

Financial Report

Semi-Annual Report



per September 30, 2003

PHONAK
hearing systems

Dear Phonak Shareholder

These are busy and exciting days at the Phonak Group! At the beginning of this fiscal year, we outlined a detailed action plan how to bring Phonak back on the route to success. In this report, we are happy to report the progress we have made and to present the improved financial results we have already achieved in the first half of this year.

In the first six months of this fiscal year, sales have reached a record high of CHF 300 million. This represents 18% growth, in local currencies, over the same period last year. The strong sales of new products, in particular Perseo, have contributed to the overall sales result and to an increase in the gross profit to 54.8%, up from 51.6% last year. EBITA for the period reached CHF 39 million, which is a 50% increase over last year, and represents 13.0% of sales – a significant improvement from the 8.7% posted last year.

In addition to the financial milestones, we have also achieved some significant operational milestones in the first six months of this year. We have opened the new Phonak/Unitron facility in China, from which first shipments of products were made on September 30! We have also opened Phonak Japan, our newest distribution company, preparing to tackle the 3rd largest private market in the industry. In addition, we announced the creation of a joint venture company with Cochlear of Australia, in which we are developing a new implantable hearing device.

Finally, in October 2003, we enjoyed a very successful UHA industry convention in Nuremburg, Germany – during which the Phonak Group was praised for launching another slate of innovative products. Highlights include **Liaison**, Unitron Hearing's new premium digital product, **Supero+**, an upgraded version of Phonak's digital high power product line launched last year, and **MAXX Directional**, which adds directional signal processing to the popular product family launched by Phonak in June. Exciting new products from Phonak Communications include **SmartLink** that incorporates a remote control, a transmitter, a directional microphone system and bluetooth mobile phone access into a single device, as well as **EduLink**, an innovative FM device to assist the learning development of children with Auditory Processing Disorder (APD).

We are certainly not yet satisfied with these results. There are further challenges and increasing expectations in the future. However, we are confident that we are doing the right things to bring the Phonak Group into a solid leadership position in this industry.

We are accomplishing our objectives through the hard work and dedication of our people. Therefore, we want to make a special thank you to our employees, who are demonstrating tremendous creativity and flexibility in the midst of many changes. We also want to thank our growing number of shareholders who are clearly interested in the momentum that is building within the Phonak Group.



Andy Rihs
Chairman of the Board



Valentin Chaperó Rueda
CEO

Business Report

Sales up 18% over prior year

Consolidated sales for H1 reached CHF 300.9 million. This represents an 18% growth, in local currency, over the prior year, or 13% year over year growth. The strong sales performance is a result of:

- sales of many new products, especially Perseo;
- recovery and/or continued growth in key markets;
- improvement in the Unitron Hearing sub-Group performance; and
- signs of market growth in certain markets.

The sales of new products are generally exceeding our expectations, in particular sales of Perseo, Phonak's new high-end digital line. While sales of Claro have naturally receded against the strength of Perseo, the first class product segment (Perseo and Claro together) is now accounting for approximately 35% of total hearing instrument sales. MAXX and Amio, Phonak's new entry-level digital products launched in June 2003, have also been very successful in just the first three months. We are now seeing the effect and benefit of

having a complete digital product portfolio in all segments. On the other hand, this leads to a significant sales decline of older, analog products. Conversely, Unitron Hearing's mid-level digital product launched in June 2003, has also been selling above expectation and contributing to a general increase in average selling prices for the brand. Sales of the other top-selling products, Aero from Phonak and Unison from Unitron Hearing, continue according to expectations. Sales of Supero, Phonak's digital high power product line, will be boosted by the launch of Supero+ in October, which will reconfirm Phonak's strength in this product segment.

From a market perspective, we have generally seen good year over year improvement. Based on local currencies, highlights include over-proportionate growth in the United States, Australia and New Zealand, the United Kingdom, the Netherlands, Spain and the Middle East. Phonak in Switzerland has also improved significantly – over 30% growth compared to last year. Finally, we have also seen a tremendous recovery and growth in sales in the key German and French markets, over the previous year, as a result of the new products launched in the past year.

Unitron Hearing is growing!

We are pleased to report that Unitron Hearing is progressing well. Compared to last year, Unitron Hearing has grown over-proportionately to the consolidated growth rate, due to the success of its new products, the increasing average selling prices and the recovery and growth in the key United States market. We expect further improvement in Unitron Hearing, fueled by the launch of Liaison, the company's new premium digital product family, of which the Behind-the-Ear versions are being launched in new, modern housings.

Phonak Group:			
Key figures for the six months ended September 30, 2003			
	April to September		Change
	2003	2002	6 months
	(CHF in millions) 2003/2002		
Sales	300.9	266.6	+12.9%
Gross Profit	164.8	137.6	+19.7%
% of sales	54.8	51.6	
Operating profit EBITA	39.1	26.1	+49.9%
% of sales	13.0	9.8	
Operating profit / (loss) EBIT	34.9	(55.3)	
% of sales	11.6	(20.7)	
Income / (loss) after taxes	25.8	(60.8)	
% of sales	8.6	(22.8)	
Net cash from operating activities	65.1	23.3	+179.5%
% of sales	21.6	8.7	
Capital expenditure	8.5	10.0	-14.8%
% of net cash from operating activities	13.1	42.9	
Total assets	630.4	636.5	-0.9%
Shareholders' equity	307.9	279.1	+10.3%
% of total assets	48.8	43.8	+5.0%
Net debt	49.7	87.3	-43.1%
Number of employees			
- At September 30	2,459	2,416	+1.8%
- Average	2,425	2,404	+0.9%

Interim financial statements are unaudited and are prepared in accordance with International Accounting Standards (IAS 34)

Gross profit improves 3 percentage points from prior year

In June, we announced our target to increase gross profit from the 51.6% (of sales) reported last year to around 60% in the mid-term (approximately three years from now). For H1, we are pleased to report a quick improvement in gross profit to 54.8%, an improvement of 3 percentage points from last year. As expected, this gross profit improvement comes from:

- Perseo sales in the premium segment where average selling prices are higher;
- sales of MAXX, in the entry-level segment, where the cost structure yields a good gross profit (especially relative to the analog products that MAXX is replacing), despite lower average selling prices than the premium segment; and
- sales of Conversa, the mid-level digital product line from Unitron Hearing which is bringing up the reported average selling price of this brand.

50% increase in EBITA over prior year

Operating expenses are in line with budget and represent an increase of 13% over the same period last year. The main increases in operating expenses are related to R&D, specifically to the Palio (new product hardware platform) and Chinook (new fitting software architecture) projects, as well as an increase in marketing and sales costs, consistent with the reported sales increase.

EBITA in H1 reached CHF 39 million, 50% higher than the level reported for the same period last year. This represents 13.0% of sales, compared to the 8.7% reported for 2002/03. This improvement, due mainly to the improvement in gross profit, is in line with our mid-term target of increasing EBITA to 15–20% over the mid-term.

Phonak goes East: Japan and China

We have also made much progress on implementing several strategic projects. In April, we announced our plans to open a wholly-owned group company in Japan and a low-cost manufacturing facility in Asia. Several weeks ago, the company announced the grand opening of Phonak Japan and Unitron Hearing (Suzhou) in China.

Unitron Hearing (Suzhou) is a wholly-owned subsidiary of Phonak Holding AG and will manufacture products for both the Phonak and the Unitron Hearing brands, leveraging common hardware platforms and manufacturing processes. In addition to being a key manufacturing centre, Unitron Hearing (Suzhou)

is also designed to become an Asian hub for the Phonak Group, providing a platform on which to build a market presence in China and the rest of South-East Asia.

The company shipped its first finished products on September 30, 2003, in line with its planned target of October 1. The first products manufactured in China are Phonak's entry-level digital In-the-Ear (ITE) product line, MAXX. By the end of the calendar year, Phonak's Aero, and Unitron Hearing's Conversa and ITE products will begin production in China as well. In the next fiscal year, as the company finalizes its business infrastructure, it will take on more product mandates for both Phonak and Unitron Hearing brands.

On October 24 and 25, 2003, Phonak held its grand opening ceremonies for Phonak Japan, a complete distribution company in Tokyo – including sales, marketing, service and ITE product customization – to increase its focus and sales in the Japanese market. Today, the Japanese market represents approximately 430,000 units and CHF 300 million in value, making this the 3rd largest private market in the world. 19% of Japan's population of 127 million are over the age of 65 years, confirming that demographics alone make this a key market for the hearing instrument industry. In addition, the market is driven by technology and product innovation, with digital products accounting for over 40% of the unit sales. Hence, Phonak's "Swiss made" and technology leader positioning, combined with the recent launch of many new digital products in all segments, will appeal to the Japanese market.

Key projects well on track

Last year, we described a number of key development projects that were aimed at reducing cost, decreasing product development cycle time and creating efficiencies among the business units within the Group. These key projects are named Palio (new product hardware platform), NemoTech (automated shell manufacturing for ITE products) and Chinook (new fitting software architecture). We are pleased to report that we have made good progress on these projects. First, we expect to launch the first premium products on the Palio platform next fiscal year. Second, we have now established the second NemoTech production facility in Stäfa and we will increase the number of ITE products made with this innovative technology, receiving positive customer feedback. Finally, we plan to launch the first updated fitting software, on the Chinook software architecture, at next year's two major tradeshows.

New management members

During the past six months, a number of key people have joined the management team of the Phonak Group to support the expanding business and new opportunities. On December 1, 2003, **Toni Schrofner** will join as Executive Vice President Operations & Supply Chain and a member of the Group Executive Management of the Phonak Group. Prior to joining Phonak, Toni Schrofner was President of Tecan Instruments and a member of Tecan's Executive Leadership Committee.

Key people who joined Phonak Group during the past months are **Hans Leysieffer**, Vice President of R&D, **Gary Roesel**, Director of Global ITE Competence Center, **Christian Stromsted**, Vice President of Marketing (Phonak brand) as well as **Michaela Stoeckli**, Vice President of Sales (Phonak brand). Phonak Group also announced the appointment of **Urs Eller** as Managing Director of Unitron Hearing (Suzhou) as well as **Teruo Ishii** as President of Phonak Japan. Finally, **Christian Dotzauer** has joined Hansaton as Co-Managing Director of Phonak's retail organization in Austria.

Outlook for the remainder of 2003/04

Based on the current perspective, we reiterate our full year target of around CHF 600 million in consolidated sales. This target is based on our forecast of new product sales, offset by the reduced analog product sales and by the weaker United States dollar.

We expect that the gross profit and EBITA percentages will also be consistent with what we have seen in the first half of the year.

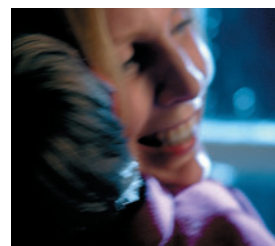
Duracell unveils new advertising spot featuring Phonak hearing systems

Duracell expanded its highly successful "Trusted Everywhere" campaign with a new television commercial, "Listen", which highlights the importance of pediatric hearing healthcare. Building on the brand platform of trust, Duracell partnered with Phonak Hearing Systems to create this particularly emotional spot that illustrates the world of opportunity a hearing aid opens for hearing-impaired children.

The commercial can be viewed online by visiting Phonak's professional Web site at www.PhonakPro.com



The "Listen" piece opens with a young boy playing with a battery-powered robot. As the camera zooms in, the child stops playing and is surprised, when with the help of his Phonak Hearing Aid, he hears the rain for the first time. This moving spot closes when the mother cheerfully comforts the boy as she says, "You heard the rain!"



Consolidated Income Statement

April to September (1,000 CHF)

	Notes	2003	2002
Sales	3	300,919	266,558
Sales related costs		(13,784)	(18,078)
Cost of sales		(122,377)	(110,891)
Gross profit		164,758	137,589
Research and development		(31,076)	(23,620)
Marketing and sales		(60,834)	(56,923)
Administration and general overheads		(34,790)	(31,082)
Exchange differences		884	406
Other income / (expenses), net		206	(260)
Operating profit (EBITA)		39,148	26,110
Amortization of goodwill		(4,227)	(6,428)
One-time charge for goodwill impairment		0	(75,000)
Operating profit / (loss) (EBIT)		34,921	(55,318)
Financial expense, net		(469)	(2,924)
Income / (loss) before deduction of taxes and minority interests		34,452	(58,242)
Income taxes		(8,344)	(2,415)
Minority interest		(320)	(168)
Income / (loss) after taxes		25,788	(60,825)
Basic earnings / (loss) per share (CHF/share)			
— before one-time charge		0.3960	0.2178
— after one-time charge		0.3960	(0.9344)
Diluted earnings / (loss) per share (CHF/share)			
— before one-time charge		0.3948	0.2175
— after one-time charge		0.3948	(0.9344)

Consolidated Balance Sheet

Assets			
(1,000 CHF)	30.09.2003	31.03.2003	30.09.2002
Cash and cash equivalents	96,508	75,028	73,404
Marketable securities	10,022	9,344	12,000
Trade receivables	114,367	102,574	98,053
Other receivables and prepayments	15,248	16,095	14,921
Inventories	72,429	83,345	103,828
Total current assets	308,574	286,386	302,206
Land and buildings	66,920	67,069	67,385
Plant and equipment	58,057	58,642	60,302
Total tangible assets	124,977	125,711	127,687
Other investments and long-term loans	10,056	6,102	6,991
Deferred tax assets	45,080	47,695	51,735
Intangible assets	136,917	137,298	144,056
Retirement benefit assets	4,817	3,669	3,776
Total non-current assets	321,847	320,475	334,245
Total assets	630,421	606,861	636,451

Liabilities and shareholders' equity			
(1,000 CHF)	30.09.2003	31.03.2003	30.09.2002
Short-term debts	26,731	29,277	32,385
Trade payables	24,248	32,009	29,661
Taxes payable	14,817	11,613	29,019
Other liabilities and provisions	96,908	71,758	77,485
Total current liabilities	162,704	144,657	168,550
Mortgages	35,497	37,091	38,464
Other long-term debts	94,006	105,266	118,953
Deferred tax liabilities	19,401	20,357	21,962
Other liabilities and provisions	9,873	9,031	8,161
Total long-term liabilities	158,777	171,745	187,540
Total liabilities	321,481	316,402	356,090
Minority interests	1,086	908	1,214
Share capital	3,270	3,269	3,268
Capital reserves	134,351	133,643	133,644
Treasury shares	(3,961)	(7,258)	(7,976)
Retained earnings	195,097	177,120	163,171
Cumulative translation adjustment	(20,903)	(17,223)	(12,960)
Total shareholders' equity	307,854	289,551	279,147
Total liabilities and shareholders' equity	630,421	606,861	636,451

Condensed Consolidated Statement of Cash Flows

April to September (1,000 CHF)	Notes	2003	2002
Income / (loss) after taxes		25,788	(60,825)
Depreciation of tangible assets		10,169	9,677
Amortization of intangible assets		4,623	6,972
One-time non cash charge for goodwill impairment		0	75,000
Other non cash items		1,970	(2,187)
Changes in net current assets and liabilities		22,572	(5,340)
Net cash from operating activities		65,122	23,297
Purchase of tangible assets		(8,522)	(9,965)
Proceeds from sale of tangible assets		184	439
Loans provided		(3,876)	0
Acquisition of subsidiaries (net of cash acquired)	2	0	(1,654)
Net cash used in investing activities		(12,214)	(11,180)
Change in marketable securities		0	(1,436)
Decrease in debts, net		(16,054)	(15,336)
Dividend paid by Phonak Holding Ltd.		(7,811)	(7,812)
Other financial items, net		2,722	(855)
(Decrease) / increase from hedge of net foreign entity investment		(5,767)	12,155
Net cash from financing activities		(26,910)	(13,284)
Currency translation differences		(4,518)	1,525
Increase in cash and cash equivalents		21,480	358
Cash and cash equivalents at April 1		75,028	73,046
Cash and cash equivalents at September 30		96,508	73,404

Summary of Changes in Shareholders' Equity

(1,000 CHF)	Share capital	Capital reserves	Retained earnings	Cumulative translation adjustment	Treasury shares	Total shareholders' equity
Balance April 1, 2002	3,260	130,544	231,808	(871)	(3,920)	360,821
Capital increase of Phonak Holding Ltd.						
from conditional capital	8	3,100				3,108
Dividend paid by Phonak Holding Ltd.			(7,812)			(7,812)
Purchase of treasury shares, net					(4,056)	(4,056)
Consolidated net loss			(60,825)			(60,825)
Currency translation differences				(12,089)		(12,089)
Balance September 30, 2002	3,268	133,644	163,171	(12,960)	(7,976)	279,147
Balance April 1, 2003	3,269	133,643	177,120	(17,223)	(7,258)	289,551
Capital increase of Phonak Holding Ltd.						
from conditional capital	1	554				555
Dividend paid by Phonak Holding Ltd.			(7,811)			(7,811)
Sale of treasury shares		154			3,297	3,451
Consolidated net income			25,788			25,788
Currency translation differences				(3,680)		(3,680)
Balance September 30, 2003	3,270	134,351	195,097	(20,903)	(3,961)	307,854

Notes to the Condensed Consolidated Financial Statements per September 30, 2003

1. Basis of preparation of the condensed consolidated financial statements

These unaudited financial statements are the interim condensed consolidated financial statements of Phonak Holding Ltd. and its subsidiaries for the six-month period ended September 30, 2003. These financial statements are prepared in accordance with the International Accounting Standards on Interim Financial Reporting, IAS 34 and should be read in conjunction with the consolidated financial statements for the year ended March 31, 2003. The accounting policies used are consistent with those used in the annual financial statements. The presentation of the interim financial statements is consistent with the annual financial statements.

The preparation of these interim consolidated financial statements requires management to make assumptions and estimates that affect the reported amounts of revenues, expenses, assets and liabilities at the date of these interim financial statements. If in the future such assumptions and estimates deviate from the actual circumstances, the original assumptions and estimates will be modified as appropriate in the year in which the circumstances change. Income tax expense is recognized based upon the best estimate of the average annual income tax rate expected for the full year. Certain prior year amounts were restated to reflect the accounting treatment of currency translation differences in connection with net investments in foreign subsidiaries and hedges thereon as applied in the annual financial statements. Therefore, CHF 5.6 million has been reclassified from exchange differences on the income statement to cumulative translation adjustment on the balance sheet. Also in the prior year, a one-time, non-cash impairment charge of CHF 75 million was recorded to restate the goodwill asset related to the Unitron acquisition based on a revised projection of the future cash flows, using a discount rate of 8%.

The Phonak Group (the "Group") is involved in the development, manufacture and distribution of hearing systems and related products for the hearing impaired. The Group operates worldwide and distributes its products through its own distribution network in the major industrial countries and through independent representatives in over 60 other countries. The Group operates in industries where material seasonal or cyclical variations in total sales are not experienced during the financial year. The ultimate parent company is Phonak Holding Ltd., a limited liability company incorporated in Switzerland. Phonak Holding Ltd. registered office is located at Laubisrütistrasse 28, CH-8712 Stäfa, Switzerland.

2. Changes in group structure

The Phonak Group founded two new subsidiaries in June 2003, Phonak Japan Co. Ltd. in Japan and Unitron Hearing (Suzhou) Co. Ltd. in the People's Republic of China. Phonak Holding holds a 100% interest in both subsidiaries and the results were included in the consolidated figures at September 30, 2003.

The Phonak Group also entered into a joint venture with Cochlear Ltd., called Cochlear Acoustics Ltd., a newly founded enterprise for the development of products in the field of implantable acoustical hearing systems. Phonak holds a 25% interest in the new enterprise and Cochlear holds 75%. The investment has been incorporated in the consolidated results following the equity method.

3. Segment information

The Group is active in only one segment: the development, production, distribution and service of hearing instruments and related products. The primary segment information is presented according to geographical regions, which also correspond to the organisational structure. Transactions between segments are generally conducted at market rates.

	Europe	North America	Australasia	Eliminations/others	Total
Six months ended September 30, 2002 (1,000 CHF)					
Sales					
Third parties	110,483	146,344	10,879	(1,148)	266,558
Sales within the same segment	16,633	9,444	321	(26,398)	0
Intersegment sales	94,378	8,735	5,729	(108,842)	0
Total sales	221,494	164,523	16,929	(136,388)	266,558
Operating profit / (loss) (EBIT)	49,189	2,680	1,934	(109,121)	(55,318)
Financial expense, net					(2,924)
(Loss) before taxes and minority interest					(58,242)
Taxes					(2,415)
Minority interest					(168)
Net (loss)					(60,825)
Total assets	1,053,698	491,923	14,438	(923,608)	636,451
Total liabilities	632,085	269,367	5,930	(551,292)	356,090

Other information:

Investments in tangible and intangible assets	8,169	1,587	209	0	9,965
Depreciation on tangible assets	7,097	2,394	186	0	9,677
Depreciation on intangible assets					
and write-offs of other investments	618	4,459	0	1,895	6,972
One-time impairment of goodwill charge	0	0	0	75,000	75,000

	Europe	North America	Australasia	Eliminations/others	Total
Six months ended September 30, 2003 (1,000 CHF)					
Sales					
Third parties	137,110	152,597	13,181	(1,969)	300,919
Sales within the same segment	18,289	7,640	19	(25,948)	0
Intersegment sales	120,358	1,723	2,665	(124,746)	0
Total sales	275,757	161,960	15,864	(152,663)	300,919
Operating profit / (loss) (EBIT)	56,431	13,227	(494)	(34,243)	34,921
Financial expense, net					(469)
Income before taxes and minority interest					34,452
Taxes					(8,344)
Minority interest					(320)
Net income					25,788
Total assets	1,043,426	408,274	20,180	(841,459)	630,421
Total liabilities	657,567	235,682	11,327	(583,095)	321,481

Other information:

Investments in tangible and intangible assets	6,104	1,392	1,075	(49)	8,522
Depreciation on tangible assets	7,388	2,614	167	0	10,169
Depreciation on intangible assets					
and write-offs of other investments	543	2,185	0	1,895	4,623

4. Earnings (loss) per share

The basic earnings (loss) per share are calculated by dividing the consolidated net income (loss) by the weighted average number of shares outstanding (net of treasury shares) during the period. For the current business year, the weighted average number of shares outstanding amounted to 65,127,230 shares (previous year 65,095,521 shares). The diluted earnings per share consider the dilutive effect which could arise upon the possible exercise of all outstanding options. The weighted average number of shares used to determine the diluted earnings (loss) per share was 65,323,118 shares.

5. Contingencies

There were no material changes in contingent liabilities.

6. Share capital, capital reserves and treasury shares

A dividend in respect of business year 2002/03 of 0.12 per share (amounting to a total of CHF 7,811,000) was paid in July 2003 to all shares outstanding, excluding treasury shares.

	Outstanding shares	Share capital	Capital reserves	Treasury shares
Six months ended September 30, 2002 (1,000 CHF)				
Opening balance April 1, 2002	65,066,500	3,260	130,544	(3,920)
Purchase of treasury shares, net	(232,806)	0	0	(4,056)
Issue of new shares from conditional capital	168,000	8	3,100	0
Closing balance September 30, 2002	65,001,694	3,268	133,644	(7,976)

	Outstanding shares	Share capital	Capital reserves	Treasury shares
Six months ended September 30, 2003 (1,000 CHF)				
Opening balance April 1, 2003	65,041,590	3,269	133,643	(7,258)
Sale of treasury shares, net	188,868	0	154	3,297
Issue of new shares from conditional capital	30,000	1	554	0
Closing balance September 30, 2003	65,260,458	3,270	134,351	(3,961)

Investor Relations Calendar

June 8, 2004

Media Conference; Presentation to Financial Analysts;
Mailing of Annual Report

July 8, 2004

General Meeting of Phonak Holding Ltd.

November 2004

Semi-Annual Report per September 30, 2004

Phonak Holding Ltd.

Laubisrütistrasse 28

CH-8712 Stäfa (Switzerland)

Phone: ++41 1 928 01 01

Fax: ++41 1 928 03 90

Internet: www.phonak.com

E-Mail: ir@phonak.ch

This report is also available in German.
The English version is the governing text.