

2019 COCHLEAR LIMITED  
Annual Report



*Hear now. And always*



# Contents

Hear now. And always



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## Shareholder reports

Cochlear publishes a number of online shareholder reports aimed at improving transparency and making information easier to access. They are a great companion to the Annual Report and are all available at the Investor section of the website, [www.cochlear.com](http://www.cochlear.com).



### Strategy Overview

The Strategy Overview provides an insight into Cochlear's strategy to retain market leadership, grow the hearing implant market and deliver consistent revenue and earnings growth over the long term.



### ESG Report

The ESG (Environmental, Social and Governance) Report outlines how we aim to improve the impact we have on our communities, the environment and our employees and reflects our commitment to high standards of corporate governance.



### Corporate Governance Statement

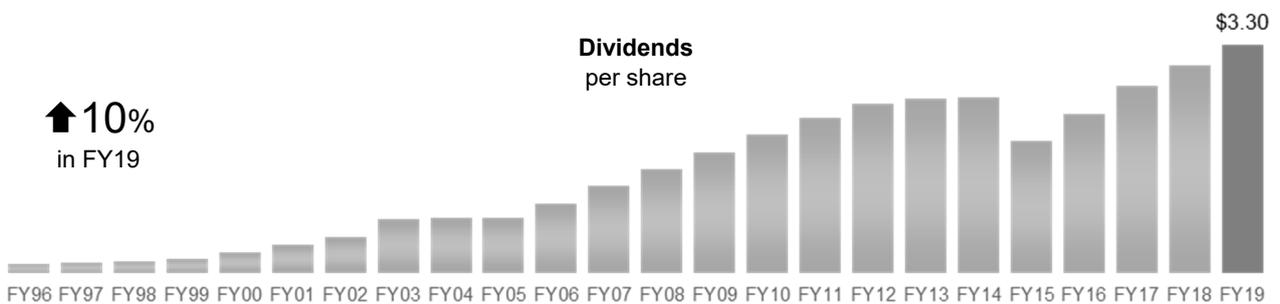
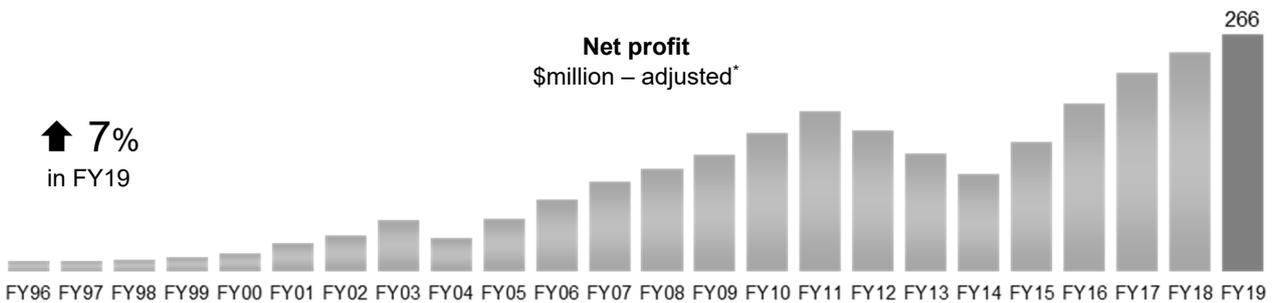
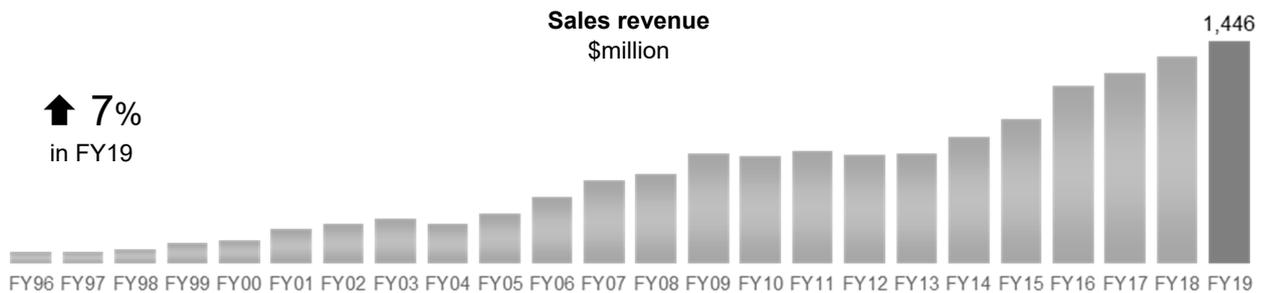
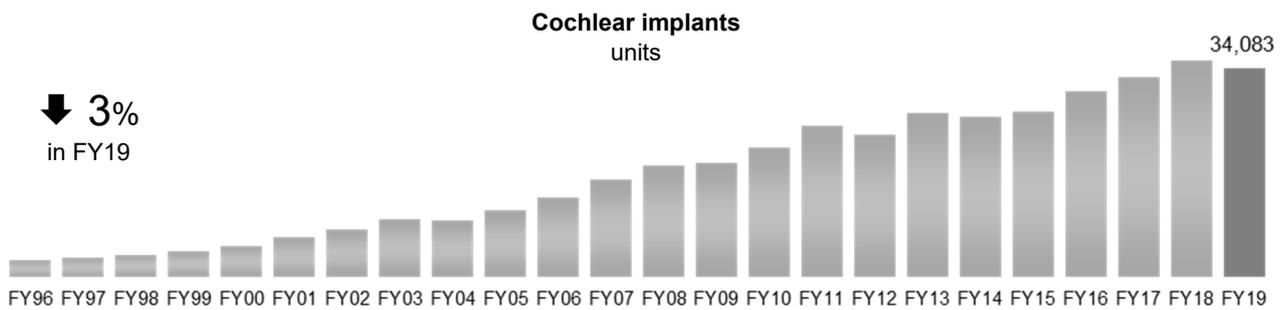
The Corporate Governance Statement summarises the Company's corporate governance practices and incorporates the disclosures required by the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations (3rd Edition).



### Tax Contribution Report

The Tax Contribution Report covers Cochlear's taxes paid in Australia and globally and details the global tax strategy.

**Cochlear has a long track record of delivering growing sales revenue, profits and dividends**



\* FY12 excludes product recall costs of \$101 million after tax, FY14 excludes patent dispute provision of \$16 million after tax and FY19 excludes a net \$11 million gain after tax from the revaluation of innovation fund investments.

Strategic priorities

FY19 achievements

Retain market leadership



Market-leading technology

World-class customer experience

- Increased investment in R&D by 10% to \$184m (13% of sales revenue)
- Product launches include Nucleus® Profile™ Plus Series cochlear implant, ForwardFocus feature, Nucleus 7 Android audio streaming capability, Cochlear™ Research Platform ECoChG surgical tool and Remote Check (pilot roll-out stage)
- Increased organisational capability through skills and leadership development
- Commenced clinical feasibility study for the totally implantable cochlear implant
- Investments in customer experience and customer engagement including rolling out website refresh in the US and expansion of Cochlear Family
- Strengthened the technology and commercial alliance with GN Hearing

Grow the hearing implant market



Awareness

Market access

Clinical evidence

- 7% growth in sales revenue
- Expansion of direct-to-consumer marketing and hearing aid channel referral programs
- Investment in activities to support cochlear implants becoming the standard of care for adults and seniors with severe to profound hearing loss
- Expanded market access capabilities globally
- Cost effectiveness data supporting continued funding of cochlear implantation in adults
- Positive results from clinical studies demonstrating the effectiveness of cochlear implants over hearing aids

Deliver consistent revenue and earnings growth



Invest to grow

Operational improvement

Strong financial position

- Realised operational improvements and efficiencies in supply chain, customer service, and transactional areas
- Cash flows reinvested into market growth activities, construction of China manufacturing facility, IT infrastructure, emerging market distributor acquisitions and investment in Nyxoah
- Operational improvements drive gross margin expansion, providing additional funds for investment
- Maintained strong balance sheet position with net debt increasing modestly to \$103m
- Increased dividends by 10%, achieving a 69% payout
- Delivered net profit of \$266m (excluding innovation fund revaluation gains), within guidance range provided
- Delivered net profit margin of 18%, in line with target



**FY19 has been a busy year, with a focus on building awareness and market access to cochlear implants, expanding our marketing activities and customer servicing capability while maintaining our commitment to product innovation through our investment in research and development (R&D).**

Cochlear reported a net profit of \$276.7 million, an increase of 13% on the FY18 result. Reported net profit includes a \$10.8 million net gain from the revaluation of innovation fund investments. Net profit excluding the revaluation was \$265.9 million, an increase of 7%.

### **Growing dividends**

Earnings growth, combined with strong cash flow generation, supported a second half dividend of \$1.75, with full year dividends increasing by 10% to \$3.30, fully franked.

The current dividend policy is maintained with the objective being to pay out around 70% of net profit as dividends. This policy is reviewed annually.

### **Building a consistent treatment pathway for adults**

Over the past 30 years, cochlear implants have been established as the standard of care for children born with a severe to profound hearing loss, with high adoption rates across most developed countries.

The challenge today is the lack of a consistent treatment pathway for diagnosing and treating adults. For many adults who are clear candidates, the pathway to cochlear implants is often haphazard with the vast majority unaware of the existence of cochlear implants.

Cochlear continues to work to build grass roots awareness with candidates including through its successful direct-to-consumer marketing activities. We have focused on building referrals from the hearing aid channel in the US

through the establishment of the Cochlear Provider Network, which links surgeons with hearing aid clinics, while building professional awareness through improved education.

We are also encouraging initiatives within the professional community, including leading cochlear implant surgeons and audiologists, to develop a consensus on the appropriate treatment pathway for adults with severe to profound sensorineural hearing loss, with solid progress made this year.

In March, an independent steering committee and panel of 30 audiologists and ENT surgeons across 13 countries, chaired by Professor Craig Buchman from Washington University, reached a consensus that could lay the foundations for the creation of international clinical practice guidelines for cochlear implantation, including patient identification, referral, implantation and rehabilitation.

The independent process has received funding support from a cross-industry group, including Cochlear, none of which had a voting role in the consensus.

### **Quality of life benefits of cochlear implants**

Positive results were achieved in the recent 'CI532 Multi-Center Clinical Study (532)\*', a study designed to measure the benefits of bimodal cochlear implantation – a cochlear implant in one ear, and a hearing aid in the other – on a large group of adults. The study found significant improvements in speech performance, self-perception of abilities and quality of life for people for this group, who had previously been hearing aid users.

We have been greatly encouraged by the results of the '532' study which found that, on average, participants achieved a 10-fold improvement in satisfaction with their hearing performance with cochlear implants over hearing aids, with dramatic improvements in the ability to understand conversations, hear on the phone and listen to and appreciate music.

We have long understood the hearing improvement provided by cochlear implants. This study goes a step further, demonstrating the impact the implant has on the patient's quality of life, an increasingly important component of determining the value of funded interventions to payers. As we increasingly work with the hearing aid channel, the '532' study provides an important foundation for educating hearing professionals of the benefits of cochlear implants over hearing aids in this patient population.

\* Clinical Evaluation of the Cochlear Nucleus CI532 Cochlear Implants in Adults. 2019 Jan; Data on file.

### Expanding indications for cochlear implants

One of the drivers of market growth for cochlear implants is the expansion of indications for funded implants. There are many countries that have either restrictive clinical indications or capped funding which limits access. We have been building our market access capability globally to advocate for the expansion of both indications and funding for cochlear implants.

In March, the UK announced an expansion to the reimbursement criteria for cochlear implants to include candidates with severe hearing loss, doubling the total addressable market. This change is a major milestone and is expected to support growth in the UK over the coming years. It follows recent changes in Japan and Taiwan (Greater China) where the expansion of clinical indications and/or reimbursement for cochlear implants has driven growing demand for implants.

We have other applications being assessed by health authorities and payers across the regions and hope to see further extension of the reimbursement criteria for cochlear implants in the coming years.

### Cost effectiveness of cochlear implants in adults

The senior's segment is the fastest growing segment across the developed markets driven by the growing awareness of the benefits of cochlear implants.

Cochlear implantation in older adults is an important treatment option as we better understand how severe to profound hearing loss reduces a person's ability to communicate and be socially engaged. Hearing loss is also associated with an increase in anxiety and depression, reduced quality of life, and can result in poor lifetime economic outcomes<sup>1</sup>.

At the same time, payers are increasingly demanding cost effectiveness data to support funding for health interventions. There are numerous studies demonstrating the cost effectiveness of cochlear implants in children but fewer adult studies. With the growing uptake of adult implantation, we are seeing a growing number of studies which support the value to payers of funding cochlear implantation of adults.

In the UK, the recent extension of the reimbursement criteria was supported by a health technology assessment conducted on behalf of NICE which supported the cost effectiveness of cochlear implantation in adults. In 2019, Macquarie University's Centre for the Health Economy also evaluated the cost effectiveness of cochlear implantation in

adults in the UK, finding that unilateral cochlear implants continue to be a cost-effective intervention for adults.

### Next phase in the development of a totally implantable cochlear implant

In October, Cochlear entered the next phase in its long-term R&D program towards a totally implantable cochlear implant, with the start of a further clinical feasibility study.

The study has been initiated to evaluate the performance and safety of our totally implantable cochlear implant technology, which can be used with and without an externally-worn sound processor, providing people with 24-hour hearing.

The study is being conducted in Australia, led by Associate Professor Robert Briggs (The Royal Victorian Eye and Ear Hospital) and Professor Robert Cowan (The HEARing CRC). This clinical feasibility study is expected to build on the initial clinical research conducted in 2005 with the first-generation investigational device and will inform further technology development.

The development of totally implantable cochlear implant technology is complex, with a commercially available product not expected for years.

### Cochlear and GN Hearing expand the Smart Hearing Alliance collaboration

In November, Cochlear and GN Hearing agreed to further strengthen their technology and commercial alliance to develop best-in-class integrated hearing solutions. The deepening of this relationship includes joint R&D, shared technology and a strengthened global Smart Hearing Alliance commercial collaboration between Cochlear and GN Hearing, the hearing aid division of the GN Group.

By expanding our collaboration with GN Hearing, we bring the latest in connectivity and wireless technology to our implant recipients more quickly. We are also able to give bimodal recipients unparalleled performance and a seamless experience with both devices. As two leaders in our areas of hearing health, this collaboration demonstrates our commitment to design and bring to market the best hearing solutions available.

### New addition to innovation fund

In November, Cochlear invested €13 million (A\$21 million) in Nyxoah S.A., a medical device company focused on the development and commercialisation of a best-in-class

hypoglossal nerve stimulation therapy for the treatment of obstructive sleep apnea.

The Nyxoah investment forms part of Cochlear's innovation fund, a fund established to invest in novel technologies and implantable devices that over the long term could leverage or enhance Cochlear's core technology.

### Patent dispute update

In November 2018, the US District Court awarded damages of US\$268 million against Cochlear in the long-running patent dispute with Alfred E. Mann Foundation for Scientific Research (AMF) and Advanced Bionics LLC (AB). Cochlear has appealed the decision, including the damages award and the finding of 'wilfulness' and has arranged an insurance bond of US\$335 million to stay the Judgment pending the appeal.

AMF and AB have subsequently asked the District Court to award US\$123 million in prejudgment interest. Cochlear has opposed both the application and the calculation methodology. The Judge has reserved his decision until further notice. Any interest award is contingent upon the current damages being upheld in the Appeals Court.

The Board has obtained independent legal advice on Cochlear's appeal prospects. The Board is of the opinion it is probable that Cochlear's appeal will result in the lawsuit being remanded to the District Court for a retrial on damages.

Cochlear's current product portfolio is not affected by this litigation as the patent at issue has expired. The Company maintains a very strong balance sheet with conservative gearing levels. In the event the appeal is unsuccessful, the Board is confident that Cochlear will be able to access debt facilities to fund the existing decision and any award of interest and costs.

### Talent development and engagement

Training, development and engagement of our employees is vital for Cochlear to continue to thrive into the future. We are a fast-growing organisation, with over 900 people hired or promoted in FY19, up 26% on FY18.

Training and development has been strengthened with the implementation of globally consistent leadership programs, with Cochlear recognised by the Association for Talent Development as a 'Best Learning Organisation'.

Our 'Diversity and Inclusion Framework', launched 15 months ago, is driving greater awareness of the importance

of a diverse and inclusive workplace, resulting in better recruiting and promotion results. We are actively targeting an improved gender balance with 58% of hires female while 45% of applicants were female.

We have continued to progress succession planning and implement targeted development for our senior executives and managers, with an increase in women identified as successors for these roles.

Our employees continue to find Cochlear a rewarding place to work. Overall employee engagement scores remain high at 79%, up one percentage point on FY18.

### Changes to long-term incentive plan

This year we are proposing changes to our long-term incentive plan, extending the length of the plan from three to four years, and recalibrating the EPS targets.

The EPS targets are shifting from 10% to 20% compound annual growth over three years to 7.5% to 12.5% over four years. The change is material and requires some context.

The current EPS targets have been in place for at least fifteen years and are now considered inconsistent with our expectations and strategic objectives for growth. The shift will provide better alignment to our strategy, factoring in the market conditions, and related growth rates, we believe are realistic.

Fifteen years ago, our industry was at an earlier stage of development with 15-20% unit growth more common as we were quickly penetrating the newborn segment across our developed markets.

Today, cochlear implantation for newborns is the standard of care across most developed markets with most children receiving cochlear implants at around 12 months of age, an enormous achievement.

Future growth will be focused on the adults in developed markets and children in emerging markets. Each poses its challenges but provides a long-term opportunity.

The Board believes the components of our diversified revenue base, including the growth in the Services business, and our focus on delivering steady long-term profit growth means the new EPS targets better aligns this component of long-term incentives to the Company's strategy.

We want to deliver consistent growth in revenue over time, with earnings expected to grow at a similar rate to revenue

as we invest to grow the business with an intention to hold the net profit margin.

We believe the revised range reflects stretch performance and will ensure executives are engaged and incentivised appropriately to deliver results.

### Appointment of Abbas Hussain to the Board

In November, Abbas Hussain was appointed to the Board. Abbas worked in the pharmaceutical industry for over 30 years and has significant global experience in building relationships with professionals within the healthcare industry.

Abbas brings expertise to business development and growth opportunities across a diverse range of markets. He is well-equipped to provide valuable strategic insight and has demonstrated strong values in customer focus which is intrinsic to Cochlear's strategic objectives.

Abbas' appointment follows the retirement of long-serving non-executive director Prof Edward Byrne, AC in October.

### New shareholder reports

This year we published our inaugural Strategy Overview and ESG (Environmental, Social and Governance) reports and improved the usability of our Corporate Governance Statement.

The Strategy Overview provides an insight into Cochlear's strategy to retain market leadership, grow the hearing implant market and deliver consistent revenue and earnings growth over the long term. The ESG Report outlines how we aim to improve the impact we have on our communities, the environment and our employees and reflects our commitment to high standards of corporate governance.

These reports are available on the website and I encourage you to read them.

### Chairman's last term

After discussion with the Board, I will present myself for re-election at the upcoming AGM to serve my last term as Chairman and a director of the Cochlear Board. I will be working closely with the Board on the renewal process for my role. It is highly likely I will retire from the Board during this new term.

### Our employees

Cochlear has a diverse global workforce focused on our business and on transforming the lives of people with hearing loss. We employ over 4,000 people and sell our products in over 100 countries. The knowledge, expertise and passion of our employees are key to our future and the focus on delivering excellence for our customers is an important part of our success and our market leadership position.

Our employees understand the importance of Cochlear being successful over the long-term so that we can continue to support our recipients. There are few companies that start a lifetime journey with each new customer every day.

On behalf of the Board, I congratulate and thank all Cochlear employees for their outstanding efforts and contributions this year.



Rick Holliday-Smith  
Chairman





**The business delivered a 7% increase in sales revenue (2% in CC\*) with underlying net profit growing by 7% (6% in CC) in FY19. The highlight was the strong growth of the Services business with a slower year for cochlear implant system sales.**

Services revenue grew by 20% (14% in CC), with sound processor upgrade revenue increasing by 17% in CC. The Services business continues to grow in importance as our recipient base grows, now representing 30% of sales revenue. In FY19, Services benefitted from the continued strong uptake of the Nucleus® 7 Sound Processor.

The cochlear implant business grew revenue by 2% (down 3% in CC) with units declining by 3%. After four years of strong growth driven by a combination of market growth and share gains, our developed markets units were in line with last year, while emerging markets units declined.

The US and Germany lost market share following a competitor product launch. Sales however returned to growth following the launch of the Nucleus Profile™ Plus Series cochlear implant in Europe in mid May and the US in late June. The Nucleus Profile Plus Series cochlear implant has been well-received by the market and has driven an uplift in sales since its launch late in FY19.

Japan momentum continues with strong demand following the expansion of indications and funding for cochlear implants in late 2017.

Emerging markets units declined, with around 700 fewer Chinese Central Government tender units than last year and very significant declines in Argentina and Turkey driven by recession and currency devaluation. Strong growth was delivered across many regions including the Middle East and Eastern Europe, with the shipment of a number of tenders won in FY19 expected in FY20.

A key component of our strategy in emerging markets is to build our direct presence, which improves our knowledge and influence in these markets, providing a base for future growth. In FY19 we acquired distributors in some key emerging markets.

### Strong financial position

Cochlear delivered net profit of \$276.7 million, an increase of 13% on FY18 (11% in CC), which includes \$10.8 million in non-cash net gains from the revaluation of innovation fund investments. Net profit excluding the revaluation was \$265.9 million, an increase of 7% (6% in CC).

Operating cash flow increased by \$37.9 million to \$296.0 million and the Board has declared a final dividend of \$1.75, an increase of 9%. Full year dividends increased by 10% to \$3.30 in FY19, fully franked.

Cochlear continues to target the delivery of consistent revenue and earnings growth over time. We have a strong balance sheet and generate operating cash flows sufficient to fund investing activities, capital expenditure and acquisitions whilst increasing dividends to shareholders and maintaining conservative gearing levels.

### Commitment to technology leadership

Cochlear has been the global leader in implantable hearing solutions for close to 40 years and continues to invest around 12% of sales revenue each year on R&D. We launched a number of new products this year including the Nucleus Profile Plus Series cochlear implant, built on the world's thinnest implant platform, and designed for routine 1.5 and 3 Tesla magnetic resonance imaging (MRI) scans without the need to remove the internal magnet.

The Nucleus 7 Sound Processor expanded its range of connectivity features, enabling direct audio streaming from compatible Android devices. The functionality will be accessible to Android devices using Google's Audio Streaming for Hearing Aids (ASHA) protocol, which is expected in early FY20. A new control feature, ForwardFocus, was added to the Nucleus Smart App, allowing Nucleus 7 Sound Processor users to better control their listening environment by reducing distracting noise coming from behind them so they can more easily enjoy a face-to-face conversation.

We introduced the Cochlear™ Research Platform ECoChG, which assists surgeons with the electrode insertion process by providing real time feedback, and the Remote Check pilot commenced in the UK. Remote Check is a convenient, at-home testing tool that allows patients with a Nucleus 7

\* Constant currency (CC) removes the impact of foreign exchange (FX) rate movements and FX contract gains/(losses) to facilitate comparability.

Sound Processor to complete a routine review of their cochlear implant at home using their mobile device, reducing the need to visit their clinic in person.

Cochlear continues to advance its innovation agenda with a number of new products in the pipeline. We have an exciting portfolio of products to be launched over the next 18 months.

### Revaluation of innovation fund

Cochlear's innovation fund has made several small investments in companies with novel technologies that may, over the longer term, enhance or leverage the Company's core technology. The innovation fund includes investments in Saluda, Nyxoah, Earlens, EpiMinder and Sensorion. FY19 net profit includes \$10.8 million in non-cash net gains from the revaluation of the fair value of the innovation fund to \$50.9 million.

### FY20 financial outlook

For FY20, Cochlear expects to deliver reported net profit of \$290-300 million, a 9-13% increase on underlying net profit for FY19. We expect strong growth in cochlear implant units in FY20, driven by a number of new products launched late in FY19 and the continued investment in market awareness and access activities. While still early in the year, we have seen an uplift in sales since the launch of the Nucleus Profile Plus Series cochlear implant which is currently being rolled out across the developed markets as regulatory approvals are received.

As the global leader in implantable hearing solutions, we continue to be excited by the long-term opportunity to grow the hearing implant market. Our strategy to retain market leadership and grow the hearing implant market has clear priorities that drive investment decisions and capital allocation. And we have a strong financial position that enables the business to fund its growth activities while rewarding shareholders along the way with a growing dividend stream.

We expect to continue to deliver growth in revenue and earnings in the coming years, underpinned by the investments made in product development and market growth initiatives. The balance sheet and free cash flow generation remain strong and we continue to target a dividend payout ratio of around 70% of net profit.

### Key guidance considerations for FY20:

- Expect strong growth in cochlear implant units in developed markets driven by the recent launch of the Nucleus Profile Plus Series cochlear implant and continued investment in market awareness and access activities;
- Emerging market growth rates over time continue to be strong, however, annual growth rates can be variable driven by the timing of tender based activity and macro-economic conditions;
- Expect to release the new osseointegrated steady-state implant (OSIA) product later in FY20 to extend the Acoustics product portfolio;
- Capital expenditure to increase to around \$180 million, including the continued development of the China manufacturing facility, fitout of the new, larger Denver office as well as investment in IT platforms to strengthen connected health, digital and cyber security capabilities. Capital expenditure is expected to drop to around \$100 million in FY21;
- Includes an estimated \$2-3 million pre-tax earnings impact from the introduction of the new Australian leasing accounting standard (AASB 16);
- Excludes any revaluation of innovation fund investments that may occur;
- Targeting to maintain the net profit margin; and
- Forecasting a weighted average AUD/USD exchange rate of 70 cents for FY20 (72 cents in FY19) and AUD/EUR of 0.62 EUR (0.63 EUR in FY19).



Dig Howitt  
CEO & President

### About Cochlear

For close to 40 years, Cochlear has been the global leader in implantable hearing solutions.

Cochlear commenced operations in 1981 as part of the Nucleus group and in 1995, listed on the Australian Securities Exchange. Today, Cochlear is a Top 50 listed Australian company with a market capitalisation of over A\$10 billion.

Cochlear aims to support cochlear implantation becoming the standard of care for people with severe to profound hearing loss and provide bone conduction implants for people with conductive hearing loss, mixed hearing loss and single-sided deafness. The Company has provided more than 550,000 implant devices to people who benefit from one – or two – of the Company’s implantable solutions. Whether these hearing solutions were implanted today or many years ago, Cochlear continues to bring innovative new products to market as well as sound processor upgrades for all generations of recipients.

Cochlear invests more than \$180 million each year in R&D and currently participates in over 100 collaborative research programs worldwide. The global headquarters are on the campus of Macquarie University in Sydney, with regional offices in Asia Pacific, Europe and the Americas. Cochlear has a deep geographical reach, selling in over 100 countries, with a direct presence in over 30 countries and a global workforce of over 4,000 employees.

### Cochlear’s mission

Cochlear’s mission is the passion that drives the organisation and, at a high level, focuses the strategy.



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.

### Strategic priorities

To achieve its mission, Cochlear aims to support cochlear implantation becoming the standard of care for people with severe to profound hearing loss and provide bone conduction implants for people with conductive hearing loss, mixed hearing loss and single-sided deafness.

Cochlear is committed to maintaining its technology leadership position in the industry by investing in R&D to improve hearing outcomes and expand the indications for implantable solutions. We aim to grow the hearing implant market by growing awareness and access for implant candidates. And with a growing recipient base, Cochlear is actively strengthening its servicing capability to provide products, programs and services to support the lifetime relationship with recipients.

### Cochlear's strategic priorities



#### Retain market leadership

Market-leading technology | World-class customer experience



#### Grow the hearing implant market

Awareness | Market access | Clinical evidence



#### Deliver consistent revenue and earnings growth

Invest to grow | Operational improvement | Strong financial position

For an in-depth review of Cochlear's strategy and financial history, please refer to the Strategy Overview which is available at [www.cochlear.com](http://www.cochlear.com).

**Cochlear’s implantable hearing solution portfolio**

Cochlear generates sales revenue from a range of implantable solutions for people with moderate to profound hearing loss. Cochlear’s latest products include:

**Cochlear implants (88% of sales revenue)**



Cochlear™ Nucleus® Profile™ Plus with Slim Modiolar Electrode (CI632)



Cochlear™ Nucleus® Kanso® Sound Processor (CP950)



Cochlear™ Nucleus® 7 Sound Processor (CP1000)



Cochlear™ Nucleus® Smart App

**Acoustics (12% of sales revenue)**

**Bone conduction implants**



Cochlear™ Baha® 5, Baha 5 Power and Baha 5 SuperPower



Cochlear™ Baha® SoundArc



Cochlear™ Baha® Smart App

**Acoustic implants**



Cochlear™ Carina® System

## Results of operations

### Product and service highlights

	2019 \$m	2018 \$m	Change % (reported)	Change % (CC) <sup>1</sup>
Cochlear implants (units)	34,083	35,260	↓ 3%	
<b>Sales revenue</b>				
Cochlear implants	845.1	831.0	↑ 2%	↓ 3%
Services (sound processor upgrades and other)	427.2	355.2	↑ 20%	↑ 14%
Acoustics (bone conduction and acoustic implants)	173.8	165.2	↑ 5%	↓ 1%
<b>Total sales revenue</b>	<b>1,446.1</b>	<b>1,351.4</b>	<b>↑ 7%</b>	<b>↑ 2%</b>

<sup>1</sup> Constant currency (CC) removes the impact of exchange rate movements and foreign exchange (FX) contract gains/(losses) to facilitate comparability. See Notes on page 17 for further detail.

### Cochlear implants – 58% of sales revenue

Cochlear implant revenue grew 2% (down 3% in CC) with units declining by 3%. Cochlear's developed markets business, which represents around 80% of revenue, delivered units and CC revenue broadly in line with last year.

The US and Germany lost market share following a competitor product launch. Both markets have experienced an uplift in sales since the launch of the Nucleus Profile Plus Series cochlear implant in Germany in mid May and the US in late June. Japan momentum continues with strong demand following the expansion of indications and funding for cochlear implants in late 2017.

The seniors segment continues to be the fastest growing segment across the developed markets as awareness increases. Surgeries for seniors, in the US in particular, are increasingly being driven by the Company's successful direct-to-consumer marketing campaigns, with a small but growing number being referred from the hearing aid channel.

Emerging markets units declined, with around 700 fewer Chinese Central Government tender units than last year and very significant declines in Argentina and Turkey driven by recession and currency devaluation. Strong growth was delivered across many regions including the Middle East and Eastern Europe, with the shipment of a number of tenders won in FY19 expected in FY20.

### Services (sound processor upgrades and other) – 30% of sales revenue

Services sales revenue increased by 20% (14% in CC). Sound processor upgrade revenue, which represents around 75% of Services revenue, increased by 17% in CC driven by strong uptake of the Nucleus 7 Sound Processor. The growing recipient base, initiatives to strengthen connectivity with recipients as well as the product's market-leading functional and lifestyle features, have all contributed to the strong Services growth.

Cochlear continues to invest to provide its growing customer base with a world-class customer experience with increased connectivity and engagement. Cochlear Family, the recipient membership program, provides Cochlear with the opportunity to connect directly with recipients to provide service and support. Membership continues to grow rapidly, increasing by 40% over the last 12 months, to now exceed 140,000 members with an acceleration in recruitment in recent years driven by a combination of direct outreach programs and improvements in customer onboarding.

### Acoustics (bone conduction and acoustic implants) – 12% of sales revenue

Acoustics revenue increased by 5% (down 1% in CC), with revenue impacted by lower upgrade sales. The business expects to release the new osseointegrated steady-state implant (OSIA) product later in FY20 to extend the Acoustics product portfolio.

## Regional review

Sales revenue	2019 \$m	2018 \$m	Change % (reported)	Change % (CC)
Americas	688.6	648.5	↑ 6%	↓ 1%
EMEA (Europe, Middle East and Africa)	519.2	478.9	↑ 8%	↑ 6%
Asia Pacific	238.3	224.0	↑ 6%	↑ 2%
<b>Total sales revenue</b>	<b>1,446.1</b>	<b>1,351.4</b>	<b>↑ 7%</b>	<b>↑ 2%</b>

### Americas (US, Canada and Latin America) – 48% of sales revenue

Sales revenue increased by 6% (down 1% in CC). The US experienced a lower rate of growth for much of the year, losing market share following a competitor product launch. The launch of the Nucleus Profile Plus Series cochlear implant in late June has been well-received by the market, driving an uplift in sales since launch. Services revenue grew driven by upgrades to the Nucleus 7 Sound Processor.

The business continues to invest in expanding direct-to-consumer marketing in the US with a growing emphasis on working with the hearing aid channel to grow referrals. The Cochlear Provider Network is expanding rapidly and is increasing education of the indications and benefits of cochlear implants to hearing aid audiologists and is starting to provide a referral pathway to cochlear implant surgeons.

Units and revenue in Latin America declined primarily the result of significant declines in Argentina, following currency devaluation and economic impacts.

### EMEA (Europe, Middle East and Africa) – 36% of sales revenue

Sales revenue increased by 8% (6% in CC). Germany, the largest market in Europe, experienced a decline in system sales revenue with a loss of market share following a competitor product launch. The launch of the Nucleus Profile Plus cochlear implant in mid May has been well-received by the market, driving an uplift in sales since launch.

After a slower start to the year, cochlear implant system sales in Western Europe (excluding Germany) improved, growing high single-digit in the second half. Services performed strongly driven by upgrade demand for the Nucleus 7 Sound Processor.

In March, the UK announced the expansion of indications for cochlear implantation to include candidates with severe hearing loss, a major milestone that is expected to support growth in the UK over the coming years.

Units and sales revenue across EMEA's emerging markets grew as a result of the timing of a number of tenders and is underpinned by investments in the organisation in recent years. The solid result was partially offset by declines in Turkey, following devaluation of the currency and recession.

### Asia Pacific (Australasia and Asia) – 16% of sales revenue

Sales revenue increased by 6% (2% in CC). Japan experienced strong unit growth, with Australia delivering strong growth in sound processor upgrades. Solid revenue growth was delivered across the developed markets and non-tender emerging market portions of the region with expanded indications and Cochlear's growing presence.

Growth for Asia Pacific overall was affected by the timing of emerging market tender ordering as well as around 700 fewer Chinese Central Government tender units than last year.

## Financial review

### Profit and loss

	2019 \$m	2018 \$m	Change % (reported)	Change % (CC) <sup>1</sup>
<b>Sales revenue</b>	<b>1,446.1</b>	<b>1,351.4</b>	<b>7%</b>	<b>2%</b>
Cost of sales	351.1	361.2	(3%)	(6%)
<i>% gross margin</i>	<i>76%</i>	<i>73%</i>	<i>3 pts</i>	<i>2 pts</i>
Selling, marketing and general expenses	450.9	397.0	14%	9%
Research and development expenses	184.4	167.7	10%	9%
<i>% of sales revenue</i>	<i>13%</i>	<i>12%</i>		
Administration expenses	94.8	97.4	(3%)	(3%)
<b>Total expenses</b>	<b>1,081.2</b>	<b>1,023.3</b>	<b>6%</b>	<b>3%</b>
Other net income	13.8	10.2		
Other net income (revaluation of investments)	10.8	(2.2)		
FX contract gains / (losses)	(19.4)	12.3		
<b>Earnings before interest and tax (EBIT)</b>	<b>370.1</b>	<b>348.4</b>	<b>6%</b>	<b>5%</b>
<i>% of sales revenue</i>	<i>26%</i>	<i>26%</i>		
Net finance expense	4.5	7.9	(43%)	
Income tax expense	88.9	94.7	(6%)	
<i>% effective tax rate</i>	<i>24%</i>	<i>28%</i>		
<b>Net profit (reported)</b>	<b>276.7</b>	<b>245.8</b>	<b>13%</b>	<b>11%</b>
<b>Net profit (excl revaluation of investments)</b>	<b>265.9</b>	<b>248.0</b>	<b>7%</b>	<b>6%</b>
<i>% net profit margin</i>	<i>18%</i>	<i>18%</i>		

<sup>1</sup> Constant currency (CC) removes the impact of exchange rate movements and FX contract gains/(losses) to facilitate comparability. See Notes on page 17 for further detail.

Reported sales revenue increased by 7% (2% in CC) to \$1,446.1 million. Reported net profit increased by 13% (11% in CC) to \$276.7 million and includes \$10.8 million in non-cash net gains from the revaluation of innovation fund investments. Underlying net profit, which excludes the revaluation, increased by 7% (6% in CC), with the net profit margin remaining stable at 18%.

#### Key points of note:

- Cost of sales declined by 3% (6% in CC) to \$351.1 million, reflecting manufacturing efficiencies, improved sound processor reliability, lower warranty costs and lower repair expenses resulting from the centralisation of repairs. As a result, gross margin improved by three percentage points to 76%;
- Selling, marketing and general expenses increased by 14% (9% in CC) to \$450.9 million. The increase reflects the continued investment in the sales force and direct-to-consumer marketing, with a growing investment in longer-term market growth activities including standard of care and market access initiatives;
- Investment in R&D increased 10% (9% in CC) to \$184.4 million, representing 13% of sales revenue;
- Other net income of \$13.8 million includes \$10.8 million relating to a release in the contingent consideration value of Cycle;



- Other net income (revaluation of innovation fund) of \$10.8 million reflects non-cash net gains from the revaluation of the innovation fund to \$50.9 million; and
- The effective tax rate reduced from 28% to 24%, primarily reflecting the full year impact of lower US federal corporate tax rates and the impact of the innovation fund revaluation which is not tax affected. FY18 included a \$6.3 million revaluation of the deferred tax assets which was directly related to the US tax changes.

### Cash flow

	2019	2018	Change
	\$m	\$m	\$m
EBIT	370.1	348.4	21.7
Depreciation and amortisation	38.5	34.2	4.3
Changes in working capital and other	(17.4)	(15.3)	(2.1)
Net interest paid	(4.5)	(7.9)	3.4
Income taxes paid	(90.7)	(101.3)	10.6
<b>Operating cash flow</b>	<b>296.0</b>	<b>258.1</b>	<b>37.9</b>
Capital expenditure	(86.6)	(44.6)	(42.0)
Acquisition of other intangible assets	(28.0)	(5.1)	(22.9)
Other net investments	(23.2)	(5.7)	(17.5)
<b>Free cash flow</b>	<b>158.2</b>	<b>202.7</b>	<b>(44.5)</b>

Operating cash flow increased by \$37.9 million to \$296.0 million, with free cash flow reducing by \$44.5 million to \$158.2 million driven by increases in capital expenditure and other investments.

#### Key points of note:

- Operating cash flow increase was driven by improved earnings, with EBIT increasing by \$21.7 million and lower tax payments;
- Capital expenditure (capex) increased by \$42.0 million to \$86.6 million, reflecting stay in business capex, IT platform development to strengthen connected health, digital and cyber security capabilities as well as the partial construction of the China manufacturing facility;
- Acquisition of other intangible assets includes amounts relating to the expanded GN Hearing collaboration – license fees for existing technology and contribution to the development of intellectual property. Cochlear moved to direct distribution across a number of emerging markets during the year resulting in the acquisition of some distributors; and
- Other net investments primarily relates to the investment in Nyxoah, a medical device company focused on the development and commercialisation of a best-in-class hypoglossal nerve stimulation therapy for the treatment of obstructive sleep apnea.

## Capital employed

	2019	2018	Change
	\$m	\$m	\$m
Trade receivables	299.5	299.1	0.4
Inventories	195.4	167.4	28.0
Less: Trade and other payables	(160.8)	(140.5)	(20.3)
Working capital	334.1	326.0	8.1
<i>Working capital / sales revenue</i>	23%	24%	
<i>Debtor days</i>	67	69	(2) days
<i>Inventory days</i>	203	171	32 days
Property, plant and equipment	166.5	128.4	38.1
Intangible assets	424.4	345.3	79.1
Investments	47.8	15.8	32.0
Other net liabilities	(143.9)	(118.5)	(25.4)
<b>Capital employed</b>	<b>828.9</b>	<b>697.0</b>	<b>131.9</b>

Capital employed increased by \$131.9 million to \$828.9 million since June 2018.

### Key points of note:

- Inventories increased by \$28.0 million, primarily reflecting stock build ahead of the launch of the new Nucleus Profile Plus Series cochlear implant;
- Property, plant and equipment increased by \$38.1 million and includes the partly-constructed China manufacturing facility;
- Intangible assets increased by \$79.1 million to \$424.4 million, reflecting investments in IT infrastructure and contributions to the expanded GN Hearing collaboration. In addition, Cochlear moved to direct distribution across a number of emerging markets during the year resulting in the acquisition of some distributors; and
- Investments increased by \$32.0 million, reflecting the investment in Nyxoah and the \$10.8 million revaluation of the innovation fund.

## Net debt

	2019	2018	Change
	\$m	\$m	\$m
Loans and borrowings:			
Current	3.3	3.7	(0.4)
Non-current	178.3	144.0	34.3
Total loans and borrowings	181.6	147.7	33.9
Less: Cash and cash equivalents	(78.6)	(61.5)	(17.1)
<b>Net debt</b>	<b>103.0</b>	<b>86.2</b>	<b>16.8</b>

Net debt increased by \$16.8 million to \$103.0 million since June 2018, driven by higher capital investment levels including the partial construction of the China manufacturing facility and IT infrastructure development.

## Dividends

	2019	2018	Change %
Interim ordinary dividend (per share)	\$1.55	\$1.40	11%
Final ordinary dividend (per share)	\$1.75	\$1.60	9%
Total ordinary dividends (per share)	\$3.30	\$3.00	10%
% payout ratio	69%	70%	
% franking	100%	100%	

Strong free cash flow and the continued strength of the balance sheet have supported the declaration of a final dividend of \$1.75 per share, an increase of 9%, franked at 100%. Full year dividends increased by 10% to \$3.30 per share, franked at 100% and representing a payout of 69% of reported net profit.

The record date for determining dividend entitlements is 20 September 2019 and the final dividend will be paid on 14 October 2019.

## Notes

### Forward-looking statements

Cochlear advises that this document contains forward-looking statements which may be subject to significant uncertainties outside of Cochlear's control. No representation is made as to the accuracy or reliability of forward-looking statements or the assumptions on which they are based. Actual future events may vary from these forward-looking statements and it is cautioned that undue reliance not be placed on any forward-looking statement.

### Non-International Financial Reporting Standards (IFRS) financial measures

Given the significance of foreign exchange rate movements, the directors believe the presentation of the non-IFRS financial measure, constant currency, is useful for the users of this document as it reflects the underlying financial performance of the business. This non-IFRS financial measure has 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 group.

### Constant currency

Constant currency removes the impact of foreign exchange rate movements to facilitate comparability of operational performance for Cochlear. This is done by converting the prior comparable period net profit of entities in the group that use currencies other than Australian dollars at the rates that were applicable to the current period (translation currency effect) and by adjusting for current year foreign currency gains and losses (foreign currency effect). The sum of the translation currency effect and foreign currency effect is the amount by which reported EBIT and net profit is adjusted to calculate the result at constant currency.

### Reconciliation of constant currency net profit to reported net profit

	2019 \$m	2018 \$m	Change %
<b>Net profit (reported)</b>	<b>276.7</b>	<b>245.8</b>	<b>13%</b>
FX contract gains		(31.7)	
Spot exchange rate effect to sales revenue and expenses <sup>1</sup>		39.0	
Balance sheet revaluation <sup>1</sup>		(4.5)	
<b>Net profit (CC)</b>	<b>276.7</b>	<b>248.6</b>	<b>11%</b>

<sup>1</sup> FY19 actual v FY18 at FY19 rates.

## Business risks

Cochlear has a sound and robust Risk Management Framework to identify, assess and appropriately manage risks. Details of Cochlear’s Risk Management Framework can be found in the 2019 Corporate Governance Statement, which is available on the website.

Cochlear’s principal business risks are outlined below. These are significant risks that may materially 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 these risks cannot provide absolute assurance that a risk will not materialise.

Risk	Description and potential consequences	Strategies used by Cochlear to mitigate the risk
Product innovation and competition	<p>Cochlear is exposed to the risk of failing to develop and produce innovative products for customers.</p> <p>Increased competition exposes Cochlear to the risk of losing market share as well as a decrease in average selling prices in the industry.</p> <p>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 for future candidates. This could result in a loss of new business.</p>	<p>In FY19, Cochlear invested 13% of sales revenue in R&amp;D. Cochlear also works with over 100 external research partners.</p> <p>The creation of new intellectual property and the protection of new and existing intellectual property are a key focus for Cochlear.</p> <p>Cochlear has plans to launch a series of new products across all categories of the business over the coming years, focused on both market share and market growth. Cochlear also has a practice of identifying and assessing potential disruptive technologies.</p>
Infringement litigation	<p>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 of litigation for alleged infringement. This could result in Cochlear paying royalties to be able to continue to manufacture product, or paying damages and/or receiving injunctions preventing Cochlear selling products it had developed.</p>	<p>Cochlear has a comprehensive patent portfolio across its technologies.</p> <p>Cochlear conducts freedom to operate searches as part of its internal processes before launching new products.</p> <p>Cochlear utilises internal and external legal resources to manage any litigation issues.</p>
Misappropriation of know-how and intellectual property	<p>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 third parties 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.</p>	<p>Cochlear monitors its key systems and database, for inappropriate access from both internal and external sources.</p> <p>Confidentiality agreements are in place with key employees and third parties that are exposed to Cochlear’s know-how and intellectual property.</p>

Risk	Description and potential consequences	Strategies used by Cochlear to mitigate the risk
Medical device regulations	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. Regulatory bodies periodically perform audits at Cochlear's manufacturing and distribution sites. If Cochlear or a third-party supplier fails to satisfy regulatory requirements or the regulations change and modifications are not made, this could result in the imposition of sanctions or Cochlear's products being subject to recall and/or the loss of sales and reputational harm. Changes to medical device regulations or delays in achieving regulatory approval can impact Cochlear's ability to sell its products.	Cochlear has a worldwide quality assurance system in place. Regulatory requirements and changes in the regulatory environment are actively monitored and assessed.
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 which may lead to pressure on reimbursed prices. Cochlear may also be subject to healthcare related taxes imposed by government agencies and this could negatively impact the ability of candidates to access Cochlear's products.	Cochlear continues to work with reimbursement and government agencies throughout the world to emphasise the health and economic benefits and cost effectiveness of intervention to restore or improve hearing.
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 implanted.	Cochlear maintains product liability insurance and operates a worldwide quality assurance system related to the design, testing, manufacture and post-market monitoring of its products.
Interruption to product supply	Cochlear relies on third-party suppliers 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. Cochlear manufactures its latest generation products across five sites globally. 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 made at this facility. This approval could take many months or years.	Cochlear monitors its suppliers and identifies potential second-source supply. Inventories are managed and purchased in sufficient quantities for continued product supply in the short term. Where appropriate, lifetime buys, strategic raw materials purchases and supply chain interventions are made. Cochlear also regularly reviews its disaster recovery plans for its manufacturing sites and maintains business interruption insurance.

Risk	Description and potential consequences	Strategies used by Cochlear to mitigate the risk
Political, economic or social instability	Cochlear sells in over 100 countries. Several of the emerging markets are heavily biased to tender sales, including the Chinese Central Government tenders. The future outcome of tender sales is uncertain. Regional political, economic 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 material political, economic or social instability. Cochlear utilises global scanning software to assess partners, distributors and suppliers against sanctions checklists on an ongoing basis.
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 Australian dollars (AUD), US dollars (USD), Euros (EUR), Japanese yen (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 cash flow. 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 level of cover 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 significant debtors are governments, government-supported universities and clinics or major hospital chains.	Policies and procedures for credit management and administration of receivables are established and executed at a regional level. 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 potential restrictions on future trading, including suspending future shipments and administering dispatches on a prepayment basis. In addition, where appropriate, 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.

Risk	Description and potential consequences	Strategies used by Cochlear to mitigate the risk
Operations	Operational risk is the risk of direct and indirect loss arising from a wide variety of causes associated with Cochlear’s processes, personnel (including executive transitions), technology and infrastructure and generally accepted standards of corporate behaviour. Operational risks arise from all of Cochlear’s operations. These risks could result in the loss of sales and reputational harm.	Standards for the management of operational risk are in place in the following key areas: <ul style="list-style-type: none"> <li>• Requirements for appropriate segregation of duties, including the independent authorisation of transactions;</li> <li>• Requirements for the reconciliation and monitoring of transactions;</li> <li>• Appropriate insurance programs;</li> <li>• Documentation of controls and procedures;</li> <li>• Requirements for the periodic assessment of operational risks faced, and the adequacy of controls and procedures to address the risks identified;</li> <li>• Internal and external audit programs;</li> <li>• Development of contingency plans;</li> <li>• Succession planning for key management personnel;</li> <li>• Training and professional development;</li> <li>• Employee health and safety programs; and</li> <li>• Ethical and business standards.</li> </ul>
Information security	Cochlear handles and stores personal information, including health information, for its customers and employees. With expanding information privacy and security regulations, and an increasingly hostile cyber environment, Cochlear recognises information privacy and cyber security as an increasing risk.	Cochlear regularly assesses its information governance and cyber security controls in light of emerging technological threats and expanding privacy laws. These assessments are used to determine any appropriate corrective actions. In addition to the ongoing assessment and remediation of operational privacy and security activities, Cochlear maintains cyber insurance as part of its overall risk mitigation strategy for information privacy and security risk.
Talent management	Cochlear operates in a very competitive environment, particularly in relation to attracting scientific talent into the group.	Talent management programs are in place, both within Australia and in our key international markets.



**Rick Holliday-Smith**

**Chairman** Age 69

**Appointed to the Board 1 March 2005:** Chairman of the Nomination Committee. Member of the Audit and People & Culture Committees.

**Background:** Global executive and leadership experience in capital markets and derivatives, and a background in venture capital activities. Former President of NationsBank-CRT, Chicago and Managing Director of Hong Kong Bank Limited, London.

**Other boards:** Chairman, ASX Limited and Director, Servcorp Limited. Non-executive Chairman, QBiotics and member of the Macquarie University Faculty of Business and Economics Advisory Board.

**Former directorships:** Chairman, Snowy Hydro Limited and SFE Corporation Limited. Director, St George Bank Limited, Exco Resources NL, DCA Group Limited and MIA Group Limited.

**Qualifications:** BA (Hons), FAICD, CA



**Dig Howitt**

**CEO & President and Managing Director** Age 52

**Appointed to the Board 14 November 2017 and as CEO & President 3 January 2018:** Member of the Medical Science and Technology & Innovation Committees.

**Background:** Joined Cochlear in 2000 and has a wealth of experience across the Company in roles including Chief Operating Officer, SVP, Manufacturing and Logistics and President, Asia Pacific. Prior to joining Cochlear, worked for Boral and Boston Consulting Group. Dig is a member of the Male Champions of Change STEM group. Appointed as President of Cochlear on 31 July 2017 and became CEO & President on 3 January 2018.

**Qualifications:** BE (Hons), MBA



**Yasmin Allen**

**Non-executive Director** Age 55

**Appointed to the Board 2 August 2010:** Chairman of the Audit Committee. Member of the People & Culture, Nomination and Technology & Innovation Committees.

**Background:** Extensive career in investment banking with senior roles in strategic analysis and corporate advice. Former Vice President of Deutsche Bank AG.

**Other boards:** Director, Santos Limited, ASX Limited and National Portrait Gallery. Member of the George Institute for Global Health Board. Chairman, Advance (Global Australian Network) and Acting President, Australian Government Takeovers Panel.

**Former directorships:** Director, Insurance Australia Group Limited. National director of the Australian Institute of Company Directors. Member of The Salvation Army Advisory Board. Chair of Macquarie Specialised Asset Management. Director, ANZ Investment Bank and Associate Director, HSBC London.

**Qualifications:** BCom, FAICD





**Andrew Denver**

**Non-executive Director** Age 70

**Appointed to the Board 1 February 2007:** Member of the Audit, Medical Science, Technology & Innovation and Nomination Committees.

**Background:** Extensive experience in the life sciences industry. Former Managing Director of Memtec Limited and President Asia for Pall Corporation.

**Other boards:** Chairman, SpeedX and Director, Vaxxas and QBiotics.

**Former directorships:** Executive Chairman, Universal Biosensors.

**Qualifications:** BSc (Hons), MBA, FAICD



**Donal O'Dwyer**

**Non-executive Director** Age 66

**Appointed to the Board 1 August 2005:** Member of the Audit, Medical Science, Nomination and Technology & Innovation Committees.

**Background:** Executive experience in global general management of healthcare products and medical devices. Former worldwide President of Cordis Cardiology (a Johnson & Johnson company) and President of Baxter's Cardiovascular Group, Europe.

**Other boards:** Director, Mesoblast Limited, Fisher & Paykel Healthcare and NIB Holdings Ltd. Chairman of Endoluminal Sciences.

**Former directorships:** Chairman, CardieX (formerly Atcor Medical).

**Qualifications:** BE Civil, MBA



**Glen Boreham, AM**

**Non-executive Director** Age 55

**Appointed to the Board 1 January 2015:** Chairman of the People & Culture Committee. Member of the Audit, Nomination and Technology & Innovation Committees.

**Background:** Led organisations in information technology, new media and the creative industries through periods of rapid change and innovation. Former Managing Director of IBM Australia and New Zealand.

**Other boards:** Director, Southern Cross Media Group and Link Group. Chairman, Advisory Board IXUP.

**Former directorships:** Director of Data#3. Chairman of Screen Australia, Advance (Global Australian Network), Business School and Industry Advisory Board for the University of Technology, Sydney.

**Qualifications:** BEc, FAICD



**Alison Deans**

**Non-executive Director** Age 51

**Appointed to the Board 1 January 2015:** Chairman of the Technology & Innovation Committee. Member of the Audit, Nomination and People & Culture Committees.

**Background:** Extensive experience leading technology-enabled businesses across e-commerce, media and financial services. Former Chief Executive Officer of netus, Hoyts Cinemas, ecorp and eBay Australia and New Zealand.

**Other boards:** Director, Westpac Banking Corporation, Ramsay Health Care and Deputy Pty Ltd. Senior Advisor to McKinsey & Company. Member of Investment Committee, CSIRO Innovation fund (Main Sequence Ventures) and Director of SCEGGS Darlinghurst Limited.

**Former directorships:** Director of Insurance Australia Group Limited, Social Ventures Australia and kikki.K Holdings Pty Ltd. Chairman of ninemsn, Allure Media and Downstream Media.

**Qualifications:** BA, MBA, GAICD



**Prof Bruce Robinson, AM**

**Non-executive Director** Age 62

**Appointed to the Board 13 December 2016:** Chairman of Medical Science Committee. Member of the Nomination, People & Culture and Technology & Innovation Committees.

**Background:** Over 20 years' leadership experience as an academic physician/scientist across research, healthcare and medicine, and tertiary education. Former Dean, The University of Sydney's Sydney Medical School, Head of Medicine at Sydney's Royal North Shore Hospital and Head of the Cancer Genetics Laboratory at the Kolling Institute for Medical Research.

**Other boards:** Chairman, National Health and Medical Research Council and Medical Benefits Schedule Review Taskforce. Director, MaynePharma and QBiotics.

**Former directorships:** Director of Firefly and Digital Health Agency CRC.

**Qualifications:** MD, MSc, FRACP, FAAHMS, FAICD



**Abbas Hussain**

**Non-executive Director** Age 54

**Appointed to the Board 1 December 2018:** Member of the Nomination, Medical Science and Technology & Innovation Committees.

**Background:** Over 30 years' global experience in the pharmaceutical industry with significant experience in building relationships with professionals within the healthcare industry. Former Global President, Pharmaceuticals at GlaxoSmithKline.

**Other boards:** Director, CSL Limited and Immunocore Limited. Senior Advisor, CellResearch Corp and C-Bridge Group, Hikma PLC.

**Qualifications:** BSc (Hons)



**Prof Edward Byrne, AC**

**Non-executive Director** Age 66

**Appointed to the Board 1 July 2002. Retired on 16 October 2018:** Former member of the Medical Science, Nomination and Technology & Innovation Committees.

**Background:** A neuroscientist with extensive experience in clinical neurology and basic neurological research. Vice Chancellor of Monash University (2009-2014). Former Executive Dean of the Faculty of Biomedical Sciences, Vice Provost and Head of the Medical School at University College London. Former Dean of Faculty of Medicine, Nursing and Health Sciences at Monash University, Melbourne (2003-2006).

**Other boards:** President and Principal, King's College London. Chairman, King's Health Partners, and Director, Russell Group UK.

**Former directorships:** Deputy Chairman, Group of Eight Vice Chancellors, Australia and Chairman, Global Foundation. Director, Bupa Group Board, London and Bupa Australia Pty Ltd.

**Qualifications:** DSc, MD, MBA, FRCP, FRACP, FTSE



**Dig Howitt**

**CEO & President**

Dig joined Cochlear in 2000 and has a wealth of experience across the Company in roles including Chief Operating Officer, SVP, Manufacturing and Logistics and President, Asia Pacific. Prior to joining Cochlear, Dig worked for Boral and Boston Consulting Group. Dig is a member of the Male Champions of Change STEM group. He was appointed as President of Cochlear on 31 July 2017 and became CEO & President on 3 January 2018.

**Qualifications:** BE (Hons), MBA



**Brent Cubis**

**Chief Financial Officer**

Brent is responsible for accounting, corporate finance, treasury, audit, and investor relations. He joined Cochlear in February 2017 and has over 30 years' experience working in senior finance roles across a broad range of global industries and companies, including health, media (PBL Media) and property (Westfield, Bankers Trust and Sheraton). Brent qualified as a Chartered Accountant at Deloitte, which included a transfer to the US. Brent has also been a director for various charities and is an Alumni Leader for UNSW Business School.

**Qualifications:** BComm, CA



**Jan Janssen**

**Chief Technology Officer**

Jan leads a team of over 350 highly qualified engineers and scientists who implement the R&D strategy. This includes responsibility for identifying and developing cutting-edge technologies and bringing these innovations through to commercial products. Since 2017, he is also responsible for the business development strategy of Cochlear.

Jan started his career at Philips Electronics in 1990 and joined Cochlear in 2000 as Head of the Cochlear Technology Centre based in Belgium. After relocation to Sydney in 2003, Jan was promoted to SVP, Design and Development in 2005. In 2017, he was appointed Chief Technology Officer.

**Qualifications:** MScEE



**Tony Manna**

**President, Americas Region**

Tony is responsible for the development and execution of the strategic direction for our North America operations.

Tony joined Cochlear in 2005 and has over 30 years' medical device experience, including senior commercial management roles at BEI Medical and Gyrus Medical. Prior roles in Cochlear include VP, Sales USA, General Manager, Cochlear Bone Anchored Solutions, USA and President, Cochlear Bone Anchored Solutions, Sweden.

**Qualifications:** BS EET



### **Richard Brook**

#### **President, EMEA & Latin American Region**

Richard is responsible for the development and execution of the strategic direction for all our operations in Europe, Middle East and Africa (EMEA) and Latin America. This includes sales in over 60 countries.

Before joining Cochlear in 2003, Richard held senior roles in Guidant Corporation and Alaris Medical Systems. He has over 20 years' experience in the medical device industry.

**Qualifications:** BSc Management, MBA



### **Anthony Bishop**

#### **President, Asia Pacific Region**

Anthony was appointed President, Asia Pacific in July 2016. Anthony is responsible for the development and execution of the strategic direction for all our operations in Australia, Asia and the South Pacific.

Anthony joined Cochlear in July 2015 as Director of Marketing and Business Development, Asia Pacific. Prior to Cochlear, Anthony spent 21 years at Johnson & Johnson Medical in various roles including marketing, sales and general management around the world including being Managing Director, Johnson & Johnson Medical, Australia/New Zealand prior to joining Cochlear.

**Qualifications:** BBus (Hons), MManagement, GAICD



### **Rom Mendel**

#### **President, Acoustics**

Rom is responsible for the development and execution of the strategic direction for our Acoustics Division and is the General Manager for Cochlear Bone Anchored Solutions, Sweden.

Rom joined Cochlear in 2007. He has over 20 years' experience in various commercial roles within hearing care and other high-tech industries in Denmark, the US and Sweden including senior commercial management roles at Oticon and Eicon Networks. Prior roles in Cochlear include Director of Marketing Cochlear Bone Anchored Solutions, Sweden and General Manager, Cochlear Bone Anchored Solutions, USA.

**Qualifications:** MSc International Business, BSc



### **Stu Sayers**

#### **President, Services**

Stu was appointed as Cochlear's inaugural President, Services in May 2016. The Services business provides aftercare services for Cochlear recipients and professionals, generating revenue from post-implant products and other offerings.

Stu comes with a wealth of experience in establishing and building customer-focused business-to-customer and business-to-business service businesses, online and at scale. Most recently, Stu led the Amazon subsidiary Audible in Asia Pacific. Prior to Amazon, Stu ran E\*TRADE and then Yahoo!7 in Australia and New Zealand. Prior to that, he worked for Procter & Gamble and McKinsey & Company.

**Qualifications:** BEc (Hons), MBA



**Dean Phizacklea**

**Senior Vice President, Global Marketing**

Dean joined Cochlear in June 2016. Dean has responsibility for product marketing and commercialisation, consumer marketing, innovation, market access, market insights and corporate communications.

Dean has more than 20 years' experience in medical devices and pharmaceuticals, covering a range of senior commercial roles in the US, Japan, Europe and Australia. Prior to joining Cochlear, Dean led Global Strategic Marketing for Abbott Diabetes Care. Other roles include General Manager for Abbott's pharmaceutical and diabetes care businesses in Australia/New Zealand and commercial roles in Asia with AstraZeneca.

**Qualifications:** BSc Microbiology, MBA



**David Hackshall**

**Chief Information Officer**

David joined Cochlear in July 2015 as Cochlear's first Chief Information Officer and has global responsibility for the Company's information technology strategy and management. David's focus is to ensure Cochlear has the platforms in place to deliver and drive growth. This capability is critical in connecting Cochlear with both professionals and recipients and evolving Cochlear into both a business-to-business as well as business-to-customer organisation.

Prior to Cochlear, David was Chief Information Officer at Wesfarmers Insurance Ltd and brings over 15 years of executive experience across the communications, logistics and finance sectors.

**Qualifications:** DipFN, MIT, MBA



**Greg Bodkin**

**Senior Vice President, Supply Chain & Operational Excellence**

Greg has functional responsibility for new product industrialisation, procurement, manufacturing, logistics and warranty & repair. These functions enable the technologies developed in design and development to be supplied as commercial products in Cochlear's global markets. In addition, he leads the Cochlear Program Office and management of the Global Property portfolio.

Greg joined Cochlear in 2007 as Head of Supply with 20 years' prior experience in supply chain management and operations consulting positions, including appointments at Taylor Ceramic Engineering, Warman International Ltd, Weir Minerals PLC and National Australia Bank. In August 2014, he was promoted to the position of SVP Manufacturing and Logistics. In January 2018, he was promoted to the position of SVP, Supply Chain & Operational Excellence.

**Qualifications:** BE (Hons), MComm (UNSW)



**Jennifer Hornery**

**Senior Vice President, People & Culture**

Jennifer joined Cochlear in 2008 as Senior HR Business Partner with responsibility for manufacturing and logistics and safety and wellness before taking on responsibility for People & Culture Business Partnering for Cochlear's global functions in 2016. Jennifer was appointed SVP, People & Culture in 2017.

Prior to Cochlear, Jennifer worked in commercial, strategy and HR leadership roles across a number of industries within Australia and the US, including senior positions at Campbell Arnott's and Booz & Company.

**Qualifications:** BComm, MBA

## Letter from the People & Culture Committee (P&CC) Chairman

Dear Shareholders

On behalf of the Cochlear Board, I am pleased to share with you the FY19 Remuneration report where we outline Cochlear's remuneration strategy, summarise the performance outcomes for FY19, and detail the associated remuneration outcomes for Cochlear's key management personnel.

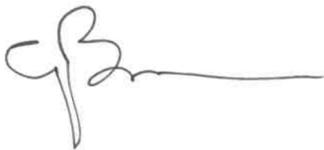
The Board is committed to a strong growth focus and believes that our approach to executive remuneration supports behaviours that will achieve sustainable revenue and earnings growth over the longer term. Our executive remuneration framework enables Cochlear to attract, motivate and retain high performing executives across many locations in a dynamic and highly competitive market.

In FY19, the P&CC reviewed Cochlear's executive remuneration framework to ensure it aligns with our business objectives, performance and shareholder expectations. Following this review, we are proposing changes to Cochlear's long-term incentive (LTI) plan for FY20. These changes, made following extensive consultation, include extending the performance period from three to four years and recalibrating target and maximum earnings per share (EPS) measures. As noted in the Chairman's report, the current EPS targets have been in place for at least 15 years and are now considered inconsistent with our expectations and strategic objectives for growth.

We are also making changes to the short-term incentive (STI) plan for all eligible employees, including executives. We are retaining the key financial performance measures of profitability and revenue. However, we are changing the balance of these measures by introducing a minimum net profit gateway to first determine if STI is achieved or not. If the profit gateway is met, the STI pool will be determined by revenue growth, in addition to the achievement of company strategic objectives. This provides clarity and focus around our growth objectives. The net impact of this change will reduce STI payments for low-to-moderate performance but increase payments for strong-to-exceptional achievement.

For FY19, the Board is satisfied that key performance targets were met. Overall sales revenue grew by 7% and underlying net profit after tax was within guidance. Relative total shareholder return against the ASX 100 was at the 81st percentile and Cochlear achieved a growth in basic EPS representing a 11.7% compound annual growth rate (CAGR) over the last three years. Because of these results, incentives were awarded to the CEO & President and executives under the FY19 STI and the FY17-19 LTI plans. Further detail on this year's remuneration outcomes are provided in this report.

Cochlear has a long history of growth, navigating a complex and geographically diverse business, subject to rapidly changing competitive forces, and technical innovation. The Board believes Cochlear's approach to Board and executive remuneration remains balanced, fair and equitable and rewards and motivates a successful and experienced executive team to deliver ongoing business growth and manage the risks of the business, which meets the expectations of shareholders over the long term.



Glen Boreham, AM  
Chairman, People & Culture Committee

## CONTENTS

This report covers:

1. Key management personnel;
2. Executive KMP remuneration received in FY19 (unaudited);
3. Our remuneration strategy and framework;
4. Executive KMP remuneration and link to performance;
5. Executive KMP statutory remuneration disclosure;
6. Executive service agreements;
7. Remuneration governance;
8. Executive KMP equity disclosures; and
9. Non-executive director fees.

## 1. KEY MANAGEMENT PERSONNEL

This report covers key management personnel (KMP) who have authority for planning, directing and controlling the activities of Cochlear and comprise non-executive directors (NEDs) and executive KMP as outlined in the table below.

Name	Position	Term as KMP
<b>Non-executive directors</b>		
Rick Holliday-Smith	Chairman	Full year
Yasmin Allen	Non-executive director	Full year
Glen Boreham, AM	Non-executive director	Full year
Alison Deans	Non-executive director	Full year
Andrew Denver	Non-executive director	Full year
Abbas Hussain	Non-executive director	Part year appointed 1 December 2018
Donal O'Dwyer	Non-executive director	Full year
Bruce Robinson, AM	Non-executive director	Full year
<b>Former non-executive director</b>		
Edward Byrne, AC	Non-executive director	Part year until 16 October 2018
<b>Executive KMP</b>		
Dig Howitt	CEO & President (CEO&P)	Full year
Anthony Bishop	President, Asia Pacific Region	Full year
Richard Brook	President, EMEA & Latin American Region	Full year
Brent Cubis	Chief Financial Officer	Full year
Jan Janssen	Chief Technology Officer	Full year
Tony Manna	President, Americas Region	Full year

There were no changes to KMP after the reporting date and before the date the Directors' report was authorised for issue. The information provided in this Remuneration report has been audited as required by section 308(3C) of the *Corporations Act 2001*.

## 2. EXECUTIVE KMP REMUNERATION RECEIVED IN FY19 (UNAUDITED)

The table below presents the remuneration paid to, received by or vested to each executive KMP during the year. Fixed remuneration and cash STI relate to amounts earned during the year, and vested deferred STI and vested LTI represent equity vesting from prior years.

The figures presented below are different to the statutory disclosures in section 5 which are prepared in accordance with the accounting standards and therefore include the accounting value for all unvested deferred STI and LTI awards expensed in the year. The table below has been provided voluntarily to ensure shareholders are able to clearly understand the remuneration outcomes and actual 'take-home pay' of executive KMP for FY19.

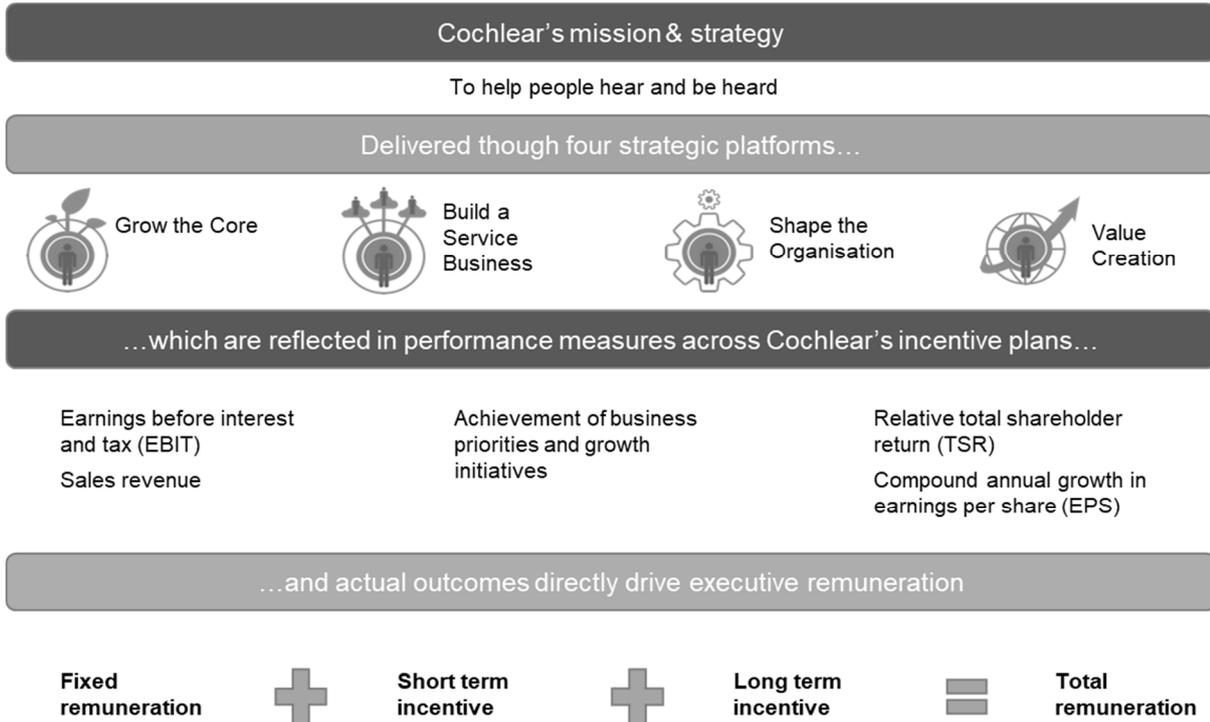
Amounts \$	Year	Fixed remuneration <sup>1</sup>	Cash STI <sup>2</sup>	Vested deferred STI <sup>3</sup>	Vested LTI <sup>4</sup>	Total
<b>Executive KMP</b>						
Dig Howitt	<b>FY19</b>	<b>1,725,969</b>	<b>1,105,225</b>	<b>155,430</b>	<b>2,075,203</b>	<b>5,061,827</b>
	FY18	1,547,833	1,135,893	167,895	1,084,544	3,936,165
Anthony Bishop	<b>FY19</b>	<b>524,528</b>	<b>244,481</b>	<b>148,896</b>	-	<b>917,905</b>
	FY18	496,754	222,571	-	-	719,325
Richard Brook	<b>FY19</b>	<b>1,182,003</b>	<b>360,020</b>	<b>164,934</b>	<b>1,858,388</b>	<b>3,565,345</b>
	FY18	1,077,831	374,457	228,060	981,182	2,661,530
Brent Cubis	<b>FY19</b>	<b>633,522</b>	<b>284,927</b>	-	-	<b>918,449</b>
	FY18	605,656	304,304	-	-	909,960
Jan Janssen	<b>FY19</b>	<b>783,783</b>	<b>422,605</b>	<b>153,450</b>	<b>1,436,076</b>	<b>2,795,914</b>
	FY18	672,817	370,955	185,378	1,100,132	2,329,282
Tony Manna	<b>FY19</b>	<b>838,581</b>	<b>353,068</b>	<b>147,114</b>	<b>1,293,946</b>	<b>2,632,709</b>
	FY18	767,602	379,388	242,865	-	1,389,855

1. Fixed remuneration earned in the year (base salary, superannuation and non-monetary benefits which may include insurances and car allowances).
2. Cash STI earned and relating to performance during the financial year. For example, FY19 is reported as STI payments which are accrued at year end, and received in August 2019, after the reporting year end.
3. Vested deferred STI is the value of the deferred STI from prior years that vested in August of the reported financial year (calculated as the number of rights that vested multiplied by the share price on the vesting date). For example, FY19 is reported as the FY16 deferred STI grant which vested in August 2018.
4. Vested LTI is the value of performance rights and options that vested in August of the reported financial year (rights are calculated as the number of rights that vested multiplied by the share price on the vesting date and options are calculated as the number of options multiplied by the share price on the date of vesting/exercise less the exercise price). For example, FY19 is reported as the FY16 LTI grant which vested in August 2018.



### 3. OUR REMUNERATION STRATEGY AND FRAMEWORK

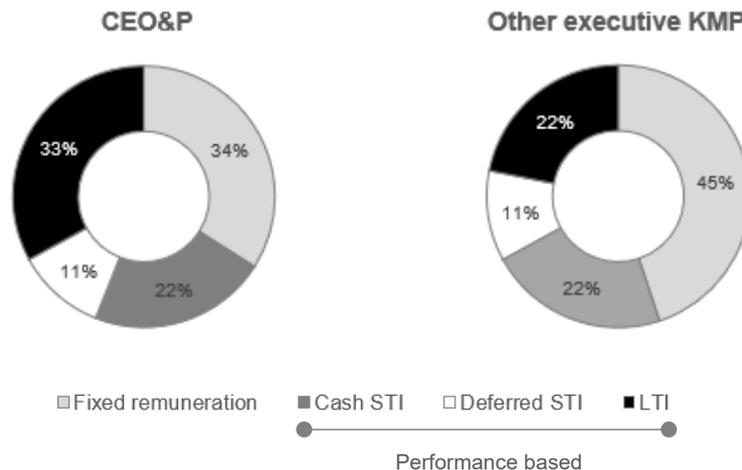
Cochlear’s executive remuneration strategy is designed to attract, motivate and retain a highly qualified and experienced group of executives employed across diverse geographies. The following diagram links each of the executive team remuneration components to Cochlear’s mission and strategy.



#### 3.1 Target remuneration mix

The remuneration mix for executive KMP is weighted towards at-risk performance based remuneration to ensure a strong focus on short, medium and long-term performance. A portion of executive remuneration is paid in equity (approximately, 44% for the CEO&P and 33% for other executive KMP) to align our executives with shareholder interests.

The Board believes this approach aligns executive KMP remuneration to shareholder interests and expectations.



## 3.2 Fixed remuneration

Fixed remuneration comprises base salary, superannuation and non-monetary benefits. Non-monetary benefits may include health insurance, car allowances and insurances. It is set at a level to attract and retain executive talent with the appropriate capabilities to deliver Cochlear's objectives.

Fixed remuneration is generally positioned at the median of the relevant market and is reviewed annually to ensure alignment with local market benchmarks, and it is reflective of the executives' expertise and performance in the role. Market benchmarks are typically set with reference to market capitalisation and include organisations within Cochlear's industry sector and/or similar in global operations and complexity as determined by the P&CC each year.

## 3.3 Short-term incentive

<b>Purpose</b>	To reward executives for the achievement of group (for group executives) and regional (for regional executives) sales revenue, EBIT and strategic performance targets set by the Board at the beginning of the performance period.		
<b>Performance measures</b>	STI is dependent on meeting financial and strategic performance measures:		
	<b>Performance measure and weighting</b>	<b>FY19 description</b>	<b>Changes for FY20 and rationale</b>
	Sales revenue and EBIT (60%)	<ul style="list-style-type: none"> <li>Sales revenue</li> <li>EBIT</li> <li>Financial targets are set by the Board, having regard to prior year performance, global market conditions, competitive environment, future prospects and the Board approved budgets. The specific targets are not disclosed to the market due to their commercial sensitivity.</li> <li>The weighting between Cochlear group and regional financial goals depends on the responsibilities and scope of influence of the individual.</li> </ul>	<ul style="list-style-type: none"> <li>Introduction of a Group Performance Gateway (minimum net profit after tax threshold)</li> <li>Removal of EBIT as a performance measure</li> <li>Reward determined only on revenue provided profit gateway is met</li> </ul> <p><b>Rationale:</b> Introduction of a Group Performance Gateway will further drive global alignment Removal of EBIT will focus performance on revenue growth. Revenue growth is critical to long-term shareholder returns.</p>
	Strategic measures (40%)	<ul style="list-style-type: none"> <li>Strategic measures recognise that in addition to short-term financial results, a number of strategic initiatives are required to enable sustained growth over time.</li> </ul>	<ul style="list-style-type: none"> <li>No change</li> </ul>
Individual contribution	<ul style="list-style-type: none"> <li>Each executive's contribution against the strategic measures is assessed at an individual level at the end of the performance period. This assessment determines the level at which awards are made.</li> </ul>	<ul style="list-style-type: none"> <li>No change</li> </ul>	
	Refer to section 4 for further detail on measures for FY19.		
<b>Opportunity</b>	<p><b>CEO&amp;P:</b> target opportunity is 100% of base salary, and maximum is up to 180% of base salary.</p> <p><b>Other executive KMP:</b> target opportunity is 75% of base salary, and maximum is up to 135% of base salary.</p>		
<b>Delivery</b>	<p>Two thirds of the award is paid in cash annually, with one third deferred into service rights for a period of two years (subject to a service condition) to reinforce alignment to longer-term shareholder interests and for retention purposes. No dividends are attached to service rights.</p> <p>The number of rights to be allocated is calculated using the 'gross contract value', which refers to a Black-Scholes-Merton pricing model without discounting for service or performance hurdles. The model uses Cochlear's five-day volume-weighted average share price following the announcement of full year results in August each year.</p>		
<b>Cessation of employment</b>	<p><b>Prior to STI payment date:</b> if an executive ceases employment with Cochlear prior to any cash being paid, or rights being granted, the executive will forfeit any awards to be paid for the performance period, unless the Board determines otherwise.</p> <p><b>Post STI payment date:</b> if an executive is dismissed for serious misconduct or resigns from their position after service rights have been granted, but prior to the relevant vesting date, any unvested rights will generally be forfeited, unless the Board determines otherwise.</p>		

## 3.4 Long-term incentive

<b>Purpose</b>	To align the remuneration opportunity for the executive team with shareholder value and provide a stimulus for the retention of executives within the Company.																																					
<b>Element</b>	<b>FY19 description</b>	<b>Changes for FY20 and rationale</b>																																				
<b>Award vehicle</b>	LTI is delivered in the form of options and performance rights. Executives are given choice of electing between rights and options (with a minimum 30% in options).	<ul style="list-style-type: none"> <li>Standardise mix to 50% rights and 50% options</li> </ul> <p><b>Rationale:</b> Standardising the election of rights and options provides greater simplicity and clarity for the executive team. Retaining a portion of equity delivered via options will also ensure the executive team is engaged and incentivised to deliver shareholder value.</p>																																				
<b>Opportunity</b>	<b>CEO&amp;P:</b> maximum opportunity is 100% of base salary. <b>Other executive KMP:</b> maximum opportunity ranges from 40% to 50% of base salary.	<ul style="list-style-type: none"> <li>No change</li> </ul>																																				
<b>Allocation method</b>	<p>The LTI opportunity is calculated using the 'gross contract value', which refers to a Black-Scholes-Merton pricing model without discounting for service or performance hurdles.</p> <p>Gross contract value discounts for dividends not paid, share price volatility and the risk free rate of return. There is no discount for the likelihood of service or performance conditions. The model uses Cochlear's five-day volume-weighted average price following the announcement of full year results in August each year.</p>	<ul style="list-style-type: none"> <li>No change</li> </ul>																																				
<b>Performance period</b>	Performance is measured over a three-year performance period. Post vesting, options expire seven months after the vesting date if they have not been exercised. There is no retesting of performance hurdles under the LTI plan.	Performance will be measured over a four-year performance period.																																				
<b>Performance measures and hurdles</b>	<p>Awards are subject to:</p> <ul style="list-style-type: none"> <li>50% weighting on relative TSR against the constituents of the ASX 100 index; and</li> <li>50% weighting on CAGR in EPS.</li> </ul> <p>The proportion of awards that vest for performance are:</p> <table border="1" style="display: inline-table; margin-right: 20px;"> <thead> <tr> <th colspan="2">Relative TSR</th> </tr> <tr> <th>Performance</th> <th>% of instruments that vest</th> </tr> </thead> <tbody> <tr> <td>Less than 50<sup>th</sup> percentile</td> <td>0%</td> </tr> <tr> <td>At the 50<sup>th</sup> percentile</td> <td>40%</td> </tr> <tr> <td>50<sup>th</sup> percentile to 75<sup>th</sup> percentile</td> <td>40% to 100% (pro-rata)</td> </tr> <tr> <td>Above 75<sup>th</sup> percentile</td> <td>100%</td> </tr> </tbody> </table> <table border="1" style="display: inline-table; margin-right: 20px;"> <thead> <tr> <th colspan="2">EPS</th> </tr> <tr> <th>Performance (CAGR)</th> <th>% of instruments that vest</th> </tr> </thead> <tbody> <tr> <td>Less than 10%</td> <td>0%</td> </tr> <tr> <td>10%</td> <td>50%</td> </tr> <tr> <td>10% to 20%</td> <td>50% to 100% (pro-rata)</td> </tr> <tr> <td>Above 20%</td> <td>100%</td> </tr> </tbody> </table> <p>These measures have been selected to incentivise the executive team towards long-term sustainable growth of the business and are generally accepted proxies for the creation of shareholder value.</p>	Relative TSR		Performance	% of instruments that vest	Less than 50 <sup>th</sup> percentile	0%	At the 50 <sup>th</sup> percentile	40%	50 <sup>th</sup> percentile to 75 <sup>th</sup> percentile	40% to 100% (pro-rata)	Above 75 <sup>th</sup> percentile	100%	EPS		Performance (CAGR)	% of instruments that vest	Less than 10%	0%	10%	50%	10% to 20%	50% to 100% (pro-rata)	Above 20%	100%	<ul style="list-style-type: none"> <li>No change to weightings of relative TSR and EPS</li> <li>No change to relative TSR measure</li> <li>Recalibration of target and maximum measures for EPS</li> </ul> <table border="1" style="display: inline-table;"> <thead> <tr> <th colspan="2">EPS</th> </tr> <tr> <th>Performance (CAGR)</th> <th>% of instruments that vest</th> </tr> </thead> <tbody> <tr> <td>Less than 7.5%</td> <td>0%</td> </tr> <tr> <td>7.5%</td> <td>50%</td> </tr> <tr> <td>7.5% to 12.5%</td> <td>50% to 100% (pro-rata)</td> </tr> <tr> <td>Above 12.5%</td> <td>100%</td> </tr> </tbody> </table> <p><b>Rationale:</b> Recalibration of the EPS measure will ensure it remains aligned to the Company's growth targets and current market conditions. The revised measure is reflective of stretch performance and will ensure the executive team is engaged and incentivised to deliver shareholder value.</p>	EPS		Performance (CAGR)	% of instruments that vest	Less than 7.5%	0%	7.5%	50%	7.5% to 12.5%	50% to 100% (pro-rata)	Above 12.5%	100%
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<b>Dividends</b>	No dividends are attached to options or performance rights.	<ul style="list-style-type: none"> <li>No change</li> </ul>
<b>Cessation of employment</b>	<p>If a member of the executive team ceases employment before the end of the performance period, unvested LTI awards will be forfeited.</p> <p>In exceptional circumstances such as in the case of redundancy and retirement, the Board may in its discretion, determine that all or a portion of the award will vest in line with the original performance criteria and vesting date.</p>	<ul style="list-style-type: none"> <li>No change</li> </ul>

## Transitional arrangements for FY20 LTI

Increasing the performance period of the Cochlear LTI plan from three to four years, will result in a gap year of LTI vesting in FY22 for executives. To address this issue, for FY20 only, two grants will be provided to the executive team (excluding the CEO&P):

- Grant 1:** 50% of the annual LTI grant opportunity with a three-year performance period; and
- Grant 2:** 75% of the annual LTI grant opportunity with a four-year performance period.

No transitional arrangement will be provided to the CEO&P. The CEO&P's FY20 LTI grant opportunity will be 100% of base salary and will have a four-year performance period.

Further detail on the remuneration framework is provided in Cochlear's Remuneration Policy, available in 'Investors' or 'Investor Centre' section of the Company's website. <https://www.cochlear.com/intl/about/investor/corporate-governance/company-policies>

## 4. EXECUTIVE KMP REMUNERATION AND LINK TO PERFORMANCE

### 4.1 FY19 STI outcomes

STI is based on performance against financial measures (60%) and strategic measures (40%).

When reviewing financial performance, the Board excludes revaluation gains and losses from non-core investments (the innovation fund) from the calculation of STI. For FY19, this resulted in a reduced incentive outcome. In FY19, Cochlear's sales revenue grew by 7% and EBIT grew by 2% (excluding revaluation of innovation fund).

In addition to financial measures, the Board also considered progress against strategic measures which are critical to the achievement of Cochlear's longer-term goals.

Validation of performance against the measures set for:

- the CEO&P involves an independent review and endorsement by the Chief Financial Officer (CFO), reviewed and approved by the P&CC and Board; and
- other executive KMP involves a review by the CEO&P based on inputs from the CFO. Final review is undertaken by the P&CC.

Any anomalies or discretionary elements are validated and approved by the Board.

The table below provides a summary, and achievement against each, of the financial measures and strategic measures of the STI plan. Measures are agreed with the P&CC at the commencement of each financial year and are aligned to the delivery of initiatives that support Cochlear's strategic priorities.

	Strategic priority	Business priority	Description	Achievement
Strategic measures (40%)	 Retain market leadership	<ul style="list-style-type: none"> <li>Ensure technology leadership</li> <li>Engage with more recipients</li> <li>Create world-class customer experiences</li> <li>Drive upgrade penetration</li> <li>Develop organisational talent and capability</li> <li>Implement the digital strategy</li> <li>Develop partnerships and alliances</li> </ul>	<ul style="list-style-type: none"> <li>Launched products including Nucleus® Profile™ Plus Series cochlear implant, Nucleus 7 ForwardFocus, and Nucleus 7 Android Audio Streaming</li> <li>Commenced clinical feasibility study for the totally implantable cochlear implant</li> <li>Invested in customer experience and customer engagement</li> <li>Strengthened the technology and commercial alliance with GN Hearing</li> <li>Realised operational improvements and efficiency in supply chain, customer service, and transactional areas</li> <li>Increased organisational capability through skill and leadership development</li> </ul>	●
	 Grow the hearing implant market	<ul style="list-style-type: none"> <li>Grow demand</li> </ul>	<ul style="list-style-type: none"> <li>Expanded direct-to-consumer marketing and hearing aid channel referral programs</li> <li>Invested to support cochlear implants becoming the standard of care for adults and seniors with profound hearing loss</li> <li>Expanded market access capabilities globally</li> </ul>	●
Financial measures (60%)	 Deliver consistent revenue and earnings growth	<ul style="list-style-type: none"> <li>Achieve the FY19 financial targets</li> <li>Drive operational excellence</li> </ul>	<ul style="list-style-type: none"> <li>Met guidance provided to the market (NPAT of \$266 million)</li> <li>Grew Revenue by 7%</li> <li>Delivered net profit margin of 18%, in line with target</li> <li>Realised operational improvements and efficiency in supply chain, customer service, and transactional areas</li> </ul>	●

○ = Below expectations      ● = Met expectations      ● = Exceeded expectations

Key performance targets were met for FY19. These performance outcomes resulted in an average actual STI of 98% of target for executive KMP.

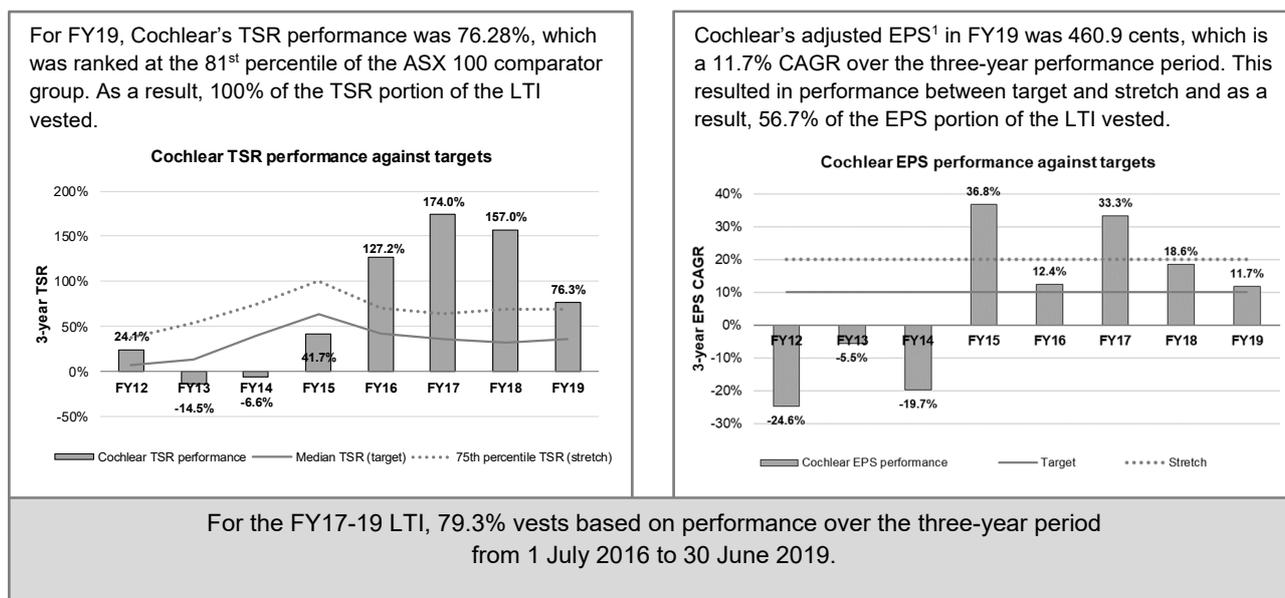
The FY19 STI earned is outlined in the table below:

Executive KMP	STI target as a % of base salary	STI maximum as a % of base salary	Actual STI as a % of target	Actual STI as a % of maximum	STI forfeited as a % of maximum	Actual STI (total) \$
Dig Howitt	100%	180%	99%	54.8%	45.2%	1,657,754
Anthony Bishop	75%	135%	98%	54.5%	45.5%	366,721
Richard Brook	75%	135%	97%	53.9%	46.1%	540,031
Brent Cubis	75%	135%	94%	52.2%	47.8%	427,390
Jan Janssen	75%	135%	108%	60.0%	40.0%	633,908
Tony Manna	75%	135%	94%	52.0%	48.0%	529,602

Two thirds of the actual STI will be delivered in cash in August 2019, and one third will be deferred into service rights, and subject to service conditions until August 2021.

## 4.2 FY17-19 LTI vesting outcomes

LTI is based on performance against relative TSR (50%) and EPS growth (50%) over a three-year performance period. The graphs below illustrate Cochlear's TSR and EPS performance over the past eight years, relative to the target and stretch performance targets set.



1. Adjusted EPS excludes revaluation of innovation fund

## 4.3 Financial performance history (FY15 to FY19)

	FY15	FY16	FY17	FY18	FY19
Sales revenue (\$million)	941.9	1,158.1	1,239.7	1,351.4	1,446.1
Earnings before interest and tax (EBIT) (\$million)	206.4	262.6	315.6	348.4	370.1
EBIT (excl. revaluation of innovation fund) (\$million)	n/a	n/a	n/a	350.6	359.3
Net profit after tax (NPAT) (\$million)	145.8	188.9	223.6	245.8	276.7
NPAT (excl. revaluation of innovation fund) (\$million)	n/a	n/a	n/a	248.0	265.9
Basic earnings per share (EPS) (cents)	256.1	330.6	389.7	427.3	479.6
EPS growth (3-yr CAGR)	36.8%	12.4%	33.3%	18.6%	13.2%
EPS growth (excl. revaluation of innovation fund) (3-yr CAGR)	n/a	n/a	n/a	n/a	11.7%
Total dividend per share (\$)	1.90	2.30	2.70	3.00	3.30
Share price as at 30 June (\$)	80.15	121.25	155.45	200.17	206.84
Relative total shareholder return (TSR) (3 years)	41.7%	127.2%	174.0%	157.0%	76.3%
TSR percentile ranking <sup>1</sup>	38 <sup>th</sup>	94 <sup>th</sup>	96 <sup>th</sup>	97 <sup>th</sup>	81 <sup>st</sup>

1. TSR ranking is shown over three financial years to 30 June. For LTI, performance is compared to the TSR of the constituents of the ASX 100.

For further explanation of details on Cochlear performance, see the Operating and financial review section on pages 9 to 21 of this Annual Report.

## 5. EXECUTIVE KMP STATUTORY REMUNERATION DISCLOSURE

The table below presents the total remuneration for executive KMP in accordance with the accounting standards.

Amounts \$	Year	Short-term benefits			Post-employment	Other long-term benefits	Share based payments			Total	% of performance related remuneration
		Salary	Cash STI	Non-monetary benefits <sup>1</sup>	Super-annuation contributions	Long service leave	Deferred STI <sup>2</sup>	LTI performance rights <sup>3</sup>	LTI options <sup>3</sup>		
<b>Executive KMP</b>											
Dig Howitt	<b>FY19</b>	<b>1,704,308</b>	<b>1,105,225</b>	<b>1,130</b>	<b>20,531</b>	<b>(19,078)</b>	<b>344,269</b>	<b>124,402</b>	<b>413,778</b>	<b>3,694,565</b>	<b>53.80%</b>
	FY18	1,526,654	1,135,893	1,130	20,049	208,620	193,952	86,856	289,019	3,462,173	49.27%
Anthony Bishop	<b>FY19</b>	<b>503,356</b>	<b>244,481</b>	<b>640</b>	<b>20,531</b>	<b>2,583</b>	<b>99,369</b>	<b>45,172</b>	<b>24,710</b>	<b>940,842</b>	<b>43.97%</b>
	FY18	476,065	222,571	640	20,049	3,509	92,901	29,221	15,030	859,986	41.83%
Richard Brook	<b>FY19</b>	<b>753,728</b>	<b>360,020</b>	<b>275,439</b>	<b>152,836</b>	<b>-</b>	<b>150,706</b>	<b>89,567</b>	<b>75,067</b>	<b>1,857,363</b>	<b>36.36%</b>
	FY18	686,850	374,457	252,578	138,403	-	126,234	113,054	98,182	1,789,758	39.78%
Brent Cubis	<b>FY19</b>	<b>612,350</b>	<b>284,927</b>	<b>640</b>	<b>20,531</b>	<b>2,472</b>	<b>96,139</b>	<b>34,503</b>	<b>35,415</b>	<b>1,086,977</b>	<b>41.49%</b>
	FY18	584,967	304,304	640	20,049	2,039	50,323	19,745	13,444	995,511	38.96%
Jan Janssen	<b>FY19</b>	<b>762,121</b>	<b>422,605</b>	<b>1,130</b>	<b>20,531</b>	<b>22,880</b>	<b>157,525</b>	<b>69,669</b>	<b>88,896</b>	<b>1,545,357</b>	<b>47.80%</b>
	FY18	651,638	370,955	1,130	20,049	29,297	120,001	82,666	95,900	1,371,636	48.81%
Tony Manna	<b>FY19</b>	<b>743,718</b>	<b>353,068</b>	<b>75,508</b>	<b>19,355</b>	<b>-</b>	<b>150,682</b>	<b>30,346</b>	<b>120,337</b>	<b>1,493,014</b>	<b>43.83%</b>
	FY18	669,798	379,388	79,195	18,609	-	121,813	37,666	116,044	1,422,513	46.04%
<b>Total</b>	<b>FY19</b>	<b>5,079,581</b>	<b>2,770,326</b>	<b>354,487</b>	<b>254,315</b>	<b>8,857</b>	<b>998,690</b>	<b>393,659</b>	<b>758,203</b>	<b>10,618,118</b>	<b>46.34%</b>
	FY18	4,595,972	2,787,568	335,313	237,208	243,465	705,224	369,208	627,619	9,901,577	45.34%

The total remuneration for FY18 of \$9,901,577 in this table is less than the total for FY18 in the 2018 Remuneration report of \$14,814,340 as it does not include \$4,912,763 for the former CEO&P, Chris Smith.

1. Non-monetary benefits include insurances for all KMP and car and housing allowances for overseas based KMP which are market based payments. For Richard Brook, the amount also includes compulsory social security contributions of approximately \$173,000.
2. Deferred STI is granted in service rights and deferred for a further two years. The cost of the plan is expensed across three years. The FY19 amount represents the portion of the FY17, FY18 and FY19 deferred STI expensed in FY19. The FY18 amount represents the portion of the FY16, FY17 and FY18 deferred STI expensed in FY18.
3. LTI granted in performance rights and options are expensed evenly over the period from grant date to vesting date. The value is calculated at the date of grant using the Black-Scholes-Merton pricing model discounted for vesting probabilities of non-market performance criteria. 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 of performance rights and options. The value disclosed above is the portion of the value of the performance rights and options recognised as an expense in the financial year. The ability to exercise the performance rights and options is conditional on Cochlear achieving certain performance hurdles. Further details of performance rights and options granted during the financial year are set out in this report.

## 6. EXECUTIVE SERVICE AGREEMENTS

### Summary table of service contract details for executives

Cochlear does not enter into (limited) service contracts for executive KMP. The terms of employment for executive KMP meet local employment law requirements. Key provisions are similar but do, on occasion, vary to suit different needs.

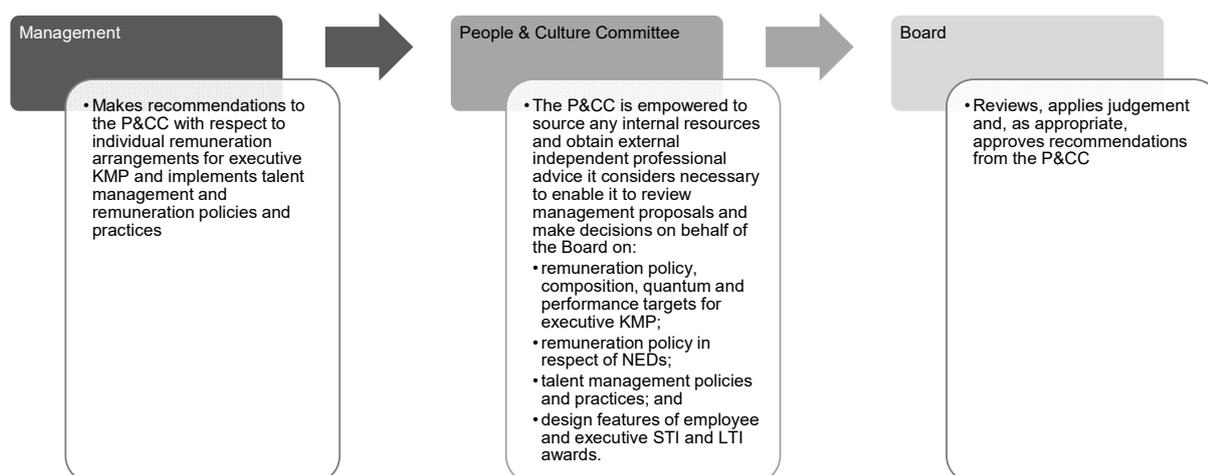
The following sets out details of the employment agreements relating to executive KMP.

<b>Length of contract</b>	Permanent contract until notice is given by either party.
<b>Notice periods</b>	CEO&P: 12 months' written notice by either party. Other executive KMP: between 60 days to six months' written notice by either party (exact period specified in each contract).
<b>Post-employment restraints</b>	All executive KMP are subject to post-employment restraints for up to 12 months.
<b>Other arrangements</b>	Richard Brook will receive a maximum of CHF 30,000 for repatriation costs in the case of termination or resignation.

## 7. REMUNERATION GOVERNANCE

### 7.1 Governance framework for remuneration at Cochlear

The Board is responsible for all areas of Cochlear’s strategy and policy related to its people. Consistent with this responsibility, the Board has established the P&CC which comprises solely of independent NEDs.



### 7.2 Advice from external advisors

To inform decisions, the P&CC sought advice and, at times, recommendations from the CEO&P and other management throughout the year.

During FY19, the P&CC engaged Godfrey Remuneration Group (GRG) and received remuneration and market practice advice and information in relation to STI, LTI, remuneration of executive KMP and remuneration of NEDs. GRG was paid \$158,532 (excluding GST) for these services.

The P&CC is satisfied that the advice received from GRG is free from undue influence of the KMP to whom the remuneration recommendations relate as GRG confirmed in writing that the remuneration recommendations were made free from undue influence by management, in accordance with the *Corporations Act 2001*.

### 7.3 Share ownership requirements

Executive KMP are required to retain vested equity until they hold and maintain a holding of Cochlear shares equivalent to their annual salary in the previous year. The Board considers the minimum shareholding guidelines to be best practice to strengthen the alignment of executives’ interests to those of shareholders. The table in section 8.2 details the current holdings of executive KMP.

### 7.4 Clawback Policy

All participants of the deferred STI and LTI plan are subject to the Clawback Policy, available in the ‘Investors’ or ‘Investor Centre’ section of the Company’s website. The policy enables the Board to claw back remuneration outcomes in the event of a material non-compliance with any financial reporting requirement, misconduct, or following inappropriate behaviour post-employment in cases where the Board has exercised its discretion to allow retention of equity following termination of employment. The policy is designed to further align the interests of participants with the long-term interests of Cochlear and shareholders, and to ensure that excessive risk taking is not rewarded.



## 8. EXECUTIVE KMP EQUITY DISCLOSURES

Executive KMP participate in the deferred STI and LTI plan which offers equity under the Cochlear Executive Incentive Plan (CEIP). The purpose of the CEIP is to encourage employees and executives to hold Cochlear shares and to align their interests to shareholders' interests.

Under the LTI plan, vesting of options or performance rights only occurs if Cochlear achieves challenging and market competitive hurdles related to EPS growth and relative TSR. Under the deferred STI plan, grants are based on performance in the first year, and are then deferred for a further two years.

### 8.1 Equity granted as remuneration

The table below presents the number of options and performance rights granted to executive KMP as well as the number of instruments that vested or were forfeited during the year.

No options or rights vest if the conditions are not satisfied, hence the minimum value is nil. The maximum value of the grants has been determined as the fair value of awards at grant date that is yet to be expensed.

Plan	Grant date	Options		Performance rights		Vesting date <sup>2</sup>	Vested	Forfeited	
		Number	Maximum value to be expensed (\$) <sup>1</sup>	Number	Maximum value to be expensed (\$) <sup>1</sup>				
<b>Executive KMP</b>									
Dig Howitt	FY16 LTI	20-Oct-15	18,682	-	-	17-Aug-18	96.5%	3.5%	
	FY16 deferred STI	16-Aug-16	-	-	785	17-Aug-18	100%	0%	
	FY17 LTI	19-Oct-16	10,375	-	1,537	19-Aug-19			
	FY17 deferred STI	24-Aug-17	-	-	949	19-Aug-19			
	FY18 LTI	18-Oct-17	46,842	173,862	3,372	46,888	19-Aug-20		
	FY18 deferred STI	24-Aug-18	-	-	1,692	113,922	19-Aug-20		
	FY19 LTI	17-Oct-18	35,907	389,591	1,685	65,438	16-Aug-21		
	<b>Total</b>		<b>111,806</b>	<b>563,453</b>	<b>10,020</b>	<b>226,248</b>			
	Anthony Bishop	FY16 deferred STI	16-Aug-16	-	-	752	17-Aug-18	100%	0%
FY17 LTI		19-Oct-16	2,171	-	751	19-Aug-19			
FY17 deferred STI		24-Aug-17	-	-	596	19-Aug-19			
FY18 LTI		18-Oct-17	1,778	6,599	697	9,692	19-Aug-20		
FY18 deferred STI		24-Aug-18	-	-	440	29,625	19-Aug-20		
FY19 LTI		17-Oct-18	1,598	17,338	700	27,185	16-Aug-21		
<b>Total</b>		<b>5,547</b>	<b>23,937</b>	<b>3,936</b>	<b>66,502</b>				
Richard Brook	FY16 LTI	20-Oct-15	12,601	-	2,402	17-Aug-18	96.5%	3.5%	
	FY16 deferred STI	16-Aug-16	-	-	833	17-Aug-18	100%	0%	
	FY17 LTI	19-Oct-16	5,622	-	1,944	19-Aug-19			
	FY17 deferred STI	24-Aug-17	-	-	944	19-Aug-19			
	FY18 LTI	18-Oct-17	6,965	25,852	1,170	16,269	19-Aug-20		
	FY18 deferred STI	24-Aug-18	-	-	665	44,774	19-Aug-20		
	FY19 LTI	17-Oct-18	4,565	49,530	857	33,282	16-Aug-21		
<b>Total</b>		<b>29,753</b>	<b>75,382</b>	<b>8,815</b>	<b>94,325</b>				
Brent Cubis	FY17 deferred STI	24-Aug-17	-	-	243	19-Aug-19			
	FY18 LTI	18-Oct-17	3,622	13,444	1,420	19,745	19-Aug-20		
	FY18 deferred STI	24-Aug-18	-	-	547	36,830	19-Aug-20		
	FY19 LTI	17-Oct-18	4,050	43,943	760	29,515	16-Aug-21		
<b>Total</b>		<b>7,672</b>	<b>57,387</b>	<b>2,970</b>	<b>86,090</b>				
Jan Janssen	FY16 LTI	20-Oct-15	9,736	-	1,856	17-Aug-18	96.5%	3.5%	
	FY16 deferred STI	16-Aug-16	-	-	775	17-Aug-18	100%	0%	
	FY17 LTI	19-Oct-16	7,900	-	1,171	19-Aug-19			
	FY17 deferred STI	24-Aug-17	-	-	867	19-Aug-19			
	FY18 LTI	18-Oct-17	7,060	26,204	1,186	16,491	19-Aug-20		
	FY18 deferred STI	24-Aug-18	-	-	667	44,909	19-Aug-20		
	FY19 LTI	17-Oct-18	5,223	56,670	981	38,097	16-Aug-21		
<b>Total</b>		<b>29,919</b>	<b>82,874</b>	<b>7,503</b>	<b>99,497</b>				
Tony Manna	FY16 LTI	20-Oct-15	10,216	-	834	17-Aug-18	96.5%	3.5%	
	FY16 deferred STI	16-Aug-16	-	-	743	17-Aug-18	100%	0%	
	FY17 LTI	19-Oct-16	9,414	-	598	19-Aug-19			
	FY17 deferred STI	24-Aug-17	-	-	995	19-Aug-19			
	FY18 LTI	18-Oct-17	10,385	38,546	436	6,063	19-Aug-20		
	FY18 deferred STI	24-Aug-18	-	-	645	43,428	19-Aug-20		
	FY19 LTI	17-Oct-18	7,530	81,701	353	13,709	16-Aug-21		
<b>Total</b>		<b>37,545</b>	<b>120,247</b>	<b>4,604</b>	<b>63,200</b>				

1. The options granted in FY19 have an exercise price of \$202.84 and an expiry date of 18 March 2022. Fair values (IFRS-2) of FY19 options and performance rights under the LTI plan as at the date of grant are as follows: options (EPS growth: \$37.43; relative TSR: \$32.55) and performance rights (EPS growth: \$199.29; relative TSR: \$116.51). This valuation is for accounting purposes only and forms the basis of the expense in future years. Further detail on the allocation methodology is provided in section 3.4.

2. To ensure plans vest as close to the end of the performance period as possible, from FY18, vesting will be aligned to the day following the full year results announcement in August each year.

## 8.2 Executive KMP equity holdings and minimum shareholding

This section details the movement in equity holdings during the financial year.

### Shares held during the year

During the year, the FY16 LTI plan and FY16 deferred STI plan vested and executives' options/rights converted into shares under these plans.

	Balance 1 July 2018	Received on exercise of options/rights <sup>1</sup>	Purchases and sales	Balance 30 June 2019
<b>Executive KMP</b>				
Dig Howitt	31,281	18,813	(10,000)	40,094
Anthony Bishop	-	752	-	752
Richard Brook	5,000	15,309	(13,493)	6,816
Brent Cubis	-	-	-	-
Jan Janssen	11,786	11,961	(16,961)	6,786
Tony Manna	1,056	11,405	(10,279)	2,182
<b>Total</b>	<b>49,123</b>	<b>58,240</b>	<b>(50,733)</b>	<b>56,630</b>

1. For options exercised, the amount paid per option was the exercise price of \$82.89.

### Rights held during the year

Rights are acquired by executive KMP under the deferred STI and LTI plan. During the year, the FY18 STI deferral grant was made in August 2018 (based on the FY18 performance year), the FY19 LTI grant was made in October 2018 and 96.5% of the FY16 LTI grant and 100% of the FY16 deferred STI grant vested in August 2018.

	Balance 1 July 2018	Deferred STI service rights			LTI performance rights			Balance 30 June 2019
		Granted	Vested	Forfeited	Granted	Vested	Forfeited	
<b>Executive KMP</b>								
Dig Howitt	6,643	1,692	(785)	-	1,685	-	-	9,235
Anthony Bishop	2,796	440	(752)	-	700	-	-	3,184
Richard Brook	7,293	665	(833)	-	857	(2,317)	(85)	5,580
Brent Cubis	1,663	547	-	-	760	-	-	2,970
Jan Janssen	5,855	667	(775)	-	981	(1,791)	(65)	4,872
Tony Manna	3,606	645	(743)	-	353	(804)	(30)	3,027
<b>Total</b>	<b>27,856</b>	<b>4,656</b>	<b>(3,888)</b>	<b>-</b>	<b>5,336</b>	<b>(4,912)</b>	<b>(180)</b>	<b>28,868</b>

### Options held during the year

Options over ordinary shares are acquired by executive KMP under the LTI plan. During the year, the FY19 LTI grant was made in October 2018 and 96.5% of the FY16 LTI grant vested in August 2018.

All options held at the end of the year are unvested.

	Balance 1 July 2018	LTI options			Balance 30 June 2019
		Granted	Vested and exercised <sup>1</sup>	Forfeited	
<b>Executive KMP</b>					
Dig Howitt	75,899	35,907	(18,028)	(654)	93,124
Anthony Bishop	3,949	1,598	-	-	5,547
Richard Brook	25,188	4,565	(12,159)	(442)	17,152
Brent Cubis	3,622	4,050	-	-	7,672
Jan Janssen	24,696	5,223	(9,395)	(341)	20,183
Tony Manna	30,015	7,530	(9,858)	(358)	27,329
<b>Total</b>	<b>163,369</b>	<b>58,873</b>	<b>(49,440)</b>	<b>(1,795)</b>	<b>171,007</b>

1. The value of exercised options at the date of exercise is \$115.11 (closing share price at the vesting date 15 August 2018 \$198.00 less the exercise price of \$82.89).

## Executive minimum shareholding

As at 30 June 2019, all executive KMP are compliant with the Share Ownership Policy (minimum shareholding requirements). For new KMP, it is expected that executives will achieve the minimum shareholding requirement over time. The table below presents a summary of executive KMP holdings and compliance with minimum shareholding requirements.

	Ordinary shares held	Policy value of Cochlear shares at year end (\$)¹	% of base salary²
<b>Executive KMP</b>			
Dig Howitt	40,094	7,572,554	444%
Anthony Bishop	752	142,030	28%
Richard Brook	6,816	1,287,338	171%
Brent Cubis	-	-	0%
Jan Janssen	6,786	1,281,672	168%
Tony Manna	2,182	412,114	55%
<b>Total</b>	<b>56,630</b>	<b>10,695,708</b>	

1. In line with the Share Ownership Policy, the value has been calculated as the average daily share price over the previous 12 months (\$188.87), as at closing on the ASX up to 30 June 2019, times the number of shares.

2. The % of base salary is calculated as the value of shares divided by the actual base salary for the preceding 12 months to 30 June 2019.

## 8.3 Potential dilution if options vest and ordinary shares issued (unaudited)

The Board encourages employee ownership of Cochlear shares. To restrict dilution of shareholders' interests, the total employee interests in unvested equity cannot exceed 5% of share capital.

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 2019 (\$)²
		Issued	Forfeited/lapsed¹	At report date			
FY17 LTI	19-Oct-16	95,586	16,580	79,006	135.84	Aug-19 to Mar-20	5,609,426
FY18 LTI	18-Oct-17	106,713	2,337	104,376	154.73	Aug-20 to Mar-21	5,439,033
FY19 LTI	17-Oct-18	80,231	-	80,231	202.84	Aug-21 to Mar-22	320,924
<b>Total</b>		<b>282,530</b>	<b>18,917</b>	<b>263,613</b>			<b>11,369,383</b>

1. Forfeited/lapsed options from unvested grants relate to plan participants who have departed Cochlear.

2. Closing share price as at 30 June 2019 was \$206.84.

Total unvested equity currently accounts for approximately 0.65% of the total number of issued shares, as set out below:

Instrument	Number of equivalent shares at 30 June 2019
Unvested LTI options	263,613
Unvested LTI rights	41,841
Unvested deferred STI rights	64,355
Service rights under the APAC Employee Equity Plan¹	4,034
<b>Total</b>	<b>373,843</b>
as % of total shares	0.65%
<b>Number of issued shares</b>	<b>57,715,821</b>

1. Refer to Note 4.3 in the Notes to the financial statements for further information on the APAC Employee Equity Plan.

## 8.4 Transactions and loans with KMP

No transactions or loans involving directors or executive KMP, their close family members or entities they control or have significant influence over, were made during the year.

## 9. NON-EXECUTIVE DIRECTOR FEES

NEDs are paid from an aggregate annual fee pool for FY19 of \$3,500,000<sup>1</sup>. Total remuneration paid during the year was \$2,753,336 (including payments made in relation to the directors' retirement scheme<sup>2</sup>) which is within the fee pool limit (represented 78.7% of fee pool). NEDs do not receive any performance-related remuneration, options or performance rights. NEDs receive reimbursement for costs directly related to Cochlear business.

### 9.1 Fee policy and changes during the year

Board fees must recognise the effort required to fulfil the responsibilities of a director. Reflecting the increasing governance requirements and the work of the Board, the Board considered it appropriate to increase annual base fees by 3%, effective 1 July 2018. This decision was made with reference to external remuneration benchmarking of companies of a similar market capitalisation to that of Cochlear.

- The directors' fee pool was temporarily increased from \$3,000,000 to \$3,500,000 for FY19 based on shareholder approval obtained at the 2014 annual general meeting (AGM).
- As at 23 October 2006, the directors' retirement scheme no longer forms a part of the Company's remuneration strategy. Under the scheme, non-executive directors may be paid a retirement allowance of an amount equivalent to the aggregate of fees received over the three years prior to retirement following five years of service as a director of the Company. In compliance with the terms of its employment agreement obligations with Professor Byrne, the Company paid a retirement allowance to Professor Byrne following his retirement on 16 October 2018, for which shareholder approval had been obtained at the 2018 AGM.

The table below outlines the base and committee fees for FY18 and FY19.

Amounts \$	FY18 <sup>1</sup>		FY19 <sup>1</sup>	
	Chair <sup>2</sup>	Member	Chair <sup>2</sup>	Member
Cochlear Board	491,165	160,950	505,900	165,779
<b>Committees</b>				
Audit	50,000	25,000	50,000	25,000
People & Culture	40,000	20,000	40,000	20,000
Medical Science	30,000	15,000	30,000	15,000
Technology & Innovation	40,000	20,000	40,000	20,000
Nomination	No fee	No fee	No fee	No fee

- Superannuation contributions have been made in accordance with Australian superannuation legislation at a rate of 9.5% up to the Australian Government's prescribed maximum contributions limit. Fees are presented exclusive of superannuation.
- Committee fees are not paid to the Chairman of the Board.

### 9.2 NED statutory remuneration

The table below presents the total remuneration for NEDs.

Amounts \$	Year	Short-term benefits		Post-employment benefits		Total
		Fees	Accrued interest <sup>1</sup>	Directors' retirement scheme <sup>2</sup>	Superannuation	
Rick Holliday-Smith	<b>FY19</b>	<b>505,617</b>	-	-	<b>20,531</b>	<b>526,148</b>
	FY18	490,802	-	-	20,049	510,851
Yasmin Allen	<b>FY19</b>	<b>255,686</b>	-	-	<b>20,531</b>	<b>276,217</b>
	FY18	250,735	-	-	20,049	270,784
Glen Boreham	<b>FY19</b>	<b>250,686</b>	-	-	<b>20,531</b>	<b>271,217</b>
	FY18	245,639	-	-	20,049	265,688
Alison Deans	<b>FY19</b>	<b>230,686</b>	-	-	<b>20,384</b>	<b>251,070</b>
	FY18	225,735	-	-	19,931	245,666
Andrew Denver	<b>FY19</b>	<b>245,686</b>	-	-	<b>20,531</b>	<b>266,217</b>
	FY18	240,831	-	-	20,049	260,880
Abbas Hussain <sup>3</sup>	<b>FY19</b>	<b>111,973</b>	-	-	<b>10,635</b>	<b>122,608</b>
	FY18	-	-	-	-	-

# Remuneration report

Hear now. And always



Amounts \$	Year	Short-term benefits		Post-employment benefits		Total
		Fees	Accrued interest <sup>1</sup>	Directors' retirement scheme <sup>2</sup>	Superannuation	
Donal O'Dwyer	<b>FY19</b>	<b>225,686</b>	-	-	<b>20,165</b>	<b>245,851</b>
	FY18	220,831	-	-	19,712	240,543
Bruce Robinson	<b>FY19</b>	<b>235,686</b>	-	-	<b>20,531</b>	<b>256,217</b>
	FY18	220,985	-	-	19,826	240,811
<b>Former non-executive director</b>						
Edward Byrne <sup>4</sup>	<b>FY19</b>	<b>62,460</b>	-	<b>461,136</b>	<b>6,007</b>	<b>529,603</b>
	FY18	202,754	8,366	-	18,890	230,010
<b>Total<sup>5</sup></b>	<b>FY19</b>	<b>2,124,166</b>	-	<b>461,136</b>	<b>159,846</b>	<b>2,745,148</b>
	FY18	2,098,312	8,366	-	158,555	2,265,233

1. Amounts accrued for interest during the financial year relating to the directors' retirement scheme. Prior to 2003, Cochlear operated a directors' retirement scheme which provided retirement benefits of three times a NED's average annual remuneration over the previous three years. In 2006, the Board resolved to discontinue the ongoing accrual of benefits subject to a transition period to 2011. The benefits accrued are indexed by reference to the bank bill rate. At 30 June 2019, no directors are entitled to this benefit.
2. Edward Byrne was paid his accrued entitlement under the Cochlear directors' retirement scheme of \$461,136 on 24 October 2018. The directors' retirement scheme no longer forms a part of the Company's remuneration strategy.
3. Abbas Hussain was appointed to the Board on 1 December 2018.
4. Edward Byrne retired from the Board on 16 October 2018.
5. The year-on-year changes in Board fees reflect the increases to Board NED base fees.

### 9.3 Minimum shareholding requirement for NEDs

NEDs are requested to hold shares equivalent to the fees (including both Board and committee fees) received in the previous 12 months. The share ownership requirement must be satisfied within three years of appointment to the Board.

As at 30 June 2019, all NEDs are compliant with the Share Ownership Policy which allows three years to build their shareholdings. The table below presents Cochlear Limited shareholdings for each NED.

	Balance 1 July 2018	Purchases	Sales	Balance 30 June 2019	Policy value of shares as at 30 June 2019 (\$) <sup>1</sup>	% of fees
Rick Holliday-Smith	10,000	-	-	10,000	1,888,702	359%
Yasmin Allen	3,500	-	-	3,500	661,046	239%
Glen Boreham	2,800	-	-	2,800	528,837	195%
Alison Deans	3,000	-	-	3,000	566,611	226%
Andrew Denver	4,000	-	-	4,000	755,481	284%
Abbas Hussain <sup>2</sup>	-	-	-	-	--	0%
Donal O'Dwyer	6,000	-	-	6,000	1,133,221	461%
Bruce Robinson	322	1,330	-	1,652	312,014	118%
<b>Former non-executive director</b>						
Edward Byrne	3,250	-	-	N/A		
<b>Total</b>	<b>32,872</b>	<b>1,330</b>	-	<b>30,952</b>		

1. In line with the Share Ownership Policy, available in the 'Investors' or 'Investor Centre' section of the Company's website, the value of Cochlear Limited ordinary shares is calculated using the average daily share price over the previous 12 months (\$188.87), as at closing on the ASX up to 30 June 2019, times the number of shares.
2. Abbas Hussain was appointed to the Board on 1 December 2018, and in accordance with the policy has until 1 December 2021 to build his shareholding.

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 2019, 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 (Chairman), Mrs YA Allen, Mr G Boreham, AM, Prof E Byrne, AC, Ms A Deans, Mr A Denver, Mr D Howitt, Mr A Hussain, Mr DP O'Dwyer and Prof B Robinson, AM.

Information on the current 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.

## COMPANY SECRETARY

The Company Secretarial function is responsible for ensuring that the Company complies with its statutory duties and maintains proper documentation, registers and records. It also provides advice to directors and officers about corporate governance and gives practical effect to any decisions made by the Board.

Mr R Jarman was the Company Secretary during and since the end of the financial year. He has qualifications in law and science from The University of New South Wales and is an admitted solicitor in New South Wales. Mr Jarman joined Cochlear in 2008 as the inaugural Group General Counsel. He has over 30 years' experience in corporate and commercial law, litigation and dispute resolution, legal compliance and corporate governance across medical device, steel, mining and consumer goods industries.

## 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		People & Culture Committee		Medical Science Committee		Nomination Committee		Technology & Innovation Committee	
	Held	Attended	Held	Attended	Held	Attended	Held	Attended	Held	Attended	Held	Attended
Mr R Holliday-Smith	9	9	5	5	4	4	-	-	4	4	-	-
Mrs YA Allen	9	9	5	5	4	4	-	-	4	4	2	2
Mr G Boreham, AM	9	9	5	5	4	4	-	-	4	4	2	2
Prof E Byrne, AC <sup>1</sup>	4	3	-	-	-	-	1	1	3	1	-	-
Ms A Deans <sup>2</sup>	9	9	5	5	4	4	-	-	4	3	2	2
Mr A Denver <sup>3</sup>	9	9	5	5	-	-	2	2	4	4	2	2
Mr D Howitt	9	9	-	-	-	-	2	2	-	-	2	2
Mr A Hussain <sup>4</sup>	4	4	-	-	-	-	1	1	1	1	1	1
Mr DP O'Dwyer	9	9	5	5	-	-	2	2	4	3	2	2
Prof B Robinson, AM	9	9	-	-	4	4	2	2	4	4	2	2

1. Prof E Byrne retired on 16 October 2018 and ceased being a member of the Medical Science, Technology & Innovation and Nomination Committees.

2. Ms Deans was appointed as the Chair of the Technology & Innovation Committee commencing from 23 July 2019.

3. Mr Denver ceased being the Chair of the Technology & Innovation Committee commencing from 23 July 2019.

4. Mr Hussain was appointed to the Board on 1 December 2018 and became a member of the Medical Science, Technology & Innovation and Nomination Committees.

## PRINCIPAL ACTIVITIES

Information on the principal activities, operations and financial position of Cochlear Limited and its business strategies and prospects is set out in the Operating and financial review on pages 9 to 21 of this Annual Report.

## DIVIDENDS

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

	Dollars per share	Total amount \$m	Franked/unfranked	Date of payment
Interim 2019 ordinary	1.55	89.5	100% Franked	16 April 2019
Final 2018 ordinary	1.60	92.3	100% Franked	10 October 2018
<b>Total amount</b>	<b>3.15</b>	<b>181.8</b>		
<b>Subsequent event</b>				
Since the end of the financial year, the directors declared the following dividends:				
Final 2019 ordinary	1.75	101.0	100% Franked	14 October 2019
<b>Total amount</b>	<b>1.75</b>	<b>101.0</b>		

The financial effect of the 2019 final dividend will be recognised in the subsequent financial year as it was declared after 30 June 2019. Franked dividends paid or declared during the financial year were franked at the tax rate of 30% (2018: 30%).

## ENVIRONMENTAL REGULATIONS

Cochlear's operations are subject to 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, 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	
	2019	2018
	\$	\$
<b>Audit services</b>		
Audit and review of financial reports	1,795,339	1,780,268
Other regulatory compliance services	147,161	100,866
<b>Total audit services</b>	<b>1,942,500</b>	<b>1,881,134</b>
<b>Non-audit services</b>		
Taxation compliance and advisory services	1,764,533	1,031,640
IT advisory	643,260	673,000
Other	357,650	147,973
<b>Total non-audit services</b>	<b>2,765,443</b>	<b>1,852,613</b>

## STATE OF AFFAIRS

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

## REMUNERATION REPORT

Information on Cochlear's remuneration framework and the outcomes for the financial year ended 30 June 2019 for the Cochlear Limited Board, the Chief Executive Officer & President and other key management personnel, and changes for the financial year ending 30 June 2020, is included in the Remuneration report on pages 28 to 43 of this Annual Report.

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

#### Dividends

For dividends declared after 30 June 2019, see Note 2.6 to the financial statements.

### LEAD AUDITOR'S INDEPENDENCE DECLARATION

The lead auditor's independence declaration is set out on page 48 and forms part of the Directors' report for the financial year ended 30 June 2019.

### ROUNDING OFF

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

Dated at Sydney this 16th day of August 2019.

Signed in accordance with a resolution of the directors:



Director



Director



## 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 2019 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, 16 August 2019

Julian McPherson, Partner

## Income statement

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	Note	2019 \$m	2018 \$m
Revenue	2.2	1,426.7	1,363.7
Cost of sales	2.3	(351.1)	(361.2)
<b>Gross profit</b>		<b>1,075.6</b>	<b>1,002.5</b>
Selling, marketing and general expenses		(450.9)	(397.0)
Research and development expenses		(184.4)	(167.7)
Administration expenses		(94.8)	(97.4)
Other income	2.4	29.0	10.2
Other expenses	2.3	(4.4)	(2.2)
<b>Results from operating activities</b>		<b>370.1</b>	<b>348.4</b>
Finance income - interest		0.7	0.6
Finance expense - interest		(5.2)	(8.5)
<b>Net finance expense</b>		<b>(4.5)</b>	<b>(7.9)</b>
<b>Profit before income tax</b>		<b>365.6</b>	<b>340.5</b>
Income tax expense	3.1	(88.9)	(94.7)
<b>Net profit</b>		<b>276.7</b>	<b>245.8</b>
Basic earnings per share (cents)	2.5	479.6	427.3
Diluted earnings per share (cents)	2.5	479.5	426.7

The Consolidated Entity has initially applied AASB 9 and AASB 15 at 1 July 2018. Under the transition methods chosen, comparative information is not restated. See Note 7.6.

The notes on pages 54 to 91 are an integral part of these consolidated financial statements.

	2019	2018
	\$m	\$m
<b>Net profit</b>	<b>276.7</b>	<b>245.8</b>
<b>Other comprehensive (loss)/income</b>		
Items that will not be reclassified subsequently to the income statement:		
Defined benefit plan actuarial losses	(0.2)	(0.2)
Financial investments measured at fair value through other comprehensive income, net of tax	(1.3)	-
Total items that will not be reclassified subsequently to the income statement	(1.5)	(0.2)
Items that may be reclassified subsequently to the income statement:		
Foreign currency translation differences	12.6	3.7
Effective portion of changes in fair value of cash flow hedges, net of tax	(17.8)	(19.4)
Net change in fair value of cash flow hedges transferred to the income statement, net of tax	13.6	(8.6)
Net change in fair value of available for sale financial assets, net of tax	-	0.1
Total items that may be reclassified subsequently to the income statement	8.4	(24.2)
<b>Other comprehensive income/(loss), net of tax</b>	<b>6.9</b>	<b>(24.4)</b>
<b>Total comprehensive income</b>	<b>283.6</b>	<b>221.4</b>

The Consolidated Entity has initially applied AASB 9 and AASB 15 at 1 July 2018. Under the transition methods chosen, comparative information is not restated. See Note 7.6.

The notes on pages 54 to 91 are an integral part of these consolidated financial statements.

## Balance sheet

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	Note	2019 \$m	2018 \$m
<b>Assets</b>			
Cash and cash equivalents		78.6	61.5
Trade and other receivables	6.4(b)	319.7	316.7
Forward exchange contracts		2.2	3.7
Inventories	5.1	195.4	167.4
Current tax assets	3.2	12.2	9.6
Prepayments		26.9	25.3
<b>Total current assets</b>		<b>635.0</b>	<b>584.2</b>
Other receivables		3.3	2.1
Forward exchange contracts		2.1	0.4
Property, plant and equipment	5.2	166.5	128.4
Intangible assets	5.3	424.4	345.3
Investments	5.4	47.8	15.8
Deferred tax assets	3.2	100.1	80.7
<b>Total non-current assets</b>		<b>744.2</b>	<b>572.7</b>
<b>Total assets</b>		<b>1,379.2</b>	<b>1,156.9</b>
<b>Liabilities</b>			
Trade and other payables		160.8	140.5
Forward exchange contracts		20.9	13.1
Loans and borrowings	6.3(a)	3.3	3.7
Current tax liabilities	3.2	34.8	22.1
Employee benefit liabilities	4.2	69.5	57.3
Provisions	5.5	27.3	24.5
Deferred revenue		42.9	26.5
<b>Total current liabilities</b>		<b>359.5</b>	<b>287.7</b>
Trade and other payables		42.4	28.1
Forward exchange contracts		7.6	9.2
Loans and borrowings	6.3(a)	178.3	144.0
Employee benefit liabilities	4.2	13.1	12.0
Provisions	5.5	44.2	54.4
Deferred tax liabilities	3.2	5.5	8.1
Deferred revenue		2.7	2.6
<b>Total non-current liabilities</b>		<b>293.8</b>	<b>258.4</b>
<b>Total liabilities</b>		<b>653.3</b>	<b>546.1</b>
<b>Net assets</b>		<b>725.9</b>	<b>610.8</b>
<b>Equity</b>			
Share capital		182.3	173.0
Reserves		(15.3)	(33.8)
Retained earnings		558.9	471.6
<b>Total equity</b>		<b>725.9</b>	<b>610.8</b>

The Consolidated Entity has initially applied AASB 9 and AASB 15 at 1 July 2018. Under the transition methods chosen, comparative information is not restated. See Note 7.6.

The notes on pages 54 to 91 are an integral part of these consolidated financial statements.

# Statement of changes in equity

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Amounts \$m	Issued capital	Translation reserve	Hedging reserve	Fair value reserve	Share based payment reserve	Retained earnings	Total equity
<b>2018</b>							
Balance at 1 July 2017	169.4	(63.5)	15.2	(0.3)	35.7	387.1	543.6
<i>Total comprehensive income/(loss)</i>							
Net profit	-	-	-	-	-	245.8	245.8
<i>Other comprehensive (loss)/income</i>							
Defined benefit plan actuarial losses	-	-	-	-	-	(0.2)	(0.2)
Foreign currency translation differences	-	3.7	-	-	-	-	3.7
Effective portion of changes in fair value of cash flow hedges, net of tax	-	-	(19.4)	-	-	-	(19.4)
Net change in fair value of cash flow hedges transferred to the income statement, net of tax	-	-	(8.6)	-	-	-	(8.6)
Net change in fair value of available for sale financial assets, net of tax	-	-	-	0.1	-	-	0.1
<b>Total other comprehensive income/(loss)</b>	-	<b>3.7</b>	<b>(28.0)</b>	<b>0.1</b>	-	<b>(0.2)</b>	<b>(24.4)</b>
<b>Total comprehensive income/(loss)</b>	-	<b>3.7</b>	<b>(28.0)</b>	<b>0.1</b>	-	<b>245.6</b>	<b>221.4</b>
<b>Transactions with owners, recorded directly in equity</b>							
Share options exercised	3.6	-	-	-	(2.5)	-	1.1
Performance rights vested	-	-	-	-	(1.5)	-	(1.5)
Share based payment transactions	-	-	-	-	8.5	-	8.5
Deferred tax recognised in equity	-	-	-	-	(1.2)	-	(1.2)
Dividends to shareholders	-	-	-	-	-	(161.1)	(161.1)
<b>Balance at 30 June 2018</b>	<b>173.0</b>	<b>(59.8)</b>	<b>(12.8)</b>	<b>(0.2)</b>	<b>39.0</b>	<b>471.6</b>	<b>610.8</b>
<b>2019</b>							
Balance at 1 July 2018 (as reported)	173.0	(59.8)	(12.8)	(0.2)	39.0	471.6	610.8
Change on initial application of AASB 9, net of tax	-	-	-	0.4	-	(2.3)	(1.9)
Change on initial application of AASB 15, net of tax	-	-	-	-	-	(5.1)	(5.1)
<b>Balance at 1 July 2018 (restated)</b>	<b>173.0</b>	<b>(59.8)</b>	<b>(12.8)</b>	<b>0.2</b>	<b>39.0</b>	<b>464.2</b>	<b>603.8</b>
<i>Total comprehensive income/(loss)</i>							
Net profit	-	-	-	-	-	276.7	276.7
<i>Other comprehensive (loss)/income</i>							
Defined benefit plan actuarial losses	-	-	-	-	-	(0.2)	(0.2)
Financial investments measured at fair value through other comprehensive income, net of tax	-	-	-	(1.3)	-	-	(1.3)
Foreign currency translation differences	-	12.6	-	-	-	-	12.6
Effective portion of changes in fair value of cash flow hedges, net of tax	-	-	(17.8)	-	-	-	(17.8)
Net change in fair value of cash flow hedges transferred to the income statement, net of tax	-	-	13.6	-	-	-	13.6
<b>Total other comprehensive income/(loss)</b>	-	<b>12.6</b>	<b>(4.2)</b>	<b>(1.3)</b>	-	<b>(0.2)</b>	<b>6.9</b>
<b>Total comprehensive income/(loss)</b>	-	<b>12.6</b>	<b>(4.2)</b>	<b>(1.3)</b>	-	<b>276.5</b>	<b>283.6</b>
<b>Transactions with owners, recorded directly in equity</b>							
Share options exercised	9.3	-	-	-	(1.8)	-	7.5
Performance rights vested	-	-	-	-	(0.1)	-	(0.1)
Share based payment transactions	-	-	-	-	8.5	-	8.5
Deferred tax recognised in equity	-	-	-	-	4.4	-	4.4
Dividends to shareholders	-	-	-	-	-	(181.8)	(181.8)
<b>Balance at 30 June 2019</b>	<b>182.3</b>	<b>(47.2)</b>	<b>(17.0)</b>	<b>(1.1)</b>	<b>50.0</b>	<b>558.9</b>	<b>725.9</b>

The Consolidated Entity has initially applied AASB 9 and AASB 15 at 1 July 2018. Under the transition methods chosen, comparative information is not restated. See Note 7.6.

The notes on pages 54 to 91 are an integral part of these consolidated financial statements.

## Statement of cash flows

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	Note	2019 \$m	2018 \$m
<b>Cash flows from operating activities</b>			
Cash receipts from customers		1,448.5	1,350.3
Cash paid to suppliers and employees		(1,064.7)	(987.8)
Grant and other income received		7.4	4.8
Interest received		0.7	0.6
Interest paid		(5.2)	(8.5)
Income taxes paid	3.1	(90.7)	(101.3)
<b>Net cash provided by operating activities</b>	<b>2.7(b)</b>	<b>296.0</b>	<b>258.1</b>
<b>Cash flows from investing activities</b>			
Acquisition of land and buildings	5.2	-	(2.6)
Acquisition of leasehold improvements and plant and equipment	5.2	(59.9)	(25.8)
Proceeds from sale of non-current assets		-	0.3
Acquisition of IT system costs	5.3	(26.7)	(16.2)
Acquisition of other intangible assets	5.3	(28.0)	(5.1)
Acquisition of investments		(23.2)	(6.0)
<b>Net cash used in investing activities</b>		<b>(137.8)</b>	<b>(55.4)</b>
<b>Cash flows from financing activities</b>			
Repayments of borrowings		(405.6)	(321.2)
Proceeds from borrowings		439.1	250.0
Net proceeds/(outlay) from exercise of share options and performance rights		7.4	(0.4)
Dividends paid	2.6	(181.8)	(161.1)
<b>Net cash used in financing activities</b>		<b>(140.9)</b>	<b>(232.7)</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>			
Cash and cash equivalents, net of overdrafts at 1 July		61.5	89.5
Effect of exchange rate fluctuations on cash held		(0.2)	2.0
<b>Cash and cash equivalents, net of overdrafts at 30 June</b>		<b>78.6</b>	<b>61.5</b>

The notes on pages 54 to 91 are an integral part of these consolidated financial statements.

## 1. BASIS OF PREPARATION

This section 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.

### 1.1 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 2019 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.

### 1.2 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 Board approved the consolidated financial statements on 16 August 2019.

#### (b) Basis of measurement

The consolidated financial statements have been prepared on the historical cost basis except for derivative financial instruments and financial investments measured at fair value. The fair value measurement method of derivative instruments and financial investments measured at fair value through other comprehensive income is discussed further in Note 6.4(d).

#### (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 Corporations (Rounding in Financial/Directors' Reports) Instrument 2016/191 dated 24 March 2016 and in accordance with that Instrument, all financial information presented in AUD has been rounded to the nearest one hundred thousand dollars unless otherwise stated.

#### (d) Foreign currency

##### **Foreign currency transactions**

Transactions in foreign currencies are translated to the respective functional currencies of 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 within other income and other expenses.

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

The assets and liabilities of foreign operations are translated to the Company's functional currency at foreign exchange rates ruling at the reporting date. The revenues and expenses of foreign operations are translated to the Company's functional currency at rates approximating the foreign exchange rates ruling at the dates of transactions.



Foreign currency differences arising from translation of controlled entities are recognised in the foreign currency translation reserve (translation reserve) in equity. 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.

### **(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.

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 4.2 – Employee benefit liabilities

Note 4.3 – Share based payments

Note 5.3 – Intangible assets

Note 5.5 – Provisions

Note 5.6 – Contingent liabilities

Note 6.4 – Financial risk management.

### **(f) Basis of consolidation**

#### ***Controlled entities***

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 investment purposes. A SPE is consolidated if 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) Goods and services tax (GST)**

Revenues, expenses and assets are recognised net of the amount of GST. Where the amount of GST incurred is not recoverable from the taxation authority, 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.

## 2. PERFORMANCE FOR THE YEAR

### 2.1 Operating segments

Cochlear's three reportable segments, determined on a geographical basis, 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.

Performance is measured based on segment earnings before interest and income tax (EBIT) as included in the internal management reports that are reviewed by Cochlear's Chief Executive Officer & President, who is also the chief operating decision-maker.

#### Information about reportable segments

	Americas		EMEA <sup>1</sup>		Asia Pacific		Total	
	2019	2018	2019	2018	2019	2018	2019	2018
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Reportable segment revenue	688.6	648.5	519.2	478.9	238.3	224.0	1,446.1	1,351.4
Reportable segment EBIT	374.6	349.4	238.9	213.7	79.2	71.3	692.7	634.4
Reportable segment assets	257.7	215.2	261.4	245.2	143.5	125.0	662.6	585.4
Reportable segment liabilities	93.7	81.2	57.8	54.2	43.1	37.0	194.6	172.4
<b>Other material items</b>								
Depreciation and amortisation	2.2	1.4	1.7	1.0	1.4	1.0	5.3	3.4
Write-down in value of inventories	0.6	0.7	0.7	1.6	0.3	0.4	1.6	2.7
Acquisition of non-current assets	5.4	6.0	2.4	1.9	3.2	0.7	11.0	8.6

1. Europe, Middle East and Africa.

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

Revenues	Cochlear implants	Services (sound processor upgrades and other)	Total Cochlear implants	Acoustics (bone conduction and acoustic implants)	Reportable segment revenue	Foreign exchange (loss)/gain on hedged sales	Consolidated revenue
	\$m	\$m	\$m	\$m	\$m	\$m	\$m
2019	845.1	427.2	1,272.3	173.8	1,446.1	(19.4)	1,426.7
2018	831.0	355.2	1,186.2	165.2	1,351.4	12.3	1,363.7

<b>Profit or loss</b>	Reportable segment EBIT	Corporate and other net expenses	Foreign exchange (loss)/gain on hedged sales	Net finance expense	<b>Consolidated profit before income tax</b>
	\$m	\$m	\$m	\$m	\$m
2019	692.7	(303.2)	(19.4)	(4.5)	<b>365.6</b>
2018	634.4	(298.3)	12.3	(7.9)	<b>340.5</b>

<b>Assets and liabilities</b>	Reportable segment assets	Corporate and manufacturing assets	<b>Consolidated total assets</b>	Reportable segment liabilities	Corporate and manufacturing liabilities	<b>Consolidated total liabilities</b>
	\$m	\$m	\$m	\$m	\$m	\$m
2019	662.6	716.6	<b>1,379.2</b>	194.6	458.7	<b>653.3</b>
2018	585.4	571.5	<b>1,156.9</b>	172.4	373.7	<b>546.1</b>

<b>Other material items</b>	Reportable segment total		Corporate and manufacturing total		<b>Consolidated total</b>	
	2019	2018	2019	2018	2019	2018
	\$m	\$m	\$m	\$m	\$m	\$m
Depreciation and amortisation	5.3	3.4	33.2	30.8	<b>38.5</b>	<b>34.2</b>
Write-down in value of inventories	1.6	2.7	5.0	0.1	<b>6.6</b>	<b>2.8</b>
Acquisition of non-current assets	11.0	8.6	162.5	47.1	<b>173.5</b>	<b>55.7</b>

## 2.2 Revenue

Revenue from the sale of cochlear and acoustic implants and associated sound processors and accessories to customers is based on the contracted sales price. Revenue is recognised at the point in time when control passes to the customer with the exact timing dependent on the agreed sales terms for each contract. Revenue from product sales is also deferred based on the historical rates of product returns.

Revenue from the rendering of services, including ongoing customer support and software licensing are provided to customers over time. Where payments are received in advance, the agreed transaction price is initially deferred and progressively recognised over the life of the agreement as the service is provided. The value of unfulfilled performance obligations under these contracts is reflected in the consolidated entity's deferred revenue balance.

Customers include implant recipients, medical practitioners and governments. Contracts are short-term with the exemption of software licences which are recognised over multiple years. The accounting policy for foreign exchange gains/losses arising from hedges of forecast sales transactions is set out in Note 6.4(a).

	2019	2018
	\$m	\$m
Sale of goods before hedging	1,415.3	1,324.9
Foreign exchange (loss)/gain on hedged sales	(19.4)	12.3
<b>Revenue from sale of goods</b>	<b>1,395.9</b>	<b>1,337.2</b>
Rendering of services	30.8	26.5
<b>Total revenue</b>	<b>1,426.7</b>	<b>1,363.7</b>

### 2.3 Expenses

	2019	2018
	\$m	\$m
<b>(a) Cost of sales</b>		
Carrying amount of inventories recognised as an expense	337.8	352.7
Other	6.7	5.7
Write-down in value of inventories	6.6	2.8
<b>Total cost of sales</b>	<b>351.1</b>	<b>361.2</b>
<b>(b) Profit before income tax has been arrived at after charging the following item:</b>		
Operating lease rental expense	29.4	27.0

### Other expenses

	2019	2018
	\$m	\$m
Fair value change in investments measured at fair value through profit or loss	-	2.2
Foreign exchange loss	4.4	-
<b>Total other expenses</b>	<b>4.4</b>	<b>2.2</b>

### 2.4 Other income

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. If the costs have already been incurred, the amount is recognised in the year the entitlement is confirmed. Foreign exchange gains/losses are recognised in accordance with the accounting policy at Note 1.2(d).

Changes to the contingent consideration value recognised for the Sycle, LLC business acquisition were considered at 30 June 2019. Based on FY19 revenue growth relative to the performance hurdle, \$10.8 million (2018: \$5.3 million) has been released to the income statement and \$19.4 million remains as contingent consideration (2018: \$28.4 million).

	2019	2018
	\$m	\$m
Grant received or due and receivable	1.9	2.3
Release of contingent consideration	10.8	5.3
Foreign exchange gain	-	0.1
Fair value change in investments measured at fair value through profit or loss	10.8	-
Other income	5.5	2.5
<b>Total other income</b>	<b>29.0</b>	<b>10.2</b>

## 2.5 Earnings per share

Cochlear presents basic and diluted earnings per share (EPS) for its ordinary shares.

### Basic earnings per share

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

	2019	2018
Net profit attributable to equity holders of the parent entity	\$276,697,000	\$245,792,000
<i>Weighted average number of ordinary shares (basic):</i>		
Issued ordinary shares at 1 July (number)	57,547,820	57,426,649
Effect of options, performance shares and performance rights exercised (number)	134,937	94,306
Effect of shares issued under Employee Share Plan (number)	5,448	6,710
<b>Weighted average number of ordinary shares (basic) at 30 June</b>	<b>57,688,205</b>	<b>57,527,665</b>
<b>Basic earnings per share (cents)</b>	<b>479.6</b>	<b>427.3</b>

### Diluted earnings per share

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

	2019	2018
Net profit attributable to equity holders of the parent entity	\$276,697,000	\$245,792,000
<i>Weighted average number of ordinary shares (diluted):</i>		
Weighted average number of shares (basic) (number)	57,688,205	57,527,665
Effect of options, performance shares and performance rights unvested (number)	21,948	73,803
<b>Weighted average number of ordinary shares (diluted) at 30 June</b>	<b>57,710,153</b>	<b>57,601,468</b>
<b>Diluted earnings per share (cents)</b>	<b>479.5</b>	<b>426.7</b>

## 2.6 Dividends

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

	Dollars per share	Total amount \$m	Franked/unfranked	Date of payment
Dividends recognised in the current financial year by the Company are:				
<b>2019</b>				
Interim 2019 ordinary	1.55	89.5	100% Franked	16 April 2019
Final 2018 ordinary	1.60	92.3	100% Franked	10 October 2018
<b>Total amount</b>	<b>3.15</b>	<b>181.8</b>		
<b>2018</b>				
Interim 2018 ordinary	1.40	80.6	100% Franked	12 April 2018
Final 2017 ordinary	1.40	80.5	100% Franked	11 October 2017
<b>Total amount</b>	<b>2.80</b>	<b>161.1</b>		

	Dollars per share	Total amount \$m	Franked/unfranked	Date of payment
<b>Subsequent event</b>				
Since the end of the financial year, the directors declared the following dividends:				
Final 2019 ordinary	1.75	101.0	100% Franked	14 October 2019
<b>Total amount</b>	<b>1.75</b>	<b>101.0</b>		

The financial effect of the 2019 final dividend will be recognised in the subsequent financial year as it was declared after 30 June 2019.

#### Dividend franking account

Franked dividends paid during the financial year were franked at the tax rate of 30% (2018: 30%). There are no further tax consequences as a result of paying dividends other than a reduction in the franking account.

At 30 June 2019, there are \$39.2 million of franking credits (2018: \$39.2 million) available to shareholders of Cochlear Limited for subsequent financial years.

The dividend franking account at year end is 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 \$43.3 million (2018: \$39.5 million).

Dividends in excess of the dividend franking account balance will be unfranked.

## 2.7 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.

The operating cash account received an average interest rate of 0.79% (2018: 0.73%) per annum.

### (b) Reconciliation of net profit to net cash provided by operating activities

	2019 \$m	2018 \$m
Net profit	276.7	245.8
<b>Add item classified as investing activities:</b>		
Loss on disposal of property, plant and equipment	0.5	0.6
<b>Add/(less) non-cash items:</b>		
Depreciation and amortisation	38.5	34.2
Release of contingent consideration	(10.8)	(5.3)
Change in fair value measurement of investments through profit or loss	(10.8)	2.2
Equity settled share based payment transactions	8.5	8.5
<b>Net cash provided by operating activities before changes in assets and liabilities</b>	<b>302.6</b>	<b>286.0</b>
<b>Changes in assets and liabilities:</b>		
Change in trade and other receivables	(4.2)	(25.9)
Change in inventories	(28.0)	(7.4)
Change in prepayments	(1.6)	(6.7)
Change in deferred tax assets/liabilities	(22.0)	(11.8)
Change in trade and other payables	34.6	3.8
Change in current tax assets/liabilities	10.1	(6.5)
Change in employee benefit liabilities	13.3	5.9
Change in provisions	(7.4)	(0.8)
Change in deferred revenue	16.5	0.5
Effect of movements in foreign exchange	(17.9)	21.0
<b>Net cash provided by operating activities</b>	<b>296.0</b>	<b>258.1</b>

### 3. INCOME TAXES

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.

#### 3.1 Income tax expense

Income tax expense includes current and deferred tax. Current and deferred tax is recognised in the income statement except to the extent that they relate to items recognised directly in other comprehensive income or equity.

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

#### Income tax expense recognised in the income statement

	Current year	Adjustment for prior years	Total current tax expense	Origination and reversal of temporary differences	Total deferred tax benefit	Total income tax expense
	\$m	\$m	\$m	\$m	\$m	\$m
2019	105.0	(1.4)	103.6	(14.7)	(14.7)	88.9
2018	103.1	(1.6)	101.5	(6.8)	(6.8)	94.7

#### Consolidated Entity - Numerical reconciliation between income tax expense and profit before income tax

	2019 \$m	2018 \$m
<b>Profit before income tax</b>	<b>365.6</b>	<b>340.5</b>
Tax at the Australian tax rate of 30% (2018: 30%)	109.7	102.1
<b>Increase in income tax expense due to:</b>		
Non-deductible expenses, net	-	0.1
Restatement of US deferred tax asset <sup>1</sup>	-	6.3
<b>Decrease in income tax expense due to:</b>		
Non-assessable income	(3.4)	-
Research and development allowances	(9.7)	(9.8)
Effect of tax rates in foreign jurisdictions	(6.3)	(2.4)
	90.3	96.3
Adjustment for prior years	(1.4)	(1.6)
<b>Income tax expense on profit before income tax</b>	<b>88.9</b>	<b>94.7</b>

1. Restatement of US deferred tax balances as at 31 December 2017 resulting from the enactment of H.R. 1 (US tax reform legislation) on 22 December 2017.



**Tax expense for items relating to other comprehensive loss or equity**

	Note	2019 \$m	2018 \$m
Total deferred tax recognised in other comprehensive loss relating to derivative financial instruments	3.2	(1.8)	(12.0)
Total deferred tax recognised directly in equity relating to share based payments	3.2	(4.4)	1.2

**Consolidated Entity - Numerical reconciliation between income tax expense and cash taxes paid**

	2019 \$m	2018 \$m
Income tax expense on profit before income tax	88.9	94.7
Timing differences recognised in deferred tax	12.5	0.4
Effect of tax rates in foreign jurisdictions	0.3	0.1
Current year tax instalments payable next year	(26.0)	(15.0)
Prior year tax instalments paid this year	15.0	21.1
<b>Cash taxes paid per statement of cash flows</b>	<b>90.7</b>	<b>101.3</b>

**Cochlear Limited's Australian tax consolidated group - Numerical reconciliation between income tax expense and profit before income tax**

	2019 \$m	2018 \$m
<b>Profit before income tax (excluding dividends from wholly owned foreign subsidiaries)</b>	<b>300.5</b>	<b>274.2</b>
Add: Dividends from wholly owned foreign subsidiaries	6.9	47.1
<b>Profit before income tax</b>	<b>307.4</b>	<b>321.3</b>
Tax at the Australian tax rate of 30% (2018: 30%)	92.2	96.4
<b>Increase in income tax expense due to:</b>		
Controlled foreign company income	0.7	1.0
Other non-deductible expenses	0.6	2.1
<b>Decrease in income tax expense due to:</b>		
Research and development allowances	(8.5)	(8.5)
Exempt foreign sourced dividends from wholly owned subsidiaries	(2.1)	(14.1)
	82.9	76.9
Adjustment for prior years	(1.6)	(1.0)
<b>Income tax expense on profit before income tax</b>	<b>81.3</b>	<b>75.9</b>

### 3.2 Current and deferred tax assets and liabilities

Deferred tax is recognised on all temporary differences between the carrying amounts of assets and liabilities for financial reporting and taxation purposes.

The measurement of deferred tax mirrors the tax consequences that the Consolidated Entity expects to recover or settle from 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.

A deferred tax asset is recognised 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 if it is no longer probable that the related tax benefit will be realised.

#### Recognised deferred tax assets and liabilities

	Assets		Liabilities		Net	
	2019	2018	2019	2018	2019	2018
	\$m	\$m	\$m	\$m	\$m	\$m
Property, plant and equipment	0.4	0.3	(2.2)	(2.6)	(1.8)	(2.3)
Intangible assets	0.8	0.4	(6.5)	(6.2)	(5.7)	(5.8)
Inventories	40.8	25.7	-	-	40.8	25.7
Provisions	33.0	32.8	-	-	33.0	32.8
Deferred revenue	5.3	1.6	(2.5)	-	2.8	1.6
Forward exchange contracts	7.4	5.6	-	-	7.4	5.6
Other	20.4	19.9	(2.3)	(4.9)	18.1	15.0
<b>Deferred tax assets/(liabilities)</b>	<b>108.1</b>	<b>86.3</b>	<b>(13.5)</b>	<b>(13.7)</b>	<b>94.6</b>	<b>72.6</b>
Set off tax	(8.0)	(5.6)	8.0	5.6	-	-
<b>Deferred tax assets/(liabilities)</b>	<b>100.1</b>	<b>80.7</b>	<b>(5.5)</b>	<b>(8.1)</b>	<b>94.6</b>	<b>72.6</b>

#### Unrecognised deferred tax liabilities

At 30 June 2019, a deferred tax liability of \$12.0 million (2018: \$32.5 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.

#### Movement in temporary differences during the year

	Note	2019	2018
		\$m	\$m
Carrying amount at beginning of financial year		72.6	60.8
Recognised in the income statement	3.1	14.7	6.8
Recognised in other comprehensive loss	3.1	1.8	12.0
Recognised directly in equity	3.1	4.4	(1.2)
Restatement of US deferred tax asset	3.1	-	(6.3)
Effect of movements in foreign exchange		1.1	0.5
<b>Carrying amount at end of financial year</b>		<b>94.6</b>	<b>72.6</b>

### Current tax assets and liabilities

The current tax assets for the Consolidated Entity of \$12.2 million (2018: \$9.6 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 \$34.8 million (2018: \$22.1 million) represent the amount of income taxes payable in respect of current and prior financial years.

## 4. EMPLOYEE BENEFITS

### 4.1 Employee expenses

	2019	2018
	\$m	\$m
Wages and salaries	378.1	338.0
Contributions to superannuation plans	31.6	25.3
Increase in leave liabilities	6.9	4.7
Equity settled share based payment transactions	8.5	8.5
<b>Total employee expenses</b>	<b>425.1</b>	<b>376.5</b>

### 4.2 Employee benefit liabilities

#### Wages, salaries and annual leave

Liabilities for employee benefits for wages, salaries and annual leave are recognised in other payables and provisions if Cochlear has a present obligation to pay an amount as a result of past services provided by the employee. The liability is calculated on remuneration rates as at the reporting date including related on-costs, such as workers' compensation insurance and payroll tax.

#### Long service leave

The provision for long service leave is the present value of the estimated future cash outflows as a result of services provided by the employee 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 corporate bond rates which most closely match the terms to maturity of the related liabilities.

#### Defined benefit plans

The consolidated entity has defined benefit plans that cover, in aggregate, 87 employees in two countries (2018: 80 employees). Cochlear contributed cash of \$1.3 million (2018: \$1.2 million) to defined benefit plans in the year ended 30 June 2019 and expects to contribute \$1.6 million in the year ending 30 June 2020.

The defined benefit obligations are calculated annually by a qualified actuary using the projected unit credit method. Remeasurements of the net defined benefit liability (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 period to the opening net defined benefit liability (asset), adjusted for any changes in the net defined benefit liability (asset) during the period resulting from contributions and benefit payments. Net interest expense related to defined benefit plans is recognised in the income statement.

### 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 2019, Prof E Byrne, AC was the only non-executive director entitled to this benefit. Prof E Byrne received the accrual retirement benefit upon his retirement on 16 October 2018.

	2019	2018
	\$m	\$m
<b>Current</b>		
Provision for long service leave	12.9	11.0
Provision for annual leave	31.0	26.5
Provision for short-term incentives	25.6	19.8
<b>Total current employee benefit liabilities</b>	<b>69.5</b>	<b>57.3</b>
<b>Non-current</b>		
Provision for long service leave	6.4	5.9
Defined benefit plan	6.7	5.6
Provision for directors' retirement scheme	-	0.5
<b>Total non-current employee benefit liabilities</b>	<b>13.1</b>	<b>12.0</b>
<b>Total employee benefit liabilities</b>	<b>82.6</b>	<b>69.3</b>

### 4.3 Share based payments

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 expense is adjusted by the actual number of options, shares and rights that are expected to vest except where forfeiture is due to market related conditions.

The fair value is measured using the Black-Scholes-Merton pricing model at the date the options, performance shares or performance rights are granted, taking into account market based criteria and the terms and conditions attached to the instruments. The options, performance shares or performance rights are expensed over the vesting period after which the employees become unconditionally entitled to them.

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 in the Company's accounts.

At 30 June 2019, the unissued ordinary shares of the Company under option and rights and the terms and conditions of the grants and issues are as follows:

Grant date	Exercise price of options	Number of options	Number of performance rights	Contractual life
October 2016 <sup>1</sup>	\$135.84	79,006	20,726	4 years
August 2017 <sup>2</sup>	N/A	-	37,038	2 years
October 2017 <sup>1</sup>	\$154.73	104,376	11,835	4 years
August 2018 <sup>2</sup>	N/A	-	27,317	2 years
October 2018 <sup>1</sup>	\$202.84	80,231	9,280	4 years
<b>Total</b>		<b>263,613</b>	<b>106,196</b>	

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

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

Grants are split between deferred short-term incentives (STI) and long-term incentives (LTI).

For deferred STI, certain employees under the CEIP are granted performance rights based on achievement of a mandatory portion of their STI. The number of performance rights under the deferred STI grants is calculated at the end of each year and then held for two years until vesting.

Grants under LTI are in two equal tranches assigned to compound annual growth in EPS and ranking of total shareholder return (TSR) against the ASX 100. The conditions for minimum vesting are three years of service and:

- a minimum compound annual growth rate in EPS of 10% assigned to 50% of grant; or
- the Consolidated Entity's TSR is above the 50th percentile against the ASX 100 over three years assigned to 50% of grant.

The grant date fair value of options and performance rights 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 the grant date are the following:

	17 October 2018		24 August 2018	18 October 2017		24 August 2017
	TSR based conditions	EPS performance based conditions	Deferred STI service based conditions	TSR based conditions	EPS performance based conditions	Deferred STI service based conditions
Fair value of options at grant date	\$32.55	\$37.43	N/A	\$22.27	\$23.91	N/A
Fair value of performance rights at grant date	\$116.51	\$199.29	\$201.99	\$83.43	\$142.31	\$145.96
Share price at valuation date	\$207.50	\$207.50	\$207.50	\$155.18	\$155.18	\$155.18
Option exercise price	\$202.84	\$202.84	N/A	\$154.73	\$154.73	N/A
Expected volatility (weighted average volatility)	22.59%	22.59%	22.59%	24.91%	24.91%	24.91%
Option life	3 - 4 years	3 - 4 years	2 years	3 - 4 years	3 - 4 years	2 years
Expected dividend yield	1.35%	1.35%	1.35%	2.95%	2.95%	2.95%
Risk free interest rate (based on government bonds)	2.04%	2.04%	2.04%	2.00%	2.00%	2.00%

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
	2019	2019	2018	2018
Outstanding at 1 July	\$119.60	318,227	\$93.51	292,934
Forfeited	\$82.89	(4,724)	\$149.52	(3,228)
Exercised	\$82.89	(130,121)	\$68.56	(78,192)
Granted	\$202.84	80,231	\$154.73	106,713
<b>Outstanding at 30 June</b>	<b>\$163.71</b>	<b>263,613</b>	<b>\$119.60</b>	<b>318,227</b>
Exercisable at 30 June	\$135.84	79,006	\$82.89	134,845

130,121 options were exercised in 2019 (2018: 78,192 options were exercised). The weighted average market share price on the Australian Securities Exchange (ASX) at date of exercise was \$196.26 (2018: \$160.23). The weighted average remaining contractual life of options outstanding at the end of the year is two years (2018: two years).

#### Employee Share Plan

Cochlear's Employee Share Plan (Plan) was approved by special resolution at the Annual General Meeting held on 19 October 1999. Under the Plan, the directors can at their discretion, allocate at nil consideration up to a maximum of \$2,000 worth of shares per eligible employee in any one year. 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 2019, the Company issued 7,590 shares (2018: 8,874 shares) under the Plan; see Note 6.2.

#### APAC Employee Equity Plan

The APAC Employee Equity Plan, established in 2016, aligns with the Cochlear Employee Share Plan and provides up to \$1,000 of service rights annually per eligible employee in selected Asian countries. Upon vesting, each service right converts to one share. For the year ended 30 June 2019, the Company issued 1,092 shares under the plan (2018: nil).

#### 4.4 Key management personnel

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

##### Non-executive directors

Mr R Holliday-Smith (Chairman), Mrs YA Allen, Mr G Boreham, AM, Prof E Byrne<sup>1</sup>, AC, Ms A Deans, Mr A Denver, Mr A Hussain<sup>2</sup>, Mr DP O'Dwyer and Prof B Robinson, AM

##### Executive KMP

Mr D Howitt, Mr A Bishop, Mr R Brook, Mr B Cubis, Mr J Janssen and Mr T Manna.

1. Retired on 16 October 2018.

2. Appointed on 1 December 2018.

### Key management personnel disclosures

The KMP compensation is included in employee expenses as follows:

	Short-term employee benefits \$	Post- employment benefits \$	Other long- term benefits \$	Directors' retirement benefits \$	Share based payments \$	End of service \$	Total \$
2019	10,328,560	414,161	8,857	461,136	2,150,552	-	<b>13,363,266</b>
2018	11,706,507	412,566	243,465	8,366	3,256,080	1,452,589	<b>17,079,573</b>

Information regarding individual KMP remuneration and some equity instruments disclosures as permitted by section 300A of the *Corporations Act 2001* is provided in the Remuneration report of this Annual Report on pages 28 to 43.

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

## 5. OPERATING ASSETS AND LIABILITIES

### 5.1 Inventories

Inventories are measured at the lower of cost and net realisable value.

Cost is based on the first-in-first-out principle including 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 production overheads based on normal operating capacity.

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.

	Raw materials \$m	Work in progress \$m	Finished goods \$m	Total inventories \$m
2019	70.3	26.2	98.9	<b>195.4</b>
2018	68.3	22.1	77.0	<b>167.4</b>

### 5.2 Property, plant and equipment

#### Owned assets

The value of property, plant and equipment is measured as the cost of the asset, minus accumulated depreciation and impairment losses (see Note 5.3). The cost of the asset is the consideration provided plus incidental costs directly attributable to the acquisition.

The value of internally-constructed assets includes the cost of material and direct labour 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 capitalised in the carrying amount of the item if it is probable that future economic benefits will flow to Cochlear and its cost can be measured reliably. All other costs are recognised in the income statement as incurred.

### Leased assets

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 to expense the cost of items of property, plant and equipment less their estimated residual values on a straight-line basis over their estimated useful lives. The estimated useful lives in the current and comparative years are as follows: leasehold improvements between one to 15 years, plant and equipment between three to 14 years and buildings between 10 to 30 years.

Depreciation is recognised in the income statement from the date of acquisition or, in respect of internally-constructed assets, from the time an asset is completed and held ready for use.

Depreciation rates and methods, 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.

	Leasehold improvements		Plant and equipment		Land and buildings		Total net book value	
	2019 \$m	2018 \$m	2019 \$m	2018 \$m	2019 \$m	2018 \$m	2019 \$m	2018 \$m
At cost	42.0	38.6	277.5	221.8	30.1	30.1	349.6	290.5
Accumulated depreciation	(28.2)	(25.3)	(154.4)	(136.5)	(0.5)	(0.3)	(183.1)	(162.1)
<b>Net book value</b>	<b>13.8</b>	<b>13.3</b>	<b>123.1</b>	<b>85.3</b>	<b>29.6</b>	<b>29.8</b>	<b>166.5</b>	<b>128.4</b>
<b>Reconciliations of the carrying amounts are:</b>								
Opening balance	13.3	12.8	85.3	80.0	29.8	27.3	128.4	120.1
Additions	3.3	3.0	56.6	22.8	-	2.6	59.9	28.4
Disposals	-	-	(0.5)	(0.6)	-	-	(0.5)	(0.6)
Depreciation	(3.2)	(2.7)	(19.5)	(17.7)	(0.2)	(0.1)	(22.9)	(20.5)
Effect of movements in foreign exchange	0.4	0.2	1.2	0.8	-	-	1.6	1.0
<b>Net book value</b>	<b>13.8</b>	<b>13.3</b>	<b>123.1</b>	<b>85.3</b>	<b>29.6</b>	<b>29.8</b>	<b>166.5</b>	<b>128.4</b>

### 5.3 Intangible assets

#### 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 tested annually for impairment.

#### IT system costs

IT system costs are recognised as an intangible asset where Cochlear controls future economic benefits as a result of the costs incurred, and are stated at cost less accumulated amortisation. Costs include expenditure directly related to the development and implementation (hardware and software costs) of IT systems including direct labour.



### Other intangible assets

Other intangible assets, comprising acquired technology, patents and licences, customer relationships, capitalised development expenditure and intellectual property, are acquired individually or through business combinations and are stated at cost less accumulated amortisation and impairment losses (see below).

### Amortisation

Amortisation is calculated to expense the cost of intangible assets less their estimated residual values on a straight-line basis over their estimated useful lives. The estimated useful lives for the current and comparative years are as follows: IT system costs between two to seven years, acquired technology, patents and licences between four to 15 years, customer relationships up to 31 years and capitalised development expenditure between four to 10 years.

Amortisation is recognised in the income statement from the date the assets are available for use unless their lives are indefinite.

Goodwill and intangible assets with an indefinite useful life are systematically tested for impairment annually.

	Intangible assets with indefinite useful life	Intangible assets with finite useful life			Intangible assets
	Goodwill	IT system costs	Acquired technology, patents and licences	Other intangible assets	Total
	\$m	\$m	\$m	\$m	\$m
<b>2019</b>					
At cost	268.8	109.2	122.9	56.3	<b>557.2</b>
Accumulated amortisation	-	(58.8)	(50.4)	(23.6)	<b>(132.8)</b>
<b>Net book value</b>	<b>268.8</b>	<b>50.4</b>	<b>72.5</b>	<b>32.7</b>	<b>424.4</b>
<i>Reconciliations of the carrying amounts are:</i>					
Opening balance	265.4	32.9	29.0	18.0	<b>345.3</b>
Additions	-	26.7	48.4	15.3	<b>90.4</b>
Amortisation	-	(9.2)	(4.9)	(1.5)	<b>(15.6)</b>
Effect of movements in foreign exchange	3.4	-	-	0.9	<b>4.3</b>
<b>Net book value</b>	<b>268.8</b>	<b>50.4</b>	<b>72.5</b>	<b>32.7</b>	<b>424.4</b>
<b>2018</b>					
At cost	265.4	82.3	74.3	37.9	<b>459.9</b>
Accumulated amortisation	-	(49.4)	(45.3)	(19.9)	<b>(114.6)</b>
<b>Net book value</b>	<b>265.4</b>	<b>32.9</b>	<b>29.0</b>	<b>18.0</b>	<b>345.3</b>
<i>Reconciliations of the carrying amounts are:</i>					
Opening balance	268.9	24.1	32.1	14.9	<b>340.0</b>
Additions	-	16.2	1.5	3.6	<b>21.3</b>
Amortisation	-	(7.6)	(4.6)	(1.5)	<b>(13.7)</b>
Effect of movements in foreign exchange	(3.5)	0.2	-	1.0	<b>(2.3)</b>
<b>Net book value</b>	<b>265.4</b>	<b>32.9</b>	<b>29.0</b>	<b>18.0</b>	<b>345.3</b>

## Impairment

Cochlear annually tests goodwill and other intangible assets with indefinite useful life for impairment. Other non-financial assets, other than inventories (see Note 5.1) and deferred tax assets (see Note 3.2), are tested if there is any indication of impairment or if there is any indication that an impairment loss recognised in a prior period may no longer exist or may have decreased.

Assets are impaired if their carrying value exceeds their recoverable amount. The asset's recoverable amount is estimated based on its value in use.

An asset that does not generate independent cash flows and its individual value in use cannot be estimated is tested for impairment as part of a cash generating unit (CGU).

An impairment loss is recognised in the income statement when the carrying amount of an asset or CGU exceeds its recoverable amount. 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. An impairment loss in respect of goodwill is not reversed.

### Impairment tests for CGUs

Cochlear allocates goodwill and other intangible assets to CGUs based on the expected benefits that each CGU will receive from use of those assets.

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

	Americas \$m	EMEA \$m	Asia Pacific \$m	Total \$m
2019	184.2	74.6	10.0	268.8
2018	182.5	73.0	9.9	265.4

The recoverable amount of each CGU is based on value-in-use calculations. Those calculations use five year cash flow projections based on actual operating results, the next year's budget and the mid-term business plan. Cash flows for year 6 onwards are extrapolated using a conservative terminal growth rate of 3.0% (2018: 3.0%) per annum which is consistent with long-term economic growth rates. The pre-tax discount rate for each CGU is as follows: Americas 10.6% (2018: 10.4%), EMEA 10.3% (2018: 9.4%) and Asia Pacific 11.2% (2018: 10.5%).

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 reflecting current market assessments of the time value of money and risks specific to the CGU.
EBIT growth rate	Based on a five year cash flow projection taking into account historical growth rates and product lifecycle.
Terminal value growth rate	Based on long-term economic growth rates.

The recoverable amount of each CGU including unallocated corporate assets is in excess of the 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.

#### 5.4 Investments

Cochlear's investments are valued individually using quoted prices or unobservable market inputs. Unobservable inputs are those not readily available in an active market. These inputs are generally derived from other observable inputs that match the risk profile of the financial instruments and validated against current market assumptions and historical transactions where available. Refer to Note 6.4(d) for further details on the valuation of financial assets.

Equity investments at fair value through other comprehensive income are ordinary shares. Investments measured at fair value through profit or loss are interests in entities that do not meet the definition of equity, such as instruments convertible into ordinary shares.

	2019	2018
	\$m	\$m
Opening balance	15.8	15.1
Additions	22.1	2.8
Fair value gain/(loss) through profit or loss	10.8	(2.2)
Fair value loss through other comprehensive income	(1.3)	-
Effect of movements in foreign exchange	0.4	0.1
<b>Total investments</b>	<b>47.8</b>	<b>15.8</b>

At 30 June 2019 \$46.4 million of investments is measured at fair valued through profit or loss with the remaining \$1.4 million measured at fair valued through other comprehensive income.

#### 5.5 Provisions

A provision is recognised in the balance sheet when:

- Cochlear has a present obligation (legal or constructive) as a result of a past event;
- a reliable estimate can be made of the amount of the obligation; 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.

2019	Warranties	Legal and insurance	Product recall	Make good lease costs	Patent dispute	Total
	\$m	\$m	\$m	\$m	\$m	\$m
Opening balance	39.8	4.9	11.1	1.8	21.3	<b>78.9</b>
Provision made	12.5	22.3	-	0.1	-	<b>34.9</b>
Provision used	(16.1)	(5.2)	(0.6)	(0.7)	-	<b>(22.6)</b>
Provision released	-	-	-	-	(21.3)	<b>(21.3)</b>
Effect of movements in foreign exchange	1.6	-	-	-	-	<b>1.6</b>
<b>Total provisions</b>	<b>37.8</b>	<b>22.0</b>	<b>10.5</b>	<b>1.2</b>	-	<b>71.5</b>
Represented by:						
Current	15.5	10.0	1.8	-	-	<b>27.3</b>
Non-current	22.3	12.0	8.7	1.2	-	<b>44.2</b>
<b>Total provisions</b>	<b>37.8</b>	<b>22.0</b>	<b>10.5</b>	<b>1.2</b>	-	<b>71.5</b>

### Warranties

A provision for warranty claims is recognised 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 insurance

During the year ended 30 June 2019 a provision for estimated future costs related to the AMF patent dispute, including legal fees, bond costs and other costs associated with defending this matter was made. As at 30 June 2019, AUD 17.9 million of the provision remains. A contingent liability is held in relation to this matter as outlined in Note 5.6 below.

Cochlear self-insures certain risks associated with operating in its line of business. Claims are recognised when an incident occurs that may give rise to a claim. They are measured at the cost that Cochlear expects to incur in defending or 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.

### 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.

No amount has been recognised as a charge or released as a credit in the year ended 30 June 2019.

### 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 and overhauls.

### 5.6 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.

#### Patent dispute

In November 2018, the US District Court awarded damages of USD 268 million against Cochlear Limited and its US subsidiary Cochlear Americas (the Defendants) in the long-running patent dispute with Alfred E. Mann Foundation for Scientific Research (AMF) and Advanced Bionics LLC (AB). The Defendants have appealed the damages award and the finding of “willfulness”. An insurance bond of USD 335 million has been arranged to stay the Judgment pending the appeal.

AMF and AB have subsequently asked the District Court to award USD 123 million in prejudgment interest. The Defendants have opposed both the application and the calculation methodology. The Judge has reserved his decision until further notice. The Defendants have arranged a facility to enable the procurement of another insurance bond, if necessary to stay any prejudgment interest award pending the outcome of the appeal against damages. Any interest award will be contingent on the appeal against damages.

The Board of directors has obtained independent legal advice on the Defendants’ appeal prospects. The Board is of the opinion it is probable that the Defendants’ appeal will result in the lawsuit being remanded to the District Court for a retrial on damages.

There is significant uncertainty on the final damages award following a retrial. Given the inherent uncertainties in assessing the likely damages amount of this case following the appeal, the Board is unable to make a reliable estimate of the amount that will ultimately be paid to AMF and AB. As a result, the provision for damages held at 30 June 2018 of AUD 21.3 million has been released and a contingent liability is disclosed.

Cochlear's current product portfolio is not affected by this litigation as the patent at issue has expired.

In the event the appeal is unsuccessful, the Board is confident that Cochlear will be able to access debt facilities to fund the existing Judgment and any award of interest and costs.

### Product liability claims

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

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

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

## 6. CAPITAL AND FINANCIAL STRUCTURE

### 6.1 Capital management

Cochlear's capital management objectives are to safeguard its ability to continue as a going concern, provide returns to shareholders, provide benefits to other stakeholders and 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.

Senior management tracks, manages and reports against these capital management metrics periodically as part of broader corporate governance responsibilities. The Board undertakes periodic reviews 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.

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.

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	2019 \$m	2018 \$m
Net debt	6.3(a)	103.0	86.2
Total equity - reported		725.9	610.8
<b>Net gearing ratio at 30 June</b>		<b>12%</b>	<b>12%</b>

## 6.2 Capital and reserves

### Share capital

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

	Total number of issued shares	
	2019	2018
On issue 1 July – fully paid	57,547,820	57,426,649
Issued for nil consideration under Employee Share Plan	7,590	8,874
Issued from exercise of APAC Equity Plan	1,092	-
Issued from the exercise of options	112,093	52,046
Issued from the exercise of performance rights	47,226	60,251
<b>On issue 30 June – fully paid</b>	<b>57,715,821</b>	<b>57,547,820</b>

During the 2019 financial year, Cochlear purchased 18,813 shares (2018: 35,706 shares) on market to satisfy exercise of options and performance rights.

Cochlear has also issued shares to employees under the Employee Share Plan (see Note 4.3).

Ordinary shares are classified as equity and 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.

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.

### 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 1.2(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.

### Fair value reserve

The fair value reserve comprises the cumulative net change in the fair value of investments revalued through other comprehensive income (2018: available for sale) until the assets are derecognised or impaired.

### Share based payment reserve

The share based payment reserve comprises the cost of shares, options, performance shares and performance rights granted to eligible executives under the CEIP, as detailed in Note 4.3 less any payments made to meet Cochlear's obligations through the acquisition of shares on market, together with any deferred tax asset/liability on such payments.

### 6.3 Net debt and finance costs

#### (a) Net debt

Loans and borrowings are recognised initially at fair value less attributable transaction costs. Subsequently, 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.

Debt establishment costs are capitalised and recognised as a reduction in loans and borrowings. They are recorded initially at cost and are amortised over the period of the loan. Included within loans and borrowings is an amount of \$0.8 million (2018: \$1.0 million) in relation to unamortised loan establishment fees.

	2019	2018
	\$m	\$m
<b>Loans and borrowings</b>		
Current	3.3	3.7
Non-current	178.3	144.0
Total loans and borrowings	181.6	147.7
Less: Cash and cash equivalents	(78.6)	(61.5)
<b>Net debt</b>	<b>103.0</b>	<b>86.2</b>

#### (b) Financing arrangements

	Multi-option bank facilities		Other credit facilities		
	Unsecured non-current bank loan	Bank guarantees <sup>1</sup>	Unsecured bank overdrafts	Unsecured current bank loan	Bank guarantees
	\$m	\$m	\$m	\$m	\$m
<b>2019</b>					
Utilised at reporting date	179.1	5.3	-	3.3	4.6
Not utilised at reporting date	229.4	9.7	2.9	2.7	5.1
<b>Total facilities</b>	<b>408.5</b>	<b>15.0</b>	<b>2.9</b>	<b>6.0</b>	<b>9.7</b>
<b>2018</b>					
Utilised at reporting date	145.0	6.5	-	3.7	2.9
Not utilised at reporting date	205.0	8.5	2.7	1.8	1.5
<b>Total facilities</b>	<b>350.0</b>	<b>15.0</b>	<b>2.7</b>	<b>5.5</b>	<b>4.4</b>

1. Bank guarantees include standby letters of credit.

### Multi-option bank facilities - Unsecured bank loan

During the year ended 30 June 2019, Cochlear restructured its bank loan facilities as follows:

Facility type	1 - 2 year term	2 - 3 year term	3 - 4 year term	> 4 year term	Total facilities
	\$m	\$m	\$m	\$m	\$m
Committed debt including guarantees	46.2	100.0	100.0	177.3	423.5

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

### Other credit facilities

#### Unsecured bank overdrafts

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

#### Unsecured bank loan

Cochlear has a Japanese yen (JPY) 450.0 million loan facility, a Swedish kroner (SEK) 300.0 million loan facility and a Chinese yuan (CNY) 300.0 million loan facility. The facilities are unsecured bank loans. Interest on unsecured bank loans is variable and is charged at prevailing market rates.

#### Bank guarantees/Standby letters of credit

As at 30 June 2019, Cochlear had additional contingent liability facilities denominated in United States dollars (USD), Euros (EUR), Sterling (GBP), Indian rupees and New Zealand dollars totalling AUD 9.7 million (2018: AUD 4.4 million).

### (c) Finance costs

Interest income is recognised as it accrues in the income statement. Borrowing costs are recognised as they accrue in the income statement as a finance expense.

### 6.4 Financial risk management

The activities of Cochlear are exposed to a variety of risks, including market risk (comprising currency and interest rate risk), credit risk and liquidity risk. Cochlear's overall risk management program considers the unpredictability of financial markets and seeks to appropriately manage the potential adverse effects on financial performance.

The Board has overall responsibility for the establishment and oversight of the Risk Management Framework. Under instruction of the Board, management has established a Risk Management Committee which is responsible for identifying, assessing and appropriately managing risk throughout Cochlear. Key risks are reported to the Audit Committee on a regular basis.

The Audit Committee oversees how management monitors compliance with Cochlear's Risk Management Framework, policies and procedures and is assisted by Group Risk and Assurance which undertakes reviews of key management controls and procedures.



**(a) 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 by buying and selling forward exchange contracts and incurring financial liabilities, within acceptable parameters, while optimising the return, all in accordance with the treasury risk policy.

**Currency risk**

Cochlear is exposed to currencies other than the respective functional currencies of the controlled entities, primarily AUD, Swiss francs (CHF), CNY, EUR, GBP, JPY, SEK and USD.

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 not hedged.

Cochlear's exposure to foreign currency risk in relation to non-derivative financial instruments at 30 June 2019 was as follows, based upon notional amounts:

Amounts local currency/millions	CHF	CNY	EUR	GBP	JPY	SEK	USD
<b>2019</b>							
Trade receivables	0.5	12.2	59.4	5.7	1,139.7	7.5	78.0
Unsecured bank loan	-	(14.1)	-	-	(250.0)	(300.0)	-
Trade payables	(0.9)	(20.8)	(8.4)	(4.8)	(122.1)	(44.2)	(17.4)
<b>Balance sheet exposure</b>	<b>(0.4)</b>	<b>(22.7)</b>	<b>51.0</b>	<b>0.9</b>	<b>767.6</b>	<b>(336.7)</b>	<b>60.6</b>
<b>2018</b>							
Trade receivables	0.4	2.4	58.3	5.3	928.1	7.2	82.7
Unsecured bank loan	-	-	-	-	(300.0)	-	-
Trade payables	(1.8)	(18.7)	(7.7)	(7.3)	(104.5)	(61.2)	(22.0)
<b>Balance sheet exposure</b>	<b>(1.4)</b>	<b>(16.3)</b>	<b>50.6</b>	<b>(2.0)</b>	<b>523.6</b>	<b>(54.0)</b>	<b>60.7</b>

**Derivative assets and liabilities**

In order to reduce the impact of short-term fluctuations on Cochlear's earnings, Cochlear enters into forward exchange contracts to hedge anticipated sales and purchases in CHF, EUR, GBP, JPY, SEK and USD. The amounts of forward cover taken are in accordance with approved policy and internal forecasts.

In the year ended 30 June 2019, Cochlear designated the majority of forward exchange contracts as cash flow hedges. 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.

At the start of a hedge relationship, Cochlear designates and documents the relationship between the hedging instrument and hedged item. This includes identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how Cochlear will assess the effectiveness of the hedging relationship. Cochlear regularly assesses whether the hedging instruments are expected to be highly effective in offsetting the changes in the cash flows of the respective hedged items.

Forward exchange contracts are recognised initially at fair value. Subsequently, forward exchange contracts are measured at fair value. Changes in the fair value are recognised directly in equity to the extent that the hedge is effective. The ineffective part of any hedging instrument is recognised immediately in the income statement.

If the forward exchange contract 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.

For cash flow hedges, the associated cumulative gain or loss is removed from equity and recognised in the income statement in the same period the hedged forecast transaction affects the income statement and on the same line item as that hedged forecast transaction.

For the year ended 30 June 2019, all cash flow hedges were effective at the reporting date.

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

	Weighted average rate	< 1 year \$m	1 - 2 years \$m	2 - 5 years \$m
<b>2019</b>				
Buy CHF	0.697	(19.9)	-	-
Sell EUR	0.606	141.2	84.7	7.6
Sell GBP	0.541	20.2	14.9	1.9
Sell JPY	76.902	17.7	9.5	1.6
Buy SEK	6.391	(43.0)	-	-
Sell USD	0.746	266.0	135.0	21.0
<b>2018</b>				
Buy CHF	0.742	(17.8)	-	-
Sell EUR	0.633	125.7	77.5	13.4
Sell GBP	0.554	19.3	12.7	1.9
Sell JPY	80.510	14.7	10.6	2.7
Buy SEK	6.367	(41.7)	(1.5)	-
Sell USD	0.761	305.6	184.9	32.5

### **Currency risk - Sensitivity analysis**

An analysis based on a 10% strengthening of foreign currencies would have decreased Cochlear's profit for the year ended 30 June 2019 after tax by approximately AUD 2.5 million (2018: AUD 6.5 million) and increased Cochlear's equity by AUD 25.8 million (2018: increase by AUD 33.9 million). A 10% weakening of the foreign currencies would have increased Cochlear's profit after tax by AUD 3.5 million (2018: AUD 7.6 million) and decreased equity by AUD 67.2 million (2018: decrease by AUD 69.5 million).

This analysis assumes that all other variables remain constant and ignores any impact from the translation of foreign operations.

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

AUD 1 =	Average rate		Reporting date spot rate	
	2019	2018	2019	2018
CHF	0.712	0.749	0.683	0.735
CNY	4.877	5.046	4.814	4.888
EUR	0.627	0.649	0.616	0.635
GBP	0.553	0.575	0.552	0.564
JPY	79.582	85.288	75.355	81.765
SEK	6.557	6.453	6.494	6.629
USD	0.716	0.772	0.700	0.739

### **Interest rate risk**

Cochlear is exposed to interest rate risks in Australia, China, Sweden and Japan. See Note 6.4(c) for effective interest rates, repayment and repricing analysis of outstanding debt.

In order to reduce the impact of fluctuations in market interest rates, Cochlear has entered into interest rate swaps to manage the interest rate risk by using a floating versus fixed rate debt framework. The notional principal amount of these interest rate swaps is \$50.0 million. These interest rate swaps are recognised at fair value.

At the reporting date, the interest rate profile of Cochlear's interest-bearing financial instruments is financial assets of \$78.6 million (2018: \$61.5 million) and financial liabilities of \$181.6 million (2018: \$147.7 million).

### **Interest rate risk - Sensitivity analysis**

For the year ended 30 June 2019, 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 \$0.7 million (2018: \$1.0 million). A one percent general decrease in interest rates would have had the equal but opposite effect on Cochlear's profit and equity.

### **(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. Cochlear is exposed to credit risk from its operating activities (primarily from trade and other receivables) and from financing activities, including deposits with financial institutions and foreign exchange contracts. The carrying amounts of these financial assets at year end represent Cochlear's maximum exposure to credit risk.

### **Credit risk management - Trade and other receivables**

Customer credit risk is managed at a regional level, subject to Board approved policies and procedures. The ageing profile of total receivables balances, individually significant debtors by geographic region, high risk customers and collection activities are reported to management and the Board on a monthly basis. Where high risk customers are identified, regional management is responsible for placing restrictions on future trading, including suspending future shipments and administering dispatches on a prepayment basis.

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

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

	Americas \$m	EMEA \$m	Asia Pacific \$m	Total \$m
2019	96.0	140.1	63.4	<b>299.5</b>
2018	95.1	131.5	72.5	<b>299.1</b>

Depending on the region, Cochlear's credit terms are generally 30 days; however, there are certain jurisdictions where it is customary practice for customers to make payment beyond 270 days. Although Cochlear discloses the balance as overdue, it is not indicative of a higher than normal credit risk as payments are typically received by Cochlear within the extended timeframes.

Cochlear has established an allowance for impairment that represents its estimate of the expected credit losses in respect of trade receivables. The expected credit losses are assessed by reference to historical collection trends and timing of recoveries of each customer type within a region.

Trade and other receivables are stated at amortised cost less impairment losses. The ageing of Cochlear's trade receivables at the reporting date was:

	2019 \$m	2018 \$m
<b>Trade receivables</b>		
Not past due	239.3	247.3
Past due 1 - 60 days	42.4	34.8
Past due 61 - 180 days	16.7	18.0
Past due 181 - 360 days	6.6	2.6
Past due 361 days and over	8.4	6.3
	<b>313.4</b>	<b>309.0</b>
Allowance for impairment losses	(13.9)	(9.9)
<b>Trade receivables net of allowance for impairment losses</b>	<b>299.5</b>	<b>299.1</b>
Other receivables - current	20.2	17.6
<b>Trade and other receivables</b>	<b>319.7</b>	<b>316.7</b>

#### **Credit risk management - Cash deposits and forward exchange contracts**

The majority of Cochlear's cash deposits and all forward exchange contracts are only executed with leading financial institutions whose credit rating is at least A on the Standard & Poor's rating index.

#### **(c) Liquidity risk**

Liquidity risk is the risk that Cochlear will not be able to meet its financial obligations as they fall due. Cochlear manages liquidity risk by ensuring, as far as possible, that it will always have sufficient liquidity to meet its liabilities when due.

**Non-derivative liabilities**

Contractual maturities of non-derivative financial liabilities, including estimated interest payments and excluding the impact of netting agreements, are as follows:

	Effective interest rate	Carrying amount	Contractual cash flows	< 1 year	1 - 2 years	2 - 5 years	More than 5 years
	Per annum	\$m	\$m	\$m	\$m	\$m	\$m
<b>2019</b>							
AUD floating rate loan	2.42%	129.2	138.0	3.1	63.1	71.8	-
CNY floating rate loan	4.11%	2.9	3.5	0.1	0.1	3.3	-
JPY floating rate loan	0.53%	3.3	3.3	3.3	-	-	-
SEK floating rate loan	0.57%	46.2	46.5	0.3	46.2	-	-
Trade and other payables	-	203.2	203.2	160.8	30.3	12.1	-
<b>Total</b>		<b>384.8</b>	<b>394.5</b>	<b>167.6</b>	<b>139.7</b>	<b>87.2</b>	<b>-</b>
<b>2018</b>							
AUD floating rate loan	2.99%	144.0	159.3	4.3	4.3	109.3	41.4
JPY floating rate loan	0.55%	3.7	3.7	3.7	-	-	-
Trade and other payables	-	168.6	168.6	140.5	12.0	16.1	-
<b>Total</b>		<b>316.3</b>	<b>331.6</b>	<b>148.5</b>	<b>16.3</b>	<b>125.4</b>	<b>41.4</b>

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 are expected to occur:

	Carrying amount	Contractual cash flows	< 1 year	1 - 2 years	2 - 5 years
	\$m	\$m	\$m	\$m	\$m
<b>2019</b>					
Assets	4.3	4.4	2.2	2.1	0.1
Liabilities	(28.5)	(27.7)	(22.6)	(5.0)	(0.1)
<b>Total</b>	<b>(24.2)</b>	<b>(23.3)</b>	<b>(20.4)</b>	<b>(2.9)</b>	<b>-</b>
<b>2018</b>					
Assets	4.1	4.3	3.8	0.4	0.1
Liabilities	(22.3)	(22.9)	(13.3)	(8.2)	(1.4)
<b>Total</b>	<b>(18.2)</b>	<b>(18.6)</b>	<b>(9.5)</b>	<b>(7.8)</b>	<b>(1.3)</b>

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

**(d) Fair value**

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

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

**Valuation of financial assets and liabilities**

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

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

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

**7. OTHER NOTES****7.1 Auditors' remuneration**

	2019	2018
	\$	\$
<b>Audit services</b>		
Auditors of the Company - KPMG:		
- audit and review of financial reports	1,795,339	1,780,268
- other regulatory compliance services	147,161	100,866
<b>Total audit services</b>	<b>1,942,500</b>	<b>1,881,134</b>
<b>Non-audit services</b>		
Auditors of the Company - KPMG:		
- taxation compliance and advisory services	1,764,533	1,031,640
- IT advisory	643,260	673,000
- other	357,650	147,973
<b>Total non-audit services</b>	<b>2,765,443</b>	<b>1,852,613</b>

**7.2 Commitments****Operating lease commitments**

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.

Future non-cancellable operating lease rentals not provided for in the financial statements are payable as follows:

	2019	2018
	\$m	\$m
Not later than one year	30.0	30.3
Later than one year but not later than five years	107.5	77.9
Later than five years	83.3	63.6
<b>Total operating lease commitments</b>	<b>220.8</b>	<b>171.8</b>

### Capital expenditure commitments

As at 30 June 2019, Cochlear entered into contracts to purchase property, plant and equipment for \$44.0 million (2018: \$40.2 million).

### 7.3 Controlled entities

Subsidiaries conduct business transactions with various controlled entities. Such transactions include purchases and sales of certain products, dividends, interest and loans.

Company	Interest held		Country of incorporation/formation
	2019	2018	
	%	%	
<b>Company</b>			
Cochlear Limited			Australia
<b>Controlled entities</b>			
Acoustic Implants Limited (i)	-	100	UK
Cochlear AG	100	100	Switzerland
Cochlear Americas	100	100	USA
Cochlear Austria GmbH	100	100	Austria
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 Colombia SAS	100	-	Colombia
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 (ii)	-	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 (iii)	-	100	Belgium
Cochlear Incentive Plan Pty Ltd	100	100	Australia
Cochlear Investments Pty Ltd	100	100	Australia
Cochlear Investments (No. 2) Pty Ltd	100	100	Australia
Cochlear Italia SRL	100	100	Italy
Cochlear Korea Limited	100	100	Korea

Cochlear Labs Pty Limited	(iv)	100	100	Australia
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 (Chengdu) Co Ltd		100	100	China
Cochlear Medical Device Company India Private Limited		100	100	India
Cochlear Mexico SA de CV		100	-	Mexico
Cochlear Middle East FZ-LLC		100	100	UAE
Cochlear Nordic AB		100	100	Sweden
Cochlear Norway AS		100	100	Norway
Cochlear NZ Limited		100	100	New Zealand
Cochlear Research and Development Limited		100	100	UK
Cochlear Shared Services S.A.		100	100	Panama
Cochlear Sweden Holdings AB		100	100	Sweden
Cochlear Technology Innovation Fund LP	(v)	-	99	Australia
Cochlear Thailand Limited		100	-	Thailand
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	(vi)	100	100	UK
Medical Insurance Pte Limited		100	100	Singapore
Nihon Cochlear Co Limited		100	100	Japan
Sichuan Keli ShuangChuang Technology Co Ltd		51	51	China
Sycle, LLC		100	100	USA
Sycle.Net Technologies (Canada) Ltd		100	100	Canada

(i) Deregistered.

(ii) Wound up during the year ended 30 June 2019.

(iii) Merged with Cochlear Benelux NV (CBNV), with CBNV absorbing Cochlear Holdings NV during the year ended 2019.

(iv) Name changed during the year ended 2019, previously Cochlear Technology Innovation Fund Pty Limited.

(v) Wound up and cancelled during the year ended 2019.

(vi) Dormant.

#### 7.4 Parent entity disclosure

At, and throughout the financial year ended, 30 June 2019, the parent company of Cochlear was Cochlear Limited.

	2019	2018
	\$m	\$m
<b>Result of the parent entity</b>		
Net profit	225.0	244.0
Other comprehensive loss	(4.0)	(28.3)
<b>Total comprehensive income</b>	<b>221.0</b>	<b>215.7</b>
<b>Financial position of the parent entity at year end</b>		
Current assets	456.0	451.0
Total assets	1,015.7	935.0
Current liabilities	211.7	158.0
Total liabilities	502.4	481.0



	2019	2018
	\$m	\$m
<b>Total equity of the parent entity comprising:</b>		
Share capital	182.3	173.0
Hedging reserve	(17.0)	(13.0)
Share based payment reserve	50.0	39.0
Retained earnings	298.0	255.0
<b>Total equity</b>	<b>513.3</b>	<b>454.0</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 5.6.

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

As at 30 June 2019, the parent entity entered into contracts but had not provided for or paid to purchase plant and equipment for \$17.0 million (2018: \$10.2 million).

#### 7.5 Deed of Cross Guarantee

Cochlear Limited (the holding entity) together with wholly owned subsidiaries set out below (together referred to as the 'Closed Group') have entered a Deed of Cross Guarantee on 17 April 2019 in accordance with ASIC Corporations (Wholly-owned Companies) Instrument 2016/785 and are relieved from the Corporations Act 2001 requirement to prepare and lodge an audited financial report and directors' report. The effect of the deed is that Cochlear Limited has guaranteed to pay any outstanding liabilities upon the winding up of any wholly owned subsidiary that is party to the Deed. Wholly owned subsidiaries that are party to the Deed have also been given a similar guarantee in the event that Cochlear Limited or another party to the Deed is wound up.

The subsidiaries party to the deed are:

Cochlear Finance Pty Limited;

Cochlear German Holdings Pty Limited;

Cochlear Investments Pty Ltd; and

Cochlear Investments (No. 2) Pty Ltd.

Set out below is the income statement, statement of comprehensive income, balance sheet and a summary of movements in retained earnings of the entities party to the Deed of Cross Guarantee for the year ended 30 June 2019 and 30 June 2018:

	2019	2018
	\$m	\$m
<b>Income statement</b>		
Revenue	972.9	909.6
Cost of sales	(310.4)	(300.9)
<b>Gross profit</b>	<b>662.5</b>	<b>608.7</b>
Selling, marketing and general expenses	(65.4)	(59.4)
Research and development expenses	(122.6)	(109.1)
Administration expenses	(92.8)	(93.0)
Other income	34.3	50.1
Other expenses	(102.6)	(70.3)
<b>Results from operating activities</b>	<b>313.4</b>	<b>327.0</b>
Finance income - interest	10.7	11.8
Finance expense - interest	(16.6)	(20.5)
<b>Net finance expense</b>	<b>(5.9)</b>	<b>(8.7)</b>
<b>Profit before income tax</b>	<b>307.5</b>	<b>318.3</b>
Income tax expense	(81.3)	(75.0)
<b>Net profit</b>	<b>226.2</b>	<b>243.3</b>
<b>Statement of comprehensive income</b>		
Financial investments measured at fair value through other comprehensive income, net of tax	(1.3)	-
Foreign currency translation differences	18.7	7.1
Effective portion of changes in fair value of cash flow hedges, net of tax	(17.8)	(19.4)
Net change in fair value of cash flow hedges transferred to the income statement, net of tax	13.6	(8.8)
<b>Total comprehensive income</b>	<b>239.4</b>	<b>222.2</b>
Retained earnings at beginning of year	232.3	151.2
Transfers to and from reserves	49.6	128.3
Dividends recognised	(6.9)	(47.2)
<b>Retained earnings at end of year</b>	<b>275.0</b>	<b>232.3</b>

	2019	2018
	\$m	\$m
<b>Balance sheet</b>		
<b>Assets</b>		
Cash and cash equivalents	21.8	8.2
Trade and other receivables	306.6	328.1
Forward exchange contracts	2.0	3.5
Inventories	111.9	102.4
Current tax assets	5.0	2.5
Prepayments	14.4	9.8
<b>Total current assets</b>	<b>461.7</b>	<b>454.5</b>
Other receivables	3.1	2.0
Forward exchange contracts	2.1	0.4
Loans and borrowings - internal	60.0	4.5
Investments in subsidiaries	462.6	567.4
Property, plant and equipment	110.6	100.6
Intangible assets	121.3	39.1
Deferred tax assets	42.8	40.0
<b>Total non-current assets</b>	<b>802.5</b>	<b>754.0</b>
<b>Total assets</b>	<b>1,264.2</b>	<b>1,208.5</b>
<b>Liabilities</b>		
Trade and other payables	114.7	89.3
Forward exchange contracts	20.9	13.1
Loans and borrowings - internal	60.5	23.0
Current tax liabilities	23.2	12.9
Employee benefit liabilities	38.7	30.9
Provisions	17.0	18.9
Deferred revenue	2.3	2.2
<b>Total current liabilities</b>	<b>277.3</b>	<b>190.3</b>
Trade and other payables	81.8	146.9
Forward exchange contracts	7.6	9.2
Loans and borrowings - external	175.4	144.1
Loans and borrowings - internal	188.2	256.5
Employee benefit liabilities	4.7	4.9
Provisions	40.3	45.5
Deferred tax liabilities	4.6	4.2
<b>Total non-current liabilities</b>	<b>502.6</b>	<b>611.3</b>
<b>Total liabilities</b>	<b>779.9</b>	<b>801.6</b>
<b>Net assets</b>	<b>484.3</b>	<b>406.9</b>
<b>Equity</b>		
Share capital	182.3	173.0
Reserves	27.0	1.6
Retained earnings	275.0	232.3
<b>Total equity</b>	<b>484.3</b>	<b>406.9</b>

### 7.6 Changes in accounting policies

AASB 9 Financial Instruments has replaced the previous financial instruments guidance including AASB 139 Financial Instruments: Recognition and Measurement.

The Consolidated Entity performed a review of its classification and measurement of financial assets and liabilities, as well as hedge accounting, for compliance with AASB 9. The new standard has had the following impacts on Cochlear's consolidated financial statements:

- investments held in the form of ordinary shares previously classified as available for sale investments are now classified as fair value through other comprehensive income under AASB 9, having elected to make this designation for investments held at 1 July 2018. Under AASB 139, fair value gains or losses were recognised in other comprehensive income whilst impairment losses were recognised in the income statement. Under AASB 9, all gains or losses from these investments, including impairment losses, will be recognised in other comprehensive income. In addition, any realised gains or losses on disposal will no longer be recycled through the income statement;
- other investments, which include instruments convertible into ordinary shares, were previously classified as available for sale investments and are now classified as fair value through profit or loss under AASB 9. Under AASB 9, all gains or losses from these investments, including impairment losses, will be recognised in the income statement. Previously recognised fair value losses in the fair value reserve of \$0.4 million (net of tax) have been transferred to retained earnings as at 1 July 2018; and
- impairment losses on financial assets, including trade receivables, are now required to be measured using an expected credit loss model rather than the incurred credit loss model. Under the new model, Cochlear is required to recognise the expected credit loss from possible future default events rather than only the credit losses arising from counterparties with indicators of impairment. This resulted in a decrease in retained earnings of \$1.9 million (net of tax) at 1 July 2018, with a corresponding impact on the carrying value of trade receivables and deferred tax assets. Other financial assets held by Cochlear are not expected to be impacted by the new standard.

AASB 15 Revenue from Contracts with Customers has replaced the previous revenue recognition guidance including AASB 118 Revenue.

The Consolidated Entity performed a review of its revenue recognition policies for compliance with AASB 15. The new standard has had the following impacts on Cochlear's consolidated financial statements:

- the core principle of AASB 15 is that an entity recognises revenue related to the transfer of goods or services when control of the goods or services passes to the customer. AASB 15 requires the identification of discrete performance obligations within a transaction and an allocation of a portion of the transaction price to each of these obligations. Under AASB 15, revenue is recognised to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur; and
- as at 1 July 2018, an adjustment to opening retained earnings of \$5.1 million (net of tax) has been made to defer revenue related to supplemental warranties and to reflect changes in the timing of revenue for certain customer pricing arrangements and expected product returns.

### 7.7 New standards and interpretations not yet adopted

AASB 16 Leases will replace the current AASB 117 Leases standard for Cochlear's 2020 consolidated financial statements.

Under AASB 117, leases are classified as either operating leases or finance leases based on their nature. The adoption of AASB 16 will primarily impact Cochlear's accounting for leases which are currently classified as operating leases, being mainly leases over premises, office equipment and motor vehicles. Under AASB 117, operating leases were not recognised on the balance sheet, with payments instead recognised in profit or loss on a straight-line basis over the term of the lease.

The adoption of AASB 16 will result in agreements that were previously classified as operating leases now being recognised on the balance sheet. For these agreements, this will result in the recognition of a right-of-use asset and a corresponding lease liability, being the present value of future lease payments. Over the life of the lease, the lease liability will incur interest expense and is reduced as lease payments are made. The right-of-use asset is amortised on a straight-line basis over its useful life. As compared to AASB 117, the pattern of expense recognition changes with a higher expense at lease commencement due to a higher lease liability at that time.

Cochlear plans to adopt AASB 16 using the modified retrospective approach. Under this approach, the cumulative impact of adoption on 1 July 2019, will be recognised as an adjustment to opening retained earnings with no restatement of comparative periods. Cochlear has elected to apply practical expedients allowed under the modified retrospective approach and not to recognise short-term or low-value leases on the balance sheet.

Based on work completed to date, it is expected that a right-of-use asset in the range of \$175 to \$190 million and lease liability in the range of \$215 to \$230 million will be recognised as of 1 July 2019. The net effect of the new right-of-use asset and lease liability adjusted for deferred tax will be recognised in retained earnings. It is further expected that the new standard will result in additional expenses for the year ending 30 June 2020 of between \$2 to \$3 million (before tax).

### **7.8 Events subsequent to the reporting date**

Other than the matter 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 2019, see Note 2.6.

1. In the opinion of the directors of Cochlear Limited (the Company):
  - (a) the consolidated financial statements and notes and the Remuneration report 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 2019 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; and
  - (c) at the date of this declaration, there are reasonable grounds to believe that that Company and each of the Closed Group entities identified in Note 7.5 will be able to meet any liabilities to which they are or may become subject to, because of the Deed of Cross Guarantee between the Company and those group entities pursuant to ASIC Corporations (Wholly-owned Companies) Instrument 2016/785.
2. The directors have been given the declarations required by section 295A of the *Corporations Act 2001* from the Chief Executive Officer & President and Chief Financial Officer for the financial year ended 30 June 2019.
3. The directors draw attention to Note 1.2(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 16th day of August 2019.



Director



Director



# Independent audit report to the shareholders of Cochlear Limited

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## Report on the audit of the Financial Report

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### Opinion

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We have audited the Financial Report of Cochlear Limited (the Company).

In our opinion, the accompanying Financial Report of the Company is in accordance with the *Corporations Act 2001*, including:

- giving a true and fair view of the Consolidated Entity's financial position as at 30 June 2019 and of its financial performance for the year ended on that date; and
- complying with *Australian Accounting Standards* and the *Corporations Regulations 2001*.

The Financial Report comprises:

- Balance sheet as at 30 June 2019;
- Income statement, Statement of comprehensive income, Statement of changes in equity, and Statement of cash flows for the year then ended;
- Notes including a summary of significant accounting policies; and
- Directors' Declaration.

The Consolidated Entity consists of the Company and the entities it controlled at the year-end or from time to time during the financial year.

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### Basis for opinion

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We conducted our audit in accordance with *Australian Auditing Standards*. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the Financial Report* section of our report.

We are independent of the Consolidated Entity in accordance with the *Corporations Act 2001* and the ethical requirements of the *Accounting Professional and Ethical Standards Board's APES 110 Code of Ethics for Professional Accountants* (the Code) that are relevant to our audit of the Financial Report in Australia. We have fulfilled our other ethical responsibilities in accordance with the Code.

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### Emphasis of matter – Patent dispute

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We draw attention to Note 5.6 in the Financial Report which describes the inherent uncertainty in the final future outcome related to the patent infringement lawsuit filed against Cochlear Limited and its US subsidiary Cochlear Americas (the lawsuit).

The uncertainty relates to the Consolidated Entity's litigation process in the US Court system regarding the issue of damages and wilfulness of infringement of two claims. The range of possible outcomes and associated estimation of financial outflows of the likely loss cannot be reliably estimated by the Board, the resolution of which may significantly impact the Consolidated Entity.

In our judgement, this issue is fundamental to the users' understanding of the Financial Report, and the financial position and performance of the Consolidated Entity. Our opinion is not modified in respect of this matter.

In concluding the possible financial outflow of likely loss cannot be reliably estimated, we evaluated the extent of uncertainty regarding the outcome of the Consolidated Entity's litigation process in the Court system and its potential impact on the Financial Report. Our procedures included:

- enquiring of management and the Directors for updates regarding the lawsuit, the range of possible outcomes and associated estimation of financial outflows;
  - reading the November 2018 District Court Judgment;
  - interviewing the Consolidated Entity's external lawyers regarding the lawsuit, the range of possible outcomes and the degree of accuracy in estimating any financial outflows;
  - reading the independent legal advice obtained by the board of directors on the Consolidated Entity's appeal prospects;
  - assessing the consistency to facts and conditions gathered across our work; and
  - considering the Consolidated Entity's disclosures in relation to the patent dispute contingent liability, against the requirements of the accounting standards.
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# Independent audit report to the shareholders of Cochlear Limited

## Key Audit Matters

The key audit matters we identified are:

- Recoverability of trade receivables; and
- Warranty provision.

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the Financial Report of the current period.

These matters were addressed in the context of our audit of the Financial Report as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

### Recoverability of trade receivables \$299.5 million

Refer to note 6.4(b) Financial risk management, credit risk

#### The key audit matter

#### How the matter was addressed in our audit

Recoverability of trade receivables was considered a key audit matter due to:

- The varying characteristics of customers which include governments, government-supported universities, clinics and major hospital chains;
- The different geographical locations of customers and the political and economic environments they are subject to, which may affect the timely recovery of certain receivables;
- Trade receivables past due at the reporting date which have certain risk characteristics and therefore have a greater inherent risk of not being recovered;
- The inherent subjectivity involved in the Consolidated Entity making forward-looking judgements in relation to the recovery of credit risk exposures; and
- The Consolidated Entity's adoption of AASB 9 Financial Instruments requiring the use of an expected credit loss model.

These conditions gave rise to additional audit effort, including:

- Greater involvement by our senior team members to gather evidence across the various customer profiles and their trade receivables; and
- To challenge the forward-looking judgements made by the Consolidated Entity.

We involved IT specialists to supplement our senior team members in assessing this key audit matter.

Our procedures included:

- With the assistance of our IT specialists, testing key controls within the credit control process including:
  - management review and approval of new customer credit limits within the Consolidated Entity's credit limit policies;
  - the system configuration of credit limits; and
  - management's evaluation of trade receivables ageing and trade receivables past due;
- Assessing the Consolidated Entity's expected credit loss model in significant geographies against the requirements of the accounting standards;
- Challenging the Consolidated Entity's view of credit risk and recoverability in certain locations by selecting a sample of significant overdue customer balances with indicators of credit deterioration. We:
  - noted the historical patterns for long outstanding trade receivables in those locations for those customer types, to form an understanding of the normal pattern of recovery and compared this to the age of the customer balances sampled;
  - assessed cash received subsequent to year-end from the Consolidated Entity's bank statements for its effect in reducing amounts outstanding at year-end;
  - evaluated other evidence including customer correspondence; and
  - questioned the Consolidated Entity's knowledge of future conditions which may impact expected customer receipts based on consistency with the results of the procedures performed above; and
- Assessing the Consolidated Entity's disclosures of the quantitative and qualitative considerations in relation to trade receivable credit risk, by comparing these disclosures to our understanding of the matter and the requirements of the accounting standards.





## Independent audit report to the shareholders of Cochlear Limited

### Warranty provision \$37.8 million

Refer to note 5.5 Provisions

The key audit matter	How the matter was addressed in our audit
<p>The warranty provision was considered a key audit matter due to:</p> <ul style="list-style-type: none"><li>• The estimation uncertainty inherent in the key assumptions applied by the Consolidated Entity to determine the warranty provision;</li><li>• The Consolidated Entity's evolving product portfolio, through the introduction of new generations, where each product's design and quality attributes can impact the key assumptions;</li><li>• The increased use of the Global Repair Centre intended to reduce forecast repair cost;</li><li>• The inherent unpredictability of future failures resulting in claims under warranty; and</li><li>• The calculation is largely manually developed and therefore is at greater risk of error.</li></ul> <p>The key assumptions used in the Consolidated Entity's determination of the warranty provision are:</p> <ul style="list-style-type: none"><li>• The forecast claim rates of the multiple products in the portfolio;</li><li>• The ratio of repairing to replacing failed products;</li><li>• The forecast repair cost; and</li><li>• The forecast replacement cost which is based on standard forecasts of manufacturing costs.</li></ul> <p>Challenging these key assumptions required greater involvement by our senior team members.</p>	<p>Our procedures included:</p> <ul style="list-style-type: none"><li>• Obtaining an understanding of the evolving product portfolio, each product's warrantable period and history of claim rates, and the different attributes which impact the key assumptions used in the Consolidated Entity's warranty provision;</li><li>• Testing the sensitivity of the warranty provision by varying key assumptions, within a reasonably possible range, to focus our further procedures;</li><li>• Challenging the Consolidated Entity's ability to reliably estimate the key assumptions by comparing previous estimates to actual outcomes;</li><li>• Assessing the integrity of the model for the warranty provision. This included checking the accuracy of the formulas within the model;</li><li>• Comparing the forecast claim rates of a sample of products to the historical warranty claims for that product or the historical warranty claims of previous generations of similar products;</li><li>• Comparing the forecast proportion of claims that can be repaired and associated repair costs to historical performance of the Global Repair Centre;</li><li>• Comparing the forecast replacement cost to:<ul style="list-style-type: none"><li>- the standard manufacturing cost used in board approved budgets; and</li><li>- actual manufacturing costs to identify variances and their impact on the warranty provision;</li></ul></li><li>• Enquiring of management responsible for product design and quality attributes and the Global Repair Centre to challenge the forward-looking assumptions used in the model; and</li><li>• Assessing the disclosures of the quantitative and qualitative considerations in relation to the warranty provision, by comparing these disclosures to our understanding of the matter and the requirements of the accounting standards.</li></ul>



## Independent audit report to the shareholders of Cochlear Limited

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### Other Information

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Other Information is financial and non-financial information in Cochlear Limited's annual reporting which is provided in addition to the Financial Report and the Auditor's Report. The Directors are responsible for the Other Information.

Our opinion on the Financial Report does not cover the Other Information and, accordingly, we do not express an audit opinion or any form of assurance conclusion thereon, with the exception of the Remuneration Report and our related assurance opinion.

In connection with our audit of the Financial Report, our responsibility is to read the Other Information. In doing so, we consider whether the Other Information is materially inconsistent with the Financial Report or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

We are required to report if we conclude that there is a material misstatement of this Other Information, and based on the work we have performed on the Other Information that we obtained prior to the date of this Auditor's Report we have nothing to report.

### Responsibilities of the Directors for the Financial Report

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The Directors are responsible for:

- preparing the Financial Report that gives a true and fair view in accordance with Australian Accounting Standards and the Corporations Act 2001; and
- implementing necessary internal controls to enable the preparation of a Financial Report that gives a true and fair view and is free from material misstatement, whether due to fraud or error; and
- assessing the Consolidated Entity's ability to continue as a going concern and whether the use of the going concern basis of accounting is appropriate. This includes disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless they either intend to liquidate the Consolidated Entity or to cease operations, or have no realistic alternative but to do so.

### Auditor's responsibilities for the audit of the Financial Report

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Our objective is:

- to obtain reasonable assurance about whether the Financial Report as a whole is free from material misstatement, whether due to fraud or error; and
- to issue an Auditor's Report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with *Australian Auditing Standards* will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error. They are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the Financial Report.

A further description of our responsibilities for the audit of the Financial Report is located at the *Auditing and Assurance Standards Board* website at: [http://www.auasb.gov.au/auditors\\_responsibilities/ar1.pdf](http://www.auasb.gov.au/auditors_responsibilities/ar1.pdf). This description forms part of our Auditor's Report.



## Independent audit report to the shareholders of Cochlear Limited

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### Report on the Remuneration Report

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#### Opinion

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In our opinion, the Remuneration Report of Cochlear Limited for the year ended 30 June 2019, complies with Section 300A of the *Corporations Act 2001*.

#### Directors' responsibilities

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 responsibilities

We have audited the Remuneration Report included in pages 28 to 43 of the Annual Report for the year ended 30 June 2019.

Our responsibility is to express an opinion on the Remuneration Report, based on our Audit conducted in accordance with *Australian Auditing Standards*.

KPMG  
Sydney, 16 August 2019

Julian McPherson, Partner

**Notes**

*Hear now. And always*



1. Hoppe U, Hocke T, Hast A, Hornung J. [Longterm Results of a Screening Procedure for Adult Cochlear Implant Candidates]. *Laryngo- Rhino- Otologie* [serial on the Internet]. (2017, Apr), [cited July 4, 2018]; 96(4): 234-238.  
  
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Hsu W, Hsu C, Wen M, Lin H, Tsai H, Hsu Y, et al. Increased risk of depression in patients with acquired sensory hearing loss: A 12-year follow-up study. *Medicine* [serial on the Internet]. (2016, Nov), [cited July 3, 2018]; 95(44): e5312.  
  
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Barnett S. A hearing problem. *American Family Physician* [serial on the Internet]. (2002, Sep 1), [cited July 3, 2018]; 66(5): 911.  
  
Mick P, Kawachi I, Lin F. The Association between Hearing Loss and Social Isolation in Older Adults. *Otolaryngology And Head And Neck Surgery* [serial on the Internet]. (2014), [cited July 3, 2018]; (3): 378.  
  
Tomaka J, Thompson S, Palacios R. The Relation of Social Isolation, Loneliness, and Social Support to Disease Outcomes Among the Elderly. *Journal Of Aging And Health* [serial on the Internet]. (2006), [cited July 3, 2018]; (3): 359.  
  
Kramer S, Kapteyn T, Houtgast T. Occupational performance: comparing normally-hearing and hearing-impaired employees using the Amsterdam Checklist for Hearing and Work. *International Journal Of Audiology* [serial on the Internet]. (2006, Sep), [cited July 3, 2018]; 45(9): 503-512.  
  
Nachtegaal J, Festen J, Kramer S. Hearing ability in working life and its relationship with sick leave and self-reported work productivity. *Ear And Hearing* [serial on the Internet]. (2012, Jan), [cited July 3, 2018]; 33(1): 94-103.  
  
Nachtegaal J, Kuik D, Anema J, Goverts S, Festen J, Kramer S. Hearing status, need for recovery after work, and psychosocial work characteristics: Results from an internet-based national survey on hearing. *International Journal Of Audiology* [serial on the Internet]. (2009, Oct), [cited July 3, 2018]; 48(10): 684-691.

Additional information required by Australian Securities Exchange Listing Rules and not disclosed elsewhere in this report – the information presented is as at 31 July 2019.

### Substantial shareholders

Investor	Number of ordinary shares	%
Baillie Gifford & Co	4,385,019	7.6
BlackRock Group	3,933,933	6.8
The Vanguard Group, Inc	3,058,075	5.3
Hyperion Asset Management Limited	2,882,756	5.0
<b>Total</b>	<b>14,259,783</b>	<b>24.7</b>

### Distribution of shareholders

Number of shares held	Number of ordinary shareholders
1 - 1,000	31,563
1,001 - 5,000	2,285
5,001 - 10,000	124
10,001 - 100,000	57
100,001 and over	17
<b>Total</b>	<b>34,046</b>

Non-marketable parcels – 142 shareholders held less than a marketable parcel of ordinary shares.

### Twenty largest shareholders

Shareholder	Number of ordinary shares	%
HSBC Custody Nominees (Australia) Limited	25,166,425	43.60
J P Morgan Nominees Australia Pty Limited	10,087,644	17.48
Citicorp Nominees Pty Limited	3,698,455	6.41
National Nominees Limited	1,457,411	2.53
BNP Paribas Nominees Pty Ltd <Agency Lending DRP A/C>	940,076	1.63
BNP Paribas Noms Pty Ltd <DRP>	880,118	1.52
HSBC Custody Nominees (Australia) Limited - A/C 2	672,257	1.16
Citicorp Nominees Pty Limited <Colonial First State Inv A/C>	255,957	0.44
HSBC Custody Nominees (Australia) Limited <NT-Comnwlth Super Corp A/C>	179,956	0.31
HSBC Custody Nominees (Australia) Limited-GSCO ECA	179,428	0.31
Mr Christopher Graham Roberts	161,745	0.28
AMP Life Limited	159,864	0.28
Netwealth Investments Limited <Wrap Services A/C>	140,043	0.24
National Nominees Limited <N A/C>	138,905	0.24
Australian Foundation Investment Company Limited	137,000	0.24
National Nominees Limited <DB A/C>	132,062	0.23
HSBC Custody Nominees (Australia) Limited	104,102	0.18
PGA (Investments) Pty Ltd	100,000	0.17
BNP Paribas Nominees Pty Ltd HUB24 Custodial Serv Ltd DRP	49,682	0.09
Navigator Australia Ltd <MLC Investment Sett A/C>	45,856	0.08
	<b>44,686,986</b>	<b>77.42</b>

The 20 largest shareholders held 77.42% of the ordinary shares of the Company.

### On market buy-back

There is no current on market buy-back.

## Contact information

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### Cochlear headquarters

1 University Avenue  
Macquarie University NSW 2109  
Australia  
Telephone: +612 9428 6555  
Fax: +612 9428 6353  
Website: [www.cochlear.com](http://www.cochlear.com)

### Shareholder enquiries

Access to shareholding information is available to investors through Computershare.

Computershare Investor Services Pty Limited  
GPO Box 2975  
Melbourne VIC 3001  
Australia  
Telephone: 1300 850 505  
Email: [web.queries@computershare.com.au](mailto:web.queries@computershare.com.au)  
Website: [www.computershare.com.au](http://www.computershare.com.au)

### Calendar of events

16 August 2019	FY19 results announced
20 September 2019	Dividend record date (final dividend)
14 October 2019	Payment date (final dividend)
22 October 2019	Annual general meeting
18 February 2020	HY20 results announced*
18 August 2020	FY20 results announced*

\* Indicative dates only.

### Annual general meeting

The annual general meeting of Cochlear Limited will be held on 22 October 2019 at 10.00am at the Australian Securities Exchange, Exchange Square Auditorium, 20 Bridge Street, Sydney.

# Hear now. And always

As the global leader in implantable hearing solutions, Cochlear is dedicated to helping people with moderate to profound hearing loss experience a life full of hearing. We have provided more than 550,000 implantable devices, helping people of all ages to hear and connect with life's opportunities.

We aim to give people the best lifelong hearing experience and access to innovative future technologies. We have the industry's best clinical, research and support networks.

That's why more people choose Cochlear than any other hearing implant company.

 Cochlear Ltd (ABN 96 002 618 073) 1 University Avenue, Macquarie University, NSW 2109, Australia T: +61 2 9428 6555 F: +61 2 9428 6352

[www.cochlear.com](http://www.cochlear.com)

Please seek advice from your health professional about treatments for hearing loss. Outcomes may vary, and your health professional will advise you about the factors which could affect your outcome. Always read the instructions for use. Not all products are available in all countries. Please contact your local Cochlear representative for product information.

The Cochlear Nucleus Smart App is available on App Store and Google Play. The Cochlear Nucleus 7 Sound Processor is compatible with Apple and Android devices. For compatibility information visit [www.cochlear.com/compatibility](http://www.cochlear.com/compatibility).

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ACE, Advance Off-Stylet, AOS, AutoNRT, Autosensitivity, Beam, Bring Back the Beat, Button, Carina, Cochlear, 科利耳, コクレア, 코클리어, Cochlear SoftWear, Codacs, Contour, Contour Advance, Custom Sound, ESprit, Freedom, Hear now. And always, Hugfit, Hybrid, Invisible Hearing, Kanso, MET, MicroDrive, MP3000, myCochlear, mySmartSound, NRT, Nucleus, Outcome Focused Fitting, Off-Stylet, Slimline, SmartSound, Softip, SPrint, True Wireless, the elliptical logo, and Whisper are either trademarks or registered trademarks of Cochlear Limited. Ardium, Baha, Baha SoftWear, BCDrive, DermaLock, EveryWear, SoundArc, Vistafix, and WindShield are either trademarks or registered trademarks of Cochlear Bone Anchored Solutions AB.

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