5</sup>		Total		Performance related		
Amounts \$				Total				Long-term <sup>4,5</sup>		Total		Equity related		
Name		Salary	Non-monetary benefits <sup>1</sup>	Super-annuation benefits	Long service leave	Bonus	Deferred STI <sup>3</sup>	Value of options	Value of performance shares/rights			%	%	
Chris Roberts <sup>6</sup>	F14	1,384,305	-	17,775	40,218	1,442,298	585,055	58,506	767,593	-	1,411,154	2,853,452	49.5%	29.0%
	F13	1,349,920	-	16,470	36,468	1,402,858	701,125	-	538,118	-	1,239,243	2,642,101	46.9%	20.4%
Richard Brook <sup>7</sup>	F14	550,499	77,685	90,433	-	718,617	213,405	21,340	126,994	27,480	389,219	1,107,836	35.1%	15.9%
	F13	461,027	65,909	77,526	-	604,462	166,468	-	123,627	-	290,095	894,557	32.4%	13.8%
Jan Janssen	F14	487,444	-	17,775	17,165	522,384	152,708	15,271	82,980	71,230	322,189	844,573	38.1%	20.1%
	F13	473,605	-	16,470	40,906	530,981	136,314	-	79,450	36,435	252,199	783,180	32.2%	14.8%
Neville Mitchell <sup>8</sup>	F14	524,363	-	129,280	15,001	668,644	188,025	18,803	90,228	103,626	400,682	1,069,326	37.5%	19.9%
	F13	507,936	-	134,724	17,895	660,555	168,523	-	72,697	78,284	319,504	980,059	32.6%	15.4%
Mark Salmon <sup>9</sup>	F14	567,844	-	17,775	28,534	614,153	157,372	15,737	64,668	131,483	369,260	983,413	37.5%	21.5%
	F13	550,889	-	16,470	(540)	566,819	216,151	-	50,833	102,536	369,520	936,339	39.5%	16.4%
Chris Smith <sup>10</sup>	F14	670,243	22,264	13,562	-	706,069	258,245	25,824	140,147	59,964	484,180	1,190,249	40.7%	19.0%
	F13	540,868	20,708	12,235	-	573,811	132,934	-	138,301	11,954	283,189	857,000	33.0%	17.5%
<b>Total</b>	<b>F14</b>	<b>4,184,698</b>	<b>99,949</b>	<b>286,600</b>	<b>100,918</b>	<b>4,672,165</b>	<b>1,554,810</b>	<b>155,481</b>	<b>1,272,610</b>	<b>393,783</b>	<b>3,376,684</b>	<b>8,048,849</b>	<b>42.0%</b>	<b>22.6%</b>
<b>Total</b>	<b>F13</b>	<b>3,884,245</b>	<b>86,617</b>	<b>273,895</b>	<b>94,729</b>	<b>4,339,486</b>	<b>1,521,515</b>	<b>-</b>	<b>1,003,026</b>	<b>229,209</b>	<b>2,753,750</b>	<b>7,093,236</b>	<b>38.8%</b>	<b>17.4%</b>

1. Benefits include the provision of pension plans, car allowances, health insurance, and relocation costs which are market based payments.

2. Short-term and long-term incentive bonuses are awarded annually. The service and performance criteria are set out in this report. See section 4.4.1 Table 1 for more detail on F14 STI payments delivery. For F14, STI paid represent 49.1% to 54.9% of executive KMP opportunity, with the exceptions of the President of the Americas Region and the President of the European Region who earned 70.3% and 86.1% of their opportunity respectively.

3. Deferred STI is 'invested' in performance rights and deferred for two years. The cost of the plan is expensed across three years, and this amount represents the portion of F14 STI deferral expensed in F14.

4. The value of options and performance shares/rights is calculated at the date of grant using the Black-Scholes-Merton pricing model discounted for vesting probabilities of performance criteria. The value of options and performance shares/rights is allocated to each reporting period evenly over the period from grant date to vesting date. The amount expensed each reporting period includes adjustments to the life-to-date expense of grants based on the reassessed estimate of achieving non-market performance criteria and final vesting amounts for the non-market performance criteria options and performance shares/rights.

The value disclosed above is the portion of the value of the options and performance shares/rights recognised as an expense in the financial year. The ability to exercise the options and performance shares/rights is conditional on Cochlear achieving certain performance hurdles. Further details of options and performance rights granted during the financial year are set out in this report.

5. The total value of options and performance shares/rights recognised in the current financial year for each executive KMP is higher than in the previous financial year due to a change in assumptions on discounts used for vesting probabilities related to plans that are yet to vest.

6. Chris Roberts is an executive director.

7. Year on year increases in fixed remuneration are largely attributable to currency fluctuations.

8. CFO remains on a defined contribution superannuation plan based on a fixed percentage of salary.

9. Total remuneration increase reflects a 3% base increase and increased long service leave accrual.

10. Year on year increases in fixed remuneration are attributable to currency fluctuation and market based salary increase.

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### 4.8 Executive remuneration table – unaudited

This table represents the value to the executive of cash paid and vested equity awards (intrinsic value) received during the year and unvested equity awards (IFRS-2 value) granted during the financial year, at risk. The LTI equity granted is a value determined under IFRS-2 which may or may not vest depending on future outcomes that are uncertain. Accordingly, this table incorporates data that could represent the accumulation of outcomes arising from multiple years.

Amounts \$	Year	Fixed remuneration and cash incentives received			Past at risk remuneration received during year		Actual remuneration received	Future at risk remuneration received		
		Fixed remuneration <sup>1</sup>	Incentives <sup>2</sup>	Total cash	Intrinsic value of vested options <sup>3</sup>	Intrinsic value of vested performance shares <sup>3</sup>		Incentives (deferred as cash) <sup>4</sup>	Deferred STI	LTI (equity) granted during year <sup>5</sup>
Chris Roberts	F14	1,402,080	509,264	1,911,344	-	-	1,911,344	375,483	175,517	1,030,699
	F13	1,366,390	780,312	2,146,702	38,802	-	2,185,504	299,692	-	1,026,353
Richard Brook	F14	718,617	167,620	886,237	-	-	886,237	130,730	64,021	170,649
	F13	604,462	162,124	766,586	13,019	-	779,605	84,945	-	184,030
Jan Janssen	F14	505,219	114,439	619,658	-	-	619,658	97,871	45,813	156,874
	F13	490,075	148,124	638,199	9,507	-	647,706	59,602	-	196,030
Neville Mitchell	F14	653,643	141,000	794,643	-	-	794,643	120,615	56,408	204,133
	F13	642,660	183,638	826,298	13,697	-	839,995	73,590	-	242,593
Mark Salmon	F14	585,619	160,541	746,160	-	-	746,160	112,690	47,212	185,579
	F13	567,359	192,616	759,975	12,809	-	772,784	115,859	-	254,190
Chris Smith	F14	706,069	161,941	868,010	-	-	868,010	148,052	77,473	222,477
	F13	573,811	160,574	734,385	14,818	-	749,203	51,748	-	250,102
<b>Total</b>	<b>F14</b>	<b>4,571,247</b>	<b>1,254,805</b>	<b>5,826,052</b>	<b>-</b>	<b>-</b>	<b>5,826,052</b>	<b>985,441</b>	<b>466,444</b>	<b>1,970,411</b>
Total	F13	4,244,757	1,627,388	5,872,145	102,652	-	5,974,797	685,436	-	2,153,298

1. Represents the value of base salary, non-monetary benefits and superannuation received during the year (excludes the accrued value of long service leave).

2. Represents STI payments received during the financial year. For example, F14 data includes F13 second half-year STI and F14 first-half year STI payments.

3. Reflects the intrinsic value of vested employee share scheme benefits at the end of the financial year.

4. Reflects STI payments related to the current financial year but paid in future years. For example, F14 data includes the F14 second-half year STI payment scheduled for payment during F15.

5. Represents the value of equity grants (options and/or performance rights) calculated at the date of grant using the Black-Scholes-Merton pricing model discounted for vesting probabilities of performance criteria. These grants were awarded during the year, are unvested and will be subject to achievement of future performance hurdles.



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### 5.0 Employee share scheme and other share information

This section provides:

1. a description of the employee share schemes (ESS) Cochlear uses to provide equity rewards to Cochlear employees;
2. disclosures required in relation to ESS grants provided to executive KMP;
3. disclosures required about ESS instruments that Cochlear has issued;
4. disclosures required in relation to Cochlear Limited shares and other ESS instruments held by executive KMP;
5. Cochlear's share ownership guidelines; and
6. Cochlear's Trading Policy.

### 5.1 Employee share schemes operated by Cochlear

Plan details	Type of instruments	Details	Purpose
Cochlear Employee Share Plan (CESP) Date established: 1999	Ordinary shares	Issue of ordinary shares annually to eligible employees.	The purpose of the CESP is to encourage general employee equity participation through tax concessional legislation which currently facilitates tax effective issues of up to \$1,000 worth of shares annually per eligible employee. Under the 2013 (FY14) grant, 1,318 employees each received an award of 16 shares under the plan. Executive KMP and other executives rewarded under the Cochlear Executive Long Term Incentive Plan or the Cochlear Executive Incentive Plan are not eligible for this program.
Cochlear Executive Long Term Incentive Plan (CELTIP) Date established: 2003 AGM	Ordinary shares (options and/or performance shares)	A long-term performance incentive scheme designed to reward participants for achieving market competitive EPS growth and relative TSR, as approved. Participants receive options and/or performance shares based on a predetermined formula.	The purpose of the CELTIP is to encourage employees and executives of Cochlear to receive performance shares or performance options. Vesting of performance shares and performance options occurs only if Cochlear achieves challenging and market competitive EPS growth and relative TSR hurdles. Target allocations are made based on seniority, the ascribed LTI remuneration value and a value formula approved by shareholders in 2003.
Cochlear Executive Incentive Plan (CEIP) Date established: July 2013	Awards consisting of ordinary shares; performance rights; options; and/or share appreciation rights	A performance incentive scheme designed to reward participants for achieving market competitive business outcomes. Participants receive an award based on a predetermined formula, as approved by the Board from time to time based on market standards and trends.	The purpose of the CEIP is to develop the principles established with the CELTIP but to create greater flexibility in award structure to cater for Cochlear's expanding geography and to meet changing market standards and expectations. The offer terms for CEIP awards will be flexible but will meet contemporary LTI design standards. The first grant of options and performance rights under this plan was made on 15 October 2013. Also refer section 4.4.2.

## Directors' Report Cochlear Limited for the year ended 30 June 2014

### 5.2 Employee share scheme grants to executive KMP

#### 5.2.1 Analysis of share based payments granted as remuneration

Details of vesting profile of the options and performance shares/rights granted as remuneration to each executive KMP are set out below:

	Grant date	Options				Performance shares/rights <sup>3</sup>			
		Number granted	Number vested	Number forfeited/lapsed <sup>1</sup>	Market value of exercised options (\$) <sup>2</sup>	Number granted	Number vested	Number forfeited/lapsed	Market value of vested shares (\$) <sup>4</sup>
Chris Roberts	17-Aug-09	58,599	23,235	58,599	-	-	-	-	-
	16-Aug-10	86,272	-	86,272	-	-	-	-	-
	15-Aug-11	117,620	-	-	-	-	-	-	-
	13-Aug-12	231,161	-	-	-	-	-	-	-
	15-Oct-13	123,023	-	-	-	-	-	-	-
	<b>Total</b>	<b>616,675</b>	<b>23,235</b>	<b>144,871</b>	-	-	-	-	-
Richard Brook	17-Aug-09	19,663	7,796	19,663	-	-	-	-	-
	16-Aug-10	17,674	-	17,674	-	-	-	-	-
	15-Aug-11	23,495	-	-	-	-	-	-	-
	13-Aug-12	41,448	-	-	-	-	-	-	-
	15-Oct-13	7,249	-	-	-	3,617	-	-	-
	<b>Total</b>	<b>109,529</b>	<b>7,796</b>	<b>37,337</b>	-	<b>3,617</b>	-	-	-
Jan Janssen	17-Aug-09	14,358	5,693	14,358	-	-	-	-	-
	16-Aug-10	17,559	-	17,559	-	-	-	-	-
	15-Aug-11	11,128	-	-	-	2,234	-	-	-
	13-Aug-12	26,491	-	-	-	2,473	-	-	-
	15-Oct-13	6,664	-	-	-	3,325	-	-	-
	<b>Total</b>	<b>76,200</b>	<b>5,693</b>	<b>31,917</b>	-	<b>8,032</b>	-	-	-
Neville Mitchell	17-Aug-09	20,686	8,202	12,484	-	-	-	-	-
	16-Aug-10	21,302	-	21,302	-	-	-	-	-
	15-Aug-11	27,538	-	-	-	-	-	-	-
	13-Aug-12	10,928	-	-	-	6,120	-	-	-
	15-Oct-13	13,723	-	-	-	2,934	-	-	-
	<b>Total</b>	<b>94,177</b>	<b>8,202</b>	<b>33,786</b>	-	<b>9,054</b>	-	-	-
Mark Salmon	17-Aug-09	19,344	7,670	11,674	-	-	-	-	-
	16-Aug-10	22,363	-	22,363	-	-	-	-	-
	15-Aug-11	28,859	-	-	-	-	-	-	-
	13-Aug-12	-	-	-	-	8,016	-	-	-
	15-Oct-13	10,239	-	-	-	3,284	-	-	-
	<b>Total</b>	<b>80,805</b>	<b>7,670</b>	<b>34,037</b>	-	<b>11,300</b>	-	-	-
Chris Smith	17-Aug-09	22,379	8,873	22,379	-	-	-	-	-
	16-Aug-10	-	-	-	-	5,781	-	5,781	-
	15-Aug-11	20,823	-	-	-	1,045	-	-	-
	13-Aug-12	45,063	-	-	-	1,577	-	-	-
	15-Oct-13	14,955	-	-	-	3,198	-	-	-
	<b>Total</b>	<b>103,220</b>	<b>8,873</b>	<b>22,379</b>	-	<b>11,601</b>	-	<b>5,781</b>	-

- For the F10 grant, this column includes options that were forfeited due to not having met performance hurdles and options that vested that were not exercised and subsequently lapsed.
- The market value of exercised options calculated as at the closing market price of shares of the Company on the ASX on the date of exercise less the applicable exercise price times the number of options.
- Under grants made under CELTIP from 2009 to 2012, participants could elect to receive options or performance shares, so all holdings referred to under "Performance shares/rights" granted from 2009 to 2012 represent performance shares. Under the CEIP, participants could elect to receive options or performance rights, so all holdings referred to under "Performance shares/rights" granted in 2013 represent performance rights.
- The market value of vested performance shares calculated as at the closing market price of shares of the Company on the ASX on the date of vesting times the number of performance shares.

## Directors' Report Cochlear Limited for the year ended 30 June 2014

The options granted in F14 have an exercise price of \$59.13 and an expiration date of 10 March 2017. The options granted during the year have a fair value (IFRS-2) of \$11.38 at grant date for options with EPS performance based conditions and \$9.93 at grant date for options with TSR based conditions. The performance rights granted during the financial year had a fair value (IFRS-2) at grant date of \$53.22 for performance rights with EPS performance based conditions and \$28.85 at grant date for performance rights with TSR based conditions.

### 5.2.2 Exercise of options and performance shares/rights granted as remuneration

During F14, no options were exercised by the CEO/President or by other executive KMP. Those executives with vested options remaining from the F10 CELTIP grant were unable to exercise them due to market conditions, and the F11 CELTIP grant did not meet the performance hurdles so there was no vesting from this grant.

There are no amounts unpaid on the shares issued as a result of the exercise of the options in prior years.

### 5.2.3 Analysis of movement in options and shares

The movement in number and value during the financial year of options over ordinary shares of Cochlear Limited acquired under the CELTIP and CEIP held by executive KMP is detailed below:

	Opening value		Granted in year		Exercised in year		Forfeited/lapsed in year		Closing value	
	Number	Value (\$)¹	Number	Value (\$)²	Number	Value (\$)³	Number	Value (\$)⁴	Number	Intrinsic value (\$)⁵
Chris Roberts	458,288	3,022,568	123,023	1,030,699	-	-	109,507	1,280,015	471,804	316,169
Richard Brook	90,413	769,505	7,249	60,733	-	-	25,470	291,167	72,192	18,630
Jan Janssen	60,871	535,382	6,664	55,832	-	-	23,252	269,711	44,283	17,126
Neville Mitchell	59,768	607,332	13,723	114,973	-	-	21,302	261,373	52,189	35,268
Mark Salmon	51,222	571,647	10,239	85,783	-	-	22,363	274,391	39,098	26,314
Chris Smith	74,759	556,004	14,955	125,294	-	-	8,873	84,575	80,841	38,434
<b>Total</b>	<b>795,321</b>	<b>6,062,438</b>	<b>175,853</b>	<b>1,473,314</b>	<b>-</b>	<b>-</b>	<b>210,767</b>	<b>2,461,232</b>	<b>760,407</b>	<b>451,941</b>

The movement in number and value during the financial year of performance shares/rights acquired under the CELTIP and CEIP held by executive KMP is detailed below:

	Opening value		Granted in year		Exercised in year		Forfeited/lapsed in year		Closing value	
	Number	Value (\$)¹	Number	Value (\$)²	Number	Value (\$)³	Number	Value (\$)⁴	Number	Intrinsic value (\$)⁵
Chris Roberts	-	-	-	-	-	-	-	-	-	-
Richard Brook	-	-	3,617	109,916	-	-	-	-	3,617	223,169
Jan Janssen	4,707	215,217	3,325	101,042	-	-	-	-	8,032	495,574
Neville Mitchell	6,120	249,027	2,934	89,160	-	-	-	-	9,054	558,632
Mark Salmon	8,016	326,177	3,284	99,796	-	-	-	-	11,300	697,210
Chris Smith	8,403	414,055	3,198	97,183	-	-	5,781	296,284	5,820	359,094
<b>Total</b>	<b>27,246</b>	<b>1,204,476</b>	<b>16,358</b>	<b>497,097</b>	<b>-</b>	<b>-</b>	<b>5,781</b>	<b>296,284</b>	<b>37,823</b>	<b>2,333,679</b>

- The value derived under IFRS-2 of remaining options and performance shares granted but not yet forfeited, lapsed or exercised at the beginning of the financial year is the value of the options and performance shares calculated at grant date using the Black-Scholes-Merton pricing model and discounted for vesting probabilities of performance criteria. The total value of the options and performance shares granted is included in the table above.
- The value derived under IFRS-2 of options and performance rights granted during the financial year is the value of the options and performance rights calculated at grant date using the Black-Scholes-Merton pricing model and discounted for vesting probabilities of performance criteria. The total value of the options and rights granted is included in the table above. This amount is allocated to remuneration over the vesting period (i.e. in each of F14 to F16).
- The calculated value of options exercised during the year is calculated as the market price of shares of the Company on the ASX as at close of trading on the date the options were exercised after deducting the price paid or payable to exercise the option.
- Value is calculated under IFRS-2 on date of grant.
- The intrinsic value of options and performance shares/rights calculated as at the closing market price of shares of the Company on the ASX on 30 June 2014 less the applicable exercise price times the number of options (negative values are treated as zero in the totals) and performance shares/rights as at the closing market price of shares of the Company on the ASX on 30 June 2014.

## Directors' Report Cochlear Limited for the year ended 30 June 2014

### 5.3 Potential dilution if options vest and ordinary shares issued – unaudited

At the date of this report, the number of ordinary shares that would be issued if all options were vested, having met the service and performance conditions, and exercised and assuming ordinary shares were issued, is as follows:

Grant date	Number of options				Exercise price per share (\$)	Exercise period	Current net value of outstanding options as at 30 June 2014 (\$) <sup>1</sup>
	Issued	Exercised	Forfeited/ lapsed	At report date			
17-Aug-09 <sup>2</sup>	85,674	-	85,674	-	60.04	Aug-12 to 30-Jun-14	-
16-Aug-10 <sup>3</sup>	399,869	-	399,869	-	69.80	Aug-13 to 30-Jun-15	-
15-Aug-11 <sup>4</sup>	517,065	-	32,178	484,887	68.56	Aug-14 to 30-Jun-16	-
13-Aug-12 <sup>4</sup>	735,392	-	28,265	707,127	62.78	Aug-15 to 30-Jun-17	-
15-Oct-13	224,314	-	-	224,314	59.13	Aug-16 to 10-Mar-17	576,487
<b>Total</b>	<b>1,962,314</b>	<b>-</b>	<b>545,986</b>	<b>1,416,328</b>			<b>576,487</b>

1. Price as at 30 June 2014 was \$61.70. The exercise price for options granted in F12 and F13 was above the market price as at 30 June 2014.

2. Lapsed options from the F10 grant relate to vested options that were not exercised and expired.

3. No options from the F11 grant vested.

4. Lapsed options from unvested grants (granted in F12 and F13) relate to plan members who have departed Cochlear.

### 5.4 KMP equity interests – unaudited

In accordance with the Corporations Act (section 205G(1)), Cochlear is required to notify the interests (shares and rights to shares) of directors to the ASX.

In the interests of transparency and completeness of disclosure, this information is provided for each NED (as required under the Corporations Act) and all executive KMP as well.

Please refer sections 4.5.2 (Hedging and margin lending prohibition) and 4.5.5 (Minimum shareholding guidelines).

The table below indicates Cochlear Limited shareholding:

NEDs	Held at 1 July 2013	Purchases	Sales	Cochlear Limited ordinary shares as at 30 June 2014	Total intrinsic value of Cochlear Limited securities as at year end (\$) <sup>3</sup>
Rick Holliday-Smith	9,250	-	-	9,250	570,725
Yasmin Allen	2,950	-	-	2,950	182,015
Paul Bell	3,000	-	-	3,000	185,100
Edward Byrne	3,250	-	-	3,250	200,525
Andrew Denver	4,000	-	-	4,000	246,800
Donal O'Dwyer	5,000	1,000	-	6,000	370,200
<b>Total NEDs</b>	<b>27,450</b>	<b>1,000</b>	<b>-</b>	<b>28,450</b>	<b>1,755,365</b>

## Directors' Report Cochlear Limited for the year ended 30 June 2014

The table below indicates Cochlear Limited shareholding including any vested but unexercised options and performance shares:

Executive KMP	Held at 1 July 2013	Purchases	Received on exercise of options and performance shares	Sales	Cochlear Limited ordinary shares as at 30 June 2014	Vested options over Cochlear Limited ordinary shares <sup>1</sup>	Vested performance shares over Cochlear Limited ordinary shares <sup>2</sup>	Total intrinsic value of Cochlear Limited securities as at year end (\$) <sup>3</sup>
<b>Executive director</b>								
Chris Roberts	719,803	-	-	-	719,803	-	-	44,411,845
<b>Other executives</b>								
Richard Brook	7,700	-	-	-	7,700	-	-	475,090
Jan Janssen	13,328	3,500	-	(10,930)	5,898	-	-	363,907
Neville Mitchell	10,000	-	-	-	10,000	-	-	617,000
Mark Salmon	7,240	908	-	-	8,148	-	-	502,732
Chris Smith	10,000	-	-	-	10,000	-	-	617,000
<b>Total executive KMP</b>	<b>768,071</b>	<b>4,408</b>	<b>-</b>	<b>(10,930)</b>	<b>761,549</b>	<b>-</b>	<b>-</b>	<b>46,987,574</b>

1. The number of vested but unexercised options.

2. The number of vested but unexercised performance shares.

3. The intrinsic value of Cochlear Limited ordinary shares and vested performance shares as at the closing Cochlear Limited share price on the ASX on 30 June 2014, plus the intrinsic value of vested options calculated as at the closing Cochlear Limited share price on the ASX on 30 June 2014 less the applicable exercise price times the number of options (negative values are treated as zero in the totals). Please note the share ownership guidelines apply an average share price to NEDs' and executive KMP's holdings, not intrinsic value at year end.

The table below indicates any unvested options and performance shares/rights issued to executive KMP but still subject to performance hurdles:

	Unvested options over Cochlear Limited ordinary shares <sup>1</sup>	Unvested performance shares/rights over Cochlear Limited ordinary shares <sup>2</sup>	Total intrinsic value of unvested options and performance shares/rights as at year end (\$) <sup>3</sup>
<b>Executive director</b>			
Chris Roberts	471,804	-	316,169
<b>Other executives</b>			
Richard Brook	72,192	3,617	241,799
Jan Janssen	44,283	8,032	512,700
Neville Mitchell	52,189	9,054	593,900
Mark Salmon	39,098	11,300	723,524
Chris Smith	80,841	5,820	397,528
<b>Total executive KMP</b>	<b>760,407</b>	<b>37,823</b>	<b>2,785,620</b>

1. The number of unvested options.

2. The number of unvested performance shares/rights.

3. The intrinsic value of unvested performance shares/rights as at the closing Cochlear Limited share price on the ASX on 30 June 2014 and the intrinsic value of unvested options calculated as at the closing Cochlear Limited share price on the ASX on 30 June 2014 less the applicable exercise price times the number of options (negative values are treated as zero in the totals).

### 6.0 Service contracts and employment agreements – audited

#### 6.1 Service contracts

Cochlear does not enter into service contracts for executive KMP, other than the CEO/President.

The following sets out details of the service contract terms for the current CEO/President, Dr Roberts:

Length of contract	Dr Roberts is on a permanent contract, which is an ongoing employment contract until notice is given by either party.
Notice periods	In order to terminate the employment arrangements, Dr Roberts is required to provide Cochlear with six months' written notice. Cochlear must provide Dr Roberts with 12 months' written notice.
Termination on notice by Cochlear	Cochlear may terminate employment by providing six months' written notice or payment in lieu of the notice period based on total fixed remuneration (TFR). On termination on notice by Cochlear, unless the Board determines otherwise Dr Roberts shall receive: <ul style="list-style-type: none"> <li>• payment equivalent to 12 months' TFR;</li> <li>• pro-rated STI benefits for the months of service in the financial year to which the plan relates; and</li> <li>• if determined by the Board, in its sole discretion, the entitlements (if any) to LTI benefits.</li> </ul>



## Directors' Report Cochlear Limited for the year ended 30 June 2014

Death or total and permanent disability	<p>If Cochlear terminates employment for reasons of death or total and permanent disability, a severance payment will be made that is equal to 12 months' TFR.</p> <p>All STI and LTI benefits are either:</p> <ul style="list-style-type: none"> <li>• released in full or on a pro-rata basis; or</li> <li>• remain subject to performance requirements clawback and are released at the original vesting date, at the discretion of the Board with regard to the circumstances.</li> </ul> <p>On death or total and permanent disability, the Board has discretion to allow unvested STI and LTI benefits to vest.</p>
Statutory entitlements	Payment of statutory entitlements of long service leave and annual leave applies in all events of separation.
Post-employment restraints	For a period of 12 months after termination date without the consent of Cochlear for engagement in business competition or to induce Cochlear NEDs or staff to terminate their employment.

### 6.2 Employment agreements

Other executive KMP operate under employment agreements.

The following sets out details of the employment agreements relating to other executive KMP. The terms for all other executive KMP are similar but do, on occasion, vary to suit different needs.

Length of contract	All other executive KMP are on permanent contracts, which is an ongoing employment contract until notice is given by either party.
Notice periods	In order to terminate the employment arrangements, other executive KMP are required to provide Cochlear with between 60 days' and six months' written notice.
Resignation	On resignation, unless the Board determines otherwise: <ul style="list-style-type: none"> <li>• all unvested STI or LTI benefits are forfeited.</li> </ul>
Termination on notice by Cochlear	Cochlear may terminate employment by providing between 60 days' and 12 months' written notice or payment in lieu of the notice period based on TFR. On termination by Cochlear, unless the Board determines otherwise: <ul style="list-style-type: none"> <li>• unvested STI or LTI benefits may be exercised or paid within 30 days of notice being given.</li> </ul>
Redundancy	<p>If Cochlear terminates employment for reasons of redundancy, under Cochlear policy a severance payment will be made of up to 12 months' TFR.</p> <p>All STI and LTI benefits are either:</p> <ul style="list-style-type: none"> <li>• released in full or on a pro-rata basis; or</li> <li>• remain subject to performance criteria and vesting date, at the discretion of the Board with regard to the circumstances.</li> </ul>
Death or total and permanent disability	On death or total and permanent disability, the Board has discretion to allow all unvested STI and LTI benefits to vest.
Termination for serious misconduct	<p>Cochlear may immediately terminate employment at any time in the case of serious misconduct, and other executive KMP will only be entitled to payment of TFR up to the date of termination.</p> <p>On termination without notice by Cochlear in the event of serious misconduct:</p> <ul style="list-style-type: none"> <li>• all unvested STI or LTI benefits will be forfeited; and</li> <li>• any ESS instruments provided to the employee on vesting of STI or LTI awards that are held in trust, will be forfeited.</li> </ul>
Statutory entitlements	Payment of statutory entitlements of long service leave and annual leave applies in all events of separation.
Other arrangements	<p>Richard Brook – President, European Region will receive:</p> <ul style="list-style-type: none"> <li>• a maximum of Swiss francs (CHF) 30,000 for repatriation costs in the case of termination or resignation.</li> </ul>
Post-employment restraints	All other executive KMP are subject to post-employment restraints for up to 12 months.

## Directors' Report Cochlear Limited for the year ended 30 June 2014

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### Indemnification of officers

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

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

### Insurance premiums

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

### Events subsequent to the reporting date

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

### Dividends

For dividends declared after 30 June 2014, see Note 8 to the financial statements.

### Lead auditor's independence declaration

The lead auditor's independence declaration is set out on page 55 and forms part of the Directors' Report for the financial year ended 30 June 2014.

### Rounding off

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

Dated at Sydney this 5th day of August 2014.

Signed in accordance with a resolution of the directors:



Director



Director

## Lead Auditor's Independence Declaration

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### 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 audit for the year ended 30 June 2014 there have been:

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



KPMG

Sydney, 5 August 2014



Cameron Slapp, Partner

## Income Statement Cochlear Limited and its controlled entities for the year ended 30 June 2014

	Note	2014 \$000	2013 \$000
Revenue	4	804,936	752,721
Cost of sales	5(a)	(248,285)	(208,072)
<b>Gross profit</b>		<b>556,651</b>	<b>544,649</b>
Selling and general expenses		(234,711)	(202,781)
Administration expenses		(44,162)	(38,157)
Patent dispute provision	20	(22,545)	-
Research and development expenses		(127,562)	(124,715)
Other income	6	2,532	2,379
Other expenses	5(b)	(3,112)	(2,515)
<b>Results from operating activities</b>		<b>127,091</b>	<b>178,860</b>
Finance income	21(d)	324	659
Finance expense	21(d)	(10,301)	(6,882)
<b>Net finance expense</b>		<b>(9,977)</b>	<b>(6,223)</b>
<b>Profit before income tax</b>		<b>117,114</b>	<b>172,637</b>
Income tax expense	10	(23,405)	(40,074)
<b>Net profit</b>		<b>93,709</b>	<b>132,563</b>
Basic earnings per share (cents)	7	164.6	233.0
Diluted earnings per share (cents)	7	164.2	232.4

The notes on pages 61 to 105 are an integral part of these consolidated financial statements.

## Statement of Comprehensive Income

Cochlear Limited and its controlled entities for the year ended 30 June 2014

	2014 \$000	2013 \$000 Restated*
<b>Net profit</b>	<b>93,709</b>	<b>132,563</b>
<i>Other comprehensive income/(loss)</i>		
Items that will not be reclassified subsequently to the income statement:		
Defined benefit plan actuarial gains/(losses)*	306	(230)
Total items that will not be reclassified subsequently to the income statement	306	(230)
Items that may be reclassified subsequently to the income statement:		
Foreign currency translation differences	2,344	29,179
Effective portion of changes in fair value of cash flow hedges, net of tax	6,007	(21,206)
Net change in fair value of cash flow hedges transferred to the income statement, net of tax	11,149	(26,384)
Total items that may be reclassified subsequently to the income statement	19,500	(18,411)
<b>Other comprehensive income/(loss) for the period, net of tax</b>	<b>19,806</b>	<b>(18,641)</b>
<b>Total comprehensive income</b>	<b>113,515</b>	<b>113,922</b>

\* Restated for change in accounting policy, refer Note 30.

The notes on pages 61 to 105 are an integral part of these consolidated financial statements.



**Balance Sheet** Cochlear Limited and its controlled entities as at 30 June 2014

	Note	2014 \$000	2013 \$000 Restated*
<b>Assets</b>			
Cash and cash equivalents	9(a)	56,127	52,689
Trade and other receivables	16	214,953	203,748
Inventories	17	128,613	131,574
Current tax assets	11	8,600	6,207
Prepayments		12,586	11,004
<b>Total current assets</b>		<b>420,879</b>	<b>405,222</b>
Trade and other receivables	16	5,505	944
Property, plant and equipment	18	75,776	65,898
Intangible assets	19	234,115	235,774
Deferred tax assets*	11	52,761	57,422
<b>Total non-current assets</b>		<b>368,157</b>	<b>360,038</b>
<b>Total assets</b>		<b>789,036</b>	<b>765,260</b>
<b>Liabilities</b>			
Trade and other payables		78,644	81,874
Forward exchange contracts		6,643	14,915
Loans and borrowings	21(c)	3,141	3,309
Current tax liabilities	11	8,442	6,002
Provisions	20	57,557	63,224
Deferred revenue		15,151	22,506
<b>Total current liabilities</b>		<b>169,578</b>	<b>191,830</b>
Forward exchange contracts		2,624	13,242
Loans and borrowings	21(c)	234,274	167,160
Provisions*	20	53,355	38,517
<b>Total non-current liabilities</b>		<b>290,253</b>	<b>218,919</b>
<b>Total liabilities</b>		<b>459,831</b>	<b>410,749</b>
<b>Net assets</b>		<b>329,205</b>	<b>354,511</b>
<b>Equity</b>			
Share capital		144,136	118,788
Reserves		(32,191)	(32,433)
Retained earnings		217,260	268,156
<b>Total equity</b>		<b>329,205</b>	<b>354,511</b>

\* Restated for change in accounting policy, refer Note 30.

The notes on pages 61 to 105 are an integral part of these consolidated financial statements.

## Statement of Changes in Equity

Cochlear Limited and its controlled entities for the year ended 30 June 2014

Amounts \$000	Issued capital	Treasury reserve	Translation reserve	Hedging reserve	Share based payment reserve	Retained earnings Restated*	Total equity Restated*
<b>2013</b>							
Balance at 1 July 2012	125,865	(4,729)	(84,153)	30,910	36,481	278,334	382,708
<i>Total comprehensive income</i>							
Net profit	-	-	-	-	-	132,563	132,563
<i>Other comprehensive (loss)/income</i>							
Defined benefit plan actuarial losses*	-	-	-	-	-	(230)	(230)
Foreign currency translation differences	-	-	29,179	-	-	-	29,179
Effective portion of changes in fair value of cash flow hedges, net of tax	-	-	-	(21,206)	-	-	(21,206)
Net change in fair value of cash flow hedges reclassified to the income statement, net of tax	-	-	-	(26,384)	-	-	(26,384)
<b>Total other comprehensive income/(loss)</b>	-	-	<b>29,179</b>	<b>(47,590)</b>	-	<b>(230)</b>	<b>(18,641)</b>
<b>Total comprehensive income/(loss)</b>	-	-	<b>29,179</b>	<b>(47,590)</b>	-	<b>132,333</b>	<b>113,922</b>
<i>Transactions with owners, recorded directly in equity</i>							
Shares repurchased, net	2,331	(4,679)	-	-	-	-	(2,348)
Share based payment transactions	-	-	-	-	2,740	-	2,740
Dividends to shareholders	-	-	-	-	-	(142,511)	(142,511)
<b>Balance at 30 June 2013</b>	<b>128,196</b>	<b>(9,408)</b>	<b>(54,974)</b>	<b>(16,680)</b>	<b>39,221</b>	<b>268,156</b>	<b>354,511</b>
<b>2014</b>							
Balance at 1 July 2013	128,196	(9,408)	(54,974)	(16,680)	39,221	268,156	354,511
<i>Total comprehensive income</i>							
Net profit	-	-	-	-	-	93,709	93,709
<i>Other comprehensive income</i>							
Defined benefit plan actuarial gains	-	-	-	-	-	306	306
Foreign currency translation differences	-	-	2,344	-	-	-	2,344
Effective portion of changes in fair value of cash flow hedges, net of tax	-	-	-	6,007	-	-	6,007
Net change in fair value of cash flow hedges reclassified to the income statement, net of tax	-	-	-	11,149	-	-	11,149
<b>Total other comprehensive income</b>	-	-	<b>2,344</b>	<b>17,156</b>	-	<b>306</b>	<b>19,806</b>
<b>Total comprehensive income</b>	-	-	<b>2,344</b>	<b>17,156</b>	-	<b>94,015</b>	<b>113,515</b>
<i>Transactions with owners, recorded directly in equity</i>							
Transfer between reserves	24,403	-	-	-	(24,403)	-	-
Treasury shares issued to employees	-	945	-	-	(945)	-	-
Share based payment transactions	-	-	-	-	4,971	-	4,971
Deferred tax recognised in equity	-	-	-	-	1,119	-	1,119
Dividends to shareholders	-	-	-	-	-	(144,911)	(144,911)
<b>Balance at 30 June 2014</b>	<b>152,599</b>	<b>(8,463)</b>	<b>(52,630)</b>	<b>476</b>	<b>19,963</b>	<b>217,260</b>	<b>329,205</b>

\* Restated for change in accounting policy, refer Note 30.

The notes on pages 61 to 105 are an integral part of these consolidated financial statements.

## Statement of Cash Flows

Cochlear Limited and its controlled entities for the year ended 30 June 2014

	Note	2014 \$000	2013 \$000
<b><i>Cash flows from operating activities</i></b>			
Cash receipts from customers		809,039	669,311
Cash paid to suppliers and employees		(665,370)	(555,798)
Grant and other income received		2,532	2,379
Interest received		344	617
Interest paid		(10,558)	(6,967)
Income taxes paid		(24,570)	(39,815)
<b>Net cash provided by operating activities</b>	9(b)	<b>111,417</b>	<b>69,727</b>
<b><i>Cash flows from investing activities</i></b>			
Acquisition of property, plant and equipment		(23,497)	(21,074)
Acquisition of enterprise resource planning system		(6,997)	(14,477)
Acquisition of other intangible assets		(1,452)	(14,868)
<b>Net cash used in investing activities</b>		<b>(31,946)</b>	<b>(50,419)</b>
<b><i>Cash flows from financing activities</i></b>			
Repayments of borrowings		(79,500)	(89,000)
Proceeds from borrowings		146,500	195,000
Shares repurchased, net		-	(2,348)
Dividends paid	8	(144,911)	(142,511)
<b>Net cash used in financing activities</b>		<b>(77,911)</b>	<b>(38,859)</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>		<b>1,560</b>	<b>(19,551)</b>
Cash and cash equivalents, net of overdrafts at 1 July		52,689	68,486
Effect of exchange rate fluctuations on cash held		1,878	3,754
<b>Cash and cash equivalents, net of overdrafts at 30 June</b>	9(a)	<b>56,127</b>	<b>52,689</b>

The notes on pages 61 to 105 are an integral part of these consolidated financial statements.

## Notes to the Financial Statements Cochlear Limited and its controlled entities for the year ended 30 June 2014

### Basis of preparation

This section of the Financial Report sets out the Company's accounting policies that relate to the financial statements as a whole. Where an accounting policy is specific to one note, the policy is described in the note to which it relates.

#### 1. Reporting entity

Cochlear Limited (the Company) is a company domiciled in Australia. The consolidated financial statements of the Company as at and for the year ended 30 June 2014 comprise the Company and its controlled entities (together referred to as Cochlear or the Consolidated Entity). Cochlear is a for-profit entity and operates in the implantable hearing device industry.

#### 2. Basis of preparation

##### (a) Statement of compliance

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

The consolidated financial statements were approved by the Board of directors on 5 August 2014.

##### (b) Basis of measurement

The consolidated financial statements have been prepared on the historical cost basis except for derivative financial instruments which are measured at fair value. The method used to measure the fair value of derivative instruments is discussed further in Note 22.

##### (c) Functional and presentation currency

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

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

##### (d) Foreign currency

###### *Foreign currency transactions*

Transactions in foreign currencies are translated to the respective functional currencies of controlled entities at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated to the functional currency at the foreign exchange rate ruling at that date. Non-monetary assets and liabilities denominated in foreign currencies that are stated at historical cost are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to the functional currency at the foreign exchange rates ruling at the date the fair value was determined.

Foreign exchange differences arising on translation are recognised in the income statement.

###### *Financial statements of foreign operations*

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, generally are translated to the functional currency at foreign exchange rates ruling at the reporting date.

The revenues and expenses of foreign operations are translated to the functional currency at rates approximating the foreign exchange rates ruling at the dates of transactions.

Foreign currency differences arising from translation of controlled entities with a different functional currency to that of the Company are recognised in the foreign currency translation reserve (translation reserve). When a foreign operation is disposed of, in part or in full, the relevant amount of its translation reserve is transferred to the income statement and reported as part of the gain or loss on disposal.

Foreign exchange gains and losses arising from a monetary item receivable from or payable to a foreign operation, the settlement of which is neither planned nor likely in the foreseeable future, are considered to form part of a net investment in a foreign operation and are recognised in other comprehensive income, and presented in the translation reserve in equity.

##### (e) Use of judgements and estimates

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

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

## Notes to the Financial Statements Cochlear Limited and its controlled entities for the year ended 30 June 2014

### 2. Basis of preparation (continued)

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

Information about critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in the consolidated financial statements is included in the following notes:

Note 13 – Employee benefit liabilities

Note 14 – Share based payments

Note 19 – Intangible assets

Note 20 – Provisions

Note 22 – Financial risk management

Note 27 – Contingent liabilities.

#### (f) Basis of consolidation

##### *Controlled entities*

Controlled entities are entities controlled by the Company. The Consolidated Entity controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The financial statements of controlled entities are included in the consolidated financial statements from the date that control commences until the date that control ceases.

##### *Transactions eliminated on consolidation*

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

##### *Special purpose entities*

Cochlear has established special purpose entities (SPEs) for trading and investment purposes. A SPE is consolidated if, based upon an evaluation of the substance of its relationship with Cochlear and the SPE's risks and rewards, Cochlear concludes that it controls the SPE. SPEs controlled by Cochlear were established under terms that impose strict limitations on decision-making powers of the SPE's management.

#### (g) Comparatives

Comparative information is reclassified where appropriate to enhance comparability.

#### (h) Goods and services tax (GST)

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

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

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

## Performance for the year

### 3. Operating segments

An operating segment is a component of Cochlear that engages in business activities from which it may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of Cochlear's other components if separately reported and monitored.

Cochlear has three reportable segments, which are determined on a geographical basis and are the strategic business units of Cochlear. Segment results, assets and liabilities include items directly attributable to a segment, as well as those that can be allocated on a reasonable basis. Unallocated items comprise corporate and other net expenses and corporate and manufacturing assets and liabilities.

Information about each reportable segment is included below. Performance is measured based on segment profit before income tax as included in the internal management reports that are reviewed by Cochlear's CEO/President, who is also the chief operating decision-maker. Segment profit before income tax is used to measure performance as management believes that such information is the most relevant in evaluating the results of each operating segment.

The CEO/President regularly reviews an operating segment's operating results to make decisions about resources to be allocated to the segment and assess its performance, and for which discrete financial information is available.

## Notes to the Financial Statements

Cochlear Limited and its controlled entities for the year ended 30 June 2014

### Information about reportable segments

	Americas		EMEA <sup>(1)</sup>		Asia Pacific		Total	
	2014	2013	2014	2013	2014	2013	2014	2013
	\$000	\$000	\$000	\$000 Restated*	\$000	\$000	\$000	\$000 Restated*
Reportable segment revenue	320,800	284,394	358,459	283,023	141,604	147,613	820,863	715,030
Reportable segment profit before income tax	149,083	134,439	167,182	131,523	43,464	57,672	359,729	323,634
Reportable segment assets*	111,592	111,905	194,073	177,353	81,231	70,146	386,896	359,404
Reportable segment liabilities*	24,029	31,349	39,174	55,325	13,009	12,633	76,212	99,307
<b>Other material items</b>								
Depreciation and amortisation	850	720	1,997	1,672	920	1,020	3,767	3,412
Write-down in value of inventories	310	139	112	141	133	267	555	547
Acquisition of non-current assets	478	1,812	2,547	1,035	568	255	3,593	3,102

(1) Europe, Middle East and Africa.

\* Restated for change in accounting policy, refer Note 30.

### Reconciliations of reportable segment revenues, profit or loss, assets and liabilities and other material items

	2014 \$000	2013 \$000
<b>Revenues</b>		
Reportable segment revenue	820,863	715,030
Foreign exchange (losses)/gains on hedged sales	(15,927)	37,691
<b>Consolidated revenue</b>	<b>804,936</b>	<b>752,721</b>
<b>Profit or loss</b>		
Reportable segment profit before income tax	359,729	323,634
Corporate and other net expenses	(194,166)	(182,465)
Foreign exchange (losses)/gains on hedged sales	(15,927)	37,691
Patent dispute provision	(22,545)	-
Net finance expense	(9,977)	(6,223)
<b>Consolidated profit before income tax</b>	<b>117,114</b>	<b>172,637</b>
<b>Assets</b>		
Reportable segment assets*	386,896	359,404
Unallocated corporate and manufacturing assets	402,140	405,856
<b>Consolidated total assets</b>	<b>789,036</b>	<b>765,260</b>
<b>Liabilities</b>		
Reportable segment liabilities*	76,212	99,307
Unallocated corporate and manufacturing liabilities	383,619	311,442
<b>Consolidated total liabilities</b>	<b>459,831</b>	<b>410,749</b>

\* Restated for change in accounting policy, refer Note 30.

## Notes to the Financial Statements

Cochlear Limited and its controlled entities for the year ended 30 June 2014

### 3. Operating segments (continued)

	Reportable segment total \$000	Corporate and manufacturing total \$000	Consolidated total \$000
<b>2014</b>			
<i>Other material items</i>			
Depreciation and amortisation	3,767	23,088	26,855
Write-down in value of inventories	555	981	1,536
Acquisition of non-current assets	3,593	28,353	31,946
<b>2013</b>			
<i>Other material items</i>			
Depreciation and amortisation	3,412	19,592	23,004
Write-down in value of inventories	547	935	1,482
Acquisition of non-current assets	3,102	34,880	37,982

#### Revenue by product

	2014 \$000	2013 \$000
Cochlear implants	720,762	636,393
Bone anchored hearing aids (Baha)	100,101	78,637
<b>Total</b>	<b>820,863</b>	<b>715,030</b>

4. Revenue	2014 \$000	2013 \$000
Sale of goods before hedging	813,004	708,710
Foreign exchange (losses)/gains on hedged sales	(15,927)	37,691
<b>Revenue from sale of goods</b>	<b>797,077</b>	<b>746,401</b>
Rendering of services	7,859	6,320
<b>Total revenue</b>	<b>804,936</b>	<b>752,721</b>

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

Revenues are recognised at the fair value of the consideration received net of the amount of GST.

The accounting policy for foreign exchange gains/losses arising from hedges of forecast sales transactions is set out in Note 22.



## Notes to the Financial Statements

Cochlear Limited and its controlled entities for the year ended 30 June 2014

5. Expenses	2014 \$000	2013 \$000
<i>(a) Cost of sales</i>		
Carrying amount of inventories recognised as an expense	239,462	202,124
Other	7,287	4,466
Write-down in value of inventories	1,536	1,482
<b>Total cost of sales</b>	<b>248,285</b>	<b>208,072</b>
<i>(b) Other expenses</i>		
Net foreign exchange loss	3,112	2,515
<b>Total other expenses</b>	<b>3,112</b>	<b>2,515</b>
<i>(c) Profit before income tax has been arrived at after charging the following items:</i>		
Operating lease rental expense	20,415	15,485
Loss on disposal of property, plant and equipment	2,611	1,482
<b>6. Other income</b>	<b>2014 \$000</b>	<b>2013 \$000</b>
Grant received or due and receivable	1,378	1,401
Other income	1,154	978
<b>Total other income</b>	<b>2,532</b>	<b>2,379</b>

Other income, including government grants, is recognised on a systematic basis over the years necessary to match it with the related costs for which it is intended to compensate or, if the costs have already been incurred, in the year in which it becomes receivable. The income is deemed to be receivable when the entitlement is confirmed.

## Notes to the Financial Statements Cochlear Limited and its controlled entities for the year ended 30 June 2014

7. Earnings per share	2014	2013
<b>Basic earnings per share</b>		
The calculation of basic earnings per share for the year ended 30 June 2014 was based on net profit attributable to equity holders of the parent entity of \$93,709,000 (2013: \$132,563,000) and a weighted average number of ordinary shares on issue during the year ended 30 June 2014 of 56,930,736 (2013: 56,890,261) calculated as follows:		
Net profit attributable to equity holders of the parent entity	\$93,709,000	\$132,563,000
Weighted average number of ordinary shares (basic):		
Issued ordinary shares at 1 July (number)	56,915,289	56,865,878
Effect of options and performance shares exercised (number)	599	13,619
Effect of shares issued under Employee Share Plan (number)	14,848	10,764
<b>Weighted average number of ordinary shares (basic) at 30 June</b>	<b>56,930,736</b>	<b>56,890,261</b>
<b>Basic earnings per share (cents)</b>	<b>164.6</b>	<b>233.0</b>
<b>Diluted earnings per share</b>		
The calculation of diluted earnings per share for the year ended 30 June 2014 was based on net profit attributable to equity holders of the parent entity of \$93,709,000 (2013: \$132,563,000) and a weighted average number of ordinary shares on issue during the year ended 30 June 2014 of 57,055,237 (2013: 57,047,096) calculated as follows:		
Net profit attributable to equity holders of the parent entity	\$93,709,000	\$132,563,000
Weighted average number of ordinary shares (diluted):		
Weighted average number of shares (basic) (number)	56,930,736	56,890,261
Effect of options and performance shares and rights (number)	124,501	156,835
<b>Weighted average number of ordinary shares (diluted) at 30 June</b>	<b>57,055,237</b>	<b>57,047,096</b>
<b>Diluted earnings per share (cents)</b>	<b>164.2</b>	<b>232.4</b>

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

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

## Notes to the Financial Statements

Cochlear Limited and its controlled entities for the year ended 30 June 2014

8. Dividends	Cents per share	Total amount \$000	Franked/unfranked	Date of payment
Dividends recognised in the current financial year by the Company are:				
<b>2014</b>				
Interim 2014 ordinary	127.0	72,469	0% Franked	27 March 2014
Final 2013 ordinary	127.0	72,442	30% Franked	19 September 2013
<b>Total amount</b>	<b>254.0</b>	<b>144,911</b>		
<b>2013</b>				
Interim 2013 ordinary	125.0	71,295	40% Franked	12 March 2013
Final 2012 ordinary	125.0	71,216	35% Franked	20 September 2012
<b>Total amount</b>	<b>250.0</b>	<b>142,511</b>		

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

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

### Subsequent events

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

Final 2014 ordinary	127.0	72,469	20% Franked	25 September 2014
<b>Total amount</b>	<b>127.0</b>	<b>72,469</b>		

The financial effect of the 2014 final dividend has not been brought to account in the financial statements for the year ended 30 June 2014 and will be recognised in the subsequent financial year.

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

	Company	
	2014 \$000	2013 \$000
<b>Dividend franking account</b>		
30% franking credits available to shareholders of Cochlear Limited for subsequent financial years	2,392	696

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

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

The ability to utilise the franking account credits is dependent upon the ability to declare dividends. The impact on the dividend franking account of dividends proposed after the balance sheet date but not recorded as a liability is to reduce it by \$6,211,608 (2013: \$9,313,969).

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

## Notes to the Financial Statements

Cochlear Limited and its controlled entities for the year ended 30 June 2014

### 9. Notes to the statement of cash flows

#### (a) Cash and cash equivalents

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

Cash and cash equivalents at the reporting date as shown in the statement of cash flows are reconciled to the related items in the balance sheet as follows:

	2014 \$000	2013 \$000 Restated*
Cash on hand	41,432	31,455
Cash on deposit	14,695	21,234
<b>Cash and cash equivalents</b>	<b>56,127</b>	<b>52,689</b>
<b>(b) Reconciliation of net profit to net cash provided by operating activities</b>		
Net profit	93,709	132,563
<i>Add items classified as investing activities</i>		
Loss on disposal of property, plant and equipment	2,611	1,482
<i>Add non-cash items</i>		
Amounts set aside to provisions*	60,865	60,639
Depreciation and amortisation	26,855	23,004
Reversal of impairment of property, plant and equipment	(6,346)	-
Equity settled share based payment transactions	4,971	2,740
<b>Net cash provided by operating activities before changes in assets and liabilities</b>	<b>182,665</b>	<b>220,428</b>
<i>Changes in assets and liabilities</i>		
Change in trade and other receivables	(15,766)	(43,677)
Change in inventories	2,961	(30,276)
Change in prepayments	(1,582)	(2,596)
Change in deferred tax assets*	4,661	(6,240)
Change in trade and other payables	(3,230)	(6,618)
Change in current tax liabilities	47	6,485
Change in provisions*	(51,694)	(75,409)
Change in deferred revenue	(7,355)	4,417
Effects of movements in foreign exchange	710	3,213
<b>Net cash provided by operating activities</b>	<b>111,417</b>	<b>69,727</b>

\* Restated for change in accounting policy, refer Note 30.

## Notes to the Financial Statements

Cochlear Limited and its controlled entities for the year ended 30 June 2014

### Income taxes

10. Income tax expense	Note	2014 \$000	2013 \$000
<i>Recognised in the income statement</i>			
<i>Current tax expense</i>			
Current year		25,412	31,440
Adjustment for prior years		(420)	(3,143)
		<b>24,992</b>	<b>28,297</b>
<i>Deferred tax benefit</i>			
Origination and reversal of temporary differences		(1,587)	11,777
	11	<b>(1,587)</b>	<b>11,777</b>
<b>Total income tax expense</b>		<b>23,405</b>	<b>40,074</b>

	2014 Reported \$000	2014 Patent dispute provision \$000	2014 Before patent dispute provision \$000	2013 Reported \$000
<i>Numerical reconciliation between income tax expense and profit before income tax</i>				
Net profit	93,709	15,781	109,490	132,563
Income tax expense	23,405	6,764	30,169	40,074
<b>Profit before income tax</b>	<b>117,114</b>	<b>22,545</b>	<b>139,659</b>	<b>172,637</b>
Income tax expense using the Company's domestic tax rate of 30% (2013: 30%)	35,134	6,764	41,898	51,791
Increase in income tax expense due to:				
Non-deductible expenses	1,437	-	1,437	2,637
Decrease in income tax expense due to:				
Research and development allowances	(11,221)	-	(11,221)	(10,560)
Share based payment deductions	(357)	-	(357)	(332)
Effect of tax rate in foreign jurisdictions	(1,168)	-	(1,168)	(319)
	<b>23,825</b>	<b>6,764</b>	<b>30,589</b>	<b>43,217</b>
Adjustment for prior years	(420)	-	(420)	(3,143)
<b>Income tax expense on profit before income tax</b>	<b>23,405</b>	<b>6,764</b>	<b>30,169</b>	<b>40,074</b>

	Note	2014 \$000	2013 \$000 Restated*
Deferred tax recognised in other comprehensive income/(loss) relating to derivative financial instruments*		7,353	(20,819)
<b>Total deferred tax recognised in other comprehensive income/(loss)</b>	11	<b>7,353</b>	<b>(20,819)</b>
Deferred tax recognised directly in equity relating to share based payments		(1,119)	2,537
<b>Total deferred tax recognised directly in equity</b>	11	<b>(1,119)</b>	<b>2,537</b>

\* Restated for change in accounting policy, refer Note 30.

Income tax expense comprises current and deferred tax. Current and deferred tax are recognised in the income statement except to the extent that they relate to a business combination, or items recognised directly in equity or in other comprehensive income.

## Notes to the Financial Statements Cochlear Limited and its controlled entities for the year ended 30 June 2014

### 10. Income tax expense (continued)

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years. Current tax payable also includes any tax liability arising from the declaration of dividends. Deferred taxes are explained in more detail in Note 11.

Additional income tax expenses that arise from the distribution of cash dividends are recognised at the same time that the liability to pay the related dividend is recognised. Cochlear does not distribute non-cash assets as dividends to its shareholders.

The Company and its wholly-owned Australian resident entities are part of a tax-consolidated group. As a consequence, all members of the tax-consolidated group are taxed as a single entity. The head entity within the tax-consolidated group is Cochlear Limited.

### 11. Current and deferred tax assets and liabilities

	Assets		Liabilities		Net	
	2014 \$000	2013 \$000 Restated*	2014 \$000	2013 \$000	2014 \$000	2013 \$000 Restated*
<i>Recognised deferred tax assets and liabilities</i>						
Property, plant and equipment	3,608	4,395	(977)	(729)	2,631	3,666
Intangible assets	53	55	(1,610)	(1,809)	(1,557)	(1,754)
Inventories	17,519	16,063	-	-	17,519	16,063
Provisions*	29,665	26,326	(5)	-	29,660	26,326
Deferred revenue	792	3,382	-	-	792	3,382
Forward exchange contracts	-	6,407	(229)	-	(229)	6,407
Other	5,806	4,713	(2,979)	(2,678)	2,827	2,035
Tax losses carried forward	1,118	1,297	-	-	1,118	1,297
<b>Deferred tax assets/(liabilities)</b>	<b>58,561</b>	<b>62,638</b>	<b>(5,800)</b>	<b>(5,216)</b>	<b>52,761</b>	<b>57,422</b>
Set off of tax	(5,800)	(5,216)	5,800	5,216	-	-
<b>Net deferred tax assets</b>	<b>52,761</b>	<b>57,422</b>	<b>-</b>	<b>-</b>	<b>52,761</b>	<b>57,422</b>

\* Restated for change in accounting policy, refer Note 30.

Deferred tax is recognised in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognised for:

- temporary differences on the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss;
- temporary differences related to investments in controlled entities to the extent that it is probable that they will not reverse in the foreseeable future; and
- taxable temporary differences arising on the initial recognition of goodwill.

The measurement of deferred tax reflects the tax consequences that would follow the manner in which the Consolidated Entity expects, at the end of the financial year, to recover or settle the carrying amount of its assets and liabilities.

Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date.

Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same taxation authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realised simultaneously.

A deferred tax asset is recognised for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

#### Unrecognised deferred tax liabilities

At 30 June 2014, a deferred tax liability of \$37.6 million (2013: \$23.3 million) relating to investments in subsidiaries has not been recognised because the Company controls whether the asset will be recovered or the liability will be incurred and it is satisfied that it will not be incurred in the foreseeable future.

## Notes to the Financial Statements

Cochlear Limited and its controlled entities for the year ended 30 June 2014

### Movement in temporary differences during the year

	Note	2014 \$000	2013 \$000 Restated*
Carrying amount at beginning of financial year		57,422	50,495
Recognised in the income statement	10	1,587	(11,777)
Recognised in other comprehensive income/(loss)*	10	(7,353)	20,819
Recognised directly in equity	10	1,119	(2,537)
Effects of movements in foreign exchange		(14)	422
<b>Carrying amount at end of financial year</b>		<b>52,761</b>	<b>57,422</b>

\* Restated for change in accounting policy, refer Note 30.

### Current tax assets and liabilities

The current tax assets for the Consolidated Entity of \$8.6 million (2013: \$6.2 million) represent the amount of income taxes recoverable in respect of current and prior years and arise from the payment of tax in excess of the amounts due to the relevant taxation authority. The current tax liabilities for the Consolidated Entity of \$8.4 million (2013: \$6.0 million) represent the amount of income taxes payable in respect of current and prior financial years.

## Employee benefits

12. Employee expenses		2014 \$000	2013 \$000
Wages and salaries		233,432	208,585
Contributions to superannuation plans		17,633	15,846
Increase in leave liabilities		488	2,069
Equity settled share based payment transactions		4,971	2,740
<b>Total employee benefits expense</b>		<b>256,524</b>	<b>229,240</b>
13. Employee benefit liabilities		2014 \$000	2013 \$000 Restated*
<b>Current</b>			
Provision for long service leave		6,016	7,325
Provision for annual leave		17,035	16,850
Provision for short-term incentives		8,014	6,275
	20	31,065	30,450
Wages and salaries accrued		1,857	515
<b>Total current employee benefit liabilities</b>		<b>32,922</b>	<b>30,965</b>
<b>Non-current</b>			
Provision for long service leave	20	5,200	3,589
Defined benefit plan*	20	3,130	3,161
Provision for directors' retirement scheme	20	422	411
<b>Total non-current employee benefit liabilities</b>		<b>8,752</b>	<b>7,161</b>
<b>Total employee benefit liabilities</b>		<b>41,674</b>	<b>38,126</b>

\* Restated for change in accounting policy, refer Note 30.



## Notes to the Financial Statements Cochlear Limited and its controlled entities for the year ended 30 June 2014

### 13. Employee benefit liabilities (continued)

#### Wages, salaries and annual leave

Liabilities for employee benefits for wages, salaries and annual leave represent present obligations resulting from employees' services provided up to the reporting date, calculated based on remuneration wage and salary rates that Cochlear expects to pay as at the reporting date including related on-costs, such as workers' compensation insurance and payroll tax.

#### Long service leave

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

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

#### Defined contribution plans

A defined contribution plan is a post-employment benefit plan under which the entity pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts.

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

Cochlear makes contributions to defined contribution plans. The amount recognised as expense was \$16.5 million for the year ended 30 June 2014 (2013: \$14.9 million).

#### Defined benefit plans

A defined benefit plan is a post-employment benefit plan other than a defined contribution plan.

The Company's net obligation in respect of defined benefit plans is calculated separately for each plan by estimating the amount of future benefit that employees have earned in the current and prior periods, discounting that amount and deducting the fair value of any plan assets.

The calculation of defined benefit obligations is performed annually by a qualified actuary using the direct to equity method. When the calculation results in a potential asset for the Company, the recognised asset is limited to the present value of economic benefits available in the form of any future refunds from the plan or reductions in future contributions to the plan. To calculate the present value of economic benefits, consideration is given to any applicable minimum funding requirements.

Remeasurements of the net defined benefit liability, which comprise actuarial gains and losses, the return on plan assets (excluding interest) and the effect of the asset ceiling (if any, excluding interest), are recognised immediately in other comprehensive income. The Company determines the net interest expense (income) on the net defined benefit liability (asset) for the period by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the then net defined benefit liability (asset), taking into account any changes in the net defined benefit liability (asset) during the period as a result of contributions and benefit payments. Net interest expense and other expenses related to defined benefit plans are recognised in profit or loss.

When the benefits of a plan are changed or when a plan is curtailed, the resulting change in benefit that relates to past service or the gain or loss on curtailment is recognised immediately in profit or loss. The Company recognises gains and losses on the settlement of a defined benefit plan when the settlement occurs.

Cochlear makes contributions to defined benefit plans. These defined benefit plans cover, in aggregate, 84 employees. Cochlear contributed cash of \$1.1 million (2013: \$0.9 million) to defined benefit plans in the year ended 30 June 2014 and expects to contribute \$1.1 million in the year ending 30 June 2015.

#### Directors' retirement scheme

Non-executive directors appointed prior to 2003 were entitled to retirement benefits of up to three times their annual remuneration over the previous three years once they had more than five years' service. The ongoing accrual of benefits under the directors' retirement scheme ceased from 30 June 2007. The benefits accrued to that date are indexed by reference to the bank bill rate. As at 30 June 2014, Prof E Byrne, AC is the only non-executive director entitled to this benefit.

## Notes to the Financial Statements Cochlear Limited and its controlled entities for the year ended 30 June 2014

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### 14. Share based payments

Prior to July 2013, the Company granted options and performance shares to certain employees under the Cochlear Executive Long Term Incentive Plan (CELTIP).

From 1 July 2013, the Company grants options and performance rights to certain employees under the Cochlear Executive Incentive Plan (CEIP).

The fair value of options, performance shares and performance rights granted is recognised as an employee expense with a corresponding increase in equity. The fair value is measured at the date the options, shares or rights are granted taking into account market based criteria and expensed over the vesting period after which the employees become unconditionally entitled to the options, shares and rights.

The fair value of the options, performance shares and performance rights granted is measured using the Black-Scholes-Merton pricing model, taking into account the terms and conditions attached to the instruments.

The amount recognised as an expense is adjusted to reflect the actual number of options, shares and rights that are expected to vest except where forfeiture is due to market related conditions.

When the Company grants options over its shares to employees of controlled entities, the fair value at grant date is recognised as an increase in the investment in subsidiaries, with a corresponding increase in equity over the vesting period of the grant.

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

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

Cochlear's Employee Share Plan (Plan) was approved by special resolution at the AGM held on 19 October 1999. Under the Plan, the directors can at their discretion, allocate at nil consideration up to a maximum of \$2,000 worth of shares per eligible employee in any one year. In practice, the directors issue shares worth up to the tax concessional limit, currently \$1,000 per eligible employee each year. The fair value of shares issued during the financial year is the market price of the Company's shares on the ASX as at the start of trading on the issue date. Shares under the Plan vest with the employee immediately but are non-transferable for a period of up to three years. For the year ended 30 June 2014, the Company issued 21,088 shares under the Plan.

## Notes to the Financial Statements

Cochlear Limited and its controlled entities for the year ended 30 June 2014

### 14. Share based payments (continued)

At 30 June 2014, unissued ordinary shares of the Company under option and rights, and issued shares held in the Trust and the terms and conditions of the grants and issues are as follows:

Grant date	Number of instruments	Conditions for minimum vesting	Contractual life of options
Option grant in August and October 2011	242,443	Three years of service, a minimum compound annual growth rate in EPS of 10%.	5 years
	242,444	Three years of service, the Consolidated Entity's TSR is above the 50th percentile against the S&P/ASX 100 over three years.	5 years
Option grant in August 2012	353,563	Three years of service, a minimum compound annual growth rate in EPS of 10%.	5 years
	353,564	Three years of service, the Consolidated Entity's TSR is above the 50th percentile against the S&P/ASX 100 over three years.	5 years
Option grant in October 2013	112,157	Three years of service, a minimum compound annual growth rate in EPS of 10%.	4 years
	112,157	Three years of service, the Consolidated Entity's TSR is above the 50th percentile against the S&P/ASX 100 over three years.	4 years
<b>Total options<sup>(1)</sup></b>	<b>1,416,328</b>		

(1) No options granted in August 2010 were outstanding as at 30 June 2014.

Issue date	Number of instruments	Conditions for minimum vesting	Contractual life of shares in the Trust
Performance shares issued in August 2011	10,090	Three years of service, a minimum compound annual growth rate in EPS of 10%.	5 years
	10,090	Three years of service, the Consolidated Entity's TSR is above the 50th percentile against the S&P/ASX 100 over three years.	5 years
Performance shares issued in August 2012	32,034	Three years of service, a minimum compound annual growth rate in EPS of 10%.	5 years
	32,033	Three years of service, the Consolidated Entity's TSR is above the 50th percentile against the S&P/ASX 100 over three years.	5 years
<b>Total performance shares</b>	<b>84,247</b>		

Issue date	Number of instruments	Conditions for minimum vesting	Contractual life of rights
Performance rights issued in October 2013	9,851	Three years of service, a minimum compound annual growth rate in EPS of 10%.	4 years
	9,852	Three years of service, the Consolidated Entity's TSR is above the 50th percentile against the S&P/ASX 100 over three years.	4 years
<b>Total performance rights</b>	<b>19,703</b>		

## Notes to the Financial Statements Cochlear Limited and its controlled entities for the year ended 30 June 2014

The number and weighted average exercise prices of options are as follows:

	Weighted average exercise price	Number of options	Weighted average exercise price	Number of options
	\$		\$	
	2014	2014	2013	2013
Outstanding at 1 July	65.98	1,738,000	64.33	1,635,440
Forfeited	67.83	(545,986)	61.62	(402,069)
Exercised	-	-	52.73	(255,199)
Granted	59.13	224,314	62.78	759,828
<b>Outstanding at 30 June</b>	<b>64.18</b>	<b>1,416,328</b>	<b>65.98</b>	<b>1,738,000</b>
Exercisable at 30 June	-	-	60.04	85,674

No options were exercised in 2014. In 2013, the weighted average share price at the date of exercise was \$69.77.

The estimated value of options for the current financial year is calculated at the date of grant using the Black-Scholes-Merton pricing model.

For options outstanding at 30 June 2014, 484,887 options have an exercise price of \$68.56, 707,127 options have an exercise price of \$62.78 and 224,314 options have an exercise price of \$59.13 (2013: 85,674 options had an exercise price of \$60.04, 399,869 options had an exercise price of \$69.80, 517,065 options had an exercise price of \$68.56 and 735,392 options had an exercise price of \$62.78). The weighted average remaining contractual life of options outstanding at the end of the year is three years (2013: three years).

### Inputs for measurement of grant date fair values

The grant date fair value of options, performance rights and performance shares was measured based on the Black-Scholes-Merton pricing model. Expected volatility is estimated by considering historic average share price volatility. The inputs used in the measurement of the fair values at grant date are the following:

	15 October 2013	13 August 2012
Fair value of options at grant date with:		
– EPS performance based conditions	\$11.38	\$8.56
– TSR based conditions	\$9.93	\$5.70
Fair value of performance rights at grant date with:		
– EPS performance based conditions	\$53.22	-
– TSR based conditions	\$28.85	-
Fair value of performance shares at grant date with:		
– EPS performance based conditions	-	\$62.78
– TSR based conditions	-	\$39.55
Share price at grant date	\$58.42	\$62.97
Option exercise price	\$59.13	\$62.78
Expected volatility (weighted average volatility)	31.83%	23.99%
Option life	3–4 years	3–5 years
Expected dividends	3.20%	3.80%
Risk free interest rate (based on government bonds)	2.51%	2.71%

## Notes to the Financial Statements Cochlear Limited and its controlled entities for the year ended 30 June 2014

### 15. Key management personnel

The following were key management personnel of Cochlear at any time during the financial year and unless otherwise indicated were key management personnel for the entire financial year:

#### Non-executive directors

Mr R Holliday-Smith (Chairman)

Mrs YA Allen

Mr PR Bell

Prof E Byrne, AC

Mr A Denver

Mr DP O'Dwyer

#### Executive director

Dr CG Roberts

#### Executives

Mr R Brook

Mr J Janssen

Mr NJ Mitchell

Mr MD Salmon

Mr CM Smith.

#### Key management personnel disclosures

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

	2014 \$	2013 \$
Short-term employee benefits	7,207,457	6,824,569
Post-employment benefits	388,273	368,245
Other long-term benefits	100,918	94,729
Directors' retirement benefits	10,902	12,293
Share based payments	1,821,874	1,232,235
	<b>9,529,424</b>	<b>8,532,071</b>

Information regarding individual directors' and executives' remuneration and some equity instruments disclosures as permitted by section 300A of the *Corporations Act 2001* is provided in the Remuneration Report in the Directors' Report on pages 31 to 53.

The key management personnel have not received any loans from Cochlear and there have been no other related party transactions with any of Cochlear's key management personnel.

## Notes to the Financial Statements

Cochlear Limited and its controlled entities for the year ended 30 June 2014

### Operating assets and liabilities

16. Trade and other receivables	2014 \$000	2013 \$000
<i>Current</i>		
Trade receivables net of allowance for impairment losses	201,295	187,593
Other receivables	9,099	12,691
Forward exchange contracts	4,559	3,464
<b>Total current trade and other receivables</b>	<b>214,953</b>	<b>203,748</b>
<i>Non-current</i>		
Other receivables	55	46
Forward exchange contracts	5,450	898
<b>Total non-current trade and other receivables</b>	<b>5,505</b>	<b>944</b>

Trade and other receivables are stated at amortised cost less impairment losses. Cochlear's exposure to credit and currency risks and impairment losses related to trade and other receivables is disclosed in Note 22.

17. Inventories	2014 \$000	2013 \$000
Raw materials and stores	40,593	48,653
Work in progress	19,214	15,333
Finished goods	68,806	67,588
<b>Total inventories</b>	<b>128,613</b>	<b>131,574</b>

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

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

## Notes to the Financial Statements

Cochlear Limited and its controlled entities for the year ended 30 June 2014

18. Property, plant and equipment	2014 \$000	2013 \$000
<i>Leasehold improvements</i>		
At cost	26,458	23,057
Accumulated amortisation	(18,511)	(16,613)
	<b>7,947</b>	<b>6,444</b>
<i>Plant and equipment</i>		
At cost	180,780	155,923
Accumulated depreciation and impairment	(112,951)	(96,469)
	<b>67,829</b>	<b>59,454</b>
<b>Total property, plant and equipment, at net book value</b>	<b>75,776</b>	<b>65,898</b>
<i>Reconciliations</i>		
Reconciliations of the carrying amounts of each class of property, plant and equipment are set out below:		
<i>Leasehold improvements</i>		
Carrying amount at beginning of financial year	6,444	5,466
Additions	3,256	2,171
Depreciation	(1,868)	(1,525)
Effect of movements in foreign exchange	115	332
<b>Carrying amount at end of financial year</b>	<b>7,947</b>	<b>6,444</b>
<i>Plant and equipment</i>		
Carrying amount at beginning of financial year	59,454	54,145
Additions	20,241	18,903
Disposals	(2,611)	(1,028)
Depreciation	(15,580)	(13,876)
Impairment reversal	6,346	-
Effect of movements in foreign exchange	(21)	1,310
<b>Carrying amount at end of financial year</b>	<b>67,829</b>	<b>59,454</b>



## Notes to the Financial Statements Cochlear Limited and its controlled entities for the year ended 30 June 2014

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### Owned assets

Items of property, plant and equipment are measured at cost less accumulated depreciation (see below) and impairment losses (see Note 19). An asset's cost is determined as the consideration provided plus incidental costs directly attributable to the acquisition.

The cost of self-constructed assets includes the cost of material and direct labour, an appropriate share of fixed and variable overheads, and capitalised interest and any other costs directly attributable to bringing the asset to a working condition for its intended use.

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

In respect of borrowing costs relating to qualifying assets, Cochlear capitalises borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset.

### Leased assets

#### *Operating leases*

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

### Depreciation

Depreciation is calculated over the depreciable amount, which is the cost of an asset, or other amount substituted for cost, less its residual value.

Depreciation is recognised in the income statement on a straight-line basis. Items of property, plant and equipment, including leasehold assets, are depreciated using the straight-line method over their estimated useful lives, taking into account estimated residual values. Assets are depreciated from the date of acquisition or, in respect of internally constructed assets, from the time an asset is completed and held ready for use. Leased assets are depreciated over the shorter of the lease term and their useful lives unless it is reasonably certain that Cochlear will obtain ownership by the end of the lease term.

Depreciation rates and methods, useful lives and residual values are reviewed at each balance sheet date. When changes are made, adjustments are reflected prospectively in current and future financial years only. The estimated useful lives in the current and comparative years are as follows:

Leasehold improvements	1 – 15 years
Plant and equipment	3 – 14 years.

### Impairment reversal

During the year ended 30 June 2014, plant and equipment previously impaired due to the recall was reassessed. Of the \$14.0 million impaired, \$6.3 million has been reversed as it can be used with the Nucleus Profile cochlear implant. Cochlear has increased the product recall provision (refer Note 20) by this amount to cover the uncertain outcomes.

## Notes to the Financial Statements

Cochlear Limited and its controlled entities for the year ended 30 June 2014

19. Intangible assets	2014 \$000	2013 \$000
<i>Intangible assets with indefinite useful lives</i>		
Goodwill, at cost	170,259	170,959
Technology relationship, at cost	1,800	1,800
<b>Total intangible assets with indefinite useful lives</b>	<b>172,059</b>	<b>172,759</b>
<i>Intangible assets with finite useful lives</i>		
<i>Acquired technology, patents and licences</i>		
At cost	64,176	62,811
Accumulated amortisation and impairment	(31,678)	(28,733)
	<b>32,498</b>	<b>34,078</b>
<i>Enterprise resource planning system</i>		
At cost	67,968	60,941
Accumulated amortisation	(39,725)	(33,614)
	<b>28,243</b>	<b>27,327</b>
<i>Customer relationships</i>		
At cost	4,401	4,449
Accumulated amortisation	(4,401)	(4,449)
	-	-
<i>Capitalised development expenditure</i>		
At cost	7,759	7,759
Accumulated amortisation	(7,759)	(7,759)
	-	-
<i>Other intangible assets</i>		
At cost	4,064	4,013
Accumulated amortisation	(2,749)	(2,403)
	<b>1,315</b>	<b>1,610</b>
<b>Total intangible assets with finite useful lives</b>	<b>62,056</b>	<b>63,015</b>
<b>Total intangible assets</b>	<b>234,115</b>	<b>235,774</b>

## Notes to the Financial Statements

Cochlear Limited and its controlled entities for the year ended 30 June 2014

	Note	2014 \$000	2013 \$000
<b>Reconciliations</b>			
Reconciliations of the carrying amounts of each class of intangible assets are set out below:			
<i>Goodwill</i>			
Carrying amount at beginning of financial year		170,959	151,066
Effect of movements in foreign exchange		(700)	19,893
<b>Carrying amount at end of financial year</b>		<b>170,259</b>	<b>170,959</b>
<i>Technology relationship</i>			
Carrying amount at beginning of financial year		1,800	1,800
<b>Carrying amount at end of financial year</b>		<b>1,800</b>	<b>1,800</b>
<i>Acquired technology, patents and licences</i>			
Carrying amount at beginning of financial year		34,078	24,165
Acquisitions		1,452	2,431
Amortisation		(3,030)	(2,770)
Reclassification from other intangible assets	(a)	-	9,934
Effect of movements in foreign exchange		(2)	318
<b>Carrying amount at end of financial year</b>		<b>32,498</b>	<b>34,078</b>
<i>Enterprise resource planning system</i>			
Carrying amount at beginning of financial year		27,327	17,721
Acquisitions		6,997	14,477
Amortisation		(6,086)	(4,432)
Disposals		-	(454)
Effect of movements in foreign exchange		5	15
<b>Carrying amount at end of financial year</b>		<b>28,243</b>	<b>27,327</b>
<i>Other intangible assets</i>			
Carrying amount at beginning of financial year		1,610	11,963
Amortisation		(291)	(401)
Reclassification to acquired technology, patents and licences	(a)	-	(9,934)
Effect of movements in foreign exchange		(4)	(18)
<b>Carrying amount at end of financial year</b>		<b>1,315</b>	<b>1,610</b>

**(a) Purchase of intellectual property from Otologics LLC**

As at 30 June 2012, Cochlear recorded an asset being the "Right to acquire intellectual property" of United States dollars (USD) 10.0 million to reflect its security interest in the intellectual property assets of Otologics LLC being the same value as its amount payable to Wells Fargo Bank as guarantor to Otologics LLC loan, following Otologics LLC's declaration of bankruptcy.

During year ended 30 June 2013, Cochlear settled the loan and acquired intellectual property and certain other assets of Otologics LLC for a total consideration of USD 14.0 million.

## Notes to the Financial Statements Cochlear Limited and its controlled entities for the year ended 30 June 2014

### 19. Intangible assets (continued)

#### Goodwill

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

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

#### Enterprise resource planning system

The expenditure incurred on hardware and software and the costs necessary for the implementation of the system are recognised as an intangible asset, to the extent that Cochlear controls future economic benefits as a result of the costs incurred, and are stated at cost less accumulated amortisation. Costs include expenditure that is directly attributable to the development and implementation of the system and includes direct labour.

#### Research and development expenditure

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

Development activities involve a plan or design for production of new or substantially improved products or processes before the start of commercial production or use. Development expenditure is capitalised only if development costs can be measured reliably, the product or process is technically and commercially feasible, future economic benefits are probable and Cochlear intends to and has sufficient resources to complete development and use or sell the asset.

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

#### Other intangible assets

Other intangible assets, comprising acquired technology, patents and licences, customer relationships and intellectual property, are acquired individually or through business combinations and are stated at cost less accumulated amortisation and impairment losses (see below). Expenditure on internally generated goodwill and brands is recognised in the income statement as an expense as incurred.

#### Subsequent expenditure

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

#### Amortisation

Amortisation is calculated over the cost of the asset, or an other amount substituted for cost, less its residual value.

Amortisation is recognised in the income statement on a straight-line basis over the estimated useful lives of the intangible assets from the date they are available for use unless such lives are indefinite, except for amortisation of capitalised development expenditure which is recognised in the research and development expenses line. Goodwill and intangible assets with an indefinite useful life are systematically tested for impairment annually. The estimated useful lives for the current and comparative years are as follows:

Acquired technology, patents and licences	4 – 15 years
Enterprise resource planning system	2.5 – 7 years
Customer relationships	4 years
Capitalised development expenditure	1 – 3 years.

#### Impairment

The carrying amounts of Cochlear's non-financial assets, other than inventories (see Note 17) and deferred tax assets (see Note 11), are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, the asset's recoverable amount is estimated (see below).

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

## Notes to the Financial Statements Cochlear Limited and its controlled entities for the year ended 30 June 2014

The recoverable amount of an asset or CGU is the greater of its value in use, and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset or CGU. For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generates cash inflows from continuing use that is largely independent of the cash inflows of other assets or groups of assets (CGU). The goodwill acquired in a business combination, for the purpose of impairment testing, is allocated to CGUs that are expected to benefit from the processes, intellectual property acquired and synergies of the combination.

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

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

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognised in prior years are assessed at each reporting date for indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

### Impairment tests for CGUs

Impairment testing is performed over the carrying amounts of goodwill, other intangible assets and property, plant and equipment at Cochlear's CGUs.

For the purpose of impairment testing, goodwill is allocated to Cochlear's operating divisions which represent the lowest level within Cochlear at which the goodwill is monitored for internal management purposes, which is not higher than Cochlear's operating segments as reported in Note 3.

The aggregate carrying amounts of goodwill allocated to each CGU are as follows:

	2014 \$000	2013 \$000
Americas	85,808	86,438
EMEA	74,553	74,709
Asia Pacific	9,898	9,812
	<b>170,259</b>	<b>170,959</b>

The recoverable amount of each CGU is based on value-in-use calculations. Those calculations use cash flow projections based on actual operating results, the next year's budget and the three year business plan. Cash flows for subsequent years are extrapolated using a conservative terminal growth rate of 3.0% (2013: 3.0%) per annum which is consistent with long-term economic growth rates. A pre-tax discount rate of 13.4% (2013: 13.5%) per annum has been used in discounting the projected pre-tax cash flows.

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

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

The recoverable amount of each CGU including unallocated corporate assets is in excess of their carrying amount and therefore no impairment charge was required. The excess of recoverable amount over carrying amount is such that a reasonably possible change in assumptions is unlikely to reduce the recoverable amount below the carrying amount.

## Notes to the Financial Statements

Cochlear Limited and its controlled entities for the year ended 30 June 2014

20. Provisions	Note	2014 \$000	2013 \$000 Restated*
<b>Current</b>			
Employee benefit liabilities	13	31,065	30,450
Warranties		16,469	13,231
Legal and other		4,465	7,487
Product recall		5,558	12,056
<b>Total current provisions</b>		<b>57,557</b>	<b>63,224</b>
<b>Non-current</b>			
Employee benefit liabilities	13	5,200	3,589
Defined benefit plan*	13	3,130	3,161
Warranties		5,082	4,683
Directors' retirement scheme	13	422	411
Make good lease costs		2,139	2,143
Product recall		16,049	24,530
Patent dispute		21,333	-
<b>Total non-current provisions</b>		<b>53,355</b>	<b>38,517</b>
* Restated for change in accounting policy, refer Note 30.			
<b>Reconciliations</b>			
Reconciliations of the carrying amounts of each class of provision, except for the employee benefit liabilities provision, are set out below:			
<b>Warranties</b>			
Carrying amount at beginning of financial year		17,914	13,991
Provisions made		30,036	29,152
Provisions used		(26,355)	(25,439)
Effects of movements in foreign exchange		(44)	210
<b>Carrying amount at end of financial year</b>		<b>21,551</b>	<b>17,914</b>
<b>Legal and other</b>			
Carrying amount at beginning of financial year		7,487	7,523
Provisions made		2,634	5,218
Provisions used		(5,658)	(5,294)
Effects of movements in foreign exchange		2	40
<b>Carrying amount at end of financial year</b>		<b>4,465</b>	<b>7,487</b>
<b>Make good lease costs</b>			
Carrying amount at beginning of financial year		2,143	4,024
Provisions made		-	400
Provisions used		-	(416)
Provisions released		-	(1,857)
Effects of movements in foreign exchange		(4)	(8)
<b>Carrying amount at end of financial year</b>		<b>2,139</b>	<b>2,143</b>

## Notes to the Financial Statements

Cochlear Limited and its controlled entities for the year ended 30 June 2014

	2014 \$000	2013 \$000 Restated*
<b>Defined benefit plan*</b>		
Carrying amount at beginning of financial year	3,161	2,858
Provisions made	306	303
Effects of movements in foreign exchange	(337)	-
<b>Carrying amount at end of financial year</b>	<b>3,130</b>	<b>3,161</b>
<b>Directors' retirement scheme</b>		
Carrying amount at beginning of financial year	411	399
Provisions made	11	12
<b>Carrying amount at end of financial year</b>	<b>422</b>	<b>411</b>
<b>Product recall</b>		
Carrying amount at beginning of financial year	36,586	52,970
Provisions made	6,346	-
Provisions used	(21,325)	(16,384)
<b>Carrying amount at end of financial year</b>	<b>21,607</b>	<b>36,586</b>
<b>Patent dispute</b>		
Carrying amount at beginning of financial year	-	-
Provisions made	22,545	-
Effects of movements in foreign exchange	(1,212)	-
<b>Carrying amount at end of financial year</b>	<b>21,333</b>	<b>-</b>

\* Restated for change in accounting policy, refer Note 30.

A provision is recognised in the balance sheet when Cochlear has a present legal or constructive obligation as a result of a past event that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risk specific to the liability. The unwinding of the discount rate is recognised as a finance expense.

### Warranties

Provisions for warranty claims are made for claims in relation to sales made prior to the reporting date, based on historical claim rates and respective product populations. Warranty periods on hardware products extend for three to 10 years.

### Legal and other

#### Onerous contracts

A provision for onerous contracts is recognised when expected benefits to be derived by Cochlear from a contract are lower than the unavoidable cost of meeting contractual obligations. The provision is measured at the lower of the expected cost of terminating the contract and the expected net cost of continuing with the contract. Before a provision is established, Cochlear recognises any impairment loss on the assets associated with the contract.

#### Self-insurance

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

#### Make good lease costs

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

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



## Notes to the Financial Statements Cochlear Limited and its controlled entities for the year ended 30 June 2014

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### 20. Provisions (continued)

#### Product recall

On 11 September 2011, the Company initiated a worldwide voluntary recall of its unimplanted Nucleus CI500 cochlear implant range. Management has made judgements, estimates and assumptions related to probable costs arising from the recall which affect the reported amounts of assets, liabilities, income and expenses. Actual outcomes may differ from these estimates as further information is identified.

During the year ended 30 June 2014, plant and equipment previously impaired due to the recall was reassessed. Of the \$14.0 million impaired, \$6.3 million has been reversed as it can be used with the Nucleus Profile cochlear implant. Cochlear has increased the recall provision by this amount to cover the uncertain outcomes.

No further amount has been recognised as a charge or released as a credit in the year ended 30 June 2014.

#### Patent dispute

On 24 January 2014, a jury verdict in the patent infringement lawsuit by the Alfred E. Mann Foundation for Scientific Research and Advanced Bionics LLC in the United States District Court in Los Angeles, California was reached. The jury found direct, contributory and wilful, but not induced infringement against Cochlear Limited and its USA subsidiary Cochlear Americas and awarded damages of USD 131.2 million against Cochlear.

No Judgment has been entered based on the verdict as important issues still remain to be decided by the Judge. These decisions may negate some of the findings of the jury and could alter the damages awarded by the jury. The directors have obtained external advice and are of the opinion that the facts and the law do not support the jury's findings and Cochlear has applied to overturn the verdict in post-trial motions filed with the District Court.

A Judgment is pending and the timing for entry of the Judgment is uncertain. The directors will appeal any significant adverse Judgment to the United States Court of Appeals for the Federal Circuit.

If an appeal is necessary, Cochlear will provide non-cash security to stay the execution of the Judgment against Cochlear. Providing this security will avoid the requirement for Cochlear to pay the Judgment amount prior to the outcome of the appeal.

A provision of USD 20 million (\$22.5 million) was expensed in the half year ended 31 December 2013 in relation to this dispute. No additional amount has been provided since the half year accounts. 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 dispute.

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.

## Notes to the Financial Statements

Cochlear Limited and its controlled entities for the year ended 30 June 2014

### Financial and capital structure

21. Net debt and finance costs	Note	2014 \$000	2013 \$000
<b>(a) Net debt</b>			
Total loans and borrowings	21(c)	237,415	170,469
Less: Cash and cash equivalents	9(a)	(56,127)	(52,689)
<b>Net debt</b>		<b>181,288</b>	<b>117,780</b>
<b>(b) Total cash and cash equivalents</b>			
The operating cash account received an average interest rate of 0.58% (2013: 0.82%) per annum.			
Cash held on deposit for periods not exceeding 90 days received an average interest rate of 1.77% (2013: 3.27%) per annum.			
<b>(c) Loans and borrowings</b>			
<b>Current</b>			
Secured bank loans		3,141	3,309
<b>Total current loans and borrowings</b>		<b>3,141</b>	<b>3,309</b>
<b>Non-current</b>			
Secured bank loans <sup>(i)</sup>		234,274	167,160
<b>Total non-current loans and borrowings</b>		<b>234,274</b>	<b>167,160</b>
<b>Financing arrangements</b>			
Cochlear had access to the following lines of credit at the reporting date:			
<b>Multi-option credit facilities</b>			
Secured bank loan		345,000	295,000
Standby letters of credit		17,705	19,736
Bank guarantees		2,295	264
<b>Other credit facilities</b>			
Unsecured bank overdrafts		363	352
Secured bank loan		4,711	4,963
Bank guarantees		1,456	1,198
		<b>371,530</b>	<b>321,513</b>
<b>Facilities utilised at the reporting date</b>			
<b>Multi-option credit facilities</b>			
Secured bank loan		235,000	168,000
Standby letters of credit		3,374	1,924
Bank guarantees		2,295	264
<b>Other credit facilities</b>			
Unsecured bank overdrafts		-	-
Secured bank loan		3,141	3,309
Bank guarantees		1,066	1,193
		<b>244,876</b>	<b>174,690</b>

## Notes to the Financial Statements

Cochlear Limited and its controlled entities for the year ended 30 June 2014

### 21. Net debt and finance costs (continued)

	2014 \$000	2013 \$000
<b>Facilities not utilised at the reporting date</b>		
<i>Multi-option credit facilities</i>		
Secured bank loan	110,000	127,000
Standby letters of credit	14,331	17,812
Bank guarantees	-	-
<i>Other credit facilities</i>		
Unsecured bank overdrafts	363	352
Secured bank loan	1,570	1,654
Bank guarantees	390	5
	<b>126,654</b>	<b>146,823</b>

(i) Included within secured bank loans is an amount of \$725,606 (2013: \$840,028) in relation to unamortised loan establishment fees.

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

#### Secured bank loan – multi-option credit facilities

Cochlear has two corporate loan facilities. The first was amended and extended in June 2013 for a period of three years and a total commitment limit of AUD 200.0 million. In December 2013, the total commitment limit was increased to 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 bank guarantees or letters of credit. This letter of credit sub-limit currently sits at 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 existing 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.

#### Unsecured bank overdrafts

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

#### Secured bank loan

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

#### Bank guarantees

As at 30 June 2014, Cochlear had additional contingent liability facilities denominated in USD, Euros (EUR), Sterling (GBP), Indian rupees (INR) and New Zealand dollars (NZD) totalling AUD 1.5 million (2013: AUD 1.2 million).

	2014 \$000	2013 \$000
<b>(d) Net finance expense</b>		
<i>Recognised in the income statement</i>		
Interest income	324	659
<b>Finance income</b>	<b>324</b>	<b>659</b>
Interest expense	(10,301)	(6,882)
<b>Finance expense</b>	<b>(10,301)</b>	<b>(6,882)</b>
<b>Net finance expense recognised in the income statement</b>	<b>(9,977)</b>	<b>(6,223)</b>

## Notes to the Financial Statements Cochlear Limited and its controlled entities for the year ended 30 June 2014

Interest income is recognised as it accrues in the income statement using the effective interest rate method. Borrowing costs are recognised as they accrue in the income statement as a finance expense except to the extent that borrowing costs relate to the purchase of qualifying assets in which case they are capitalised into the purchase cost of the qualifying asset. Debt establishment costs are capitalised and recognised as a reduction in loans and borrowings. They are calculated based on the effective interest rate method and are amortised over the period of the loan.

### 22. Financial risk management

Cochlear has exposure to the following risks from the use of financial instruments:

- Credit risk;
- Liquidity risk;
- Market risk; and
- Operational risk.

#### (a) Risk management framework

This note presents Cochlear's exposure to each of the above risks, its objectives, policies and processes for measuring and managing risk, and the management of capital.

The Board of directors has overall responsibility for the establishment and oversight of the risk management framework. The fundamentals of risk management are set by the risk policy. Under instruction of the Board, management has established a Risk Management Committee which is responsible for monitoring operational and financial risk management throughout Cochlear. Monitoring risk management includes ensuring appropriate policies and procedures are published and adhered to. The Risk Management Committee reports to the Audit Committee on a regular basis.

A Treasury Management Committee has been established to administer aspects of risk management involving currency exposure and cash and funding management in accordance with the treasury risk policy. The treasury risk policy aims to manage the impact of short-term fluctuations on Cochlear's earnings. Over the longer term, permanent changes in market rates will have an impact on earnings.

Cochlear is exposed to risks from movements in exchange rates and interest rates that affect revenues, expenses, assets, liabilities and forecast transactions. Financial risk management aims to limit these market risks through ongoing operational and finance activities. Selected derivative and non-derivative hedging instruments are used for this purpose.

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

The Company only hedges the risks that affect the cash flows between the parent entity and the controlled entities. Cochlear does not enter, hold or issue derivative financial instruments for trading purposes. Hedging transactions are only concluded with leading financial institutions whose credit rating is at least A on the Standard & Poor's rating index.

The Audit Committee oversees how management monitors compliance with Cochlear's risk management policies and procedures and reviews the adequacy of the risk management framework in relation to the risks faced by Cochlear. The Audit Committee is assisted in its oversight by Internal Audit. Internal Audit undertakes regular reviews of risk management controls and procedures, the results of which are reported to the Audit Committee.

#### (b) Credit risk

Credit risk is the risk of financial loss to Cochlear if a customer or counterparty to a financial instrument fails to meet its contractual obligations and arises principally from Cochlear's receivables from customers.

Cochlear's exposure to credit risk is influenced mainly by the geographical location and characteristics of individual customers. Cochlear does not have a significant concentration of credit risk with a single customer.

Policies and procedures of credit management and administration of receivables are established and executed at a regional level. Individual regions deliver reports to management and the Board on debtor ageing and collection activities on a monthly basis.

In monitoring customer credit risk, the ageing profile of total receivables balances and individually significant debtors is reported by geographic region to the Board of directors on a monthly basis. Regional management is responsible for identifying high risk customers and placing restrictions on future trading, including suspending future shipments and administering dispatches on a prepayment basis. These actions are also reported to the Board on a monthly basis.

## Notes to the Financial Statements

Cochlear Limited and its controlled entities for the year ended 30 June 2014

### 22. Financial risk management (continued)

#### *Exposure to credit risk*

The carrying amount of financial assets represents the maximum credit exposure. The maximum exposure to credit risk at the reporting date was:

	2014 \$000	2013 \$000
Cash and cash equivalents	56,127	52,689
Trade receivables and other receivables	210,449	200,330
Forward exchange contracts	10,009	4,362
	<b>276,585</b>	<b>257,381</b>

The maximum exposure to credit risk for trade receivables at the reporting date by geographic region was:

	2014 \$000	2013 \$000
Americas	56,979	59,110
EMEA	91,991	84,173
Asia Pacific	52,325	44,310
	<b>201,295</b>	<b>187,593</b>

#### *Impairment losses*

Cochlear's financial assets (cash and cash equivalents and trade and other receivables) are assessed at each reporting date to determine whether there is any objective evidence of impairment. A financial asset is considered impaired if objective evidence indicates that one or more events have had a negative effect on the estimated future cash flows of that asset.

The recoverable amount of financial assets is calculated as the present value of estimated future cash flows, discounted at the original effective interest rate (i.e. the effective interest rate computed at initial recognition of these financial assets). Financial assets with a short duration are not discounted. An impairment loss of a financial asset is measured as the difference between the asset's carrying amount and its recoverable amount.

Impairment of financial assets is not recognised until objective evidence is available that a loss event has occurred. Individual significant financial assets are individually assessed for impairment. Impairment testing of financial assets not assessed individually is performed by placing them into portfolios of similar risk profiles and undertaking a collective assessment of impairment based on objective evidence from historical experience adjusted for any effects of conditions existing at the balance date.

All impairment losses are recognised in the income statement. An impairment loss is reversed if the reversal can be related objectively to an event occurring after the impairment loss was recognised. The reversal of impairment losses on financial assets is recognised in the income statement.

In assessing collective impairment, Cochlear uses historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgement as to whether current economic and credit conditions are such that the actual losses are likely to be greater or less than suggested by historical trends.

The ageing of Cochlear's trade receivables at the reporting date was:

	2014 \$000	2013 \$000
<b>Gross receivables</b>		
Not past due	152,076	138,570
Past due 0 – 30 days	18,373	18,651
Past due 31 – 120 days	19,102	15,680
Past due 121 – 270 days	6,805	5,877
Past due 271 days and over	8,464	12,379
	<b>204,820</b>	<b>191,157</b>
Impairment losses	(3,525)	(3,564)
<b>Trade receivables net of allowance for impairment losses</b>	<b>201,295</b>	<b>187,593</b>

## Notes to the Financial Statements Cochlear Limited and its controlled entities for the year ended 30 June 2014

There are certain jurisdictions in which Cochlear operates where it is customary practice for customers to make payment beyond 270 days. As such, Cochlear discloses the balance as overdue; however, it is not indicative of a higher than normal credit risk as payments are typically received by Cochlear within the extended timeframes.

The movement in the allowance for impairment losses in respect of trade receivables during the year was as follows:

	2014 \$000	2013 \$000
Balance at 1 July	(3,564)	(2,770)
Net impairment losses utilised/(recognised)	153	(562)
Effect of movements in foreign exchange	(114)	(232)
<b>Balance at 30 June</b>	<b>(3,525)</b>	<b>(3,564)</b>

Cochlear has established an allowance for impairment that represents its estimate of incurred losses in respect of trade and other receivables. The main components of this allowance are a specific loss component that relates to individually significant exposures and a collective loss component established for groups of assets meeting certain ageing profiles and customer types which have been assessed as impaired under Cochlear's accounting policy as detailed above.

Based upon past experience, Cochlear believes that no impairment allowance is necessary in respect of trade receivables not past due.

The allowance accounts used in respect of trade receivables are used to record impairment losses unless Cochlear is satisfied that no recovery of the amount owing is possible; at that point, the amount considered non-recoverable is written off against the financial asset directly.

### (c) Liquidity risk

Liquidity risk is the risk that Cochlear will not be able to meet its financial obligations as they fall due. Cochlear's approach to managing liquidity is to ensure, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to Cochlear's reputation.

Cochlear monitors cash flow requirements and produces cash flow projections for the short and long term with a view to optimising return on investments. Typically, Cochlear ensures that it has sufficient funds on demand to meet expected operational net cash flows for a period of at least 30 days, including the servicing of financial obligations. This excludes the potential impact of extreme circumstances that cannot reasonably be predicted, such as natural disasters. In addition, Cochlear maintains lines of credit which are set out in Note 21(c).

### Non-derivative assets and liabilities

The following are the contractual maturities of non-derivative financial liabilities, including estimated interest payments and excluding the impact of netting agreements:

	Effective interest rate Per annum	Carrying amount \$000	Contractual cash flows \$000	6 months or less \$000	6 – 12 months \$000	1 – 2 years \$000	2 – 5 years \$000	More than 5 years \$000
<b>Non-derivative financial liabilities 30 June 2014</b>								
AUD floating rate loan	4.04%	234,274	256,496	4,791	4,713	209,176	37,816	-
JPY floating rate loan	0.65%	3,141	3,154	10	3,144	-	-	-
Trade and other payables	-	78,644	78,644	78,644	-	-	-	-
<b>Total</b>		<b>316,059</b>	<b>338,294</b>	<b>83,445</b>	<b>7,857</b>	<b>209,176</b>	<b>37,816</b>	<b>-</b>

	Effective interest rate Per annum	Carrying amount \$000	Contractual cash flows \$000	6 months or less \$000	6 – 12 months \$000	1 – 2 years \$000	2 – 5 years \$000	More than 5 years \$000
<b>Non-derivative financial liabilities 30 June 2013</b>								
AUD floating rate loan	4.63%	167,160	190,151	3,917	3,853	7,770	174,611	-
JPY floating rate loan	0.67%	3,309	3,324	12	3,312	-	-	-
Trade and other payables	-	81,874	81,874	81,874	-	-	-	-
<b>Total</b>		<b>252,343</b>	<b>275,349</b>	<b>85,803</b>	<b>7,165</b>	<b>7,770</b>	<b>174,611</b>	<b>-</b>

## Notes to the Financial Statements Cochlear Limited and its controlled entities for the year ended 30 June 2014

### 22. Financial risk management (continued)

It is not expected that the cash flows included in the maturity analysis could occur significantly earlier, or at significantly different amounts.

#### *Derivative assets and liabilities*

The following table indicates the periods in which the cash flows associated with Cochlear's derivatives that are cash flow hedges are expected to occur:

<b>30 June 2014</b>						
Amounts \$000	Carrying amount \$000	Expected cash flows \$000	6 months or less \$000	6 – 12 months \$000	1 – 2 years \$000	2 – 5 years \$000
<i>Forward exchange contracts</i>						
Assets	10,009	10,358	2,444	2,183	4,118	1,613
Liabilities	(9,244)	(9,456)	(3,202)	(3,519)	(1,670)	(1,065)
<b>Total</b>	<b>765</b>	<b>902</b>	<b>(758)</b>	<b>(1,336)</b>	<b>2,448</b>	<b>548</b>
<b>30 June 2013</b>						
Amounts \$000	Carrying amount \$000	Expected cash flows \$000	6 months or less \$000	6 – 12 months \$000	1 – 2 years \$000	2 – 5 years \$000
<i>Forward exchange contracts</i>						
Assets	4,362	4,454	1,821	1,697	936	-
Liabilities	(28,134)	(29,081)	(7,097)	(7,999)	(9,980)	(4,005)
<b>Total</b>	<b>(23,772)</b>	<b>(24,627)</b>	<b>(5,276)</b>	<b>(6,302)</b>	<b>(9,044)</b>	<b>(4,005)</b>

The expected impact on the income statement is not considered to be significantly different to the cash flow impact noted above.

## Notes to the Financial Statements

Cochlear Limited and its controlled entities for the year ended 30 June 2014

### (d) Market risk

Market risk is the risk that changes in market prices such as foreign exchange rates, interest rates and equity prices will affect Cochlear's net profit or the value of its holdings of financial instruments. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return.

Cochlear buys and sells derivatives in accordance with the treasury risk policy, and also incurs financial liabilities, in order to manage market risks. All such transactions are carried out within the guidelines set out by the treasury risk policy. Generally, Cochlear seeks to apply hedge accounting in order to manage volatility in earnings.

### Currency risk

Cochlear is exposed to currencies other than the respective functional currencies of the controlled entities, primarily AUD, USD, EUR, GBP, Swedish kroner (SEK), JPY and Swiss francs (CHF). The currencies in which these transactions primarily are denominated are AUD, USD, EUR, GBP, SEK and JPY.

Over 90% of Cochlear's revenues and over 50% of costs are denominated in currencies other than AUD. Currency risk is hedged in accordance with the treasury risk policy. Risk resulting from the translation of assets and liabilities of foreign operations into Cochlear's reporting currency is generally not hedged.

### Exposure to currency risk

Cochlear's exposure to foreign currency risk was as follows, based upon notional amounts:

Amounts local currency thousands	USD	EUR	GBP	SEK	JPY
<b>30 June 2014</b>					
Trade receivables	65,453	35,167	5,955	5,662	765,565
Secured bank loan	-	-	-	-	(300,000)
Trade payables	(10,572)	(4,299)	(5,919)	(33,040)	(60,776)
<b>Gross balance sheet exposure</b>	<b>54,881</b>	<b>30,868</b>	<b>36</b>	<b>(27,378)</b>	<b>404,789</b>

Amounts local currency thousands	USD	EUR	GBP	SEK	JPY
<b>30 June 2013</b>					
Trade receivables	62,627	38,978	3,211	6,100	669,529
Secured bank loan	-	-	-	-	(300,000)
Trade payables	(14,820)	(4,931)	(6,844)	(47,429)	(65,556)
<b>Gross balance sheet exposure</b>	<b>47,807</b>	<b>34,047</b>	<b>(3,633)</b>	<b>(41,329)</b>	<b>303,973</b>

Cochlear enters into forward exchange contracts to hedge anticipated sales and purchases in USD, EUR and JPY.

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



## Notes to the Financial Statements

Cochlear Limited and its controlled entities for the year ended 30 June 2014

### 22. Financial risk management (continued)

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

	Foreign exchange rates		Gross value	
	2014	2013	2014 \$000	2013 \$000
<b>Sell USD</b>				
Not later than one year			137,518	142,467
Later than one year but not later than two years			70,077	71,113
Later than two years but not later than five years			20,014	20,256
Weighted average exchange rates contracted	0.91	0.97		
<b>Sell EUR</b>				
Not later than one year			102,714	113,740
Later than one year but not later than two years			67,665	59,473
Later than two years but not later than five years			18,320	15,111
Weighted average exchange rates contracted	0.68	0.72		
<b>Sell JPY</b>				
Not later than one year			9,724	9,246
Later than one year but not later than two years			4,626	4,960
Later than two years but not later than five years			1,220	1,259
Weighted average exchange rates contracted	87.27	83.72		

The following significant exchange rates applied to Cochlear during the year:

AUD1 =	Average rate		Reporting date spot rate	
	2014	2013	2014	2013
USD	0.922	1.022	0.937	0.928
EUR	0.679	0.794	0.689	0.711
GBP	0.567	0.654	0.552	0.603
SEK	6.022	6.796	6.311	6.239
JPY	92.916	89.349	95.514	90.666

## Notes to the Financial Statements Cochlear Limited and its controlled entities for the year ended 30 June 2014

### *Interest rate risk*

Cochlear is exposed to interest rate risks in Australia and Japan. See Note 22(c) for effective interest rates, repayment and repricing analysis of outstanding debt.

Interest rate risk is hedged on a case-by-case basis by assessing the term of borrowings and the purpose for which the funds are obtained. Hedging against interest rate risk is achieved by entering into interest rate swaps.

### *Profile*

At the reporting date, the interest rate profile of Cochlear's interest-bearing financial instruments was as follows:

	2014 \$000	2013 \$000
<b>Carrying amount</b>		
<i>Variable rate instruments</i>		
Financial assets	56,127	52,689
Financial liabilities	237,415	170,469

At 30 June 2014, no interest rate hedging had been entered into.

### *Sensitivity analysis*

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

For the year ended 30 June 2014, it is estimated that a general increase of one percent in interest rates would have decreased Cochlear's profit after income tax and equity by approximately \$1.3 million (2013: \$0.6 million). A one percent general decrease in interest rates would have had the equal but opposite effect on Cochlear's profit and equity.

It is estimated that a general increase of 10 percent in the value of the AUD against other foreign currencies would have decreased Cochlear's profit for the year ended 30 June 2014, including hedging results and after income tax, by approximately \$4.7 million (2013: \$6.1 million) and decreased Cochlear's equity by \$12.9 million (2013: \$14.5 million). A 10 percent general decrease in the value of the AUD against other foreign currencies would have increased Cochlear's profit by \$5.8 million (2013: \$7.2 million) and increased equity by \$14.1 million (2013: \$14.2 million).

### **(e) Operational risk**

Operational risk is the risk of direct and indirect loss arising from a wide variety of causes associated with Cochlear's processes, personnel, technology and infrastructure, and from external factors other than credit, liquidity and market risks such as those arising from legal and regulatory requirements and generally accepted standards of corporate behaviour. Operational risks arise from all of Cochlear's operations.

Cochlear's objective is to manage operational risk so as to balance the avoidance of financial losses and damage to Cochlear's reputation with overall cost effectiveness and to avoid control procedures that restrict initiative and creativity.

The primary responsibility for the development and implementation of controls to address operational risk is assigned to the Risk Management Committee. This responsibility is supported by the development of standards for the management of operational risk in the following areas:

- requirements for appropriate segregation of duties, including the independent authorisation of transactions;
- requirements for the reconciliation and monitoring of transactions;
- compliance with regulatory and other legal requirements;
- documentation of controls and procedures;
- requirements for the periodic assessment of operational risks faced, and the adequacy of controls and procedures to address the risks identified;
- development of contingency plans;
- training and professional development;
- ethical and business standards; and
- risk mitigation, including insurance where this is effective.

Compliance with standards is supported by a program of periodic reviews undertaken by Internal Audit. The results of Internal Audit reviews are discussed with the management of the business unit to which they relate, with summaries submitted to the Audit Committee and senior management of Cochlear.

## Notes to the Financial Statements Cochlear Limited and its controlled entities for the year ended 30 June 2014

### 22. Financial risk management (continued)

#### (f) Fair values

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

	Note	2014		2013	
		Carrying amount	Fair value	Carrying amount	Fair value
		\$000	\$000	\$000	\$000
Cash and cash equivalents	9(a)	56,127	56,127	52,689	52,689
Trade and other receivables – current	16	214,953	214,953	203,748	203,748
Trade and other receivables – non-current	16	5,505	5,505	944	944
Trade and other payables – current		(78,644)	(78,644)	(81,874)	(81,874)
Forward exchange contracts – liabilities current		(6,643)	(6,643)	(14,915)	(14,915)
Forward exchange contracts – liabilities non-current		(2,624)	(2,624)	(13,242)	(13,242)
Secured bank loans – current	21(c)	(3,141)	(3,141)	(3,309)	(3,309)
Secured bank loans – non-current <sup>(i)</sup>	21(c)	(234,274)	(235,000)	(167,160)	(168,000)
<b>Total</b>		<b>(48,741)</b>	<b>(49,467)</b>	<b>(23,119)</b>	<b>(23,959)</b>

(i) Included within the carrying amount of secured bank loans is an amount of \$725,606 (2013: \$840,028) in relation to unamortised loan establishment fees.

#### Basis for determining fair values

The following summarises the significant methods and assumptions used in estimating the fair values of financial instruments reflected in the table above.

#### Forward exchange contracts

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 a risk free interest rate based upon government bonds. These fair values are provided by independent third parties.

#### Non-derivative financial assets and liabilities

The fair value of cash, receivables, payables and short-term borrowings is considered to approximate their carrying amount because of their short maturity.

The directors consider the carrying amount of long-term borrowings recorded in the financial statements approximates their fair value as interest rates on loans and borrowings are variable.

#### Other

Other non-derivative financial instruments are measured at amortised cost using the effective interest rate method, less any impairment losses.

## Notes to the Financial Statements

Cochlear Limited and its controlled entities for the year ended 30 June 2014

### Fair value hierarchy

The table below analyses financial instruments carried at fair value, by the levels in the value hierarchy. The different levels have been defined as follows:

- 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).

	Level 2 \$000	Total \$000
<b>30 June 2014</b>		
<i>Derivative financial assets</i>		
Forward exchange contracts used for hedging	10,009	10,009
<b>Total assets</b>	<b>10,009</b>	<b>10,009</b>
<i>Derivative financial liabilities</i>		
Forward exchange contracts used for hedging	(9,244)	(9,244)
Other forward exchange contracts	(23)	(23)
<b>Total liabilities</b>	<b>(9,267)</b>	<b>(9,267)</b>
<b>30 June 2013</b>		
<i>Derivative financial assets</i>		
Forward exchange contracts used for hedging	4,362	4,362
<b>Total assets</b>	<b>4,362</b>	<b>4,362</b>
<i>Derivative financial liabilities</i>		
Forward exchange contracts used for hedging	(28,134)	(28,134)
Other forward exchange contracts	(23)	(23)
<b>Total liabilities</b>	<b>(28,157)</b>	<b>(28,157)</b>

There have been no transfers between levels during the year. There are no other financial instruments carried at fair value or valued using a Level 1 or Level 3 valuation method.

### (g) Accounting policy for financial instruments

#### Non-derivative financial assets

Cochlear initially recognises loans and receivables and deposits on the date that they are originated. All other financial assets (including assets designated at fair value through profit or loss) are recognised initially on the trade date at which Cochlear becomes a party to the contractual provisions of the instrument.

Cochlear derecognises a financial asset when the contractual rights to the cash flows from the asset expire, or it transfers the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that is created or retained by Cochlear is recognised as a separate asset or liability.

Financial assets and liabilities are offset and the net amount presented in the balance sheet when, and only when, Cochlear has a legal right to offset the amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

Cochlear has the following non-derivative financial assets: financial assets at fair value through profit or loss and loans and receivables.

#### Financial assets at fair value through profit or loss

A financial asset is classified as at fair value through profit or loss if it is classified as held for trading or is designated as such upon initial recognition. Financial assets are designated at fair value through profit or loss if Cochlear manages such investments and makes purchase and sale decisions based on their fair value in accordance with Cochlear's documented risk management or investment strategy. Attributable transaction costs are recognised in profit or loss when incurred. Financial assets at fair value through profit or loss are measured at fair value, and changes therein are recognised in profit or loss.

## Notes to the Financial Statements Cochlear Limited and its controlled entities for the year ended 30 June 2014

### 22. Financial risk management (continued)

#### *Loans and receivables*

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are recognised initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition, loans and receivables are measured at amortised cost using the effective interest rate method, less any impairment losses.

Loans and receivables comprise cash and cash equivalents, and trade and other receivables.

#### *Non-derivative financial liabilities*

Cochlear initially recognises debt securities issued and subordinated liabilities on the date that they are originated. All other financial liabilities (including liabilities designated at fair value through profit or loss) are recognised initially on the trade date at which Cochlear becomes a party to the contractual provisions of the instrument.

Cochlear derecognises a financial liability when its contractual obligations are discharged or cancelled or expire.

Financial assets and liabilities are offset and the net amount presented in the balance sheet when, and only when, Cochlear has a legal right to offset the amounts and intends either to settle on a net basis or to realise the asset and settle the liability simultaneously.

Cochlear classifies non-derivative financial liabilities into the other financial liabilities category. Such financial liabilities are recognised initially at fair value less any directly attributable transaction costs. Subsequent to initial recognition, these financial liabilities are measured at amortised cost using the effective interest rate method.

Other financial liabilities comprise bank overdrafts, other loans and borrowings and trade and other payables.

Bank overdrafts that are repayable on demand and form an integral part of Cochlear's cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

Accounting for finance income and expense is discussed in Note 21(d).

#### *Derivative assets and liabilities*

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

On initial designation of the hedge, Cochlear formally documents the relationship between the hedging instrument and hedged item, including the risk management objectives and strategy in undertaking the hedge transaction, together with the methods that will be used to assess the effectiveness of the hedging relationship. Cochlear makes an assessment, both at inception of the hedge relationship as well as on an ongoing basis, whether the hedging instruments are expected to be highly effective in offsetting the changes in the fair value or cash flows of the respective hedged items during the year for which the hedge is designated, and whether the actual results of each hedge are within a range of 80% to 125%. For a cash flow hedge of a forecast transaction, the transaction should be highly probable to occur and should present an exposure to variations in cash flows that could ultimately occur.

Derivative financial instruments are recognised initially at fair value. Attributable transaction costs are recognised in the income statement when incurred. Subsequent to initial recognition, derivative financial instruments are measured at fair value with changes in fair value accounted for as described below.

In the year ended 30 June 2014, Cochlear designated some sales and purchases of various currencies as cash flow hedges to hedge the amount converted into AUD for forecast future transactions. These are hedges of forecast future transactions to manage the currency risk arising from exchange rate fluctuations. The hedged items were highly probable foreign currency transactions.

The effectiveness of the hedging relationship is calculated prospectively using regression analysis on market values. An effectiveness test is carried out retrospectively using the cumulative dollar offset method. For this, the changes in the fair values of the hedged item and the hedging instrument attributable to spot rate changes are calculated and a ratio is created. If this ratio is between 80% and 125%, the hedge is effective.

All material hedges were effective at the reporting date.

Changes in the fair value of a derivative financial instrument designated as a cash flow hedge are recognised directly in equity to the extent that the hedge is effective. To the extent that the hedge is ineffective, changes in fair value are recognised in the income statement.

If the derivative financial instrument no longer meets the criteria for hedge accounting, expires or is sold, terminated or exercised, then hedge accounting is discontinued prospectively. The cumulative gain or loss previously recognised in equity remains there until the forecast transaction occurs or when cash flows arising from the transaction are received.

When the forecast transaction subsequently results in the recognition of a non-financial asset or non-financial liability, the associated cumulative gain or loss is removed from equity and transferred to the carrying amount of the non-financial asset or liability. If a hedge of a forecast transaction subsequently results in the recognition of a financial asset or a financial liability, then the associated gains and losses that were previously recognised directly in equity are reclassified into the income statement in the same year or years during which the asset acquired or liability assumed affects the income statement.

## Notes to the Financial Statements Cochlear Limited and its controlled entities for the year ended 30 June 2014

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

### 23. Capital and reserves

#### Share capital

	Number of issued shares in market circulation		Number of shares held in Trust under CELTIP		Total number of issued shares	
	2014	2013	2014	2013	2014	2013
On issue 1 July – fully paid	56,915,289	56,865,878	125,643	63,554	57,040,932	56,929,432
Issued for nil consideration under Employee Share Plan	21,088	16,302	-	-	21,088	16,302
Shares purchased from the market	-	(68,872)	-	68,872	-	-
Issued from the exercise of options	-	95,198	-	-	-	95,198
Performance shares issued from Trust	1,142	6,783	(1,142)	(6,783)	-	-
<b>On issue 30 June – fully paid</b>	<b>56,937,519</b>	<b>56,915,289</b>	<b>124,501</b>	<b>125,643</b>	<b>57,062,020</b>	<b>57,040,932</b>

Cochlear has also issued options (see Note 14).

The Company does not have authorised capital or par value in respect of its issued shares.

#### Ordinary shares

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at shareholders' meetings.

Ordinary shares are classified as equity.

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

#### Repurchase of share capital (treasury shares)

When share capital recognised as equity is repurchased, the amount of the consideration paid, including directly attributable costs, is recognised as a deduction from equity, net of any tax effects. Repurchased shares are classified as treasury shares and are presented as a deduction from total equity. When treasury shares are subsequently sold or reissued, the amount received is recognised as an increase in equity, and the surplus or deficit on the transaction is transferred to or from the share based payments reserve.

#### Treasury reserve

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

#### Translation reserve

The translation reserve records the foreign currency differences arising from the translation of the financial statements of foreign operations as well as from the translation of liabilities that hedge the Company's net investment in a foreign subsidiary, where their functional currency is different to the presentation currency of the reporting entity. See Note 2(d) for further details.

#### Hedging reserve

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

#### Share based payment reserve

The share based payment reserve comprises the cost of shares, options and rights granted to eligible executives under the CELTIP and CEIP, as detailed in Note 14 less any payments made to meet its obligations through the acquisition of shares on market, together with any deferred tax asset/liability on such payments.

## Notes to the Financial Statements Cochlear Limited and its controlled entities for the year ended 30 June 2014

### 24. Capital management

Cochlear's objectives when managing capital are to safeguard its ability to continue as a going concern, to provide returns to shareholders, to provide benefits to other stakeholders and to maintain an optimal capital structure to reduce the cost of capital.

The Board aims to maintain and develop a capital base appropriate to Cochlear's objectives and monitors a number of qualitative metrics as follows:

- net gearing ratio – defined as net debt as a proportion of net debt plus total equity;
- dividend payout ratio – defined as dividends as a proportion of net profit after tax for a given period;
- growth in EPS – defined as the compound annual growth percentage in EPS over a three year period; and
- TSR – defined as the percentage growth in share price over a three year period plus the cumulative three year dividend return calculated against the opening share price in the same three year period.

In order to maintain or adjust the capital structure, Cochlear may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares or sell assets to reduce debt.

Senior management tracks, manages and reports against these capital management metrics periodically as part of broader corporate governance responsibilities. In addition, the Board of directors undertakes periodic reviews of Cochlear's capital management position to assess whether the metrics continue to be appropriate and whether the capital management structure is appropriate to meet Cochlear's medium and long-term strategic requirements.

Neither the Company nor any of its subsidiaries is subject to externally imposed capital requirements.

There were no significant changes in Cochlear's approach to capital management during the year.

Cochlear's net gearing ratio was as follows:

	Note	2014 \$000	2013 \$000 Restated*
Net debt	21(a)	181,288	117,780
Total equity*		329,205	354,511
<b>Net gearing ratio at 30 June</b>		<b>36%</b>	<b>25%</b>

\* Restated for change in accounting policy, refer Note 30.

## Notes to the Financial Statements

Cochlear Limited and its controlled entities for the year ended 30 June 2014

### Other notes

#### 25. Auditors' remuneration

	2014	2013
	\$	\$
<b>Audit services</b>		
<i>Auditors of the Company:</i>		
KPMG:		
– audit and review of financial reports	1,422,391	1,336,981
– other regulatory compliance services	42,875	58,925
<b>Total audit services</b>	<b>1,465,266</b>	<b>1,395,906</b>
<b>Non-audit services</b>		
<i>Auditors of the Company:</i>		
KPMG:		
– taxation compliance services	818,282	1,211,162
<b>Total non-audit services</b>	<b>818,282</b>	<b>1,211,162</b>

#### 26. Commitments

	2014	2013
	\$000	\$000
<b>Operating lease commitments</b>		
Future non-cancellable operating lease rentals not provided for in the financial statements are payable as follows:		
Not later than one year	20,716	21,763
Later than one year but not later than five years	74,934	62,709
Later than five years	97,163	100,059
<b>Total operating lease commitments</b>	<b>192,813</b>	<b>184,531</b>
<b>Capital expenditure commitments</b>		
Contracted but not provided for and payable:		
Not later than one year	1,972	1,553
<b>Total capital expenditure commitments</b>	<b>1,972</b>	<b>1,553</b>

Cochlear leases property under non-cancellable operating leases expiring from one to 15 years. Leases generally provide Cochlear with a right of renewal at which time all terms are renegotiated. Lease payments comprise a base amount plus an incremental contingent rental. Contingent rentals are based on movements in the Consumer Price Index.

#### 27. Contingent liabilities

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

##### Product liability claims

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

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

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.



## Notes to the Financial Statements

Cochlear Limited and its controlled entities for the year ended 30 June 2014

28. Controlled entities	Interest held		Country of incorporation/formation
	2014 %	2013 %	
<b>Particulars in relation to controlled entities</b>			
<i>Company</i>			
Cochlear Limited			Australia
<i>Controlled entities</i>			
Acoustic Implants Limited	100	100	UK
Cochlear AG	100	100	Switzerland
Cochlear Americas	100	100	USA
Cochlear Benelux NV	100	100	Belgium
Cochlear Bone Anchored Solutions AB	100	100	Sweden
Cochlear Boulder LLC	100	100	USA
Cochlear Canada Inc	100	100	Canada
Cochlear Clinical Services LLC	100	100	USA
Cochlear Deutschland GmbH & Co KG	100	100	Germany
Cochlear Employee Share Trust	100	100	Australia
Cochlear Europe Finance GmbH	100	100	Germany
Cochlear Europe Limited	100	100	UK
Cochlear Executive Long Term Incentive Plan (Performance Shares) Trust	100	100	Australia
Cochlear Finance Pty Limited	100	100	Australia
Cochlear France SAS	100	100	France
Cochlear German Holdings Pty Limited	100	100	Australia
Cochlear Holdings NV	100	100	Belgium
Cochlear Incentive Plan Pty Limited	100	100	Australia
Cochlear Investments Pty Ltd	100	100	Australia
Cochlear Italia SRL	100	100	Italy
Cochlear Korea Limited	100	100	Korea
Cochlear Latinoamerica S.A.	100	100	Panama
Cochlear Malaysia Sdn. Bhd.	100	100	Malaysia
Cochlear Manufacturing Corporation	100	100	USA
Cochlear Medical Device (Beijing) Co., Ltd	100	100	China
Cochlear Medical Device Company India Private Limited	100	100	India
Cochlear Middle East FZ-LLC	100	-	UAE
Cochlear Nordic AB	100	100	Sweden
Cochlear NZ Limited	100	100	New Zealand
Cochlear Research and Development Limited	100	100	UK
Cochlear Sweden Holdings AB	100	100	Sweden
Cochlear Technologies Pty Limited (i)	100	100	Australia
Cochlear Tibbi Cihazlar ve Saglik Hizmetleri Limited Sirketi	100	100	Turkey
Cochlear Verwaltungs GmbH	100	100	Germany
Cochlear (HK) Limited	100	100	Hong Kong
Cochlear (UK) Limited (i)	100	100	UK
Isitme Implantlari Tibbi Cihazlar ve Saglik Hizmetleri Ltd Sti	100	100	Turkey
Lachlan Project Development Pty Ltd	100	100	Australia
Lachlan Project Holdings Pty Ltd	100	100	Australia

## Notes to the Financial Statements

Cochlear Limited and its controlled entities for the year ended 30 June 2014

	Interest held		Country of incorporation/formation
	2014 %	2013 %	
Lachlan Project Security Holdings Pty Ltd	100	100	Australia
Medical Insurance Pte Limited	100	100	Singapore
Miaki NV	100	100	Belgium
Neopraxis Pty Limited (i)	100	100	Australia
Nihon Cochlear Co Limited	100	100	Japan
Percutis AB	-	100	Sweden

(i) Dormant.

### 29. Parent entity disclosures

At, and throughout the financial year ended, 30 June 2014, the parent company of Cochlear was Cochlear Limited.

	Company	
	2014 \$000	2013 \$000
<b>Result of the parent entity</b>		
Net profit	136,541	158,414
Other comprehensive income/(loss)	17,155	(47,449)
<b>Total comprehensive income</b>	<b>153,696</b>	<b>110,965</b>
<b>Financial position of the parent entity at year end</b>		
Current assets	209,772	197,014
Total assets	683,453	636,642
Current liabilities	85,981	110,457
Total liabilities	412,679	382,022
<i>Total equity of the parent entity comprising of:</i>		
Issued capital	152,599	128,196
Treasury reserve	(8,463)	(9,408)
Translation reserve	13	123
Hedging reserve	476	(16,680)
Share based payment reserve	19,963	39,221
Retained earnings	106,186	113,168
<b>Total equity</b>	<b>270,774</b>	<b>254,620</b>

Dividend income from subsidiaries is recognised by the parent entity when the dividends are declared by the subsidiary.

#### Parent entity contingencies

The details of all contingent liabilities in respect to Cochlear Limited are disclosed in Note 27.

## Notes to the Financial Statements Cochlear Limited and its controlled entities for the year ended 30 June 2014

### 29. Parent entity disclosures (continued)

#### Parent entity capital commitments for acquisition of plant and equipment

	Company	
	2014	2013
	\$000	\$000
<i>Plant and equipment</i>		
<i>Contracted but not yet provided for and payable:</i>		
Within one year	1,972	1,553
<b>Total parent entity capital commitments for acquisition of plant and equipment</b>	<b>1,972</b>	<b>1,553</b>

### 30. Changes in accounting policies

Cochlear has adopted the following new standards and amendments to standards, including any consequential amendments to other standards, with a date of initial application of 1 July 2013:

#### **AASB 10 Consolidated Financial Statements (2011)**

In accordance with the transitional provisions of AASB 10 (2011), the Consolidated Entity reassessed the control conclusion for its investees at 1 July 2013 and there have been no changes.

#### **AASB 13 Fair Value Measurement**

In accordance with the transitional provisions of AASB 13, the Consolidated Entity has applied the new fair value measurement guidance prospectively, and has not provided any comparative information for new disclosures (refer Note 22). Notwithstanding the above, the change had no significant impact on the measurements of the Consolidated Entity's assets and liabilities.

#### **AASB 119 Employee Benefits (2011)**

As a result of AASB 119 (2011), the Consolidated Entity has changed its accounting policy with respect to the basis for determining the income or expense related to defined benefit plans.

Under AASB 119 (2011), the Consolidated Entity determines the net interest expense/(income) for the period on the net defined benefit liability/(asset) by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the net defined benefit liability/(asset) at the beginning of the annual period, taking into account any changes in the net defined benefit liability/(asset) during the period as a result of contributions and benefit payments. Consequently, the net interest on the net defined benefit liability/(asset) now comprises:

- interest cost on the defined benefit obligation;
- interest income on plan assets; and
- interest on the effect on the asset ceiling.

Previously, the Consolidated Entity determined interest income on plan assets based on their long-term rate of expected return.

Under AASB 119 (2011), the Consolidated Entity changed its accounting policy for recognition of actuarial gains and losses arising from its defined benefit plan from the corridor method to the direct to equity method. Previously unrecognised actuarial gains and losses under the corridor method have been recognised on the balance sheet as part of the net defined benefit obligation.

## Notes to the Financial Statements Cochlear Limited and its controlled entities for the year ended 30 June 2014

The overall impact to the financial statements is considered immaterial. The following table summarises the adjustments made to the balance sheet on implementation of the new accounting policy:

	Provisions – non-current \$000	Deferred tax assets \$000	Retained earnings \$000
Balance at 1 July 2012, as previously reported	35,056	50,495	280,506
Impact of the change in accounting policy at 1 July 2012	2,858	686	(2,172)
<b>Restated balance at 1 July 2012</b>	<b>37,914</b>	<b>51,181</b>	<b>278,334</b>
Balance at 30 June 2013, as previously reported	35,356	56,663	270,558
Impact of the change in accounting policy at 1 July 2012	2,858	686	(2,172)
Impact of the change in accounting policy during the year ended 30 June 2013	303	73	(230)
<b>Restated balance at 30 June 2013</b>	<b>38,517</b>	<b>57,422</b>	<b>268,156</b>

The effect on the statement of comprehensive income was as follows:

Increase in other comprehensive loss for the year ended June 2013 by \$230,000.

The change in accounting policy had an immaterial impact on EPS for the comparative period.

### 31. New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are effective for financial years beginning after 1 July 2013, and have not been applied in preparing these consolidated financial statements. Of the new standards, only the following is expected to have an effect on the consolidated financial statements of Cochlear:

- AASB 9 Financial Instruments, which becomes mandatory for Cochlear's 2018 consolidated financial statements.

Cochlear is currently assessing the impact of the changes in the above standard and it is not expected that the changes will have a significant impact on Cochlear. As such, Cochlear does not plan to adopt this standard early.

### 32. Events subsequent to the reporting date

Other than the matters noted 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 significantly affect 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 30 June 2014, see Note 8.

## Directors' Declaration Cochlear Limited and its controlled entities for the year ended 30 June 2014

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1. In the opinion of the directors of Cochlear Limited (the Company):
  - (a) the consolidated financial statements and notes and the Remuneration Report in the Directors' Report set out on pages 31 to 105, are in accordance with the *Corporations Act 2001*, including:
    - (i) giving a true and fair view of the Consolidated Entity's financial position as at 30 June 2014 and of its performance for the financial year ended on that date; and
    - (ii) complying with Australian Accounting Standards and the Corporations Regulations 2001; and
  - (b) there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.
2. The directors have been given the declarations required by section 295A of the *Corporations Act 2001* from the CEO/President and Chief Financial Officer for the financial year ended 30 June 2014.
3. The directors draw attention to Note 2(a) to the consolidated financial statements, which includes a statement of compliance with International Financial Reporting Standards.

Signed in accordance with a resolution of the directors:

Dated at Sydney this 5th day of August 2014.



Director



Director

## Independent Audit Report to the Members of Cochlear Limited.

### Report on the financial report

We have audited the accompanying financial report of Cochlear Limited (the company), which comprises the consolidated balance sheet as at 30 June 2014, and consolidated income statement, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year ended on that date, notes 1 to 32 comprising a summary of significant accounting policies and other explanatory information and the directors' declaration of the Consolidated Entity comprising the company and the entities it controlled at the year's end or from time to time during the financial year.

### Directors' responsibility for the financial report

The directors of the company are responsible for the preparation of the 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 financial report that is free from material misstatement whether due to fraud or error. In note 2(a), the directors also state, in accordance with Australian Accounting Standard AASB 101 Presentation of Financial Statements, that the financial statements of the Consolidated Entity comply with International Financial Reporting Standards.

### Auditor's responsibility

Our responsibility is to express an opinion on the financial report based on our audit. We conducted our audit in accordance with Australian Auditing Standards. These Auditing Standards require that we comply with relevant ethical requirements relating to audit engagements and plan and perform the audit to obtain reasonable assurance whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the financial report that gives a true and fair view in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the directors, as well as evaluating the overall presentation of the financial report.

We performed the procedures to assess whether in all material respects the financial report presents fairly, in accordance with the *Corporations Act 2001* and Australian Accounting Standards, a true and fair view which is consistent with our understanding of the Consolidated Entity's financial position and of its performance.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### Independence

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

### Auditor's opinion

In our opinion:

- (a) the financial report of the Consolidated Entity is in accordance with the *Corporations Act 2001*, including:
  - (i) giving a true and fair view of the Consolidated Entity's financial position as at 30 June 2014 and of its performance for the year ended on that date; and
  - (ii) complying with Australian Accounting Standards and the Corporations Regulations 2001.
- (b) the financial report also complies with International Financial Reporting Standards as disclosed in note 2(a).

### Emphasis of matter

We draw attention to note 20 to the financial statements which describes the uncertainty related to the outcome of the lawsuit filed against the Consolidated Entity for alleged patent infringement. Our audit report is not modified in respect of this matter.

### Report on the remuneration report

We have audited the remuneration report included in pages 31 to 53 of the directors' report for the year ended 30 June 2014. The directors of the company are responsible for the preparation and presentation of the remuneration report in accordance with Section 300A of the *Corporations Act 2001*. Our responsibility is to express an opinion on the remuneration report, based on our audit conducted in accordance with auditing standards.

### Auditor's opinion

In our opinion, the remuneration report of Cochlear Limited for the year ended 30 June 2014, complies with Section 300A of the *Corporations Act 2001*.

## Additional information

Additional information required by Australian Securities Exchange Listing Rules and not disclosed elsewhere in this report – the information presented is as at 30 July 2014:

### Shareholdings

#### Substantial shareholders

Shareholder	Number of ordinary shares held	%
Baillie Gifford & Co	6,733,235	11.80
Schroders PLC	4,176,928	7.32
Generation Investment Management LLP	3,501,751	6.14
Veritas Asset Management (UK) Ltd	3,396,738	5.95
Harding Loevner LP	3,394,696	5.95
Hyperion Asset Management Limited	2,857,097	5.01
<b>Total</b>	<b>24,060,445</b>	<b>42.17</b>

#### Distribution of shareholders

Number of shares held	Number of ordinary shareholders
1 – 1,000	29,954
1,001 – 5,000	3,146
5,001 – 10,000	184
10,001 – 100,000	77
100,001 and over	16
<b>Total</b>	<b>33,377</b>

Non-marketable parcels – 196 shareholders held less than a marketable parcel of ordinary shares

#### Twenty largest shareholders

Shareholder	Number of ordinary shares held	%
HSBC Custody Nominees (Australia) Limited	13,518,047	23.69
JP Morgan Nominees Australia Limited	10,392,855	18.21
National Nominees Limited	9,141,537	16.02
Citicorp Nominees Pty Limited	2,014,156	3.53
BNP Paribas Noms Pty Ltd (DRP)	1,045,771	1.83
Dr Christopher Graham Roberts	703,803	1.23
HSBC Custody Nominees (Australia) Limited (NT-Commonwealth Super Corp a/c)	668,761	1.17
UBS Nominees Pty Limited	381,948	0.67
RBC Investor Services Australia Nominees Pty Limited (Bkcust a/c)	269,177	0.47
Citicorp Nominees Pty Limited (BHP Billiton ADR Holders a/c)	266,567	0.47
Citicorp Nominees Pty Limited (Colonial First State Inv a/c)	235,999	0.41
BNP Paribas Nominees Pty Ltd (Agency Lending DRP a/c)	190,864	0.33
National Nominees Limited (DB a/c)	166,432	0.29
Cochlear Incentive Plan Pty Ltd	124,501	0.22
AMP Life Limited	111,635	0.20
PGA (Investments) Pty Ltd	100,000	0.18
ECapital Nominees Pty Limited (Settlement a/c)	93,268	0.16
Netwealth Investments Limited (Wrap services a/c)	88,572	0.16
BNP Paribas Noms (NZ) Ltd (DRP)	88,039	0.15
USB Wealth Management Australia Nominees Pty Ltd	85,151	0.15
		<b>69.54</b>

The 20 largest shareholders held 69.54% of the ordinary shares of the Company.

#### On market buy-back

There is no current on market buy-back.

## Glossary, Company ASX Announcement Record and Company Information

### Glossary

<p><b>AGM</b> Annual General Meeting.</p> <p><b>ASIC</b> Australian Securities and Investments Commission.</p> <p><b>ASX</b> Australian Securities Exchange.</p> <p><b>EBIT</b> Earnings before interest and tax.</p> <p><b>EBITDA</b> Earnings before interest, tax, depreciation and amortisation.</p> <p><b>EMEA</b> Europe, Middle East and Africa.</p> <p><b>EPS</b> Earnings per share.</p> <p><b>F12</b> Financial year 2012: 1 July 2011 to 30 June 2012.</p> <p><b>F13</b> Financial year 2013: 1 July 2012 to 30 June 2013.</p> <p><b>F14</b> Financial year 2014: 1 July 2013 to 30 June 2014.</p> <p><b>F15</b> Financial year 2015: 1 July 2014 to 30 June 2015.</p>	<p><b>FDA</b> United States Food and Drug Administration.</p> <p><b>FX</b> Foreign exchange.</p> <p><b>IFRS</b> International Financial Reporting Standards.</p> <p><b>KMP</b> Key management personnel.</p> <p><b>NPAT</b> Net profit after tax.</p> <p><b>Previous GAAP</b> Previous Australian Generally Accepted Accounting Principles.</p> <p><b>Processor/sound processor</b> The externally worn part of the cochlear implant.</p> <p><b>R&amp;D</b> Research and development.</p> <p><b>TSR</b> Total shareholder return.</p>
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### Company Information

#### Stock exchange listing

Australian Securities Exchange  
ASX code COH

#### Solicitors

Clayton Utz

#### Share registrar

Computershare Investor Services Pty Limited  
Level 4, 60 Carrington Street  
Sydney NSW 2000, Australia  
Tel: 61 3 9415 4000

#### Auditor

KPMG

#### Bankers

**Australia** Westpac Banking Corporation and HSBC Bank Australia Limited  
**Japan** The Bank of Tokyo-Mitsubishi UFJ, Limited  
**Sweden** Skandinaviska Enskilda Banken AB (publ)  
**United Kingdom** HSBC Bank plc  
**United States** Wells Fargo Bank West, NA

#### Annual General Meeting

The Annual General Meeting will be held at 10am on Tuesday 14 October 2014 at the Australian Securities Exchange, Exchange Square Auditorium, 20 Bridge Street, Sydney. A Notice of Annual General Meeting and Proxy Form are enclosed with this Annual Report.

#### Financial calendar

##### 2014

Dividend record date 4 September  
Payment of final dividend 25 September  
Annual General Meeting 14 October

##### 2015

Interim profit announcement 10 February\*  
Interim dividend record date 5 March\*  
Payment of interim dividend 26 March\*  
Final profit announcement 11 August\*  
Annual General Meeting 20 October\*

\* Indicative dates only.

ACE, Advance Off-Stylet, AOS, AutoNRT, Autosensitivity, Beam, Button, Carina, Cochlear, コクレア, Codacs, Contour, Contour Advance, Custom Sound, ESPrit, Freedom, Hear now. And always, Hybrid, inHear, Invisible Hearing, MET, MP3000, myCochlear, NRT, Nucleus, Nucleus in Chinese characters, Off-Stylet, SmartSound, Softip, SPrint, the elliptical logo and Whisper are either trademarks or registered trademarks of Cochlear Limited. Ardiium, Baha, Baha Divino, Baha Intenso, Baha PureSound, Baha SoftWear, DermaLock, Vistafix and WindShield are either trademarks or registered trademarks of Cochlear Bone Anchored Solutions AB.

#### Design

Cross Media Communications Pty Ltd

### Company ASX Announcement Record

#### 2 June 2014

*Cochlear to launch Nucleus Profile Implant Series*

Cochlear Limited announced it would be launching the Cochlear Nucleus Profile Series across Europe in June 2014. The first implant in the series, the Cochlear Nucleus Profile implant with Contour Advance electrode, has the thinnest implant body on the market.

#### 27 March 2014

*Half year report 2014*

Cochlear Limited provided an F14 half year report to shareholders listing half year revenues and sales.

#### 21 March 2014

*FDA approves Cochlear Nucleus Hybrid for sale in USA*

Cochlear Limited announced that the US FDA had approved the Cochlear Nucleus Hybrid L24 Cochlear Implant System for commercial release.

#### 11 February 2014

*Half year results announced*

Cochlear Limited announced revenue down 5% to \$371.1 million, with cochlear implant sales down by 14% for the six months ended 31 December 2013. The interim dividend of \$1.27 per share was up 2%.

#### 24 January 2014

*Jury trial verdict on USA Patent Infringement Case*

Cochlear Limited announced that a jury verdict in the patent infringement lawsuit by the Alfred E. Mann Foundation for Scientific Research and Advanced Bionics had been reached.

### Non-IFRS financial measures

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

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

- excluding patent dispute provision: IFRS measures adjusted for the expense of the patent dispute provision;
- excluding recall costs: IFRS measures adjusted for the costs of the product recall;
- constant currency: restatement of IFRS financial measures in comparative years using F14 FX rates; and
- free cash flow: IFRS cash flow from operating and investing activities excluding interest and tax paid related to non-operating activities.

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



# Hear now. And always

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**Cochlear Medical Device (Beijing) Co., Ltd** Unit 2208 Gemdale Tower B, 91 Jijiang Road, Chaoyang District, Beijing 100022, P.R. China Tel: +86 10 5909 7800 Fax: +86 10 5909 7900  
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**Cochlear Latinoamérica S.A.** International Business Park, Building 3835, Office 103, Panama Pacifico, Panama Tel: +507 830 6220 Fax: +507 830 6218  
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