

Annual Report 2004/05

The Art  
and Science  
of Better  
Hearing



**PHONAK**  
hearing systems

**The ear**, one of our key perception organs, enables us to hear a wealth of sounds – be they speech, music or the sounds of nature. Therefore, it is no surprise that humans have decorated the outer part of their sophisticated hearing system throughout all cultural ages.

Earrings have been used from approx. 3000 BC onwards in Mesopotamia and Babylonia. The artistically manufactured decorative forms encompassed moon shapes, pomegranate, drops and animal heads – decorations which later inspired the Etruscans, Greeks and Romans to develop their own unique creations. Ear decoration reflected the current social order and was also a sign of social affiliation – even today, we make a statement about our personality and character based on the choices we make in our appearance.

Phonak hearing system wearers also make a statement: they wear technical works of art of inestimable value with unique performance features.

Hearing capability, and therefore the possibility to be active in social environments, is impaired in countless individuals. We address this handicap, a barrier to a full life and ultimate wellbeing, with "The Art and Science of Better Hearing". This central theme inspired us again in 2004 to invest all our energy and creativity in the improvement of the quality of life of hearing impaired persons.

## Five-year Key Figures (Consolidated)

in CHF 1,000 unless otherwise specified	2004/05	2003/04	2002/03	2001/02	2000/01
<b>Sales</b>	<b>678,775</b>	<b>637,602</b>	<b>550,543</b>	<b>576,078</b>	<b>460,152</b>
change compared to previous year (%)	6.5	15.8	(4.4)	25.2	46.4
<b>Gross profit</b>	<b>411,574</b>	<b>367,665</b>	<b>279,106</b>	<b>295,827</b>	<b>256,151</b>
change compared to previous year (%)	11.9	31.7	(5.7)	15.5	(18.5)
in % of sales	60.6	57.7	50.7	51.4	55.7
<b>Sales &amp; marketing costs</b>	<b>154,220</b>	<b>126,139</b>	<b>116,243</b>	<b>124,408</b>	<b>80,681</b>
in % of sales	22.7	19.8	21.1	21.6	17.5
<b>Research &amp; development costs</b>	<b>48,711</b>	<b>58,203</b>	<b>48,879</b>	<b>31,453</b>	<b>31,381</b>
in % of sales	7.2	9.1	8.9	5.5	6.8
<b>Operating profit before amortization of goodwill (EBITA)</b>	<b>127,675</b>	<b>103,515</b>	<b>48,139</b>	<b>73,013</b>	<b>99,792</b>
change compared to previous year (%)	23.3	115.0	(34.1)	(26.8)	97.2
in % of sales	18.8	16.2	8.7	12.7	21.7
<b>Operating profit / (loss) (EBIT)</b>	<b>127,675</b>	<b>94,961</b>	<b>(37,359)</b>	<b>59,770</b>	<b>95,310</b>
change compared to previous year (%)	34.4	354.2	(162.5)	(37.3)	95.3
in % of sales	18.8	14.9	(6.8)	10.4	20.7
<b>Income / (loss) after taxes</b>	<b>96,902</b>	<b>68,875</b>	<b>(46,877)</b>	<b>42,626</b>	<b>65,717</b>
change compared to previous year (%)	40.7	246.9	(210.0)	(35.1)	93.1
in % of sales	14.3	10.8	(8.5)	7.4	14.3
<b>Number of employees (average)</b>	<b>2,719</b>	<b>2,523</b>	<b>2,397</b>	<b>2,378</b>	<b>1,583</b>
change compared to previous year (%)	7.8	5.3	0.8	50.2	27.8
<b>Net cash / (net debt) <sup>1)</sup></b>	<b>93,785</b>	<b>9,501</b>	<b>(87,262)</b>	<b>(121,790)</b>	<b>(139,346)</b>
<b>Net working capital <sup>2)</sup></b>	<b>79,496</b>	<b>58,358</b>	<b>86,634</b>	<b>78,704</b>	<b>64,568</b>
in % of sales	11.7	9.2	15.7	13.7	14.0
<b>Capital expenditure (tangible and intangible assets)</b>	<b>23,083</b>	<b>21,351</b>	<b>21,515</b>	<b>29,794</b>	<b>21,842</b>
<b>Capital employed <sup>3)</sup></b>	<b>355,919</b>	<b>340,837</b>	<b>377,721</b>	<b>483,649</b>	<b>462,794</b>
in % of sales	52.4	53.5	68.6	84.0	100.6
<b>Total assets</b>	<b>743,360</b>	<b>683,684</b>	<b>606,861</b>	<b>742,246</b>	<b>703,793</b>
<b>Shareholders' equity</b>	<b>447,791</b>	<b>349,090</b>	<b>289,551</b>	<b>360,821</b>	<b>322,905</b>
<b>Equity financing ratio (%) <sup>4)</sup></b>	<b>60.2</b>	<b>51.1</b>	<b>47.7</b>	<b>48.6</b>	<b>45.9</b>
<b>Free cash flow <sup>5)</sup></b>	<b>83,781</b>	<b>118,349</b>	<b>28,662</b>	<b>18,410</b>	<b>(63,221)</b>
in % of sales	12.3	18.1	5.2	3.2	(13.7)
<b>Return on capital employed (%) <sup>6)</sup></b>	<b>36.6</b>	<b>26.4</b>	<b>(8.7)</b>	<b>12.6</b>	<b>28.3</b>
<b>Return on equity (%) <sup>7)</sup></b>	<b>24.3</b>	<b>21.6</b>	<b>(14.4)</b>	<b>12.5</b>	<b>26.0</b>
<b>Information per share <sup>8)</sup></b>					
Basic earnings per share (CHF)	1.478	1.056	(0.721)	0.658	1.039
Dividends per share (CHF)	0.30 <sup>9)</sup>	0.20	0.12	0.12	0.00 <sup>10)</sup>

1) Cash and cash equivalents + financial assets held for trading – short-term debts – financial liabilities held for trading – mortgages – long-term debts

2) Receivables + inventories – payables – other short-term liabilities – short-term provisions

3) Total assets – cash and cash equivalents – financial assets held for trading – payables – other liabilities – provisions – deferred taxes liabilities

4) Shareholders' equity in % of total assets

5) Cash flow from operating activities plus cash flow from investing activities

6) EBIT in % of capital employed (average)

7) Income after taxes in % of shareholders' equity (average)

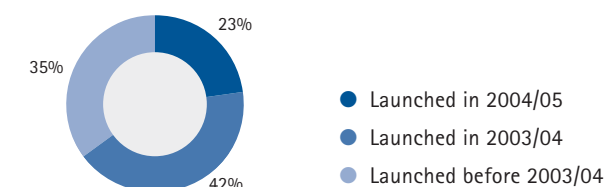
8) Prior year numbers adjusted for the 1:100 share split

9) Proposal to the Annual General Shareholders' Meeting on July 7, 2005

10) Par value reduction of CHF 0.15 paid in lieu of dividend

### Share of sales 2004/05 – new products (Phonak and Unitron hearing systems)

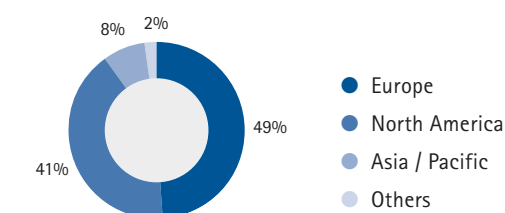
Products launched in the last 24 months comprise 65% of total sales.



### Share of sales by main markets 2004/05

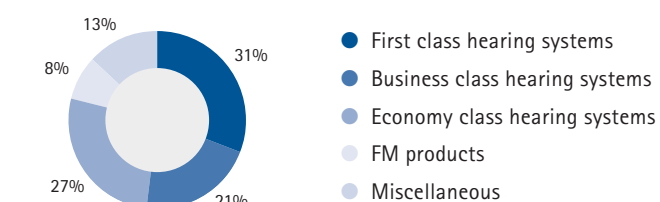
Europe and North America generate 90% of total sales.

Sales outside these regions are expected to continue growing.



### Share of sales by product groups 2004/05

The first class hearing system segments remained stable, due to consistent Perseo and first Savia sales.



Key Data





# Table of Contents

2

## Foreword

Chairman's Foreword  
CEO's Comments

6

## Financial Review

The financial results of 2004/05 fiscal year are very encouraging. Starting from a record level in the previous year, sales increased by another 9.5% in local currencies.

9

## Markets

The Phonak Group continued to increase its global market share as sales developed favorably in all key markets, with above average growth in the United States, Germany, France, Spain and Italy.

12

## New Technologies and Products

Focusing on product innovation – combining advanced technology with innovative functional design in addition to our wireless communication products.

14

## Operations and Staff

The priorities in 2004/05 included expanding the Chinese-based production, optimizing product cost and satisfying product demand for the launch and ramp-up of many new products.

15

## Outlook

Continuing to invest the Group's human and financial resources in product innovation and the distribution network will encourage sales to continue growing.

18

## Corporate Governance

The Board has committed itself to maintaining the highest standards of integrity and transparency in its governance of the Company.

36

## Sustainability

Inherent in the Group's business activities is a fundamental commitment to improve individual hearing ability and speech understanding.

45

## Consolidated Financial Statements

89

## Financial Statements of Phonak Holding Ltd.

100

## Company Information



## Chairman's Foreword

2004/05 was an important milestone year for the future of the Phonak Group: We were able to turn our large "intellectual capital" into a major piece of "real value", by completing the world's most advanced DSP platform named "PALIO" and launching the first product, Savia, based thereon. This product launch towards the end of the business year, after four years of development, represents a major breakthrough. For me it was further proof that Phonak is the world leader in technology! And it shows how our people value culture creates intellectual capital which, in turn, results in continued progress and substantial benefits for hearing impaired people. In this way, we lay the basis for a continued promising future of the Phonak Group.

The launch of Savia was clearly the highlight of the year. This product sets new standards in both hearing performance for the end user as well as fitting freedom and possibilities for the hearing instrument specialist. Since Savia was only launched in February 2005 it has not had a significant effect on sales in 2004/05, but it will, together with other PALIO-based products, be the key driver for sales and, especially, profit growth in the current year and the years to come.

Besides the exciting new technological features of Savia, I was also very impressed by its perfectly planned and executed market introduction. Thanks to the well established manufacturing and logistics processes, it was possible to bring the complete product range in large quantities to the market, thereby making Savia the quickest and most successful product launch in the history of the Phonak Group.

PALIO and Savia were not the only exciting achievements of the year – the Group also further enhanced its leadership in wireless FM technology.

The financial results for 2004/05 were again very satisfactory, with both sales and profits reaching new highs. Sales grew by 9.5% in local currencies, and both operating profit and net profit increased over-proportionally.

The Board – besides holding its regular meetings – spent considerable time on strategic discussions this past year. One key question was how the incredible potential of hearing instruments can be developed more rapidly than in the past years. A main conclusion was that, in addition to the key research and technology areas, the sales and marketing functions will play an increasingly important role in the future. Another priority of the Board in 2004/05 was the redesign of corporate governance, with a view to increase transparency and to define clear organisational responsibilities.

I continue to strongly believe that the hearing instrument market has incredible potential. Key factors for making better use of it are innovations that improve hearing instrument performance and end user awareness and satisfaction. I am convinced that Phonak will remain in the forefront and continue to set new trends in the hearing instrument market. Therefore, I look to the future of the Phonak Group with great confidence!

Finally, I would like to thank all who contributed to the success of the Phonak Group during the past year and, in particular, our devoted employees all over the world.

Andy Rihs  
Chairman of the Board

## CEO's Comments



In 2004/05, we have made major progress in the implementation of our strategy to transform the Phonak Group into the most successful company in the hearing industry. In addition, we have again delivered improved financial results that are in line with the mid-term objectives we set out in 2002.

Phonak has come a long way over the last three years. Aside from the development of our core business, we have invested a lot of dedication and attention to further develop the company in terms of its people, organization and processes, thereby creating the foundation for future sustainable growth.

Starting from a record level of sales last year, we again increased sales by another 9.5%, in local currencies. As a result of improved product mix and operational efficiencies, gross profit reached 60.6% of sales, an improvement of 290 basis points on last year and an improvement of almost 1,000 basis points since two years ago! At the same time, the operating profit before amortization of goodwill (EBITA) increased by 23.3%. The EBITA margin, as a percentage of sales, was increased to 18.8% compared to 16.2% in the previous fiscal year.

We have also achieved several strategic milestones during the 2004/05 year. First, after four years in development, we completed the new, leading-edge technology platform, code-named PALIO. This new technology, combined with the new iPFG fitting software, will help the Phonak Group launch a continuous stream of new products. In February 2005, we launched the first product line on this new PALIO platform: the high-end Savia product. Another important milestone, and contributor to the strong financial performance, was the ramp-up of the Chinese manufacturing operation, which was started in August 2003.

In the future, we expect further sales growth, increased market share, improved financial strength and attractive returns on investments. To accomplish these objectives, we will focus on product innovation and the continuous increase of functionality and customer benefits, the further strengthening of the market position of our existing sales organizations and the development of new and expanded distribution channels.

The great success achieved with the launch of Savia is the result of the dedication, commitment and great team spirit of our employees. The project to build a new platform began four years ago and has required the cooperation of cross-functional teams among various companies within the Group to bring the project to this successful conclusion. For this and many other projects, I thank each one of our employees for their devoted contribution to the success of the Phonak Group.

Last but not least, I also want to express my thanks to all our suppliers, partners, customers and shareholders for their collaboration in building the Phonak Group.

A handwritten signature in blue ink, appearing to read 'Dr. Valentin Chapero Rueda'. The signature is fluid and cursive.

Dr. Valentin Chapero Rueda, CEO

# The Art

Jewelry appeals to the senses by its combination

# and

of precious materials and elegant design.

# Science

Phonak enhances the sense of hearing through

# of Better

outstanding technology and design.

# Hearing









# Financial Results – Successful sales expansion and significant profitability increase

## Overview

The financial results of the 2004/05 fiscal year are very encouraging. Starting from a record level in the previous year, sales increased by another 9.5% in local currencies to reach CHF 678.8 million. At the same time, the operating profit before amortization of goodwill (EBITA) was increased by 23.3% to CHF 127.7 million. The operating profit margin of 18.8% surpassed the comparable previous year's figure of 16.2%. Earnings per share on a diluted basis reached CHF 1.46, which represents an improvement of 39.2%.

## Consolidated Income Statement

### Sales

Measured in local currencies, sales have grown by 9.5%. The strengthening of the CHF, especially against the USD, led to a negative currency effect of 3%. In reported currency (CHF), therefore, the growth rate is 6.5%.

Sales growth was driven by a broad base of product lines: the established full range of hearing instruments by Phonak and Unitron Hearing, Phonak's unique wireless FM systems and the recently launched Savia product line. Unitron Hearing again performed very well, particularly due to its successful Unison product line covering the digital economy segment.

Premium hearing instruments accounted for 31% of total sales (previous year 31%). Perseo sales were developing consistently throughout the year. The new premium hearing instrument, Savia, had a very successful launch, but only contributed to sales in February and March 2005. In 2005/06, Savia will be the major contributor of sales in the premium segment.

The mid-level share of total sales was 21% (previous year 24%). The decreasing share reflects the overall development of this market segment; however, the key mid-level product lines of the Phonak brand, Aero and Supero and the successfully launched Valeo, as well as Unitron's Conversa, performed according to expectations.

The economy segment accounted for 27% of total sales (previous year 25%). The strong increase of this segment reflects the strategic initiatives undertaken to strengthen the position in this market segment. The main contributor to this success was MAXX, Phonak's first digital offering in this class. In 2004/05, this product line was extended with the introduction of PowerMAXX, the world's most powerful miniature digital hearing instrument. For Unitron Hearing, Unison 3-6-Essential, the new entry-level digital line, was introduced to expand the success of Unison. FM systems are important additions to Phonak's and Unitron Hearing's hearing instrument product lines. These products accounted for 8% of total sales (previous year 7%).

### Gross Profit

The measures taken to further increase margins were very successful. Gross profit increased to CHF 411.6 million or 60.6% of sales, compared to CHF 367.7 million or 57.7% of sales in the prior year. By reaching this level in 2004/05, the previously communicated mid-term target of 60% expected for the current financial year, 2005/06, has already been surpassed.

Gross profit improved due to economies of scale as well as a result of a number of new initiatives taken in different areas of the Group. For example, in the course of 2004/05, Kitchener manufacturing activities have been scaled down and production in China has increased. Since the beginning of the fourth quarter of the financial year 2004/05, almost half of the group-wide added value in manufacturing



Without people, nothing works. At Phonak, almost 3,000 dedicated employees worldwide are working to improve the quality of life of those with a hearing impairment.

is performed in our Chinese production facility. In addition, further material purchase price reductions were realized through intensified global sourcing.

### Operating Profit

Operating profit before amortization of goodwill (EBITA) increased by 23.3% to CHF 127.7 million or 18.8% of sales, compared to CHF 103.5 million or 16.2% of sales in the previous year.

Effective April 1, 2004, in accordance with the new provisions of the International Financial Reporting Standards (IFRS 3), the Group ceased to record amortization of goodwill. Goodwill is now tested for impairment on an annual basis. In the financial year 2004/05, there was no need to recognize any goodwill impairment.

As a result, operating profit after amortization of goodwill (EBIT) also reached CHF 127.7 million or 18.8% of sales in 2004/05. In the previous year, EBIT was CHF 95.0 million or 14.9% of sales, but this was net of goodwill amortization of CHF 8.6 million.

As planned, research and development spending was lower than in 2003/04. Major development projects, especially PALIO, the new product hardware platform, reached peak spending levels in the financial year 2003/04. In the reporting year, development activities were primarily focused on the development of new products, of which Savia, the first PALIO platform product, was the most significant. The total spending for research and development was 7.2% of sales (previous year 9.1%). For 2005/06, spending for research and development will range between 7.0% and 7.5% of sales.

Following the strategy to strengthen and expand sales forces, spending for sales and marketing increased by 22.3% to CHF 154.2 million or 22.7% of sales. The additional spending is related to current sales organizations as well as the build-up of new markets and the strengthening of the Unित्रon brand. By continuing these investments in 2005/06, spending for sales and marketing will grow at a slightly lower rate than sales.

General and administration expenses increased to CHF 82.8 million or 12.2% of sales (previous year CHF 78.2 million or 12.3% of sales) due to the strengthening of the Group's management team and reinforced IT infrastructure and systems, mainly related to the worldwide roll-out of the transaction system SAP R/3.

### Income after taxes

Income tax expenses as a percentage of income before taxes and minority interest decreased to 23.0% (prior year 26.0%) as a result of higher non-taxable income and lower non-tax deductible expenses.

Consolidated income after taxes reached CHF 96.9 million compared to CHF 68.9 million in the previous year, which represents an increase of 40.7%. On a diluted basis, earnings per share increased 39.2%, over the previous year, to CHF 1.46.

# Financial Results

## Consolidated Balance Sheet

### Capital Employed

Capital employed has increased by 4.4% to CHF 355.9 million. The increase is entirely in working capital and is due to the growth of the business activities. The number of "days sales outstanding" remained stable over the previous year. Trade receivables have increased at the end of the business year as a result of accelerating sales in the fourth quarter. Inventory also increased in the last quarter of the financial year, as inventory of recently launched products – especially Savia – was increased to prevent back-orders and enable a successful launch. This effect will level out over the course of 2005/06. Capital expenditures of tangible and intangible assets amounted to CHF 23.1 million and are predominantly related to facilities and technical equipment. Taxes payable have increased corresponding to the increased profit result over the previous year. Trade payables and other short-term liabilities and provisions vary over the previous year due to timing differences, but, taken as a whole, increased in line with the higher business volume.

### Net Cash

Net cash increased by CHF 84.3 million to CHF 93.8 million (previous year CHF 9.5 million). Cash and cash equivalents, as well as financial assets held for trading minus financial liabilities held for trading, amounted to CHF 184.2 million at the end of 2004/05. In the course of the reporting period, financial debt was reduced to CHF 90.4 million, from CHF 143.0 million in the previous year, due to accelerated payments made on the mortgages and the ordinary repayment of the acquisition financing raised in 2000/01.

## Shareholders' Equity

The equity financing ratio (total shareholders' equity in % of total assets) has increased to 60.2% (prior year 51.1%), reflecting a further substantial strengthening of the Group's financial position.

## Cash Flow

Cash flow before changes in working capital increased to CHF 159.3 million (previous year CHF 131.7 million) given the higher income before taxes and minority interest, adding back the non-cash items such as depreciation and amortization.

Free cash flow, additionally taking into account the changes in working capital and the investing activities, decreased to CHF 83.8 million (previous year CHF 118.3 million), mainly as a result of the increase in working capital due to the business expansion. Investing activities largely consisted of capital expenditures in tangible and intangible assets (CHF 23.1 million versus CHF 21.4 million in the previous year) and cash considerations for acquisitions (CHF 3.0 million versus CHF 3.9 million in the previous year).

Free cash flow was applied mainly to repayments of borrowings and mortgages in an amount of CHF 52.5 million, and dividends to shareholders (CHF 13.1 million). Taking all elements of the consolidated cash flow statement into consideration, cash and cash equivalents increased to CHF 173.2 million (previous year CHF 145.1 million).

# Markets



The Phonak Group is rapidly growing through a globally integrated network of wholesale and retail organizations, customers and distributors.

## General market development

The estimated global market growth in 2004/05 was 4 to 6%, of which 1 to 2% stemmed from increases in average selling prices. Sales prices are increasing due to a strong high-end segment, which is driven by innovation, and a strong low-end segment, driven by the replacement of analog products by digital products. While all key markets grew more or less in line with the above mentioned average market growth rate, Germany was an exception. After strong growth in winter 2003/04, which was fueled by the announced changes in the reimbursement system, the market shrank over the first three quarters of the financial year, but then recovered in the last quarter of 2004/05.

## Group sales by product type

Both brands of hearing instruments, Phonak and Unitron Hearing, contributed to the expansion of sales. Behind-the-Ear (BTE) products remained very strong, supported by a series of specialty products like CROSLink and WiFi mic. FM systems again delivered consistently high growth, demonstrating their solid market position. New products sold very well throughout the different markets.

In the second half of 2004/05, the high-end segment became stronger as Perseo sales continued to develop consistently and the launch of the new high-end product, Savia, showed a very promising sales development. The share of sales from low-end products increased due to the launch of several new products.

## Group sales by geography

The Phonak Group continued to increase its global market share as sales developed favorably in all key markets, with above average growth in the United States, Germany, France, Spain and Italy. Extraordinary growth was achieved in Belgium, the United Kingdom, Australia and Scandinavian markets. Although newly established, and therefore based on a comparably small business volume, Japan and China delivered excellent progress in building their market positions.

Unitron Hearing again made important progress in the United States and internationally, where new sales organizations dedicated to the Unitron Hearing brand were established in France, the United Kingdom and Australia.

## New market development

In 2004/05, sales to key accounts increased further as a result of increased focus and cooperation with these industry players. In China, Phonak completed the acquisitions of former Phonak and Unitron Hearing distributors, which included both wholesale and retail activities. The Group began the ramp-up of its sales presence in this market. In Scandinavia, Phonak acquired its former distributor in Finland, and in Russia, Phonak opened a sales office, from which this market will be expanded. In 2005/06, the focus of the Group will remain on developing its wholesale network in Eastern Europe, India and Latin America.

## Outlook

The Phonak Group expects above market growth due to:

- having a complete product range under two brands, which is periodically rejuvenated;
- providing superior, innovative and easy-to-use products;
- strengthening its market share in In-the-Ear (ITE) products;
- further increasing its share of business with key accounts and
- expanding its distribution channels in developed and emerging markets.



# The Art

Innovation unlocks the potential of technology

# and

and secures the future. Phonak's culture

# Science

is built on discovering new possibilities and

# of Better

achieving ambitious goals.

# Hearing

# New Technologies and Products



Intelligence has a new name: Savia hearing systems with Digital Bionics.

## Platforms

One of the key success factors of the Phonak Group is the strength of its product portfolio. By focusing on product innovation – combining advanced technology with innovative functional design – we offer a complete range of hearing instruments and wireless communication products. Phonak continuously sets the standard for technology in our industry.

At the core of these products is a chip-set: a powerful computer, yet small in size, onto which software is loaded to define the functionality of the hearing instrument. Also, enabling the successful fitting of these products is the fitting software: an interactive software tool that allows the fitter to select and program the hearing instrument according to the end user's profile. Several years ago, Phonak began two very important development projects with the objective of creating a hardware platform and software platform. A platform is a common basis from which multiple products can be developed. By using platforms, the Group can benefit from economies of scale, flexibility in design and production, increased product development capacity and reduced time to market for new product launches. In 2004/2005, Phonak completed these two platform projects which include PALIO, the most powerful digital signal processing platform in the industry, and CHINOOK, the new fitting software platform using a state of the art software development architecture. The new first class hearing instrument, Savia, together with the iPFG fitting software, represents the start of an innovative line of future hearing instruments derived from these revolutionary technology platforms.

In the future, this new modular design approach using flexible, reusable hardware and software platforms will empower the Phonak Group to develop new products in all ranges and for all markets more efficiently and will shorten time-to-market.

## Savia – Digital Bionics

Not only is Savia the first product developed on the new hardware and software platforms, it is also the first hearing instrument developed to address some of the most important remaining challenges for hearing impaired people when communicating and listening in daily life. To address these challenges, Savia incorporates "digital bionics", which means that the design of the product incorporates lessons from nature and how the normal hearing system is intended to function. For example, Savia's AutoPilot function provides optimal audibility, comfort and understanding in an infinite number of listening situations, including the use of mobile telephones and FM equipment. Savia's AutoFocus function restores natural localization (i.e. the ability to detect the source of sounds) and provides unsurpassed understanding of speech in the presence of multiple interfering sound sources. Savia's SoundCleaning function addresses the problems of high resolution noise, wind noise, echo and feedback. Finally, Savia's DataLogging and User Preference Tuning track each user's personal hearing preferences and empower the fitter to optimize the settings. In all of these ways, Savia has "natural wisdom captured in technology".



The new iLink and EasyLink system provides user-friendly wireless communication benefits.



miniValeo: all the Valeo advantages in a truly miniature format.



Conversa.NT ensures that the focus remains on the conversation, regardless of the challenges of the listening situation.



The 2.7 x 3.7 mm PALIO chip, with over 6 million transistors and operating at 0.13 μm technology is the core of Savia.

### New products launched in 2004/05

Prior to Savia, the Group successfully introduced, on a worldwide basis, a variety of other new products:

- **PowerMAXX**, an extension to the popular MAXX entry-level product line by Phonak, which is the world's most powerful miniature digital hearing instrument;
- **Unison 3-6-Essential**, the new entry-level digital line of Unitron Hearing, building on the success of the Unison product family;
- **EduLink** is Phonak's new solution for people suffering from a special form of central auditory processing disorder. This innovative product has initially been launched to help children strengthen their learning ability in an educational setting.

### More new products already launched in 2005/06

The Phonak Group recently launched a number of new products that will contribute to sales in the fiscal year 2005/06:

- Phonak launched a new miniaturized Behind-the-Ear (BTE) hearing instrument called **miniValeo**, which offers all the proven functions of the Valeo mid-range digital product line, yet in a new, appealing and miniaturized BTE shell;
- Phonak also launched **iLink**, a hearing system that combines, in one device, a digital multi-frequency FM receiver and a digital multi-channel hearing instrument;
- When iLink is combined with **EasyLink** – an easy to operate remote microphone system – the end user benefits from wireless communication that is very easy to use and accessible;
- Unitron Hearing presented the new **Conversa.NT** product line which brings unparalleled value into the mid-range digital segment and
- **Conversa.NT** is also available in a modern, miniaturized and easy-to-fit version called **Moda**.

Throughout 2005/06, more new products will be launched, including another mid-level and an entry-level digital product line, both based on the new PALIO platform.

### Future product opportunities

Apart from exploiting the benefits of the PALIO modular approach by creating new, attractive products with accelerated innovation cycles, the Group remains dedicated to fundamental research in audiology, wireless communication, ultra low power electronics and new levels of "device-intelligence" driven by state of the art software technology. The results of these more long-term research activities will be visible over the next years in products which will push the envelope of hearing instruments technology into new levels of performance and ease of use. Phonak is well prepared to remain one of the most innovative drivers in our industry.



# Operations and Staff



Highly specialized manufacturing staff ensures high quality products.

## Operations

Within operations – which includes purchasing, logistics, manufacturing, quality and IT – the priorities in 2004/05 included expanding the Chinese-based production, optimizing product cost and satisfying product demand for the launch and ramp-up of many new products, especially the first PALIO platform-based product, Savia.

## Further expansion of Chinese production

During 2004/05, the Chinese manufacturing operation was expanded significantly, allowing the Group to achieve its objective of establishing a low-cost manufacturing facility concentrating on labour-intensive processes. Today, the Chinese production site represents a world-class operating center that serves the product requirements of both hearing instrument brands. Within a very short time frame, many employees were hired, trained and integrated into a highly organized manufacturing and sales environment while the infrastructure was adapted continuously to the ever increasing workload. Currently, almost one-half of the Group's value added in manufacturing is created at the Chinese production site. Throughout the financial year 2004/05, the Group's production facility in Kitchener has been scaled down.

## Focus on product costs

The establishment of the Chinese production facility was one important step to reduce product cost on a sustainable basis. An even more important step was the completion of the new product hardware platform, PALIO. With this platform, product cost is reduced in terms of direct material cost as well as reduced administrative costs for purchasing and master data maintenance.

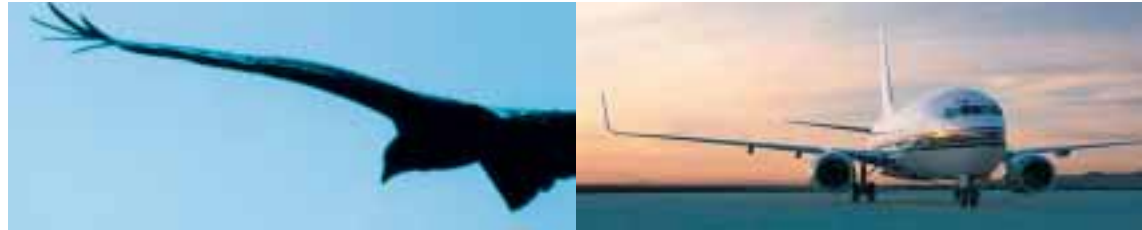
The launch of the first PALIO-based product, Savia, had little impact on product cost in the 2004/05 financial results, since the product was only launched in the last two months of the business year. As new hearing instruments from Phonak and Unitron Hearing are developed on the PALIO platform, the impact of product cost reduction will become greater.

In addition to the above priorities, the Operations team continues to optimize manufacturing processes, to contribute to cost-efficient product design and to streamline logistics processes.

## Staff

The Phonak Group employed 2,926 people as of March 31, 2005 (prior year 2,689). This total was allocated among research and development 188 (prior year 178), operations 1,439 (prior year 1,318), sales and marketing and general and administration 1,299 (prior year 1,193). Major staff increases were made in sales and marketing, to increase market coverage through direct sales representatives and to support the many product launches, and in operations, to keep up with the expansion of the Group's sales volume. The effect from acquired businesses throughout 2004/05 was insignificant.

# Outlook



Digital Bionics captures the unique capabilities of biological systems using state of the art digital technology.

## Sales target

Continuing to invest the Group's human and financial resources in product innovation and the distribution network will encourage sales to continue to develop positively. While the market for hearing instruments is expected to grow in line with the previous years, management targets to outgrow the market significantly, based on the recent and planned product launches.

## Further gross profit improvement

A further increase in the gross profit margin is expected in 2005/06; however, the year-over-year increase is not expected to be as significant as the increase seen in 2004/05 and 2003/04. The gross profit margin improvement will come from the increased share of the Chinese manufacturing in the overall production value added as well as the expected slight shift in product mix towards the high-end, driven by the impact of Savia. However, this effect will lessen towards the end of the year as new products are launched in the mid-range and low-end range. The ongoing initiatives taken to increase productivity in manufacturing and optimize the supply chain will also support the expansion of the gross profit margin.

## Spending on research and development

Spending in research and development is expected to increase slightly in 2005/06. Major projects include new product development, hardware and software platform development, automated shell manufacturing and new technology research.

## Further EBITA improvement

Management expects a further improvement in the EBITA margin as a result of the expected gross margin improvement as well as a reduction in operating expenses as a percentage of sales.

## Capital expenditures

Capital expenditures will increase slightly over the level in 2004/05 and will be used to accommodate the expansion in sales as well as to replace depreciated equipment. Major capital projects will include tooling for new products, production equipment and IT infrastructure and systems, mainly related to the SAP implementation.

## Use of financial resources

On a day-to-day basis, the financial resources of the Group are used to finance capital expenditures and repayment of debt according to existing terms. In addition, Phonak Group will invest a portion of its financial resources in developing new sales channels and in expanding our existing sales channels. We believe these investments will lead to further sales growth, increased market share and an attractive return in profits.



# The Art

Market requirements are constantly changing.

# and

Yet Phonak consistently responds

# Science

by focusing on its tradition

# of Better

of innovation and people value.

# Hearing

# Corporate Governance

The Board has committed itself to maintaining the highest standards of integrity and transparency in its governance of the Company, reflecting recent developments in corporate governance principles including the Swiss Code of Best Practice. Corporate Governance describes the way our leadership and management is organized and how it operates in practice. It ultimately aims to lead us to success, protecting the interests of our shareholders while creating value for all of the stakeholders.

Good corporate governance seeks to balance entrepreneurship, control and transparency, while supporting the company with efficient decision-making processes. Hence, the Board of Directors constantly works on improving the quality of corporate governance. In that continuous process, the Board initiated, in the course of the year 2004/05, several measures to optimize organizational structures and to increase transparency for all stakeholders. Those measures became effective after March 31, 2005. Further initiatives will be submitted to the Annual General Shareholders' Meeting of July 7, 2005 for approval.

## Further increase in transparency

The content of the Corporate Governance section on the Phonak Group website has been significantly extended.

In addition to the Corporate Governance Report, which complies with the Directive on Information relating to Corporate Governance published by the SWX Swiss Exchange, the Group's Articles of Association and the Organizational Regulations have been made accessible, as well.

Furthermore, the Invitation to this year's Annual General Shareholders' Meeting (AGM) and the respective agenda is available on the Group's website. After the AGM, the minutes will be added as well. Please visit: [www.phonak.com/company/investors/governance.htm](http://www.phonak.com/company/investors/governance.htm)

## Simplification of the committee structure within the Board of Directors

The Board of Directors decided to merge the Compensation Committee with the Nomination Committee into one committee, the Nomination and Compensation Committee. Both committees were mutually dependant and, by combining them, the Board's resources are used in a more efficient manner.

The members of the newly created Nomination and Compensation Committee are Andy Rihs (Chairman), Dr. Daniel Borel and Robert F. Spoerry, who were members of the former Compensation Committee.

## Proposal to lower the nominal share capital amount required to add items to the AGM agenda

The Board of Directors proposes to the AGM that the nominal share capital amount, which is required to have an item put on the agenda, be reduced from currently CHF one million to 5% of total share capital.

Currently 20 million shares or approx. 30% of total shares outstanding are required to have an item put on the agenda. The Annual General Shareholders' Meeting of July 5, 2001 approved a capital reduction and repayment of CHF 15 on the par value per share and a subsequent 1:100 share split. This reduced the par value of Phonak registered shares from CHF 20 to CHF 0.05. No amendments of the Articles of Association were made to offset the resultant higher requirements at that time.

This following Corporate Governance section presents the principles of management and control within the Phonak Group and gives background information on the Group's governing bodies and management as of March 31, 2005. The general rules on Corporate Governance are part of the Company's Articles of Association and the Organizational Regulations. These documents serve as the basis for the following information. The disclosure complies with the Directive on Information relating to Corporate Governance published by the SWX Swiss Exchange.

## Group Structure and Shareholders

### Group Structure

Phonak Holding AG is the parent company of the Phonak Group, headquartered in Stäfa, Switzerland, and is listed on the SWX Swiss Exchange. The Group is active in over 70 countries, through a combination of 28 subsidiaries in 20 countries and a network of distributors.

As of March 31, the following key data for the stock of Phonak Holding AG were noted:

	2005	2004	2003
Market capitalization in CHF m	2,720	1,997	788
in % of shareholders' equity	607%	572%	272%
Share price in CHF	41.20	30.50	12.05
P/E ratio (ordinary)	27.9x	28.9x	n/a

Security No. 1,254,978  
ISIN CH0012549785

### Legal Structure of the Phonak Group

Concerning the legal structure of the Phonak Group as of March 31, we refer to Note 38 to the Consolidated Financial Statements within this report on page 86. Other than Phonak Holding AG, there are no other companies belonging to the consolidated Phonak Group whose equity securities are listed on a stock exchange.

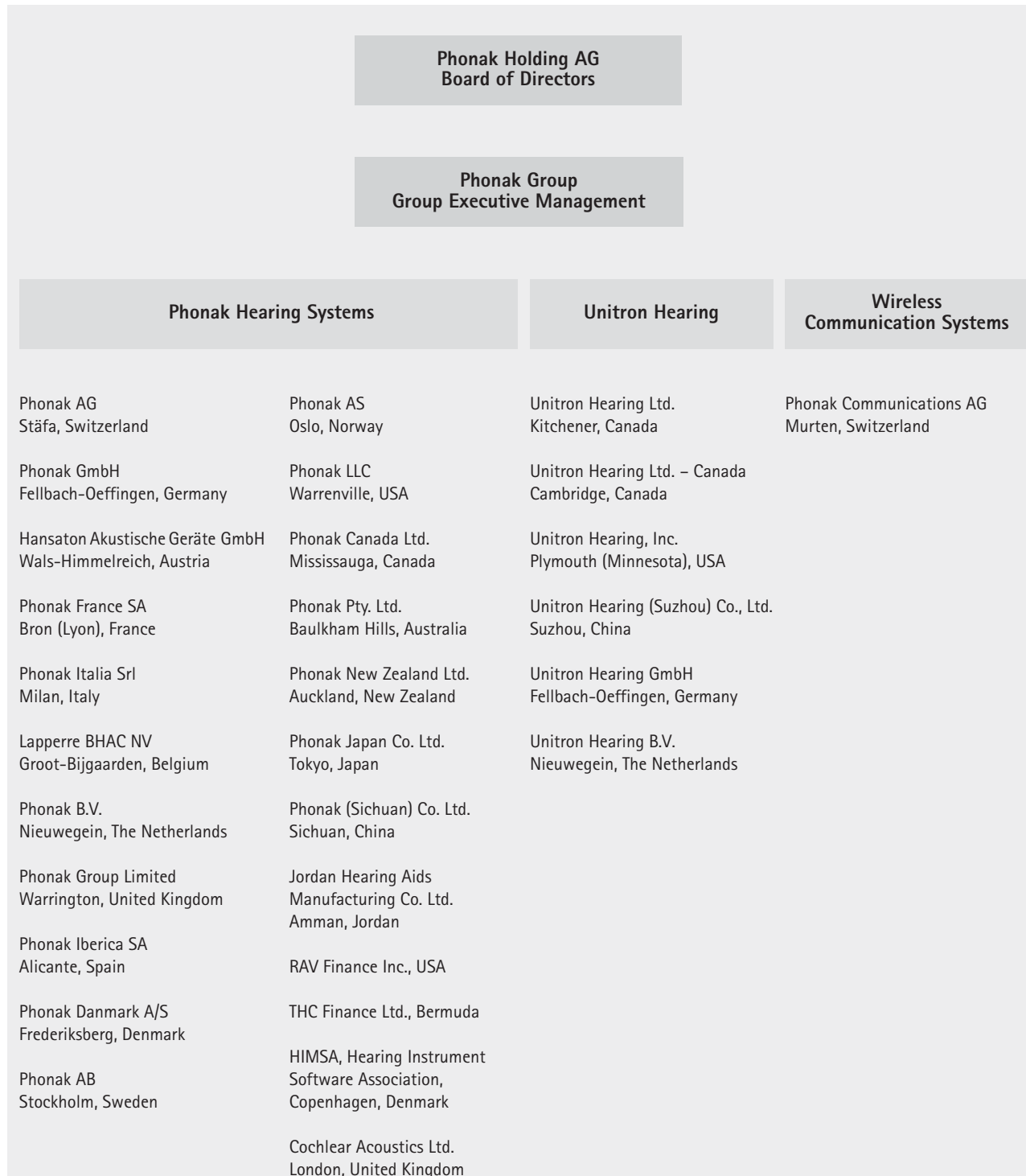
### Significant Shareholders

As of March 31, the shareholders of Phonak Holding AG were the following:

Outstanding shares	2005 amount	2005 in %	2004 in %
Pioneers			
– Andy Rihs	8,039,100	12.18	13.36
– Beda Diethelm	8,400,000	12.72	13.61
– Hans-Ueli Rihs	6,273,604	9.50	8.47
Public shareholders	43,309,696	65.60	64.56
Total share capital	66,022,400	100	100

- The pioneers are those who were already shareholders before the Initial Public Offering of November 1994. There are no shareholders' agreements between these persons.
- The biggest minority shareholder (as of Feb. 7, 2005) within the group of public shareholders is FMR Corp. with 4.99%, a US-based investment company.
- As of March 31, 2005, a total of 16,381 (previous year 18,011) shareholders were entered in the share register of Phonak Holding AG, of these 1,027 (previous year 1,077) were non-Swiss nationals who held a total of 18.1% (previous year 12.5%) of the outstanding shares.

## Corporate Governance



## Capital Structure

### Changes in capital structure within the last three financial years

As of March 31, the capital of Phonak Holding AG comprised the following:

	2005	2004	2003
Share capital	CHF 3,301,120	CHF 3,273,110	CHF 3,268,610
Total shares	66,022,400	65,462,200	65,372,200
Conditional capital	CHF 264,270	CHF 292,280	CHF 296,780
Conditional shares	5,285,400	5,845,600	5,935,600
Authorized capital	CHF 0	CHF 0	CHF 0
Authorized shares	0	0	0

Phonak Holding AG registered shares have been quoted on the Swiss stock exchange since December 1, 1994. The par value of one standard registered share amounts to CHF 0.05. The share capital is fully paid up. With the exception of the shares held by the Company itself, each ordinary share bears one voting right at the Annual General Shareholders' Meeting and is entitled to dividend payments. As of March 31, 2005, the company held 7,700 (previous year 141,712) own shares.

### Ordinary share capital

The Annual General Shareholders' Meeting of July 5, 2001 approved a capital reduction and repayment of CHF 15 on the par value per share. At the same time, shareholders approved a 1:100 share split. This reduced the par value of Phonak registered shares from CHF 20 to CHF 0.05.

In the financial year 2004/05, a total of 560,200 employee options were exercised. Each option provides the right to purchase one registered share out of the conditional capital (see table above). In the financial years 2003/04 and 2002/03, a total of 90,000 and 168,000 employee options were exercised. As a result, as of

March 31, the total number of issued shares as well as the share capital increased correspondingly. This resulted, on the other hand, in a corresponding decrease in the conditional capital each year.

### Conditional capital

The conditional capital was created with the purpose of offering Phonak shares, through an option program, to key employees of the Phonak Group. From a maximum of 8,000,000 approved shares with a par value of CHF 0.05, 2,714,600 shares have been issued until March 31, 2005, reducing the maximum conditional capital to 5,285,400 (previous year 5,845,600) shares.

In the financial year 2004/05, a total of 712,000 options, in the financial year 2003/04, a total of 780,450, and in the financial year 2002/03, a total of 875,250 options were granted as part of the Phonak Executive Equity Award Plan (EEAP) and of the Key People Program.

At March 31, 2005 a total of 1,852,250 (prior year 2,060,950) options were outstanding. Each of these options entitles the holder to purchase one registered share, with a par value of CHF 0.05.

### Authorized capital

As of March 31, 2005, the company does not have any authorized capital.

At the extraordinary Annual General Shareholders' Meeting held on December 7, 2000, shareholders approved the creation of authorized capital of 2,000,000 shares with a par value of CHF 0.05. 1,307,800 of these shares were used in the years 2000 and 2001 for the acquisitions of Unitron Hearing and Hansaton. The remaining 692,200 shares of authorized capital expired on December 7, 2002.



## Corporate Governance

Board of Directors:

(from left to right) Robert F. Spoerry, William D. Dearstyne, Andy Rihs, Heliane Canepa, Dr. Daniel Borel, Dr. Michael Jacobi.

### Equity capital, reserves, and retained earnings

Regarding changes in equity capital, reserves and retained earnings, see note 3.6 of the Notes to the Financial Statements of Phonak Holding AG (or for the third financial year prior to the reporting period refer to the same notes in the previous Annual Report 2003/04).

### Restrictions on transferability

See the chapter below entitled "Voting rights restriction and representation".

## Board of Directors

The primary duty of the Board of Directors of Phonak Holding AG is the strategic direction and management of the Company. Where indicated, the Board takes care of these tasks in close collaboration with the Group Executive Management. The Articles of Association of Phonak Holding AG state that the Board of Directors must consist of at least three and a maximum of nine members.

During the reporting period, the Board of Directors held five meetings, one of which was a two-day strategy workshop. Telephone conferences were organized in response to time-sensitive business issues. The Board receives consolidated financial statements (balance sheet, profit and loss as well as cash flow statements) on a monthly, semi-annual and annual basis. In addition, the Board receives monthly consolidated sales reports, providing turnover, average selling prices and units for each major product, subsidiary and market.

The Board of Directors approves resolutions and holds elections with the majority of its members present at the meeting. In the event of an equal number of votes, the Chairman has the casting vote.

### Audit Committee

Current members of the Audit Committee are Dr. Michael Jacobi (Chairman), Heliane Canepa and William D. Dearstyne.

Within the context, the Audit Committee reviews on behalf of the Board the work and effectiveness of the external and internal audit, evaluates the financial control, the financial structure and risk measurement mechanisms of the company, and reviews the interim and annual financial accounts of the Group. Within the context of internal audit, the Audit Committee supervises audits to be completed by the internal audit department and reviews the results of these audits.

The Audit Committee meets at least four times annually, but as often as required. In the reporting period, the Committee met four times.



### Compensation Committee

Current members of the Compensation Committee are Andy Rihs (Chairman), Dr. Daniel Borel and Robert F. Spoerry.

The primary task of this Committee is to review and propose to the Board of Directors the compensation structure and amount for the Board of Directors and the members of the Group Executive Management.

The Compensation Committee meets as often as required. In the reporting period, the Committee met four times.

### Nomination Committee

Current members of the Nomination Committee are Andy Rihs (Chairman), William D. Dearstyne and Heliane Canepa.

The primary task of this Committee is to select and propose to the Board of Directors suitable candidates for election to the Board of Directors and the appointment of Group Executive Management members.

The Nomination Committee meets as often as required. In the reporting period, the Committee met three times.

As previously mentioned, beginning in 2005/06, the Compensation Committee and the Nomination Committee have been merged to form the Nomination and Compensation Committee.

### Overview of Board Members

Name	Position	Other activities	Nationality	Born	First election to the Board	Current Board term ends
Andy Rihs	Chairman, non-executive	Chairman of the Board of ARfinanz Holding AG	Swiss	1942	1985; Chairman since 1992	AGM 2006
William D. Dearstyne	Vice-Chairman and lead director, non-executive	Membre du Conseil d'Administration of Flamel Technologies Member of the Advisory Board of Earlybird Venture Capital GmbH & Co. Member of the Board of Trustees of Bucknell University, Lewisburg Member of the Board of East-West Institute, New York Member of the Board of Bioness, Inc., California	American	1940	2003; Vice-Chairman and lead director since 2004	AGM 2006
Dr. h.c. Daniel Borel	Non-executive	Chairman of the Board of Logitech International Ltd. Member of the Board of Julius Baer Holding AG Member of the Board of Nestlé SA	Swiss	1950	1999	AGM 2005
Heliane Canepa	Non-executive	CEO Nobel Biocare Holding AG	Swiss	1948	1999	AGM 2005
Dr. Michael Jacobi	Non-executive	CFO Ciba Specialty Chemicals AG Chairman of the Board of Industry-Holding Member of the commission of Swiss GAAP FER	German	1953	2003	AGM 2006
Robert F. Spoerry	Non-executive	Chairman, President and CEO of Mettler-Toledo International Inc. Member of the Board Conzetta Holding AG Member of the Board Schaffner Holding AG	Swiss	1955	2003	AGM 2006

## Corporate Governance

### Board Member biographies

**Andy Rihs** (born in 1942) is one of the founders of the Phonak Group, together with his partner, Beda Diethelm, and his brother Hans-Ueli Rihs. Andy Rihs led the Phonak Group as CEO until April 2000 and, as interim CEO, from April to September 2002. He has been Chairman of Phonak Holding AG since 1992, a function which he continues to hold today.

In 1966, Andy Rihs joined Beda Diethelm who came to Phonak a year earlier as technical manager. Andy Rihs began to build up the marketing and commercial aspect of the Company. He first established a sales organisation for Switzerland, followed by the international export sales activity. Under his leadership, the Company grew continuously and succeeded in establishing an outstanding brand image for Phonak – known for products of the highest technological standard and reliability.

Andy Rihs completed his education and business training primarily in Switzerland and France.

**Dr. h.c. Daniel Borel** (born in 1950) co-founded Logitech in 1981 and served as CEO from 1992 to 1998.

During this time, Daniel Borel was instrumental in growing Logitech around the world and establishing the company's high-volume manufacturing capability in Asia. In 1988, he took the Logitech Group public on the SWX Swiss Exchange and became Chairman of Logitech's Board of Directors. In 1997 he took Logitech public on Nasdaq.

Daniel Borel holds an engineering degree from the Swiss Federal Institute of Technology Lausanne (Switzerland) and a master's degree in Computer Science from Stanford University. He was awarded an h.c. doctorate from Lausanne's Federal Institute of Technology in 1992.

**Heliane Canepa** (born in 1948) is President and CEO of Nobel Biocare AB, Sweden, a company primarily engaged in dental implants. In 2002, she also became CEO of the newly established group parent company, Nobel Biocare Holding AG.

Before joining Nobel Biocare, Heliane Canepa acted as CEO of the medical technology company Schneider Worldwide. In 1984, Schneider was sold to Pfizer Inc., which resold the entity to Boston Scientific in 1998. Because Boston Scientific already had a European production site in Ireland, the location in Bülach, Switzerland, was closed. Heliane Canepa earned special merit for her work in assisting employees to find new employment opportunities. Heliane Canepa became Entrepreneur of the year in Switzerland in 1999.

Heliane Canepa completed Business school in Dornbirn, Austria, West London College in London, Sorbonne, Université de Paris, and the Foreign Executive Development Program at Princeton University.

**William D. Dearstyne** (born in 1940) retired in April 2003 from his position as Company Group Chairman and member of the Medical Devices and Diagnostics Group Operating Committee of Johnson & Johnson. During the 34 years of his career managing diversified healthcare companies, he earned business experience in Asia, Central and Eastern Europe as well as Latin America. He served in many different functions during his 26 years at Johnson & Johnson. Within this period, he also led two major acquisitions for the company – Cordis and DePuy – both of which today occupy leadership positions in interventional cardiology and orthopedics respectively.

William D. Dearstyne studied at Bucknell University (Lewisburg, PA) and at Syracuse University (Syracuse, New York) where he earned an MBA in International Business.

**Dr. Michael Jacobi** (born in 1953) is the CFO, and a member of the Executive Committee, of Ciba Specialty Chemicals – a position he has held since 1997 and in which he is responsible for Treasury, M&A, Investor Relations and Controlling.

Michael Jacobi joined Ciba-Geigy's finance area in 1978 when he held positions in finance, accounting and planning in Brazil and the US. In 1987, he returned as Head of Management Accounting at the Finance Department in Basel where he later became responsible for Ciba-Geigy's overall corporate financial accounting and reporting. He also serves on the Council of the Foundation for Accounting and Reporting Recommendations and plays a significant role in setting Swiss guidelines for accounting and disclosure.

Michael Jacobi studied at the Universities of St. Gallen, Washington (Seattle) and Harvard Business School. In St. Gallen, he earned a doctorate degree with a thesis on the International Accounting Standards.

**Robert F. Spoerry** (born in 1955) is Chairman, President and CEO of Mettler-Toledo International Inc., a leading global manufacturer of precision instruments for use in laboratory, manufacturing and food retailing applications, quoted on the New York Stock Exchange (NYSE) since 1997.

Robert F. Spoerry joined Mettler-Toledo in 1983, served as Head of the Industrial and Retail Division in Europe from 1987 until 1993, and had the lead in the acquisition and integration of Toledo Scale Corporation (USA). In 1989, he was appointed to the company's Executive Board, was nominated President and CEO in 1993 and holds the additional office of Chairman since 1998.

Robert F. Spoerry graduated in mechanical engineering at the Federal Institute of Technology in Zurich (Switzerland) and received an MBA from the University of Chicago.

## **Elections and term of office**

At the Annual General Shareholders' Meeting, the shareholders elect the Board of Directors of Phonak Holding AG. Each member is normally elected for a period of three business years. The term ends on the day of the ordinary Annual General Shareholders' Meeting for the last business year of the term. If, during a term, a substitute is elected to the Board of Directors, the newly elected member finishes the term of his predecessor. Re-elections for successive terms are possible. A Board member who reaches the age of 65 during his or her term must resign at the next ordinary Annual General Shareholders' Meeting.





# The Art

Communication means connecting

# and

with your environment.

# Science

Phonak connects with its shareholders

# of Better

through open dialog.

# Hearing

Group Executive Management:  
 (from left to right) Dr. Herbert Baechler, Oliver Walker,  
 Dr. Valentin Chapero Rueda, Toni Schrofner,  
 Paul Thompson, Michael Jones

## Corporate Governance

### Group Executive Management

Name	Position	Other activities	Nationality	Born	Appointment
Dr. Valentin Chapero Rueda	CEO	Member of the Board of Xemics SA	Spanish	1956	October 2002
Oliver Walker	CFO		Swiss	1969	October 2004
Paul Thompson	EVP Corporate Development		Canadian	1967	January 2002
Michael Jones	President North American Markets		American	1949	April 1998
Dr. Herbert Baechler	CTO		Swiss	1950	June 2002
Toni Schrofner	EVP Operations & Supply Chain		Austrian	1963	December 2003

The Group Executive Management is responsible for the operational management of the Company. Furthermore, it prepares for, and later executes, the decisions made by the Board of Directors.

According to the Organizational Regulations of Phonak, the Group Executive Management consists of at least four, and at the most seven, members. Currently, the Group Executive Management consists of six people, all appointed by the Board of Directors, as recommended by the Chief Executive Officer (CEO).

#### Group Executive Member biographies

**Dr. Valentin Chapero Rueda** joined the Company as CEO as of October 2002.

Before joining Phonak, Valentin Chapero Rueda was CEO of Siemens' Mobile Networks Division. Prior to this, between mid-1996 and the end of 1999, he was CEO of the Siemens Audiology Group, the industry's largest hearing instrument manufacturer. He led Siemens into the digital age, tripling sales and, at the same time, improving profitability. Valentin Chapero Rueda began his career within the R&D department of Nixdorf Computer.

Valentin Chapero Rueda, whose parents are Spanish, grew up and completed his education in Germany. He graduated in Physics at the University of Heidelberg and was awarded his doctorate with a thesis in the medicine/physics field.

**Oliver Walker** was appointed CFO of the Phonak Group effective October 1, 2004.

Before joining Phonak he held the position of CFO of Stratec Medical Group of Oberdorf, Switzerland since 2000. Stratec is part of the Synthes-Stratec Group, a leading international medical devices company, specializing in the development, manufacture and marketing of instruments and implants for the surgical treatment of bones. Prior to Stratec, Oliver Walker worked for seven years with the Von Roll Group, a diversified industrial company. His most recent position there was as Head of Finance and Controlling for the division Von Roll Infratec.

Oliver Walker studied Economics at the University of Berne; he holds a Masters Degree in Business Economics.



**Paul Thompson** was appointed to the position of Executive Vice President Corporate Development effective October 1, 2004. In this position, he is responsible for the development of the Group Strategy and the implementation of various business development activities. Prior to this new appointment, he was CFO of the Phonak since the beginning of 2002.

Between 1998 and 2001, Paul Thompson acted as CFO, and later also as COO, of the Unitron Group. Prior to joining Unitron, between 1987 and 1998, he worked for Ernst & Young in Canada, first in the auditing division and then in the management consulting division. Paul Thompson studied Finance and Economics at the University of Waterloo, Canada. In 1992, Paul was granted his Chartered Accountant designation and in 1998, he achieved the designation of Certified Management Consultant.

**Michael Jones** has, within the overall Phonak Group, responsibility for the North American markets. Between January 2002 and January 2005 he acted additionally as CEO of Unitron Hearing.

Michael Jones has over 25 years' experience in the hearing instrument industry, working for a leading US hearing instrument manufacturer until 1995, where he was instrumental in developing the company into a successful, international player in the industry.

Michael Jones completed his education with an MBA from the University of Southern California.

**Dr. Herbert Baechler** has been a key member of Phonak's management team for the past 24 years. In June 2002, he was appointed to the position of Chief Technology Officer (CTO) and member of the Group Executive Management.

Herbert Baechler is responsible, on a group-wide basis, for directing the various research projects including the pursuit of new technologies and the application to hearing instruments and related business opportunities.

Herbert Baechler received his diploma in Electronic Engineering in 1973 and his doctorate in 1978 from the Swiss Federal Institute of Technology, Zurich.

**Toni Schrofner** joined the Phonak Group as Executive Vice President Operations & Supply Chain and became Member of the Group Executive Management effective December 1, 2003.

Before joining Phonak, Toni Schrofner was acting as President of Tecan Instruments and Member of Tecan Group's Executive Management Team. The position included the function of General Manager Tecan Schweiz AG. Prior to the appointment at Tecan headquarters, he was Managing Director of Tecan Austria GmbH between 1996 and 2001.

Toni Schrofner earned a diploma in mechanical engineering (focus on mechanical engineering and operation technology) at HTL in Salzburg and completed his MCI Studies of Economics/International Management at the University of Innsbruck, Austria.



## Corporate Governance

### Compensation, Shareholdings and Loans

Members of the Board of Directors receive a fixed payment and participation in the company's option plan as compensation. Members of the Group Executive Management receive a performance-related compensation package, including basic salary, bonus payment and option plan. The remuneration of the members of the Board as well as of the Group Executive Management is determined, and periodically reviewed, by the Board of Directors as proposed by the Compensation Committee.

During the reporting period, there were no honorariums paid for additional services above the ordinary remuneration nor were any loans awarded, or guarantees given to Board members, members of the Group Executive Management or to any closely linked parties to these governing bodies.

#### Compensation to members of the Board of Directors and the Group Executive Management

Total remuneration of the Board of Directors of Phonak Holding AG in the financial year 2004/05 amounted to CHF 0.6 million (previous year CHF 0.7 million).

Total remuneration of the members of the Group Executive Management in the financial year 2004/05 amounted to CHF 3.6 million (previous year CHF 3.4 million). The Phonak compensation plan does not provide for the distribution of shares.

#### Share ownership

As of March 31, 2005 the members of the Board of Directors and the Group Executive Management held directly and indirectly 8,056,496 shares (12.2% of total share capital). 8,049,296 of these shares were held by the members of the Board (all non-executive) and 7,200 were held by the Group Executive Management.

#### Options

As of March 31, 2005 the members of the Board of Directors (all non-executive) and the Group Executive Management held 860,000 options on Phonak stock. Each option has a share subscription ratio of 1:1 (see table on next page).

The total options granted to employees of the Group in 2004/05 (712,000 options) had a value of CHF 5.7 million over the term of the options, as calculated using the Black & Scholes method. The value of options granted is not recognized in the income statement. For further details, we refer to Note 32 on page 81 of the Consolidated Financial Statements within this report.

<b>Options granted to the Board of Directors</b>				<b>Blocking and exercise periods</b>		
<b>Options granted / outstanding</b>				<b>Blocking</b>	<b>Exercise</b>	<b>Number of</b>
<b>Year</b>	<b>Total granted</b>	<b>of which outstanding</b>	<b>Strike price (CHF)</b>	<b>period</b>	<b>period</b>	<b>options</b>
2002/03	72,000	12,000	13.00	01.02.03 – 31.01.05	01.02.05 – 31.01.06	12,000
2003/04	84,000	84,000	28.00	01.02.04 – 31.01.07	01.02.07 – 31.01.09	84,000
2004/05	72,000	72,000	39.00	01.02.05 – 31.01.06	01.02.06 – 31.01.10	18,000
				01.02.05 – 31.01.07	01.02.07 – 31.01.10	18,000
				01.02.05 – 31.01.08	01.02.08 – 31.01.10	18,000
				01.02.05 – 31.01.09	01.02.09 – 31.01.10	18,000
<b>Total</b>	<b>228,000</b>	<b>168,000</b>				<b>168,000</b>
<b>Options granted to the Group Executive Management</b>				<b>Blocking and exercise periods</b>		
<b>Options granted / outstanding</b>				<b>Blocking</b>	<b>Exercise</b>	<b>Number of</b>
<b>Year</b>	<b>Total granted</b>	<b>of which outstanding</b>	<b>Strike price (CHF)</b>	<b>period</b>	<b>period</b>	<b>options</b>
2002/03	140,000	105,000	14.00	01.10.02 – 30.09.04	01.10.04 – 30.09.06	35,000
				01.10.02 – 30.09.05	01.10.05 – 30.09.07	70,000
2003/04	87,000	87,000	28.00	01.02.04 – 31.01.07	01.02.07 – 31.01.09	87,000
2004/05	500,000	500,000	39.00	01.02.05 – 31.01.06	01.02.06 – 31.01.10	25,000
				01.02.05 – 31.01.07	01.02.07 – 31.01.10	25,000
				01.02.05 – 31.01.08	01.02.08 – 31.01.10	25,000
				01.02.05 – 31.01.09	01.02.09 – 31.01.10	25,000
				01.02.05 – 30.09.06	01.10.06 – 30.09.10	100,000
				01.02.05 – 30.09.07	01.10.07 – 30.09.10	100,000
				01.02.05 – 30.09.08	01.10.08 – 30.09.10	100,000
				01.02.05 – 30.09.09	01.10.09 – 30.09.10	100,000
<b>Total</b>	<b>727,000</b>	<b>692,000</b>				<b>692,000</b>

### Highest total compensation

The highest total compensation paid to a member of the Board of Directors in the year under review amounted to CHF 173,000 (previous year CHF 197,000). In addition, Phonak Holding AG has granted 12,000 options to this person in financial year 2004/05.

These options provide the right to purchase one Phonak share at a strike price of CHF 39 between February 1, 2006 and September 30, 2010.

The highest total compensation paid to a member of the Group Executive Management consisted of a base salary of CHF 973,000 (previous year CHF 900,000) as well as a bonus of CHF 644,000 (previous year CHF 870,000).

In the course of the renewal of the long-term employment agreement, 400,000 options at a strike price of CHF 39 were granted to this person in financial year 2004/05. These options serve as a long-term incentive and can be exercised over a period of 4 years.

## Corporate Governance

### Shareholder's Participation Rights

#### Voting rights restriction and representation

To be recognized as a shareholder with comprehensive rights, the acquirer of shares must place an application for entry in the share register.

The registration in the share register as a shareholder with voting rights is limited to 5% of the share capital (Art. 6 par. 2 of the Articles of Association). Linked parties are considered as one person. To abolish this regulation, the absolute majority of the votes represented at the Annual General Shareholders' Meeting is sufficient.

In exercising their voting rights, no shareholder may unite, by a combination of own and represented shares together, more than 10% of the shares of the company (Art. 12 par. 2 of the Articles of Association).

The restrictions on the voting and representation rights do not apply to the pioneer shareholders. The Board of Directors may approve further exceptions with good reason and no special quorum is required for such decisions. During the reporting period, no exceptions to the above listed rules were granted.

#### Right to request items on the Annual General Shareholders' Meeting agenda

Shareholders, with the right to vote and representing shares with a par value of CHF one million, may request items to be included in the agenda by indicating the motions. The respective requests must be addressed in writing to the Chairman of the Board of Directors no later than 30 days before the meeting.

#### Registering deadlines

In general, the share register will be closed for about 10 days before the Annual General Shareholders' Meeting for administrative reasons. During this period, an admission card, with corresponding voting papers, will be sent to shareholders. In case of a partial sale, or additional purchase within this time, the confirming documents must be exchanged on the day of the Annual General Shareholders' Meeting at the information desk.

### Changes of Control and Defense Measures

#### Public purchase offer

A purchaser of shares is obliged to make a public purchase offer, when he has more than 49% of the voting rights at his disposal ("opting up", as per Art. 8 of the Articles of Incorporation).

#### Clauses on changes of control

There are no agreements in place that, in the event of a change of control, provide Phonak management or Board members with abnormally high severance costs or other lucrative benefits.

### Auditors

#### Duration and term of mandate

During the ordinary Annual General Shareholders' Meeting of July 5, 2001 PricewaterhouseCoopers was elected as auditors of Phonak Holding AG and the Phonak Group. The head auditor responsible for the existing auditing mandate, Mr. Stephen W. Williams, took office as of July 5, 2001. At the Annual General Shareholders' Meeting on July 8, 2004, PricewaterhouseCoopers was re-elected for another term of one year.

#### Fees

PricewaterhouseCoopers charged CHF 538,000 for their auditing services and CHF 188,000 for non-audit services during the year under review.

#### Supervisory and control instruments

The Audit Committee of the Board of Directors regularly reviews the performance, compensation and independence of the auditors. The Audit Committee reports its findings to the Board of Directors.

## Information Policy

Today, as in the past, one of management's highest priorities is to inform business partners and existing and potential investors as directly, openly and transparently as possible about the company's organisation and worldwide operations. The focus of these efforts is to keep all interested parties informed at the same time about the Group's performance and its short and medium-term plans.

### Investor Relations Calendar

July 7, 2005	Annual General Shareholders' Meeting of Phonak Holding AG at the Kongresshaus Zurich
November 2005	Semi-annual Report per September 30, 2005
June 2006	Publication of Annual Report
June 2006	Media and Analysts Conference
July 2006	Annual General Shareholders' Meeting of Phonak Holding AG

### Names and addresses

Phonak Holding AG  
Investor Relations  
Laubisrütistrasse 28  
CH-8712 Stäfa  
Switzerland  
Phone: +41 44 928 01 01  
Fax: +41 44 928 06 84  
E-Mail: [ir@phonak.ch](mailto:ir@phonak.ch)  
Internet: [www.phonak.com](http://www.phonak.com)

### Responsible for Investor Relations

Stefan Blum

### Investor Relations Assistant

Gina Francioli

Printed financial reports can be ordered over the IR Contact and Order Form service on the Company's website.

For realtime company information please subscribe to the IR News Service at:

[www.phonak.com/company/investors/ir\\_news.htm](http://www.phonak.com/company/investors/ir_news.htm)

### Share register:

ShareCommService AG  
Margitta Christe  
Europastrasse 29  
CH-8152 Glattbrugg  
Phone: +41 44 809 58 53  
Fax: +41 44 809 58 59

# The Art

The ability to understand speech is crucial

# and

for a child's development. Phonak is

# Science

the leader in specialty hearing instruments and

# of Better

FM products for hearing impaired children.

# Hearing



# Sustainability

The Phonak Group specializes in the design, development, production and worldwide distribution of technologically advanced hearing systems for adults and children. Inherent in the Group's business activities is a fundamental commitment to improve individual hearing ability and speech understanding, thus contributing significantly to the quality of life of countless people worldwide.

Phonak's management strongly believes that striving for true economic success ultimately requires taking into account the needs and expectations of all the relevant stakeholders. Phonak's enduring success story is based on particular respect for employees, a close relationship with customers and a very constructive partnership with suppliers. Phonak's unique, innovative and powerful hearing instruments are the result of this teamwork. Finally, being economically successful allows Phonak to pass on attractive returns to its owners, i.e. the shareholders, and to help those who are less fortunate.

This well-balanced mentality is observable throughout the company and is reflected in Phonak's core values. Working at Phonak is best characterized by a flat hierarchy, equal treatment of employees responsibility for one's own actions, transparent corporate governance, and open communication with all stakeholders. To sustain and further develop Phonak's strong corporate culture is one of management's top priorities and a driver for sustainable economic success.

## **Employees: Phonak's principal asset**

The hearing instrument industry is not a capital-intensive business, but is driven by constant product and service innovation. Thus, motivated, dedicated and creative employees make a big difference.

Being an innovation leader requires a certain tolerance of mistakes but also a need for in-depth analysis of the sources of error. At Phonak, leadership is assured by a management by objectives approach. Working at Phonak is therefore clearly different. At our headquarters in Stäfa, Switzerland, more than 40 nationalities work together under one roof, while good recreational facilities give employees the opportunity to socialize outside work.

Interdisciplinary know-how in the science of "Hearing" is paramount in order to develop and build superior hearing systems. Knowledge management is consequently a core element of Phonak's management philosophy: there are no barriers, no closed doors, employees can contact anybody at any time. This philosophy is also reflected in the open and light architecture of Phonak headquarters in Staefa. A group-wide, centralized project platform supports the integration of interdisciplinary and broadly based project teams. Dedicated and systematic professional development as well as systematic internalization of external know-how are also important knowledge management drivers.

The production setup to manufacture a hearing instrument is similar to the watch industry. Very small components have to be manually positioned and soldered with the aid of microscopes, in very clean, climate-controlled and light rooms. Employees at the production sites share the same quality standards, identical production processes and standard work procedures.

In addition, a new unified employee appraisal system was introduced in 2004/05 for all employees in Switzerland, and extended globally, in a first step to senior executives. This is an essential leadership tool covering two personal dimensions: performance and competencies. Better transparency and objectivity in the evaluation process should improve the quality and effectiveness of the further development of Phonak's most valuable capital: its employees.

The global rollout of the employee appraisal system to all management levels is set to continue in 2005/06. The new group-wide skill-set inventory will offer employees better access to job opportunities within the Phonak Group.

#### **Customers buy a better quality of life**

Phonak drives innovation and has set the benchmark within the hearing industry for many decades. One of many groundbreaking Phonak inventions is the AudioZoom. In 1995, Phonak introduced the world's first adaptive directional dual-microphone system. This was a major milestone in hearing technology and is still regarded as the most valuable performance feature of a hearing instrument.

Our approach is not technology for its own sake. Instead, we think constantly about how technological innovation can solve the everyday problems of people suffering from hearing loss. Hence, Phonak has been committed to providing high-tech solutions for hearing-impaired people for over 40 years. In the case of children, Phonak's products give them access to the wealth of sounds that enrich today's world, thereby helping them to develop the auditory skills they need to build their future. Furthermore, Phonak is a pioneer in the field of high-power amplification for people with severe hearing impairment.

One of the milestones of 2004/05 was the launch of Savia, Phonak's revolutionary hearing system in the digital premium segment. Phonak once again set the benchmark with digital SurroundZoom, another significant innovation

in microphone technology. Savia also incorporates many other "world-firsts" like Real Ear Sound or EchoBlock, advanced functions which deliver unmatched hearing performance and provide an effortless and natural hearing experience.

Last year, Phonak continued to invest heavily in the education of hearing care professionals and introduced the latest scientific research to a broad audience.

More than 150 participants from all over the world joined the Phonak Satellite Event at NHS 2004 Conference in May 2004, in Cernobbio (Como), Italy. Here, internationally renowned experts were able to share their knowledge with audiologists and pediatric experts focusing mainly on early amplification for infants and young children.

In November 2004, over 550 attendees from 32 countries were in Chicago, USA for our Third International Pediatric Conference: A Sound Foundation through Early Amplification. The program was devoted to the research and clinical issues related to hearing loss, communication development, and fitting of hearing instruments to infants and young children. Over two dozen researchers and clinicians from around the world presented papers, sharing their knowledge and experience with other participants during formal and informal discussions throughout the conference.

Looking forward to 2005/06, Phonak will organize a special Satellite Event at the ICED 2005 Conference in July 2005, in Maastricht, The Netherlands. The main focus will be on how modern technology and a language-enabling environment support children in the development of fluent spoken language. In October, Phonak will hold the 2nd European Conference on Pediatric Amplification Solutions. This conference will cover a wide range of current issues in pediatric audiology. General topics include otitis media, causes of hearing loss, environmental considerations, current amplification issues and a clinical forum. Phonak's priority is still to help prepare today's children for tomorrow.



## Sustainability

Recognizing that today's hearing instruments may still be improved to rival the hearing abilities of the human ear in all hearing situations, Phonak continuously pursues the development of new, innovative technologies that further improve the benefits for end users. Therefore, Phonak will continue to invest significant R&D resources to further enhance the quality of life of many hearing-impaired children and adults. Phonak will continue its close collaboration with researchers and scientists worldwide in order to drive innovation in these respective fields even further.

### The importance of product quality

Over several decades, Phonak has built up an excellent reputation for its high-quality and high-performance hearing instruments. Phonak is perceived in the market as a premium brand and still has the image as a provider of high-end hearing instruments. Today Phonak also offers hearing instruments in the digital economy segment, but the quality standards are the same as for high-end hearing instruments.

Hearing instruments are subject to standards imposed by the Medical Device Directive of the European Community, MDD 93/42/EEC, and by ISO standards 9001:2000 and 13485:2003, respectively.

In order to comply with these rules, Phonak has to ensure biocompatibility of its products and must not use hazardous raw materials or operating supplies in its production process.

Unlike other medical devices, regulations allow a continuous product improvement process for previously introduced hearing instruments. Based on customer feedback and inputs from Phonak's quality assurance team, all hearing instruments are subject to continuous product improvements during the product lifecycle.

The introduction of the new revolutionary premium hearing instrument, Savia, in 2004/05 proved that product

quality is Phonak's main focus. Savia went through a very controlled launch process. In November 2004, first shipments were made to selective customers in order to obtain additional user feedback. At the same time, Phonak invested in extensive training and education activities for audiologists and dispensers. The full global market rollout took place in February 2005. In addition, a dedicated global quality assurance team is in place to secure product quality over the whole lifecycle of each product line.

Phonak designs very appealing hearing instruments but also creates product designs that improve usability and product safety. These efforts have been rewarded in the case of Savia, which won the 2005 Medical Design Excellence Award (MDEA). The Medical Design Excellence Awards competition is organized and presented by Canon Communications LLC in Los Angeles, USA, and is the only awards program that exclusively recognizes contributions to, and advances in, the design of medical products.

Entries are evaluated on the basis of their design and engineering features, including innovative use of materials, user-related functions that improve healthcare delivery and change traditional medical attitudes or practices, features that provide enhanced benefits to the patient, and the ability of the product development team to overcome design and engineering challenges so that the product meets its clinical objectives.

Savia marks the launch of the first product line based on the proprietary PALIO platform. In 2005/06, this platform will be developed further and will be the base for many future product lines in other market segments as well. The PALIO platform is a tool kit and is based on a modular approach that allows a high degree of reuse. Therefore product quality will further improve and every future product line will benefit from the learning curve and improvements of its predecessor. Consequently, the inherent risk of introducing a new product will decrease significantly over time.

### Close partnership with suppliers

Phonak has built close relationships with its suppliers over many years. Suppliers contribute to the development of new products and provide manufacturing equipment, raw materials, components and operating supplies that become part of the hearing systems. External partners play an important role in the development process of new products. Innovation is based on collaboration between internal departments and several high-tech companies delivering specific building blocks incorporating their areas of expertise e.g. micro-electronics or electro-mechanics. Production facilities are equipped mostly with standard semiconductor manufacturing equipment, which in combination with the huge internal hearing systems manufacturing expertise builds the backbone of Phonak's advanced production capabilities. Hearing instruments are miniaturized high-performance medical devices and Phonak's suppliers share the same challenges and quality requirements and are also subject to standards imposed by the Medical Device Directive of the European Community and by ISO norms.

The new PALIO platform was a quantum leap for Phonak in 2004/05 and also a big achievement for our suppliers. In close collaboration with suppliers, very innovative solutions have been developed.

In 2005/06 Phonak will continue to broaden and strengthen its cooperation with suppliers, which is key to keep innovation at the current high level and to further improve competitiveness.

### Corporate governance

Phonak's clear and transparent approach to Corporate Governance begins with a truly independent Board of Directors. The Board consists of well respected, very senior executives with a broad collective experience in several functions and in-depth knowledge from many sectors. Their level of professionalism, integrity and reputation guarantee that the tasks and responsibilities of the Board are executed in the interest of the shareholders.

As described in the Corporate Governance section of this Annual Report, in 2004/05 the Board streamlined the organizational structure according to the needs of the company in order to increase efficiency and enhance transparency by publishing the Articles of Association and the Organizational Regulations on the Group's website.

The Board of Directors, together with the support of management, is implementing these new guidelines and is committed to a continuous review and improvement of Corporate Governance principles.

## Sustainability

### Environmental impact is remarkably low

The quantity of raw materials going into Phonak's annual production of hearing instruments is equivalent to three middle-class passenger cars. Due to the wide range of different product lines, this analysis is based on the new PALIO BTE platform which is currently only used for Savia but will be the basis for future product lines.

Hearing instruments are subject to standards imposed by the Medical Device Directive of the European Community, MDD 93/42/EEC, and by ISO standards 9001:2000 and 13485:2003, respectively. In order to comply with these rules, Phonak must not use hazardous raw materials or operating supplies in its production process. Unfortunately, these regulations also limit the use of recycled material or used components.

Due to the premium quality of the input materials used, waste materials are still very valuable and are redirected into the recycling loop, which includes the recovery of plastic remnants from molding processes, cut-offs from printed circuit boards and metals.

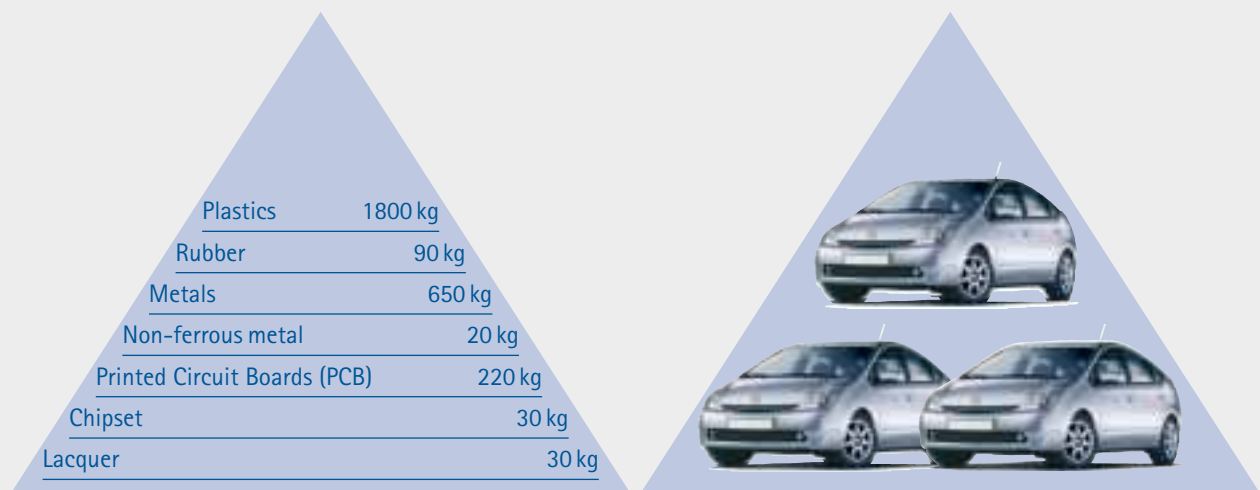
Waste water from cleaning processes is filtered, filters are disposed of and the processed water redirected into the normal water cycle. The energy consumption of the production processes is very modest. Climate control accounts for most of the energy consumed.

In 2004/05, further miniaturization led to lower consumption of raw materials and operating supplies per unit, while the acoustic performance of the hearing systems was substantially improved.

As more product lines are built on the PALIO platform, today's very low level of raw materials and operating supplies usage per unit will decrease further in 2005/06. Additional improvements in production processes will boost yields and support this trend.

### Environmental input

The quantity of raw materials going into Phonak's annual hearing instruments output equals approximately three passenger cars.



\*Analysis is based on the new PALIO BTE platform.

### **A high level of social commitment**

The Phonak Group participates in various projects and initiatives to develop awareness and provide training regarding hearing health, hearing loss and the benefits of hearing instruments. It also donates time, financial resources and products that make a difference to the quality of life for those who are less fortunate.

### **Eduplex makes full use of children's residual hearing**

In 2004/05, Phonak once again provided the Eduplex School in Pretoria, South Africa, with FM equipment that is essential for the inclusion of deaf children in regular school programs. The Eduplex School is a unique inclusive educational program, opened by Dr. Nelson Mandela in 2002.

The Eduplex program proves that today's technology, in combination with an inclusive, language-enabling environment, makes it possible for deaf and hard-of-hearing children to acquire fluent spoken language and good academic results. This approach has been successfully implemented across the world over a period of many years and its success can be seen in the lives of talking deaf adults who have achieved their full academic potential.

### **Phonak staff volunteer for special Fiji school**

In a five-year program named HearAid project, Phonak New Zealand is contributing funds, staff resources and hearing instruments for hearing-impaired children in Fiji. Staff regularly visit the Lautoka School to test children's hearing, fit hearing aids and provide other services and equipment.

### **Support for hearing-impaired children**

Unitron Hearing supported the programming of children with hearing loss through a community sponsorship with KidsAbility – Centre for Child Development. The Hearing Services program helps develop language and speech skills through listening.

Phonak New Zealand supports the Federation for Deaf Children and other voluntary organizations for deaf people, and each year awards academic prizes to deaf children who excel at their studies.

### **Sponsorship for audiology students**

Unitron Hearing assisted post-graduate audiology students through sponsorship of their membership to the Dome Information Service. Dome is an information service developed for clinicians, educators, researchers and students in the field of audiology and communication sciences and disorders. It offers students multiple resources from one accessible, online location, keeping them connected to current trends and initiatives in audiology.

Phonak also provides annual sponsorship for audiology student research projects at Auckland Medical School. Furthermore, many students are completing their theses at Phonak organizations.

We will continue our projects and intensify our contribution to the community in 2005/06 onwards.



# The Art

Existing and emerging markets hold

# and

vast growth potential. Phonak actively

# Science

invests in the development of these

# of Better

markets through technology, education

# Hearing

and promotion.





# Table of Contents

## Consolidated Financial Statements

46	Consolidated Income Statement
47	Consolidated Balance Sheet
48	Consolidated Statement of Cash Flows
49	Summary of Changes in Shareholders' Equity
50	Notes to the Consolidated Financial Statements
87	Report of the Group Auditors



## Consolidated Income Statement

1,000 CHF	Notes	2004/05	2003/04
<b>Sales</b>	<b>5</b>	<b>678,775</b>	<b>637,602</b>
Sales related costs		(26,666)	(23,700)
Cost of sales		(240,535)	(246,237)
<b>Gross profit</b>		<b>411,574</b>	<b>367,665</b>
Research and development		(48,711)	(58,203)
Sales and marketing		(154,220)	(126,139)
General and administration		(82,766)	(78,222)
Exchange differences		1,987	(1,294)
Other (expenses) / income, net	<b>8</b>	(189)	(292)
<b>Operating profit before amortization of goodwill (EBITA)</b>		<b>127,675</b>	<b>103,515</b>
Amortization of goodwill	<b>21</b>	0	(8,554)
<b>Operating profit (EBIT)</b>		<b>127,675</b>	<b>94,961</b>
Financial (expenses) / income, net	<b>9</b>	(825)	(942)
Share of gain / (loss) in associate / joint venture	<b>19</b>	152	(280)
<b>Income before taxes and minority interest</b>		<b>127,002</b>	<b>93,739</b>
Income taxes	<b>10</b>	(29,268)	(24,380)
Minority interest		(832)	(484)
<b>Income after taxes</b>		<b>96,902</b>	<b>68,875</b>
Basic earnings per share (CHF/share)	<b>11</b>	1.478	1.056
Diluted earnings per share (CHF/share)	<b>11</b>	1.462	1.050

## Consolidated Balance Sheet

<b>Assets</b>				
1,000 CHF	Notes		<b>31.3.2005</b>	<b>31.3.2004</b>
Cash and cash equivalents	13		173,243	145,128
Financial assets held for trading	7, 14		12,401	11,650
Trade receivables	15		139,197	116,320
Other receivables and prepaid expenses	16		19,972	16,285
Inventories	17		86,550	77,480
<b>Total current assets</b>			<b>431,363</b>	<b>366,863</b>
Tangible assets	18		115,391	118,858
Intangible assets	21		139,141	137,170
Investments in associate / joint venture	19		1,596	1,653
Other investments and long-term loans	20		7,811	10,127
Deferred tax assets	10		44,923	44,898
Retirement benefit assets	31		3,135	4,115
<b>Total non-current assets</b>			<b>311,997</b>	<b>316,821</b>
<b>Total assets</b>			<b>743,360</b>	<b>683,684</b>

<b>Liabilities and shareholders' equity</b>				
1,000 CHF	Notes		<b>31.3.2005</b>	<b>31.3.2004</b>
Short-term debts	23		30,789	28,222
Trade payables			30,988	34,505
Taxes payable			22,960	17,341
Financial liabilities held for trading	7		1,421	4,256
Other short-term liabilities	24		61,709	59,463
Short-term provisions	22		50,566	40,418
<b>Total current liabilities</b>			<b>198,433</b>	<b>184,205</b>
Mortgages	25		12,571	34,561
Other long-term debts	26		47,078	80,238
Long-term provisions	22		12,881	13,362
Other long-term liabilities	27		5,137	3,036
Deferred tax liabilities	10		17,556	17,944
<b>Total long-term liabilities</b>			<b>95,223</b>	<b>149,141</b>
<b>Total liabilities</b>			<b>293,656</b>	<b>333,346</b>
<b>Minority interest</b>			<b>1,913</b>	<b>1,248</b>
<b>Shareholders' equity</b>			<b>447,791</b>	<b>349,090</b>
<b>Total liabilities and shareholders' equity</b>			<b>743,360</b>	<b>683,684</b>

## Consolidated Statement of Cash Flows

1,000 CHF	Notes	2004/05	2003/04
<b>Income before taxes and minority interest</b>		<b>127,002</b>	<b>93,739</b>
Depreciation of tangible assets	18	21,761	20,126
Amortization of goodwill	21	0	8,554
Amortization of other intangible assets	21	3,546	3,607
(Gain) / loss on sale of tangible assets, net	8	(27)	430
Share of (gain) / loss of associate / joint venture	19	(152)	280
Change in other long-term provisions, net		3,123	2,140
Financial expenses / (income), net	9	825	942
Unrealized exchange differences		881	3,776
Reduction of payment / (prepayment made) to pension fund		980	(446)
Other non-cash items		1,324	37,955
		32,261	(1,454)
<b>Cash flow before changes in working capital</b>		<b>159,263</b>	<b>131,694</b>
Increase in trade receivables excl. allowances		(25,331)	(11,663)
Increase in other receivables and prepayments		(3,548)	(1,062)
(Increase) / decrease in inventories excl. allowances		(9,888)	12,237
(Decrease) / increase in trade payables		(3,277)	207
Increase in other payables, accruals and short-term provisions		12,285	30,625
Income taxes paid		(24,450)	(14,829)
		(54,209)	15,515
<b>Cash flow from operating activities</b>		<b>105,054</b>	<b>147,209</b>
Purchase of tangible assets	18	(19,576)	(18,138)
Proceeds from sale of tangible assets		934	1,128
Cash consideration for acquisitions, net of cash acquired	29	(3,001)	(3,935)
Purchase of intangible assets	21	(3,507)	(3,213)
Purchase of financial assets held for trading		(1,715)	(924)
Sale of financial assets held for trading		1,348	349
Decrease / (increase) in other investments and long-term loans		1,030	(5,456)
Interest received and realized gain from financial assets available for sale		3,214	1,329
<b>Cash flow from investing activities</b>		<b>(21,273)</b>	<b>(28,860)</b>
<b>Free cash flow</b>		<b>83,781</b>	<b>118,349</b>
Repayments of borrowings and mortgages		(52,548)	(29,941)
Proceeds of capital increases		7,560	1,387
Sale of treasury shares		5,600	3,436
Purchase of treasury shares		(319)	0
Dividend paid by Phonak Holding Ltd.		(13,074)	(7,805)
Dividend paid to minorities		(136)	(136)
Interest paid	9	(3,183)	(3,167)
Proceeds from / (payments for) foreign exchange contracts		1,360	(8,025)
<b>Cash flow from financing activities</b>		<b>(54,740)</b>	<b>(44,251)</b>
Currency translation differences		(926)	(3,998)
<b>Increase in cash and cash equivalents</b>		<b>28,115</b>	<b>70,100</b>
Cash and cash equivalents at the beginning of the financial year		145,128	75,028
<b>Cash and cash equivalents at the end of the financial year</b>		<b>173,243</b>	<b>145,128</b>

## Summary of Changes in Shareholders' Equity

1,000 CHF	Share capital	Capital reserves	Retained earnings	Cumulative translation adjustment	Treasury shares	Total shareholders' equity
<b>Balance April 1, 2003</b>	<b>3,269</b>	<b>133,643</b>	<b>177,120</b>	<b>(17,223)</b>	<b>(7,258)</b>	<b>289,551</b>
Capital increase of Phonak Holding AG						
from conditional capital	4	1,383				1,387
Dividend paid by Phonak Holding AG <sup>1)</sup>			(7,805)			(7,805)
Sale of treasury shares		138			3,298	3,436
Consolidated income after taxes			68,875			68,875
Currency translation differences				(6,354)		(6,354)
<b>Balance March 31, 2004</b>	<b>3,273</b>	<b>135,164</b>	<b>238,190</b>	<b>(23,577)</b>	<b>(3,960)</b>	<b>349,090</b>

<b>Balance April 1, 2004</b>	<b>3,273</b>	<b>135,164</b>	<b>238,190</b>	<b>(23,577)</b>	<b>(3,960)</b>	<b>349,090</b>
Changes in accounting principles (IFRS 3)			107			107
Tax on items taken directly to equity			42			42
Capital increase of Phonak Holding AG						
from conditional capital	28	7,532				7,560
Dividend paid by Phonak Holding AG <sup>1)</sup>			(13,074)			(13,074)
Sale of treasury shares		1,640			3,960	5,600
Purchase of treasury shares					(319)	(319)
Consolidated income after taxes			96,902			96,902
Currency translation differences				1,883		1,883
<b>Balance March 31, 2005</b>	<b>3,301</b>	<b>144,336</b>	<b>322,167</b>	<b>(21,694)</b>	<b>(319)</b>	<b>447,791</b>

1) Gross dividend per registered share amounted to CHF 0.20 for financial year 2003/04 and CHF 0.12 for financial year 2002/03.

Definition of the different categories of shareholders' equity recognized in the Phonak Group:

- Share capital is the share capital of the parent company Phonak Holding AG.
- Capital reserves represent the share premiums arising out of the capital increases of Phonak Holding AG and gain / loss from sale of treasury shares.
- Retained earnings comprise the undistributed profits of Group Companies and all other reserves including adjustments arising on consolidation.
- Treasury shares comprise the repurchased shares of Phonak Holding AG at their respective acquisition costs.

The aggregate gains and losses on the currency translation recognized directly in equity (currency translation differences) amount to a gain of CHF 1,883,000 (a loss of CHF 6,354,000 in 2003/04). Thereof, a profit of CHF 369,000 attributed to hedges of the net investment in foreign subsidiaries (a loss of CHF 8,905,925 in 2003/04). The gain on the sale of treasury shares recognized directly in equity amounts to CHF 1,640,000 (a gain of CHF 138,000 in 2003/04).

## Notes to the Consolidated Financial Statements

### 1. Corporate information

The Phonak Group (the "Group") is involved in the development, manufacture and distribution of hearing systems and related products. The Group operates worldwide and distributes its products through its own distribution network in the major industrialized countries and through independent representatives in over 60 other countries. The ultimate parent company is Phonak Holding Ltd., a limited liability company incorporated in Switzerland. Phonak Holding Ltd.'s registered office is located at Laubisrütistrasse 28, CH-8712 Stäfa, Switzerland.

### 2. Basis of the consolidated financial statements

In the financial year 2004/05, Phonak adopted the new standard IFRS 3 and the revised standards IAS 36 and IAS 38. IFRS 3 "Business Combinations" became effective as of April 1, 2004. The adoption of IFRS 3, IAS 36 (revised 2004) and IAS 38 (revised 2004) resulted in a change in the accounting policy for goodwill. Until March 31, 2004, goodwill was amortized on a straight line basis over its expected economic useful life, not exceeding a maximum of 20 years and assessed for an indication of impairment at each balance sheet date.

In accordance with the provisions of IFRS 3, the Group has ceased amortization of goodwill from April 1, 2004, accumulated amortization as at March 31, 2004 has been eliminated with a corresponding decrease in the cost of goodwill and goodwill is tested for impairment on an annual basis in the first half of the year, when there are indications of impairment and, in the case of newly acquired goodwill, before the end of the financial year in which the goodwill was acquired.

The impact on the income statement of applying the aforementioned standards for the financial year 2004/05 is an increase in the consolidated income after taxes of CHF 8.4 million.

The Group will adopt the new standards IFRS 2 and IFRS 5 as well as the revised standards IAS 1, IAS 2, IAS 8, IAS 10, IAS 16, IAS 17, IAS 21, IAS 24, IAS 27, IAS 28, IAS 31, IAS 32, IAS 33, IAS 39 and IAS 40 as of April 1, 2005.

### 3. Basis of the consolidated financial statements

The consolidated financial statements of the Group are based on the financial statements of the individual Group companies at March 31 prepared in accordance with uniform accounting policies. The consolidated financial statements have been prepared under the historical cost convention except for the revaluation of certain financial assets at market value, in accordance with International Financial Reporting Standards (IFRS), including International Accounting Standards and Interpretations issued by the International Accounting Standards Board (IASB). The consolidated financial statements were approved by the Board of Directors of Phonak Holding Ltd. on May 25, 2005.

The preparation of financial statements requires management to make estimates and assumptions that affect the amounts reported for assets and liabilities and contingent assets and liabilities at the date of the financial statements as well as revenue and expenses reported for the financial year. Actual results could differ from these estimates.

#### 3.1 Basis of consolidation

The consolidated financial statements include the financial statements of Phonak Holding Ltd. as well as the domestic and foreign subsidiaries over which Phonak Holding Ltd. exercises control. A list of the significant companies which are consolidated is given in Note 38.

## 3.2 Principles of consolidation

### Investments in subsidiaries

Investments in subsidiaries are fully consolidated. These are entities over which Phonak Holding Ltd. directly or indirectly exercises control. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Control is presumed to exist when the parent owns, directly or indirectly through subsidiaries, more than half of the voting power of an entity unless, in exceptional circumstances, it can be clearly demonstrated that such ownership does not constitute control. Under the full consolidation method, 100% of assets, liabilities, income and expenses are included. The interests of minority shareholders in equity and net income or loss are shown separately in the balance sheet and income statement. Group companies acquired during the year are included in the consolidation from the date on which control over the company is transferred to the Group, and are excluded from the consolidation as of the date the Group ceases to have control over the company. Intercompany balances (incl. unrealized profit on intercompany inventories), and transactions are eliminated in full.

### Investments in associates

Investments in associates are accounted for using the equity method of accounting. These are entities in which Phonak has significant influence and which are neither subsidiaries nor joint ventures of Phonak. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies (usually 20-50% of voting rights). Under the equity method, the investment in an associate is initially recognized at cost and the carrying amount is increased or decreased to recognize Phonak's share of profit or loss of the investee after the acquisition date.

The Group's share of equity in associated companies, consolidated using the equity method, is shown in the balance sheet as "Investments in associate / joint venture", and its share of the results of operations for the year is shown in the income statement as "Share of gain / (loss) in associate / joint venture".

Adjustments to the carrying amount may also be necessary for changes in Phonak's proportionate interest in the investee arising from changes in the investee's equity that have not been recognized in the investee's profit or loss. Such changes include those arising from revaluation of property, plant and equipment and from foreign exchange translation differences. Phonak's share of those changes is recognized in equity.

Associates acquired during the year are accounted for as investments in associates from the date on which significant influence over the investee is transferred to the Group, and derecognized from the position "investments in associate / joint venture" as of the date Phonak ceases to have significant influence over an associate.

### Investments in joint ventures

Investments in joint ventures are accounted for using the equity method of accounting. These are contractual arrangements whereby two or more parties undertake an economic activity that is subject to joint control. Joint control is the contractually agreed sharing of control over an economic activity, and exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control. Under the equity method, the investment in a joint venture is initially recognized at cost and the carrying amount is increased or decreased to recognize Phonak's share of profit or loss of the jointly controlled entity after the acquisition date.

The Group's share of equity in joint ventures consolidated using the equity method is shown in the balance sheet as "Investments in associate / joint venture", and its share of the results of operations for the year is shown in the income statement as "Share of gain / (loss) in associate / joint venture".

Adjustments to the carrying amount may also be necessary for changes in Phonak's proportionate interest in the joint venture arising from changes in the investee's equity that have not been recognized in the investee's profit or loss. Such changes include those arising from revaluation of property, plant and equipment and from foreign exchange translation differences. Phonak's share of those changes is recognized in equity.

Joint ventures established during the year are accounted for as investments in joint ventures from the date on which joint control of the joint venture is transferred to the Group and derecognized from that position as of the date Phonak ceases to have joint control.

### **3.3 Currency translation**

The consolidated financial statements are expressed in Swiss Francs ("CHF"), which is the company's functional and presentation currency. The functional currency of each Group Company is the applicable local currency.

Transactions in foreign currencies are accounted for at the rates prevailing at the dates of the transactions. The resulting exchange differences are recorded in the local income statements of the Group companies and included in net income. Monetary assets and liabilities of Group companies which are denominated in foreign currencies are translated using year-end exchange rates. Exchange differences are recorded as an income or expense. Non-monetary assets and liabilities are translated at historical exchange rates. Exchange differences arising on intercompany loans that are considered part of the net investment in a foreign entity are recorded in equity.

When translating foreign currency financial statements into Swiss Francs, year-end exchange rates are applied to assets and liabilities, while average annual rates are applied to income statement accounts. Translation differences arising from this process are recorded as a separate component of shareholders' equity. On disposal of a subsidiary, the related cumulative translation adjustment is transferred from shareholders' equity and included in the gain or loss on disposal in the income statement.

### **3.4 Accounting and valuation principles**

#### **Cash and cash equivalents**

This item includes cash in hand and at banks, time deposits and other short-term highly liquid investments with original maturities of 3 months or less, as well as bank overdrafts. The cash flow statement is based on cash and cash equivalents.

#### **Trade receivables**

Trade receivables are recorded at original invoice amount less provision made for impairment of these receivables. A provision for impairment of trade receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the invoice. The amount of the provision is the difference between the carrying amount and the recoverable amount, being the present value of expected cash flows.

#### **Inventories**

Purchased raw materials, components and finished goods are valued at the lower of cost or net realizable value. To evaluate cost, the standard cost method is applied. Standard costs take into account normal levels of materials, supplies, labour, efficiency and capacity utilization. Standard costs are regularly reviewed and, if necessary, revised in the light of current conditions. At each period end, any production or purchase price variances are analyzed and credited or charged to inventory if not related to abnormal amounts of wasted materials, labour or other production costs. Net realizable value is the

estimated selling price in the ordinary course of business less the estimated costs of completion and selling expenses. Manufactured finished goods and work in process are valued at the lower of production cost or net realizable value. Provisions are established for slow moving, obsolete and phase out inventory.

### **Tangible assets**

Tangible assets (land, buildings, plant and equipment) are valued at purchase or manufacturing cost less accumulated depreciation and any impairment in value. Depreciation is calculated on a straight-line basis over the expected useful lives of the individual assets or asset categories. The applicable useful lives are 25–40 years for buildings, and 3–10 years for production facilities, machinery, equipment and vehicles. Land is not depreciated. Leasehold improvements are depreciated over the shorter of useful life or lease term.

Borrowing costs incurred for the construction of any qualifying asset are capitalized during the period of time that is required to complete and prepare the asset for its intended use. Subsequent expenditure on an item of tangible assets is capitalized at cost only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. Expenditures for repair and maintenance which do not increase the estimated useful lives of the related assets are recognized as an expense in the period in which they are incurred.

### **Research and development**

The majority of research and development costs are expensed as incurred. In addition to the internal costs (direct personnel and other operating costs, depreciation on research and development equipment and allocated occupancy costs), total costs also include externally contracted research and development work. Development of tooling and equipment is recognized as an asset to the extent that it is expected that the corresponding project is determined to be technically and commercially feasible, thereby yielding probable future economic benefits.

### **Leasing**

Assets that are held under leases which effectively transfer to the Group the risks and rewards of ownership (finance leases) are capitalized at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. Minimum lease payments are the payments over the lease term that Phonak is or can be required to make, excluding contingent rent, costs for services and taxes to be paid by and reimbursed to the lessor, together with any amounts guaranteed by Phonak or by a party related to Phonak. Assets under financial leasing are depreciated over the shorter of their estimated useful life or the lease term. The corresponding financial obligations are classified as "short-term debts" or "other long-term debts", depending on whether they are payable within or after 12 months.

Leases of assets under which all the risks and rewards of ownership are effectively retained by the lessor are classified as operating leases, and payments are recognized as an expense on a straight-line basis over the lease term unless another systematic basis is more representative of the time pattern of the Group's benefit.

### **Intangible assets**

Purchased intangible assets such as software, licences and patents, are measured at cost less accumulated amortization and any impairment in value. Software is amortized over a useful life of 3 years, whereas other intangible assets are amortized over a period of 3 to 5 years or over their expected useful lives applying the straight-line method. Phonak has no intangible asset with an indefinite useful life.



## Goodwill

Goodwill represents the future economic benefits arising from assets acquired in a business combination (acquisition of either entities or businesses in the form of a share or net assets deal) that are not capable of being individually identified and separately recognized.

The cost of a business combination is determined in accordance with IFRS 3 and is equal to the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by Phonak, in exchange for control of the acquiree plus any costs directly attributable to the business combination. When a business combination agreement provides for an adjustment to the cost of the combination contingent on future events, Phonak includes the amount of that adjustment in the cost of the combination at the acquisition date if the adjustment is probable and can be measured reliably. At acquisition date (date on which the Group effectively obtains control of the acquiree), Phonak allocates the cost of a business combination by recognizing the acquiree's identifiable assets, liabilities and contingent liabilities at their fair value at that date, except for non-current assets that are classified as held for sale, which are recognized at fair value less costs to sell. Any difference between the cost of the business combination and the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities so recognized is treated as goodwill. If the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognized as described above exceeds the cost of the business combination, Phonak reassesses the identification and measurement of the acquiree's identifiable assets, liabilities and contingent liabilities and the measurement of the cost of the combination and recognizes immediately in profit or loss any excess remaining after that reassessment. At April 1, 2004, when the new standard, IFRS 3, and the revised standard IAS 36 first became effective, the carrying amount of negative goodwill has been derecognized with a corresponding adjustment to the opening balance of retained earnings.

After initial recognition, Phonak measures goodwill at cost less any accumulated impairment losses. In accordance with IFRS 3, IAS 36 and IAS 38, Phonak no longer amortizes goodwill. Instead, goodwill is tested for impairment annually in the first half of each financial year, or more frequently if events or changes in circumstances indicate that there might be an impairment. For the purpose of impairment testing, goodwill acquired in a business combination is allocated to each of Phonak's cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units or groups of units. For the impairment test, the recoverable amount of a cash-generating unit (higher of the cash-generating unit's fair value less costs to sell and its value in use) is compared to the carrying amount of the corresponding cash-generating unit. Value in use is the present value of the future cash flows expected to be derived from a cash-generating unit. Future cash flows are estimated for a period of 5 years taking into consideration a terminal value, where applicable, and discounted with the Weighted Average Cost of Capital (WACC) also using the technique of the Capital Asset Pricing Model (CAPM). Value in use is normally assumed to be higher than the fair value less costs to sell, therefore, fair value less costs to sell is only investigated when value in use is lower than the carrying amount.

## Short-term debts

Short-term debts consist of short-term bank debts and all other interest bearing debts with a maturity of 12 months or less.

## Provisions

Provisions are recognized when the Group has a present obligation (legal or constructive) as a result of a past event, where it is probable that an outflow of resources will be required to settle the obligation, and where a reliable estimate can be made of the amount of the obligation. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows. The Group especially recognizes provisions for warranty costs to cover any

costs arising from the warranty given on the sale of its products. The provision is calculated using historical and projected data on warranty rates, service costs, remaining warranty period and number of hearing aids on which the warranty is still active.

### **Income taxes**

Income taxes include current and deferred income taxes. Phonak is subject to income taxes in numerous jurisdictions and significant judgement is required in determining the worldwide provision for income taxes. The multitude of transactions and calculations imply estimates and assumptions. The Group recognizes liabilities based on estimates of whether additional taxes will be due.

Where the final tax outcome is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the period in which such determination is made.

Deferred tax is recorded on the valuation differences (temporary differences) between the tax bases of assets and liabilities and their carrying values in the consolidated balance sheet. Deferred tax assets relating to tax loss carry-forwards are recognized only to the extent that it is probable that taxable income will be available against which the tax losses can be offset.

Provision is made for non-recoverable withholding taxes only on anticipated dividend distributions from subsidiaries. No provision is made in respect of possible future dividend distributions from undistributed earnings, as these are generally reinvested.

### **Revenue recognition**

Sales are recognized net of sales taxes and discounts upon delivery of products and customer acceptance. Intercompany sales are eliminated.

### **Sales related costs**

These consist of expenditures which relate directly to sales revenue, such as cash discounts, year-end rebates, third-party sales commissions, outward freight costs and bad debts.

### **Segment reporting**

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risk and returns that are different from those of segments operating in other economic environments.

### **Impairment**

Phonak assesses at each reporting date whether there is any indication that an asset may be impaired. If any such indication exists, the entity estimates the recoverable amount of the asset. The recoverable amount of an asset or a cash-generating unit is the higher of its fair value less selling costs and its value in use. Value in use is the present value of the future cash flows expected to be derived from an asset or cash-generating unit. If the recoverable amount is lower than the carrying amount, an impairment loss is recognized. Impairment of financial assets is described under the section on financial instruments.

For goodwill, an annual impairment test is performed in the first half of each financial year, even if there is no indication of impairment (see goodwill section above).

## Related parties

A party is related to an entity if the party directly or indirectly controls, is controlled by, or is under common control with the entity, has an interest in the entity that gives it significant influence over the entity, has joint control over the entity or is an associate or a joint venture of the entity. In addition, members of the key management personnel of the entity or close members of their family are also considered related parties as are post-employment benefit plans for the benefit of employees of the entity. All transactions with related parties are on an arm's-length basis. No related party exercises control over the Group.

## Employee benefits (IAS 19)

### Pension obligations

Certain Group companies have pension plans in addition to the mandatory local statutory social security plans. Such plans are usually defined contribution plans (future benefits are determined by reference to the amount of contributions paid) and are generally administered by autonomous pension plans or independent insurance companies. These pension plans are financed through employer and employee contributions.

Phonak Holding AG's pension fund, in which the Swiss Group companies Phonak AG, and Phonak Communications AG participate, as well as Phonak AS's (Norway) plan are classified as funded defined benefit plans. Hansaton Akustische Geräte GmbH (Austria), Unitron Hearing GmbH (Germany) and Unitron Hearing Ltd. (Canada) have unfunded defined benefit plans. Pension costs are assessed using the projected unit credit method: the cost of providing pensions is charged to the income statement so as to spread the regular cost over the service lives of employees participating in these plans, in accordance with the advice of the actuaries who carry out a full valuation of the plans on an annual basis (at year end). The pension obligation is measured as the present value of the estimated future outflows using interest rates of government securities which have terms to maturity approximating the terms of the related liability. Actuarial gains and losses are recognized over the average remaining service periods of employees participating in these plans as income or expense when the cumulative unrecognized actuarial gains or losses for each individual plan exceed 10% of the higher of the defined benefit obligation and the fair value of plan assets.

### Other long-term benefits

Other long-term benefits comprise mainly length of service compensation benefits which certain subsidiary companies are required to provide in accordance with legal requirements in the respective countries. These benefits are accrued, and the corresponding liabilities are included under "Provisions for bonus, vacation pay and employee benefits".

### Equity compensation benefits

Up to financial year 2003/04, a certain number of options on the shares of Phonak Holding AG were granted annually to members of the Board of Directors of Phonak Holding AG, Group executive management as well as management and senior employees of other Group companies. In general, these option grants are subject to the condition that the respective employees have been employed by the Group for a period of at least two years. The strike price normally equalled the average market value during the one to three months prior to the date of grant (see also Note 32) and no costs were recognized in the consolidated financial statements for options granted to employees.

Starting from financial year 2004/05, the Group has launched a new Executive Equity Award Program (EEAP) for members of Management and a Share Purchase Plan (SPP) for all employees of the Group.

### **Executive Equity Award Plan (EEAP)**

In accordance with the Executive Equity Award Plan shares and options are granted annually to the Board of Directors and members of the Group Management worldwide who have worked for the company for at least two years and are entitled to receive options and/or shares free of charge.

#### ***Options***

No costs are recognized in the income statement for the option plans.

#### ***Shares***

The pro rata temporis costs of the shares offered as part of the EEAP program are charged to personnel expenses and credited to provisions over the vesting period. The shares are subject to a blocking period of one to four years. There are no performance conditions for the vesting of the shares.

### **Share Purchase Plan (SPP)**

The Share Purchase Plan is offered annually to all permanent employees of the Group, having completed their probationary period. A Participant may purchase a maximum number of shares. For every 2 shares purchased by the Participant, the Participant receives one additional share for free. The pro rata temporis costs of the shares offered as part of the SPP program are charged to personnel expenses and credited to provisions over the vesting period. The shares are subject to a blocking period of two years. There are no performance conditions for the vesting of the shares.

### **Financial Risk Factors**

The Group is exposed to the following financial risk categories:

#### ***Interest rate risk***

Interest rate risk relates primarily to long-term interest bearing liabilities. The Group's mortgages as well as a portion of the other long-term debts represent long-term fixed-rate contracts, which minimize the risk of changing interest rates. The remainder of the long-term debts are currently subject to money market rates. The interest situation and hedging possibilities are continuously monitored. Derivative instruments are currently not being used to hedge against changes in interest rates.

#### ***Exchange rate risk***

The Group buys and sells products in foreign currencies and is therefore exposed to exchange rate risks. To minimize foreign currency exchange risks, relating in particular to intercompany sales and the settlement of intercompany loans, forward currency contracts are entered into. Generally, these contracts do not qualify for hedge accounting treatment under IAS 39, and accordingly exchange losses and gains on forward currency contracts are recognized in the income statement. However, if a forward contract qualifies to be treated as a hedge, under IAS 39, such exchange gains and losses on the contract are recorded in equity. There are certain foreign currency contracts against a foreign currency denominated intercompany loan (net investment in foreign subsidiaries), which qualify as hedges under IAS 39.

#### ***Credit risk***

Financial instruments which could expose the Group to a potential concentration risk are principally cash and bank balances and trade receivables. Banking relations are maintained only with first-class financial institutions. The Group performs continuous credit checks on its customers and is not exposed to any significant concentration risks.

## **Investments**

Phonak classifies its investments in the following categories: financial assets held for trading, loans and receivables, held-to-maturity investments, and available-for-sale financial assets. The classification depends on the purpose for which the investments were acquired. Management determines the classification of its investments at initial recognition and reclassifies them whenever their intention or ability changes. All purchases and sales are recognized on the settlement date.

### ***Financial assets held for trading***

In principle, financial assets held for trading are acquired for the purpose of generating a profit from short-term fluctuations in price or dealer's margin. Derivative financial assets and derivative financial liabilities are always deemed as held for trading unless they are designated and effective hedging instruments. Financial assets held for trading are measured at their fair value plus initial transaction costs. Fair value changes on a financial asset held for trading are included in net profit or loss for the period in which they arise. Assets in this category are classified as current assets if they are either held for trading or are expected to be realized within 12 months of the balance sheet date.

### ***Loans and receivables***

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Group provides money, goods or services directly to a debtor with no intention of trading the receivable. They are included in current assets, except for maturities more than 12 months after the balance-sheet date. These are classified as non-current assets. Loans and receivables are included in trade and other receivables in the balance sheet. Loans are measured at amortized cost. Amortized cost is the amount at which the financial asset is measured at initial recognition minus principal repayments, plus or minus the cumulative amortization using the effective interest method of any difference between that initial amount and the maturity amount, minus any reduction for impairment or uncollectibility. The effective interest method is a method of calculating the amortized cost of a financial asset and of allocating the interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset.

### ***Held-to-maturity investments***

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group's Management has the intention and ability to hold to maturity. Assets under this category that have a fixed maturity are valued at amortized cost using the effective interest rate method.

### ***Available-for-sale financial assets***

Available-for-sale financial assets are non-derivative financial assets that are designated in this category or not classified in any of the other categories. They are included in non-current assets unless Management intends to dispose of the investment within 12 months of the balance sheet date. Available-for-sale financial assets are measured at their fair value. Gains or losses on an available-for-sale financial asset are included in net profit or loss for the period in which they arise.

### ***Impairment of Financial Assets***

A financial asset is impaired if its carrying amount is greater than its estimated recoverable amount. The Group assesses, at each balance sheet date, whether there is any objective evidence that a financial asset may be impaired. If any such evidence exists, the Group estimates the recoverable amount of that asset and recognizes any impairment loss in the income statement. If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be objectively

related to an event occurring after the write-down, the write-down of the financial asset is reversed. The reversal generally will not result in a carrying amount of the financial asset that exceeds what amortized cost would have been, had the impairment not been recognized, at the date the write-down of the financial asset is reversed. The amount of the reversal is included in net income for the financial year.

#### ***Derivative financial instruments and hedging***

Until November 2004, the Group entered into derivative contracts in order to hedge net investments (intercompany loans that are an extension of the net investment) in foreign entities. Such derivative contracts are designated as hedges on the date of inception. The effective portion of changes in the fair value of such derivatives was recognized in equity. All foreign exchange gains or losses arising on remeasurement of the derivative contracts were recognized in equity and included in cumulative translation differences. The gain or loss on the hedging instrument relating to the effective portion of the hedge that has been recognized directly in equity will be transferred to the income statement on disposal of the foreign operation. No net investment hedge has been made since November 2004.

Furthermore, the Group regularly hedges its net exposure of the expected future cash in- and outflows with forward contracts. Such contracts are not accounted for by applying hedge accounting. The corresponding positive and negative replacement values are recognized on the balance sheet as financial assets / financial liabilities held for trading.

#### **Prior year figures**

Prior year comparative figures are reclassified where necessary to correspond to the new, improved structure of the financial statements.

## **4. Changes in Group Structure**

As of June 8, 2004, Unitron (Sichuan) Co., Ltd. was included in the consolidation for the first time. This company is engaged in the sale of hearing instruments and related products. For more information on the acquisition refer to Note 29.

In September 2004, the Company Viennatone Hörgeräte GmbH, Vienna, Austria has been merged with its parent Company Hansaton Akustische Geräte GmbH.

During 2003/04, the following companies were included in the consolidation for the first time:

- Phonak Japan Co. Ltd., Tokyo, Japan (founded in June 2003)
- Unitron Hearing (Suzhou) Co. Ltd., Suzhou, P.R. China (founded in August 2003)
- Cochlear Acoustics Ltd., London, United Kingdom (25% interest established as of August 1, 2003)
- Viennatone Hörgeräte GmbH, Vienna, Austria (100% interest purchased as of March 1, 2004 by Hansaton Akustische Geräte GmbH, Wals-Himmelreich, Austria).

As of April 1, 2003, Phonak Middle East FZE, Dubai, was closed and its operations transferred to Jordan Hearing Manufacturing Aids & Co. Ltd., Amman, Jordan.

## 5. Segment information

The Group is active in one business segment: the development, production, distribution and service of hearing instruments and related products.

The primary segment information is presented according to geographical regions based on location of assets. This corresponds to the organizational structure. Transactions between segments are generally conducted at market rates.

1,000 CHF	Europe		North America	
	2004/05	2003/04	2004/05	2003/04
<b>P&amp;L based on location of assets</b>				
<b>Sales</b>				
Third parties	356,136	320,323	286,985	287,960
Intersegment sales	264,339	238,802	22,460	6,722
<b>Total sales</b>	<b>620,475</b>	<b>559,125</b>	<b>309,445</b>	<b>294,682</b>
<b>Operating profit / (loss) before amortization of goodwill (EBITA)</b>	<b>143,457</b>	<b>115,194</b>	<b>25,615</b>	<b>27,937</b>
<b>Operating profit / (loss) (EBIT)</b>	<b>143,457</b>	<b>110,447</b>	<b>25,615</b>	<b>24,126</b>
Financial (expense) / income, net				
Share of gain / (loss) in associate / joint venture	152	(280)		
<b>Income before taxes and minority interest</b>				
Taxes				
Minority interest				
<b>Income after taxes</b>				
<b>Total assets <sup>1)</sup></b>	<b>731,173</b>	<b>742,592</b>	<b>382,111</b>	<b>359,164</b>
<b>Total liabilities <sup>1)</sup></b>	<b>336,167</b>	<b>319,770</b>	<b>206,468</b>	<b>210,355</b>
Capital expenditure in tangible and intangible assets	17,421	15,624	3,668	4,173
Depreciation and amortization on tangible and intangible assets	19,947	22,385	4,618	9,410
<b>Third party sales based on location of customers</b>	<b>333,059</b>	<b>303,772</b>	<b>276,812</b>	<b>274,278</b>
Growth in local currencies	9.7%		7.7%	

1) "Others" include only unallocated corporate assets and liabilities.

	Asia / Pacific		Others		Eliminations		Total	
	2004/05	2003/04	2004/05	2003/04	2004/05	2003/04	2004/05	2003/04
	35,654	29,319					678,775	637,602
	30,036	5,088			(316,835)	(250,612)	0	0
	<b>65,690</b>	<b>34,407</b>			<b>(316,835)</b>	<b>(250,612)</b>	<b>678,775</b>	<b>637,602</b>
	<b>(4,107)</b>	<b>(2,959)</b>			<b>(37,290)</b>	<b>(36,657)</b>	<b>127,675</b>	<b>103,515</b>
	<b>(4,107)</b>	<b>(2,955)</b>			<b>(37,290)</b>	<b>(36,657)</b>	<b>127,675</b>	<b>94,961</b>
							(825)	(942)
							152	(280)
							<b>127,002</b>	<b>93,739</b>
							(29,268)	(24,380)
							(832)	(484)
							<b>96,902</b>	<b>68,875</b>
	<b>50,535</b>	<b>21,844</b>	<b>152,915</b>	<b>74,743</b>	<b>(573,374)</b>	<b>(514,659)</b>	<b>743,360</b>	<b>683,684</b>
	<b>50,532</b>	<b>16,849</b>	<b>78,478</b>	<b>132,743</b>	<b>(377,989)</b>	<b>(346,371)</b>	<b>293,656</b>	<b>333,346</b>
	1,994	2,391	0	0	0	(837)	23,083	21,351
	928	492	0	0	(186)	0	25,307	32,287
	<b>50,937</b>	<b>43,215</b>	<b>17,967</b>	<b>16,337</b>			<b>678,775</b>	<b>637,602</b>
	18.8%		12.0%				9.5%	



## 6. Consolidated Income Statement by type of expenditure

The income statement has been prepared using the operational format. In order to provide additional information, the income statement by nature of expenditure is presented below.

1,000 CHF	Notes	2004/05	2003/04
<b>Sales</b>	<b>5</b>	<b>678,775</b>	<b>637,602</b>
Sales related costs		(26,666)	(23,700)
Changes in finished goods and work in process		1,879	950
Other operating income		661	59
<b>Operating income</b>		<b>654,649</b>	<b>614,911</b>
Direct material costs		(141,451)	(145,275)
Own work capitalized		1,967	2,698
Personnel expenses		(224,698)	(207,111)
Other operating expenses		(139,472)	(136,681)
Depreciation and amortization on intangible assets other than goodwill	<b>18, 21</b>	(25,307)	(23,733)
Exchange differences		1,987	(1,294)
<b>Operating profit before amortization of goodwill (EBITA)</b>		<b>127,675</b>	<b>103,515</b>
Amortization of goodwill	<b>21</b>	0	(8,554)
<b>Operating profit (EBIT)</b>		<b>127,675</b>	<b>94,961</b>
Financial (expenses) / income, net	<b>9</b>	(825)	(942)
Share of gain / (loss) in associate / joint venture	<b>19</b>	152	(280)
<b>Income before deduction of taxes and minority interest</b>		<b>127,002</b>	<b>93,739</b>
Income taxes	<b>10</b>	(29,268)	(24,380)
Minority interest		(832)	(484)
<b>Income after taxes</b>		<b>96,902</b>	<b>68,875</b>

## 7. Financial instruments

Forward foreign exchange contracts		
1,000 CHF	31.3.2005	31.3.2004
Underlying principal amount	177,459	259,432
Positive replacement value	990	582
Negative replacement value	(1,421)	(4,256)
<b>Total</b>	<b>(431)</b>	<b>(3,674)</b>

Positive replacement values are recorded as financial assets held for trading (Note 14), whereas negative replacement values are recorded as financial liabilities held for trading.

The Group hedges its net foreign currency exposure based on future expected cash inflows and outflows. The hedges have a duration between 1 and 12 months. No hedge accounting has been applied to these hedges.

## 8. Other (expenses) / income, net

1,000 CHF	2004/05	2003/04
Gain / (loss) on disposal of tangible assets, net	27	(430)
Other operating expenses	(1,842)	(1,004)
Other operating income	1,626	1,142
<b>Total</b>	<b>(189)</b>	<b>(292)</b>

## 9. Financial (expenses) / income, net

1,000 CHF	2004/05	2003/04
Gain / (loss) on financial assets held for trading, net	430	1,157
Interest income on bank accounts	1,190	1,026
Other financial income	1,948	292
<b>Total financial income</b>	<b>3,568</b>	<b>2,475</b>
Mortgage interest	(1,214)	(1,313)
Leasing interest (finance leases)	(2)	(3)
Other interest expense	(1,968)	(1,854)
Change in fair value of financial assets available for sale	(1,209)	(247)
<b>Total financial expense</b>	<b>(4,393)</b>	<b>(3,417)</b>
<b>Total financial (expenses) / income, net</b>	<b>(825)</b>	<b>(942)</b>

Mortgage interest is mainly related to the mortgages on Phonak's building in Stäfa, Switzerland. The interest rate on mortgages was between 2.75% and 7.35% in 2004/05 (see Note 25). Other interest expense is mainly related to bank loans (see Notes 23 and 26).

The change in fair value of financial assets available for sale is related to an adjustment of the fair value of three investments in third party companies (less than 20% of voting rights). These adjustments have been determined based on an analysis of the financial statements of the corresponding unquoted companies.

## 10. Taxes

1,000 CHF	2004/05	2003/04
Income taxes	31,529	21,504
Change in deferred taxes	(2,261)	2,876
<b>Total tax expense</b>	<b>29,268</b>	<b>24,380</b>
<b>Reconciliation of tax expense</b>		
Income before taxes and minority interests	127,002	93,739
Weighted average expected tax rate <sup>1)</sup>	25.0%	24.8%
<b>Tax at weighted average rate</b>	<b>31,801</b>	<b>23,280</b>
<b>+/- effects of</b>		
non tax deductible expenses	591	3,164
utilization of previously unrecognized loss carryforwards	(1,345)	(2,396)
non taxable income	(2,235)	0
change in tax rates on deferred tax balances <sup>2)</sup>	(1,059)	(968)
previous year expense and other items	1,515	1,300
<b>Total tax expense</b>	<b>29,268</b>	<b>24,380</b>
as a % of consolidated income before taxes and minority interest	23.0%	26.0%

1) The expected Group tax rate is the aggregate obtained by applying the currently effective rate for each individual jurisdiction to its respective result before taxes.

2) The change in tax rate on deferred tax balances mainly relates to a decrease in tax rate in Austria from 34% in 2004 to 25% in 2005.

### Composition of deferred tax assets and liabilities

1,000 CHF	31.3.2005		31.3.2004	
	Assets	Liabilities	Assets	Liabilities
Tax loss carry forwards	9,015	0	16,306	0
Trade receivables	1,137	1,185	1,232	533
Other receivables and prepaid expenses	0	101	0	0
Inventories incl. allowances	13,874	2,281	11,509	2,699
Tangible fixed assets	30	8,559	297	10,188
Intangible assets	5,665	2,843	859	2,422
Other liabilities and short-term provisions	14,347	345	13,567	0
Long-term provisions	855	2,242	1,133	2,121
Other items	0	0	(5)	(19)
<b>Deferred taxes</b>	<b>44,923</b>	<b>17,556</b>	<b>44,898</b>	<b>17,944</b>

Deferred tax assets have been capitalized based on the projected future performance of the Group Companies, supplemented with tax planning opportunities.

In financial year 2004/05, CHF 42,000 have been credited to equity arising from the deferred tax impact on the currency translation difference related to the associate company Cochlear Acoustics Ltd., London, UK. No deferred taxes have been charged or credited to shareholders' equity in financial year 2003/04.

The gross values of unused tax loss carryforwards, which have not been capitalized as deferred tax assets, with their expiry dates are as follows:

1,000 CHF	2004/05	2003/04
Within 1 year	0	0
Within 2 years	0	0
Within 3 years	595	0
Within 4 years	0	1,209
Within 5 years	0	0
More than 5 years	80	3,293
<b>Total</b>	<b>675</b>	<b>4,502</b>

## 11. Earnings per share

### Basic earnings per share

Basic earnings per share are calculated by dividing the income after taxes attributable to the ordinary equity holders of the parent company by the weighted average number of shares outstanding during the year.

	2004/05	2003/04
Income after taxes (in 1,000 CHF)	96,902	68,875
Weighted average number of outstanding shares	65,548,317	65,198,175
<b>Basic earnings per share (in CHF)</b>	<b>1.478</b>	<b>1.056</b>

### Diluted earnings per share

In the case of diluted earnings per share, the weighted average number of shares outstanding is adjusted assuming all outstanding dilutive options will be exercised. The weighted average number of shares is adjusted for all dilutive options issued under the stock option plans which have been granted in 2003, 2004 and 2005 and which have not yet been exercised. Antidilutive options have not been considered for the diluted earnings per share calculation. For financial year 2004/05, antidilutive outstanding options amounted to 41,875 (25,000 outstanding at year end) at an exercise price of CHF 40.50 and 175,313 (15,000 outstanding at year end) at an exercise price of CHF 56.00. The calculation of diluted earnings per share is based on the same income after taxes for the period as is used in calculating basic earnings per share.

	2004/05	2003/04
Income after taxes (in 1,000 CHF)	96,902	68,875
Adjusted weighted average number of outstanding shares	66,263,423	65,605,749
<b>Diluted earnings per share (in CHF)</b>	<b>1.462</b>	<b>1.050</b>

## 12. Dividend per share

The Board of Directors of Phonak Holding AG proposes to the Annual General Shareholders' Meeting, to be held on July 7, 2005, that a dividend of CHF 0.30 per share be distributed.

### 13. Cash and cash equivalents

1,000 CHF	31.3.2005	31.3.2004
Cash on hand	5,029	3,145
Postal checking and current bank accounts	83,727	137,025
Time deposits	84,487	4,958
<b>Total</b>	<b>173,243</b>	<b>145,128</b>

For financial year 2004/05, the interest rate on short term time deposits was between 0.5% and 7.25% depending on the currency of the underlying contract; these deposits usually have a maturity of 1 to 3 months.

For details of the movements in cash and cash equivalents refer to the consolidated statement of cash flows (page 48).

### 14. Financial assets held for trading

1,000 CHF	31.3.2005	31.3.2004
Bonds	6,932	6,679
Shares	4,479	4,389
Positive replacement value of forward foreign exchange contracts	990	582
<b>Financial assets held for trading</b>	<b>12,401</b>	<b>11,650</b>

For details on forward foreign exchange contracts refer to Note 7.

## 15. Trade receivables

1,000 CHF	31.3.2005	31.3.2004
Accounts receivable	147,495	123,389
Provision for doubtful accounts	(8,298)	(7,069)
<b>Total</b>	<b>139,197</b>	<b>116,320</b>

The biggest open balance towards one single client represented 3% of the total accounts receivable balance at March 31, 2005. As usual in this industry, the Phonak Group has a large number of customers and there is no significant concentration of the credit risk.

## 16. Other receivables and prepaid expenses

1,000 CHF	31.3.2005	31.3.2004
Other receivables	11,832	11,826
Prepaid expenses	8,140	4,459
<b>Total</b>	<b>19,972</b>	<b>16,285</b>

The largest individual items included in other receivables are recoverable value added taxes and advances to suppliers.

## 17. Inventories

1,000 CHF	31.3.2005	31.3.2004
Raw materials and components	41,103	43,316
Work in process	30,151	18,551
Finished products (incl. purchased goods)	35,689	36,279
Allowances	(20,393)	(20,666)
<b>Total</b>	<b>86,550</b>	<b>77,480</b>

Allowances include writedowns for slow moving, phase out and obsolete stock.

## 18. Tangible assets

1,000 CHF	Land	Buildings	Total Land & Buildings	Plant & Equipment	Total tangible assets	Total tangible assets
<b>Cost</b>					<b>31.3.2005</b>	<b>31.3.2004</b>
Balance April 1	10,166	80,200	90,366	139,722	230,088	210,733
Change through business combinations	0	0	0	355	355	3,545
Additions	0	349	349	19,227	19,576	18,138
Disposals	0	(10)	(10)	(4,680)	(4,690)	(4,956)
Exchange differences	0	(78)	(78)	(1,254)	(1,332)	2,628
<b>Balance March 31</b>	<b>10,166</b>	<b>80,461</b>	<b>90,627</b>	<b>153,370</b>	<b>243,997</b>	<b>230,088</b>
<b>Accumulated Depreciation</b>						
Balance April 1	195	23,696	23,891	87,339	111,230	90,779
Change through business combinations	0	0	0	73	73	2,387
Additions	0	2,225	2,225	19,536	21,761	20,126
Disposals	0	(4)	(4)	(3,779)	(3,783)	(3,403)
Exchange differences	(1)	(44)	(45)	(630)	(675)	1,341
<b>Balance March 31</b>	<b>194</b>	<b>25,873</b>	<b>26,067</b>	<b>102,539</b>	<b>128,606</b>	<b>111,230</b>
<b>Net book value</b>						
Balance April 1	9,971	56,504	66,475	52,383	118,858	119,954
<b>Balance March 31</b>	<b>9,972</b>	<b>54,588</b>	<b>64,560</b>	<b>50,831</b>	<b>115,391</b>	<b>118,858</b>

The tangible assets (buildings, plant and equipment) are insured against fire at a value of CHF 235.1 million (previous year CHF 223.5 million). Pledged assets amounted to CHF 47.7 million (previous year CHF 49.3 million) and were all related to mortgages. Plant and equipment includes assets held under finance leases with the following values:

- cost CHF 0.49 million (previous year CHF 0.01 million)
- net book value CHF 0.10 million (previous year CHF 0.01 million)

The corresponding leasing liabilities amounted to CHF 0.32 million (previous year CHF 0.03 million) (see Note 34).

Expenditures recognized in the carrying amount of Plant & Equipment in the course of their construction amounted to CHF 3.5 million for financial year 2004/05 (CHF 3.5 million for financial year 2003/04).



## 19. Investments in associate and joint venture

Phonak holds the following significant investments in associates and joint ventures which are accounted for by using the equity method:

1,000 CHF	HIMSA A/S, Copenhagen, Denmark <sup>1)</sup>	
	2004	2003
Current assets	4,777	1,942
Non-current assets	279	118
<b>Total assets</b>	<b>5,056</b>	<b>2,060</b>
Current liabilities	(3,127)	(1,997)
Long-term liabilities	0	0
<b>Total liabilities</b>	<b>(3,127)</b>	<b>(1,997)</b>
<b>Net assets</b>	<b>1,929</b>	<b>63</b>
Income for the year	10,660	6,804
Expenses for the year	(8,808)	(5,124)
<b>Profit for the year</b>	<b>1,852</b>	<b>1,680</b>
% of Phonak's voting rights and share of investment	25%	25%
Net book value at year end	479	0
Share of gain recognized by Phonak	479	0

1) As the financial year of HIMSA A/S corresponds with the calendar year, financial figures as of December 31 are included.

**HIMSA A/S** is a joint venture with other leading hearing instrument manufacturers active in software development and based in Copenhagen, Denmark. The financial statements of HIMSA are prepared in accordance with Danish GAAP. Phonak's share of profit or loss is recognized in the income statement as "share of gain / (loss) in associate / joint venture".

**Cochlear Acoustics Ltd.** is an associate company which has been established during 2003. In return for its 25% equity share, Phonak AG granted a license to use certain of its patents. The fair value of the assets transferred was CHF 1.8 million. There was no cash transferred or paid for the 25% equity share. The financial statements of Cochlear Acoustics Ltd., London, are prepared in accordance with Australian GAAP. Phonak's share of profit or loss is recognized in the income statement as "share of gain / (loss) in associate / joint venture".

The accounts of Cochlear include a receivable owed by the major shareholder. The major shareholder agreed to fund the future development projects depending on milestones achieved. He also has the right to withdraw from his obligation upon certain conditions. To reflect this uncertainty when valuing the investment in Cochlear Acoustics Ltd., the likeliness of future payments is estimated on an annual basis. In financial year 2003/04, the investment was adjusted by a corresponding impairment which was recognized in the income statement as "share of gain / (loss) in associate / joint venture". In the financial year 2004/05, an amount of CHF 0.7 million of the previously recognized impairment has been reversed to the income statement, based on payments made by the main shareholder during financial year 2004/05. In the segment information (Note 5), the reversal of the impairment is recognized in the segment "Europe". Phonak's share of the 2004/05 loss reported by the associate is CHF 1.0 million (previous year CHF 0.3 million). At March 31, 2005, a net book value of CHF 1.1 million (previous year CHF 1.7 million) was recorded as investment in the balance sheet under "investments in associate / joint venture".

## 20. Other investments and long-term loans

1,000 CHF	31.3.2005	31.3.2004
Other investments	3,477	5,305
Long-term loans	4,334	4,822
<b>Total</b>	<b>7,811</b>	<b>10,127</b>

The other investments consist of minority interests in the Danish patent holding company HIMPP A/S and in the Danish software development companies HIMSA II A/S (Hearing Instruments Manufacturers Software Association II A/S) and HIMSA II K/S, in which both Phonak and Unitron have invested, together with other leading hearing instrument manufacturers, as well as two further minority interests in third party companies. Other investments are classified as available for sale in accordance with IAS 39. Long-term loans comprise loans to third parties.

## 21. Intangible assets

1,000 CHF	Goodwill	Software	Other intangibles	Total
				<b>31.3.2005</b>
<b>Cost</b>				
Balance April 1	247,791	15,673	2,360	265,824
Change in accounting principles (IFRS 3)	(117,189)	0	0	(117,189)
Changes through business combinations	0	0	1,224	1,224
Additions	0	3,472	35	3,507
Disposals	0	(1,711)	0	(1,711)
Reclassifications	0	0	0	0
Exchange differences	573	(181)	15	407
<b>Balance March 31</b>	<b>131,175</b>	<b>17,253</b>	<b>3,634</b>	<b>152,062</b>
<b>Accumulated amortization</b>				
Balance April 1	117,296	9,130	2,228	128,654
Change in accounting principles (IFRS 3)	(117,296)	0	0	(117,296)
Changes through business combinations	0	0	33	33
Additions	0	3,520	26	3,546
Disposals	0	(1,711)	0	(1,711)
Exchange differences	0	(309)	4	(305)
<b>Balance March 31</b>	<b>0</b>	<b>10,630</b>	<b>2,291</b>	<b>12,921</b>
<b>Net book value</b>				
Balance April 1	130,495	6,543	132	137,170
<b>Balance March 31</b>	<b>131,175</b>	<b>6,623</b>	<b>1,343</b>	<b>139,141</b>

No internally generated intangible assets have been capitalized during financial years 2004/05 and 2003/04. Goodwill has an indefinite life. Other intangibles and software have finite lives.

In accordance with the requirements of IFRS 3, the Group has eliminated the accumulated amortisation of goodwill at March 31, 2004 with a corresponding decrease in cost of goodwill. Negative goodwill of CHF 107,000 has been derecognized with a corresponding adjustment of the opening balance of retained earnings.

The Group has performed an impairment test on goodwill in the first half of the financial year 2004/05. For the purpose of impairment testing, goodwill is allocated to a cash-generating unit or to a group of cash-generating units, that are expected to benefit from the synergies of the corresponding business combination. For the impairment test, the recoverable amount of a cash-generating unit (higher of the cash-generating unit's fair value less selling costs and its value in use) is compared to the carrying amount of the corresponding cash-generating unit. Future cash flows are discounted with the Weighted Average Cost of Capital (WACC) including the use of the Capital Asset Pricing Model (CAPM). Value in use is normally assumed to be higher than the fair value less selling costs, therefore, fair value less selling costs is only investigated when value in use is lower than the carrying amount of the cash generating unit.

1,000 CHF	Goodwill	Software	Other intangibles	Total 31.3.2004
<b>Cost</b>				
Balance April 1	242,123	12,264	4,010	258,397
Change in accounting principles (IFRS 3)	0	0	0	0
Changes through business combinations	697	0	11	708
Additions	28	3,122	91	3,241
Disposals	0	(18)	(1,819)	(1,837)
Reclassifications	0	0	154	154
Exchange differences	4,943	305	(87)	5,161
<b>Balance March 31</b>	<b>247,791</b>	<b>15,673</b>	<b>2,360</b>	<b>265,824</b>
<b>Accumulated amortization</b>				
Balance April 1	107,748	6,507	1,087	115,342
Change in accounting principles (IFRS 3)	0	0	0	0
Changes through business combinations	0	31	0	31
Additions	8,554	2,436	1,171	12,161
Disposals	0	(13)	34	21
Exchange differences	994	169	(64)	1,099
<b>Balance March 31</b>	<b>117,296</b>	<b>9,130</b>	<b>2,228</b>	<b>128,654</b>
<b>Net book value</b>				
Balance April 1	134,375	5,757	2,923	143,055
<b>Balance March 31</b>	<b>130,495</b>	<b>6,543</b>	<b>132</b>	<b>137,170</b>

The cash flow projections are based on five-year period budgets. Cash flows beyond the five-year period are extrapolated using the long-term estimated growth rates stated below. The growth rates do not exceed the long-term average growth rate for the hearing instruments industry in which the cash-generating units operate.

Key assumptions used for value-in-use calculations of material goodwill amounts:

Cash generating unit	Carrying amount of goodwill	Currency	Basis for recoverable amount	Discount rate	Projection period	Long-term growth rate
1,000 CHF						
Unitron Group	60,731	Multiple	Value in use	9%	5 years	1.00%
Hansaton Akustische Hörgeräte GmbH	32,082	EUR	Value in use	8%	5 years	3.00%
Lapperre BHAC NV	15,903	EUR	Value in use	8%	5 years	0.50%
Phonak Iberica SA	7,919	EUR	Value in use	8%	5 years	1.00%

The discount rates applied are pre-tax. Based on the impairment tests, there was no need for the recognition of any impairment in financial year 2004/05.

## 22. Provisions

	Provisions for bonus, vacation pay and employee benefits	Provision for warranty and returns	Other provisions	Total 31.3.2005	Total 31.3.2004
1,000 CHF					
<b>Balance April 1</b>	24,603	25,749	3,428	53,780	37,015
Changes through business combinations	34	0	0	34	390
Amounts used	(16,405)	(14,350)	(1,127)	(31,882)	(25,143)
Reversals	(2,580)	(320)	(1,000)	(3,900)	223
Increases	22,740	20,348	3,677	46,765	41,264
Exchange differences	(147)	(1,203)	0	(1,350)	31
<b>Balance March 31</b>	<b>28,245</b>	<b>30,224</b>	<b>4,978</b>	<b>63,447</b>	<b>53,780</b>
thereof short-term	26,502	22,764	1,300	50,566	40,418
thereof long-term	1,743	7,460	3,678	12,881	13,362

The provision for vacation pay relates to both unconsumed holiday days as well as to payments for holidays required by law in certain countries. The provision for bonus and incentive compensation also includes a provision related to the share and option plans as described in Note 32. The provision for employee benefits mainly includes a defined contribution plan in Italy as well as provision for termination related employee benefits in Canada and in Austria.

On average, Phonak grants a 15-month warranty period for its products. During this period, products will be repaired or replaced free of charge. The provision is based on turnover and past experience of warranty claims. In some countries, extended warranty is sold against a corresponding fee.

Other provisions mainly represent management's best estimate of the expected costs of settling pending disputes and claims, which have arisen in the normal course of Phonak's business.

## 23. Short-term debts

1,000 CHF	Notes	31.3.2005	31.3.2004
Bank debts		0	2,039
Current maturities of mortgages	25	7,186	2,580
Current maturities of other long-term debts		23,603	23,603
<b>Total</b>		<b>30,789</b>	<b>28,222</b>
Unused borrowing facilities		50,288	38,931

The book value of short-term debts approximates to fair value. Current maturities of long-term debts mainly relate to bank loans; the average interest rate was 1.12% (previous year: 0.85%).

## 24. Other short-term liabilities

1,000 CHF	31.3.2005	31.3.2004
Other payables	12,113	9,162
Accrued expenses	43,348	41,985
Deferred income	6,248	8,316
<b>Total</b>	<b>61,709</b>	<b>59,463</b>

Other payables include amounts to be remitted in respect of sales taxes, value added taxes, social security payments, employees' income taxes deducted at source and customer prepayments. Accrued expenses include, among other items, salaries, social expenses and accruals for outstanding invoices.

## 25. Mortgages

1,000 CHF	31.3.2005			31.3.2004		
Analysis by currency	Short-term mortgages	Long-term mortgages	Total mortgages	Short-term mortgages	Long-term mortgages	Total mortgages
Swiss Francs	6,900	12,100	19,000	2,300	33,800	36,100
Euro	247	104	351	243	352	595
Danish Crowns	39	367	406	37	409	446
<b>Total</b>	<b>7,186</b>	<b>12,571</b>	<b>19,757</b>	<b>2,580</b>	<b>34,561</b>	<b>37,141</b>
Of which maturing beyond 5 years			7,984			9,120

The above mentioned mortgages are all secured by liens on the related real estate. Principal amounts bear interest at the following rates per annum: CHF 13.2 million at 2.79%, CHF 5.0 million at 4.20%, CHF 0.8 million at 2.75% and the remainder at 4.25% to 7.35%. In March 2005, CHF 14.4 million of the mortgage have been prematurely repaid. Of the remaining CHF mortgage of CHF 19.0 million, CHF 5.8 million have been repaid in April 2005 and the remaining CHF 13.2 million require an annual repayment in the amount of CHF 1.1 million. The fair value of the mortgages approximates to book value.

## 26. Other long-term debts

1,000 CHF	31.3.2005	31.3.2004
Bank loans	47,000	80,210
Other long-term debts	78	28
<b>Total</b>	<b>47,078</b>	<b>80,238</b>
<b>Analysis by currency</b>		
Swiss Francs	47,000	70,600
Euro	54	9,610
Other currencies	24	28
<b>Total</b>	<b>47,078</b>	<b>80,238</b>
Of which maturing beyond 5 years	284	1,400

Long-term debts denominated in Swiss Francs relate to bank loans obtained to finance the purchase of the Unitron and Hansaton subsidiaries. These loans bear interest at LIBOR + 0.5% (the average interest rate was 1.12% for the year ending March 31, 2005 and 0.85% for the year ending March 31, 2004) and are scheduled for repayment semi-annually over seven years (until December 31, 2007). At March 31, 2004, the debt in Euro related to two long-term bank credits. These loans were repaid in June 2004.

Other long-term debts mainly represent financial lease liabilities.

The carrying amounts of bank loans and other long-term debts approximate to fair value.

## 27. Other long-term liabilities

1,000 CHF	31.3.2005	31.3.2004
Long-term deferred income	3,864	1,657
Retirement benefit obligations	1,273	1,379
<b>Total</b>	<b>5,137</b>	<b>3,036</b>

Long-term deferred income relates to long term service contracts with customers. Deferred income is recognized as a sale over the period of the service contract.

The retirement benefit obligation relates to defined benefit plans. For details refer to Note 31.

## 28. Movements in share capital

<b>Issued shares</b> (each share has a nominal value of CHF 0.05)	<b>Issued shares</b>	<b>Treasury shares<sup>2)</sup></b>	<b>Outstanding shares</b>
<b>Balance April 1, 2003</b>	<b>65,372,200</b>	<b>(330,610)</b>	<b>65,041,590</b>
Issue of new shares from conditional capital <sup>1)</sup>	90,000	0	90,000
Sale of treasury shares	0	188,898	188,898
<b>Balance March 31, 2004</b>	<b>65,462,200</b>	<b>(141,712)</b>	<b>65,320,488</b>
Issue of new shares from conditional capital <sup>1)</sup>	560,200	0	560,200
Purchase of treasury shares	0	(7,700)	(7,700)
Sale of treasury shares	0	141,712	141,712
<b>Balance March 31, 2005</b>	<b>66,022,400</b>	<b>(7,700)</b>	<b>66,014,700</b>

<b>Nominal value of share capital</b> (1,000 CHF)	<b>Share capital</b>	<b>Treasury shares<sup>2)</sup></b>	<b>Outstanding share capital</b>
<b>Balance April 1, 2003</b>	<b>3,269</b>	<b>(17)</b>	<b>3,252</b>
Issue of new shares from conditional capital <sup>1)</sup>	4	0	4
Sale of treasury shares	0	10	10
<b>Balance March 31, 2004</b>	<b>3,273</b>	<b>(7)</b>	<b>3,266</b>
Issue of new shares from conditional capital <sup>1)</sup>	28	0	28
Purchase of treasury shares	0	0	0
Sale of treasury shares	0	7	7
<b>Balance March 31, 2005</b>	<b>3,301</b>	<b>0</b>	<b>3,301</b>

1) Created for purpose of the employee share option plan.

2) Treasury shares are purchased on the open market and are not entitled to dividends. As per March 31, 2005, all treasury shares were at the company's disposal.

During the Annual General Shareholders' Meetings on November 18, 1994 and July 13, 2000, a conditional share capital of a maximum of 8,000,000 shares has been created. As of March 31, 2005, 5,285,400 (previous year 5,845,600) shares thereof have not yet been issued. These shares are reserved for use in the key employees share option plans (Key People Program and Executive Equity Award Plan).

For additional information on the Shareholders and the Capital structure of the Group, refer to the Corporate Governance section (pages 19 to 22).



## 29. Acquisition of subsidiaries

During financial year 2004/05, the Group entered into the following business combinations:

Name	Place	Date	Structure	Purpose	Business acquired
Kam Hearing Technology (Guangzhou) Co., Ltd.	Guangzhou, China	8.6.2004	Net assets deal	Sale of hearing instruments	Hearing instruments business
Unitron (Sichuan) Hearing Technology Co., Ltd. <sup>1)</sup>	Chengdu, China	8.6.2004	Share deal (100%)	Sale of hearing instruments	Hearing instruments business
Scancare OY	Tampere, Finland	1.9.2004	Net assets deal	Sale of hearing instruments	Hearing instruments business

During financial year 2003/04, the Group entered into the following business combinations:

Name	Place	Date	Structure	Purpose	Business acquired
Viennatone Hörgeräte GmbH	Vienna, Austria	01.03.2004	Share deal	Sale of hearing instruments	100% of the shares

1) Unitron (Sichuan) Hearing Technology Co., Ltd. has been renamed Phonak (Sichuan), Ltd.

All acquisitions have been accounted for using the purchase method of accounting.

The newly acquired businesses contributed sales and net income in the period from the purchase date to March 31, 2005 to the overall financials of the Phonak Group of CHF 2.8 million and CHF –1.4 million, respectively. For the full financial year 2004/05, sales and net income of the acquired businesses amounted to CHF 4.2 million and CHF –1.4 million, respectively.

The assets and liabilities arising from the above mentioned acquisitions are individually immaterial and in aggregate as follows:

1,000 CHF	Notes	2004/05	2003/04
<b>Assets</b>			
Cash and cash equivalents		35	244
Trade accounts receivable		81	881
Other receivables and prepaid expenses		168	737
Inventories		1,000	2,811
Tangible assets	18	282	774
Financial assets		0	282
Deferred tax assets		0	3,705 <sup>2)</sup>
Intangible assets	21	1,191	11
<b>Total assets</b>		<b>2,757</b>	<b>9,445</b>
<b>Liabilities and shareholders' equity</b>			
Trade accounts payable		(182)	(1,754)
Other payables and accrued expenses		(447)	(1,996)
Short-term provisions	22	(34)	0
Long-term debts		0	(468)
Deferred tax liabilities		0	(396)
<b>Total liabilities</b>		<b>(663)</b>	<b>(4,614)</b>
<b>Net assets</b>		<b>2,094</b>	<b>4,831</b>
Goodwill		0	697 <sup>2)</sup>
<b>Purchase price incl. acquisition related costs</b>		<b>2,094</b>	<b>5,528</b>
For which Phonak recorded a long-term payable for the earn-out or holdback		(336)	(1,559)
<b>Cash consideration</b>		<b>1,758</b>	<b>3,969</b>
Cash and cash equivalents acquired		(35)	(244)
<b>Cash consideration, net of cash acquired</b>		<b>1,723</b>	<b>3,725</b>
Earn-out payments in respect of previous years' acquisitions		1,278	210
<b>Cash flow for acquisitions</b>		<b>3,001</b>	<b>3,935</b>

<sup>2)</sup> Prior year figures have been adjusted due to a decision of the tax authority who has accepted the recognition of Viennatone's capitalized tax losses in full, whereas in the previous year only 55% of the losses had been capitalized.

### 30. Related party transactions

The total remuneration of the Board of Directors and Group executive management of Phonak Holding AG for the current business year amounted to CHF 4.2 million (previous year CHF 4.1 million). Phonak AG entered into a sponsorship agreement with ARcycling AG effective until December 31, 2005. The corresponding expenses included in the consolidated income statement amount to CHF 6.2 million (previous year CHF 5.0 million).

## 31. Employee benefits

The pension funds of Phonak Holding AG, in which the Swiss Group companies Phonak AG and Phonak Communications AG also participate, as well as the retirement plans of Hansaton Akustische Hörgeräte GmbH (Austria), Unitron Hearing GmbH (Germany), Unitron Hearing Ltd. (Canada) and Phonak AS (Norway) are defined benefit plans in accordance with IFRS definitions (see also Note 3.4 Accounting and valuation principles). The plans of Phonak AS, Norway, and Unitron Hearing Ltd., Canada, are not material. All defined benefit plans of the Group are accounted for as defined benefit plans according to IAS 19. The results of all material plans are summarized below:

1,000 CHF	31.3.2005	31.3.2004
<b>Amounts recognized in the balance sheet</b>		
Present value of funded obligations	(82,031)	(70,798)
Fair value of plan assets	84,755	72,226
<b>Net present value of funded plan</b>	<b>2,724</b>	<b>1,428</b>
Present value of unfunded obligations	(1,087)	(1,203)
Unrecognized actuarial losses	3,135	2,687
<b>Total assets, net</b>	<b>4,772</b>	<b>2,912</b>
Amounts unrecognized in accordance with IAS 19.58b(ii)	(2,724)	0
<b>Net assets in the balance sheet</b>	<b>2,048</b>	<b>2,912</b>
thereof liabilities	(1,087)	(1,203)
thereof assets	3,135	4,115
<b>Amounts recognized in the income statement</b>		
Current service cost	4,100	3,900
Interest cost	2,714	2,389
Expected return on plan assets	(3,611)	(2,934)
Waiver of the employer contribution reserve	3,365	0
<b>Total employee benefit expenses</b>	<b>6,568</b>	<b>3,355</b>
<b>Movements in the assets, net</b>		
At beginning of the year	2,912	2,554
Total employee benefit expenses	(6,568)	(3,355)
Contributions paid	5,704	3,713
<b>At end of year</b>	<b>2,048</b>	<b>2,912</b>
<b>Principal actuarial assumptions</b>		
Discount rate	3.75%	3.75%
Future salary increases	2.50%	2.50%
Future pension increases	0%	0%
Expected return on plan assets	5%	5%
Fluctuation rate	10%	10%

The amount recognized in the consolidated income statement has been charged to cost of sales (CHF 2.1 million), research and development (CHF 1.7 million), sales and marketing (CHF 0.9 million) and general and administration (CHF 1.9 million) in the income statement by type of function and to the position personnel expenses (CHF 6.6 million) in the income statement by type of expenditure.

The actual return on plan assets was a gain of CHF 2.4 million (previous year gain of CHF 4.9 million).

#### **Defined contribution plans**

Four of the Group's entities have a defined contribution plan. The employer's contributions are recognized directly in the income statement, amounting to CHF 1.7 million in the year ended March 31, 2005 (previous year CHF 1.6 million).

#### **Termination benefits**

During financial year 2004/05, CHF 1.7 million termination benefits have been expensed (previous year CHF 2.0 million).

## **32. Employee share option and share purchase plan**

### **Key People Program (granted between 1997 and 2004)**

Up to financial year 2003/04, members of the Board of Directors of Phonak Holding AG, Group executive management as well as management and senior employees of other Group companies annually received a certain number of options on the shares of Phonak Holding AG in accordance with the "Key People Program" established in 1997. This was basically on the condition that the respective employees had been employed by the Phonak Group for a period of generally at least two years. The options were granted for no consideration and each option entitled the holder to one Phonak Holding AG share after a lock-up period of generally two or three years at a predefined exercise price. The exercise price corresponds to the average market price over the last one or three months immediately prior to the month of the grant. Also, in accordance with special agreements, key people within the Phonak Group were granted options, partially with and partially without consideration. The shares required for the share option plan were issued from the conditional share capital which was created by resolutions of the 1994 and 2000 Annual General Shareholders' Meetings in accordance with Article 3a of Phonak Holding AGs articles of incorporation.

In February 2005, the Group launched a new Executive Equity Award Program (EEAP) for Board of Directors, the members of the Group Management worldwide and a Share Purchase Plan for all employees of the Group.

### **Executive Equity Award Plan (EEAP) (granted 2005)**

The Executive Equity Award Plan is offered annually to the Board of Directors and members of the Group Management worldwide who have generally worked for the company at least two years and entitles them to receive options and/or shares free of charge. The amount of options and/or shares granted varies depending on the management level. The distribution of the options and shares corresponds to the degree of responsibility held at the different management levels. Both options and shares granted as part of the EEAP are split into 4 equal tranches. For the options, 1/4 vests after 1 year, 1/4 vests after 2 years, 1/4 vests after 3 years and the remaining 1/4 vests after 4 years. Similarly, 1/4 of the shares are blocked for 1 year, 1/4 for 2 years, 1/4 for 3 years and the remaining 1/4 is blocked for 4 years.

## Options (granted 2005)

The exercise price of the options is generally equal to the market price of Phonak shares at the SWX Swiss Stock Exchange (closing price) on the date the options are granted. The options granted may be exercised after expiration of the Vesting Period during the term of the options, which is generally 5 to 6 years from the date the options are granted. The shares delivered when exercising the options are issued from the conditional share capital. In financial year 2004/05, no costs have been recognized in the consolidated financial statements for options granted to employees. Starting in financial year 2005/06, the Group will apply IFRS 2 and therefore expense the fair value of the options at grant date over the vesting period. Financial year 2004/05 will be restated accordingly in the 2005/06 annual report. The amount of restatement related to the EEAP options and calculated by applying the Black Scholes Model is estimated to amount to approx. CHF 0.3 million. This amount would have been charged to the positions research and development, sales and marketing, general and administration as well as cost of sales in the consolidated income statement by function and to personnel expenses in the consolidated income statement by type of expenditure.

## Outstanding Options – Key People Program up to 2003/04 and Executive Equity Award Plan 2004/05

Changes in outstanding options:	2004/05		2003/04	
	Number of options	Weighted average exercise price CHF	Number of options	Weighted average exercise price CHF
Outstanding options at April 1	2,060,950	26.15	2,018,500	30.83
Granted	712,000	39.00	780,450	28.00
Exercised <sup>1)</sup>	(560,200)	13.50	(90,000)	15.42
Expired / forfeited	(360,500)	51.50	(648,000)	42.80
<b>Outstanding options at March 31</b>	<b>1,852,250</b>	<b>29.94</b>	<b>2,060,950</b>	<b>26.15</b>
<b>Exercisable at March 31</b>	<b>217,300</b>	<b>13.88</b>	<b>409,750</b>	<b>46.69</b>

1) Total consideration from exercise of options amounted to CHF 7.5 million (previous year CHF 1.4 million).

## Summary of outstanding and exercisable options at March 31, 2005:

Exercise price range	Outstanding options			Exercisable options	
	Number	Average remaining life (years)	Weighted average exercise price CHF	Number	Weighted average exercise price CHF
13.00	225,300	1.3	13.00	166,800	13.00
14.00	105,000	2.2	14.00	35,000	14.00
18.50	12,500	0.4	18.50	12,500	18.50
28.00	757,450	3.9	28.00	1,500	28.00
39.00	178,000	1.2	39.00	0	0.00
39.00	178,000	2.2	39.00	0	0.00
39.00	178,000	3.2	39.00	0	0.00
39.00	178,000	4.2	39.00	0	0.00
40.50	25,000	1.4	40.50	0	0.00
56.00	15,000	2.2	56.00	1,500	56.00
<b>13.00 – 56.00</b>	<b>1,852,250</b>	<b>3.0</b>	<b>29.94</b>	<b>217,300</b>	<b>13.88</b>

### **Shares – Executive Equity Award Plan (granted 2005)**

The shares are subject to a blocking period, which starts on the date the shares are granted. The shares delivered under this plan are shares repurchased by Phonak on the open stock market. The costs of the granted shares as part of the EEAP program have been expensed on a pro rata temporis basis over the vesting period of 1 to 4 years.

In February 2005, the Group has offered 100,850 shares free of charge to the mid and lower management of the Phonak Group. The respective costs for financial year 2004/05 amounted to CHF 0.4 million and have been recorded under the positions research and development (CHF 0.1 million), sales and marketing (CHF 0.1 million), general and administration (CHF 0.1 million) as well as cost of sales (CHF 0.1 million) in the consolidated income statement by function and in the position personnel expenses (CHF 0.4 million) in the consolidated income statement by type of expenditure. A corresponding provision has been recorded in the balance sheet.

### **Share Purchase Plan (SPP) (granted 2005)**

The Share Purchase Plan is offered annually to all permanent employees of the Group, having completed their probationary period. A Participant may purchase a maximum number of shares. For every two shares purchased by the Participant, the Participant receives one additional share for free. The share purchase price of the shares will generally be equal to the market price of a share at the SWX Swiss Stock Exchange on the date the shares are purchased and paid for and the free shares are accepted. The shares under this plan are subject to a blocking period commencing on the expiry date of the offer. The duration of the Blocking Period may be up to 24 months. The shares under this plan (the shares purchased by the Participant and the share offered for free) are repurchased by Phonak on the open stock market. The pro rata temporis costs of the shares offered as part of the SPP program have been charged to the consolidated income statement.

In financial year 2004/05, CHF 0.1 million have been expensed to reflect the cost of the free share. A corresponding provision has been recorded in the balance sheet.

### 33. Contingent liabilities

At March 31, 2005 and 2004, there were no pledges given to third parties other than in relation to mortgages of CHF 12.6 million (previous year CHF 34.6 million) secured by properties (Note 25). The net book value of these properties amounts to CHF 52.7 million at March 31, 2005 (CHF 54.2 million at March 31, 2004). Guarantees given to third parties amounted to CHF 0.3 million (previous year CHF 0.5 million). There were no recourse liabilities in respect of discounted bills of exchange at March 31, 2005 and 2004. Open purchase orders as of March 31, 2005 and 2004 were related to recurring business activities.

### 34. Leasing liabilities

At March 31, 2005 the following minimum leasing obligations existed:

1,000 CHF	Operating leases	Finance leases
<b>Business year</b>		
2005/06	7,450	189
2006/07	5,526	115
2007/08	5,089	11
2008/09	5,036	0
2009/10	4,681	0
thereafter	13,245	0
<b>Total</b>	<b>41,027</b>	<b>315</b>
Less interest component		(9)
<b>Total (excl. interest)</b>		<b>306</b>
<b>Previous year</b>	<b>45,539</b>	<b>33</b>
Less interest component		(3)
<b>Previous year (excl. interest)</b>		<b>30</b>

The operating lease commitments relate primarily to long-term rental agreements for office premises which are, in general, renewable. In financial year 2004/05, CHF 11.6 million have been recognized as expenses for leases in the consolidated income statement (previous year CHF 10.9 million).

## 35. Number of employees

At March 31, 2005, the Phonak Group employed 2,926 people (previous year 2,689). They were engaged in the following regions and activities:

<b>By region</b>	<b>31.3.2005</b>	<b>31.3.2004</b>
Switzerland	729	707
Europe (excl. Switzerland)	832	786
North America	956	977
Asia / Pacific	409	219
<b>Total</b>	<b>2,926</b>	<b>2,689</b>
<b>By activity</b>	<b>31.3.2005</b>	<b>31.3.2004</b>
Research & development	188	178
Operations	1,439	1,318
Sales and marketing, general and administration	1,299	1,193
<b>Total</b>	<b>2,926</b>	<b>2,689</b>

The average number of employees of the Phonak Group for the year was 2,719 (previous year 2,523).

## 36. Events after the balance sheet date

There have been no material events after the balance sheet date.

## 37. Exchange rates

The following exchange rates were used for currency translation:

	Year-end rates		Average rates for the year	
	Balance sheet		Income statement	
	31.3.2005	31.3.2004	2004/05	2003/04
AUD 1	0.93	0.96	0.91	0.91
CAD 1	0.99	0.97	0.96	0.97
CNY 1	0.14	0.16	0.15	0.16
DKK 100	20.85	20.93	20.70	20.74
EUR 1	1.55	1.56	1.54	1.54
GBP 1	2.25	2.33	2.26	2.23
JPY 100	1.12	1.22	1.14	1.17
JOD 1	1.63	1.74	1.72	1.86
NOK 100	18.95	18.45	18.60	18.70
NZD 1	0.85	0.84	0.82	0.80
SEK 100	17.00	16.80	16.91	16.87
USD 1	1.20	1.29	1.23	1.32



## 38. List of significant consolidated companies

Company name	Activity	Domicile	Share capital Local curr. 1,000	Shares held by Phonak Holding
<b>Switzerland</b>				
Phonak Holding AG	1	Stäfa	CHF 3,301	0
Phonak AG	2,3,4	Stäfa	CHF 2,500	99.3 %
Phonak Communications AG	2,3,4	Murten	CHF 500	100 %
<b>Europe (excluding Switzerland)</b>				
Phonak GmbH	2	Stuttgart (D)	EUR 153	100 %
Unitron Hearing GmbH	2	Stuttgart (D)	EUR 41	100 %
Phonak France SA	2	Bron-Lyon (F)	EUR 305	100 %
Phonak Italia Srl	2	Milan (I)	EUR 1,040	100 %
Phonak Iberica SA	2	Alicante (E)	EUR 7,000	100 %
Phonak Belgium SA	1,2	Brussels (B)	EUR 15,311	100 %
Lapperre BHAC NV	2	Groot-Bijgaarden (B)	EUR 124	100 %
Phonak B.V.	2	Nieuwegein (NL)	EUR 227	100 %
Unitron Hearing B.V.	2	Nieuwegein (NL)	EUR 18	100 %
Phonak Danmark A/S	2	Frederiksberg (DK)	DKK 9,000	100 %
Phonak AB	2	Stockholm (S)	SEK 200	100 %
Phonak AS	2	Oslo (N)	NOK 900	100 %
Phonak Group Ltd.	2	Warrington (GB)	GBP 150	100 %
Hansaton Akustische Geräte GmbH	2	Wals-Himmelreich (AUT)	EUR 450	100 %
HIMSA – Hearing Instruments Manufacturers Software Ass.	2	Copenhagen (DK)	DKK 1,000	25 % <sup>5)</sup>
Cochlear Acoustics Ltd.	4	London (GB)	GBP 0 <sup>7)</sup>	25 % <sup>5)</sup>
<b>North America</b>				
Phonak LLC	2	Warrenville (USA)	USD 1,250	100 %
Phonak Canada Ltd.	1,2	Mississauga (CDN)	CAD 88,694	100 %
Unitron Hearing Ltd.	2,3,4	Kitchener (CDN)	CAD 17,436	100 %
Unitron Hearing, Inc.	2	Plymouth (USA)	USD 46,608	100 %
THC Finance Ltd.	1	Bermuda	CHF 165,021	100 %
RAV Finance Inc.	1	USA	USD 0 <sup>6)</sup>	100 %
<b>Asia / Pacific</b>				
Phonak Pty. Ltd.	2	Baulkham Hills (AUS)	AUD 750	100 %
Phonak New Zealand Ltd.	2	Auckland (NZ)	NZD 250	100 %
Jordan Hearing Aids Manufacturing Co. Ltd.	2	Amman (JOR)	JOD 80	100 %
Phonak Japan Co. Ltd.	2	Tokyo (JPN)	JPY 10,000	100 %
Unitron Hearing (Suzhou) Co. Ltd.	3	Suzhou (CHN)	CNY 11,041	100 %
Phonak (Sichuan) Co. Ltd.	2	Sichuan (CHN)	CNY 1,738	100 %

### Description:

- 1) Holding/Finance: The entity is a holding or finance company
- 2) Sales: The entity performs sales and marketing activities for the Group
- 3) Production: This entity performs manufacturing for the Group
- 4) Research: This entity performs research and development activities for the Group
- 5) Consolidated using the equity method
- 6) USD 1
- 7) GBP 100

## Report of the Group Auditors



### **Report of the Group Auditors**

to the Annual General Shareholders' Meeting of  
**Phonak Holding Ltd., Staefa**

As auditors of the Group, we have audited the consolidated financial statements (consolidated income statement, consolidated balance sheet, consolidated statement of cash flows, summary of changes in shareholders' equity and notes – pages 46 to 86) of Phonak Holding Ltd. for the year ended March 31, 2005.

These consolidated financial statements are the responsibility of the board of directors. Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We confirm that we meet the legal requirements concerning professional qualification and independence.

Our audit was conducted in accordance with auditing standards promulgated by the Swiss profession and with the International Standards on Auditing, which require that an audit be planned and performed to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement. We have examined on a test basis evidence supporting the amounts and disclosures in the consolidated financial statements. We have also assessed the accounting principles used, significant estimates made and the overall consolidated financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements give a true and fair view of the financial position, the results of operations and the cash flows in accordance with International Financial Reporting Standards (IFRS) and comply with Swiss law.

We recommend that the consolidated financial statements submitted to you be approved.

PricewaterhouseCoopers AG

Stephen W. Williams

Patrick Balkanyi

Zurich, May 25, 2005



# Table of Contents

## Financial Statements of Phonak Holding AG

90	Income Statement
91	Balance Sheet
92	Notes to the Financial Statements
96	Appropriation of Available Earnings
97	Report of the Auditors

## Income Statement

1,000 CHF	Notes	2004/05	2003/04
<b>Income</b>			
Management and license fees		8,029	7,678
Investment income	4.1	28,698	21,539
Gains on marketable securities		2,036	4,652
Interest income		11,642	11,710
Exchange gains, net		0	1,124
<b>Total income</b>		<b>50,405</b>	<b>46,703</b>
<b>Expenses</b>			
Office and professional expenses		3,302	3,299
Advertising and PR expenses		392	395
Depreciation		45	0
Interest expense		3,819	3,753
Other operating expenses		1,199	875
Other expenses		350	0
Write-down of investment		370	56
Exchange losses, net		954	0
Taxes	4.2	290	(247)
<b>Total expenses</b>		<b>10,721</b>	<b>8,131</b>
<b>Net profit for the year</b>		<b>39,684</b>	<b>38,572</b>

## Balance Sheet

<b>Assets</b>				
1,000 CHF	Notes		<b>31.3.2005</b>	<b>31.3.2004</b>
<b>Current assets</b>				
Cash and cash equivalents			17,148	8,303
Marketable securities	3.1		11,164	14,453
Amounts due from Group companies			2,472	1,376
Other receivables	3.2		1,020	1,204
Prepayments			150	158
<b>Total current assets</b>			<b>31,954</b>	<b>25,494</b>
<b>Non-current assets</b>				
Investments and loans				
Loans to Group companies	3.3		335,410	299,122
Loan to third party			800	0
Investments	3.4		122,295	110,734
Tangible assets			86	0
<b>Total non-current assets</b>			<b>458,591</b>	<b>409,856</b>
<b>Total assets</b>			<b>490,545</b>	<b>435,350</b>

<b>Liabilities and shareholders' equity</b>				
1,000 CHF	Notes		<b>31.3.2005</b>	<b>31.3.2004</b>
<b>Liabilities</b>				
Trade payables				
Third parties			157	118
Other payables				
Third parties			231	597
Group companies			13,663	1,742
Loans from Group companies			183,117	174,261
Accruals			1,381	806
<b>Total liabilities</b>			<b>198,549</b>	<b>177,524</b>
<b>Shareholders' equity</b>				
Share capital			3,301	3,273
Legal reserves				
General legal reserve			142,818	135,286
Reserve for treasury shares	3.5		319	3,960
Free reserves			98,000	73,000
Retained earnings			47,558	42,307
<b>Total shareholders' equity</b>			<b>291,996</b>	<b>257,826</b>
<b>Total liabilities and shareholders' equity</b>			<b>490,545</b>	<b>435,350</b>

## Notes to the Financial Statements

### 1. General

The financial statements of Phonak Holding AG are prepared in accordance with the principles of Swiss corporate law.

### 2. Disclosure required by Swiss corporate law

#### 2.1 Sureties, guarantees and pledges given on behalf of third parties

1,000 CHF	31.3.2005	31.3.2004
Guarantees given to banks in respect of credit arrangements of foreign subsidiary companies	1,925	23,567
Guarantees given in respect of rental obligations and bank debts of Group companies	127,650	120,291

#### 2.2 Conditional capital

1,000 CHF	31.3.2005	31.3.2004
Conditional capital at year-end	264	292

During the Annual General Shareholders' Meeting on November 18, 1994 and July 13, 2000, a conditional share capital of a maximum of 8,000,000 shares has been created. As of March 31, 2005, 5,285,400 (previous year 5,845,600) shares thereof have not yet been issued. These shares are reserved for use in the key employees share option plans (Key People Program and Executive Equity Award Plan).

#### 2.3 Significant shareholders

At year-end, the following significant shareholders were listed in the share register (with shareholdings in excess of 5% of the issued share capital):

	31.3.2005	31.3.2004
– Andreas Rihs	12.2%	13.4%
– Beda Diethelm	12.7%	13.6%
– Hans-Ueli Rihs	9.5%	8.5%

### 3. Notes to the balance sheet

#### 3.1 Marketable securities

Marketable securities include, among other items, 7,700 treasury shares (previous year 141,712) purchased for a total consideration of CHF 319,368 (previous year CHF 3,959,909). At March 31, 2005, these shares had a market value of CHF 317,240 (previous year CHF 4,322,216).

#### 3.2 Other receivables

Included are, in particular, amounts due from the Swiss Federal Tax Authority in respect of recoverable withholding taxes on dividend and interest income, as well as tax assets.

#### 3.3 Loans to Group companies

Of the total loans, 54% are denominated in Swiss Francs, 38% in Canadian Dollars, 4% in Euros, 2% in US Dollars and 1% in Japanese Yen.



### 3.4 List of significant investments

Company name	Activity	Domicile	Share capital		Shares held by Phonak Holding
			Local	curr. 1,000	
<b>Switzerland</b>					
Phonak AG	2,3,4	Stäfa	CHF	2,500	99.3 %
Phonak Communications AG	2,3,4	Murten	CHF	500	100 %
<b>Europe (excluding Switzerland)</b>					
Phonak GmbH	2	Stuttgart (D)	EUR	153	100 %
Phonak France SA	2	Bron-Lyon (F)	EUR	305	100 %
Phonak Italia Srl	2	Milan (I)	EUR	1,040	100 %
Phonak Iberica SA	2	Alicante (E)	EUR	7,000	100 %
Phonak Belgium SA	1,2	Brussels (B)	EUR	15,311	100 %
Phonak B.V.	2	Nieuwegein (NL)	EUR	227	100 %
Phonak Danmark A/S	2	Frederiksberg (DK)	DKK	9,000	100 %
Phonak AB	2	Stockholm (S)	SEK	200	100 %
Phonak AS	2	Oslo (N)	NOK	900	100 %
Phonak Group Ltd.	2	Warrington (GB)	GBP	150	100 %
Hansaton Akustische Geräte GmbH	2	Wals-Himmelreich (AUT)	EUR	450	100 %
<b>North America</b>					
Phonak Canada Ltd.	1,2	Mississauga (CDN)	CAD	88,694	100 %
RAV Finance Inc.	1	USA	USD	0 <sup>5)</sup>	100 %
<b>Asia / Pacific</b>					
Phonak Pty. Ltd.	2	Baulkham Hills (AUS)	AUD	750	100 %
Phonak New Zealand Ltd.	2	Auckland (NZ)	NZD	250	100 %
Jordan Hearing Aids Manufacturing Co. Ltd.	2	Amman (JOR)	JOD	80	100 %
Phonak Japan Co. Ltd.	2	Tokyo (JPN)	JPY	10,000	100 %
Unitron Hearing (Suzhou) Co. Ltd.	3	Suzhou (CHN)	CNY	11,041	100 %
Phonak (Sichuan) Co. Ltd.	2	Sichuan (CHN)	CNY	1,738	100 %

#### Description:

- 1 Holding/Finance: The entity is a holding or finance company
- 2 Sales: The entity performs sales and marketing activities for the Group
- 3 Production: This entity performs manufacturing for the Group
- 4 Research: This entity performs research and development activities for the Group
- 5 USD 1

### 3.5 Reserve for treasury shares

A reserve for treasury shares in the amount of CHF 319,368 (previous year CHF 3,959,908) was established which is equal to the cost price (see note 3.1). The decrease in the amount of CHF 3,640,540 was credited to retained earnings.

### 3.6 Summary of changes in shareholders' equity

1,000 CHF	Share capital	General legal reserve	Free reserve	Treasury share reserve	Retained earnings	Total shareholders' equity
<b>Balance April 1, 2004</b>	<b>3,273</b>	<b>135,286</b>	<b>73,000</b>	<b>3,960</b>	<b>42,307</b>	<b>257,826</b>
Dividend paid					(13,074)	(13,074)
Capital increases (incl. share premium)						
from conditional capital	28	7,532				7,560
Allocation to free reserve			25,000		(25,000)	0
Release from reserve for treasury shares				(3,641)	3,641	0
Net profit for the year					39,684	39,684
<b>Balance March 31, 2005</b>	<b>3,301</b>	<b>142,818</b>	<b>98,000</b>	<b>319</b>	<b>47,558</b>	<b>291,996</b>

During the financial year 2004/05, an additional 560,200 registered shares with a par value of CHF 0.05 each, or a total par value of CHF 28,010, were issued from the conditional capital (which was created for the purpose of an equity participation for key employees of the Phonak Group) for a total net consideration of CHF 7,560,100. The conditional share capital with a par value of CHF 400,000 (8,000,000 shares) as authorized by the shareholders on November 18, 1994 and July 13, 2000 decreased by CHF 28,010 in the financial year 2004/05 (560,200 shares) (previous year CHF 4,500 / 90,000 shares), thereby leaving CHF 264,270 (5,285,400 shares) for distribution. Based on the remaining conditional capital, a total of 1,852,250 (previous year 2,060,950) employee stock options were outstanding as of March 31, 2005, which can be exercised until September 2010.

## 4. Notes to the income statement

### 4.1 Investment income

This comprises dividends received from Group companies and other investments.

### 4.2 Taxes

The tax expense consists of Swiss federal taxes on non-investment income (the company is exempt from income taxes in the canton of Zurich).

## Appropriation of Available Earnings

As proposed by the Board of Directors to the Annual General Shareholders' Meeting of July 7, 2005		
1,000 CHF	31.3.2005	31.3.2004 <sup>2)</sup>
<b>Carried forward from previous year</b>	<b>4,233</b>	<b>437</b>
Release from reserve for treasury shares	3,641	3,298
Net profit for the year	39,684	38,572
<b>Available earnings</b>	<b>47,558</b>	<b>42,307</b>
Allocation to free reserves	0	(25,000)
Dividend distribution	(19,804) <sup>1)</sup>	(13,074)
<b>Balance to be carried forward</b>	<b>27,754</b>	<b>4,233</b>

1) If the shareholders' meeting approves the proposed appropriation of available earnings, a gross dividend of CHF 0.30 per registered share of CHF 0.05 will be paid out.

2) Approved by the Annual General Shareholders' Meeting of July 8, 2004.

## Report of the Statutory Auditors



**Report of the Statutory Auditors**  
to the Annual General Shareholders' Meeting  
of **Phonak Holding Ltd., Staefa**

As statutory auditors, we have audited the accounting records and the financial statements (balance sheet, income statement and notes – pages 90 to 96) of Phonak Holding Ltd. for the year ended March 31, 2005.

These financial statements are the responsibility of the board of directors. Our responsibility is to express an opinion on these financial statements based on our audit. We confirm that we meet the legal requirements concerning professional qualification and independence.

Our audit was conducted in accordance with auditing standards promulgated by the Swiss profession, which require that an audit be planned and performed to obtain reasonable assurance about whether the financial statements are free from material misstatement. We have examined on a test basis evidence supporting the amounts and disclosures in the financial statements. We have also assessed the accounting principles used, significant estimates made and the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the accounting records, the financial statements and the proposed appropriation of available earnings comply with Swiss law and the company's articles of incorporation.

We recommend that the financial statements submitted to you be approved.

PricewaterhouseCoopers AG

Stephen W. Williams

Patrick Balkanyi

Zurich, May 25, 2005

# The Art

When it comes to communication, customers

# and

have great expectations. Phonak offers

# Science

them a better quality of life thanks to its high

# of Better

performance hearing systems.

# Hearing



# Company Information

## Companies in Switzerland

### Phonak Holding AG (Headquarters)

Laubisrütistrasse 28  
CH-8712 Stäfa  
Phone +41 44 928 01 01  
Fax +41 44 928 03 90  
E-Mail: [contact@phonak.ch](mailto:contact@phonak.ch)  
[www.phonak.com](http://www.phonak.com)

### Phonak AG

Laubisrütistrasse 28  
CH-8712 Stäfa  
Phone +41 44 928 01 01  
Fax +41 44 928 07 07  
E-Mail: [info@phonak.ch](mailto:info@phonak.ch)  
[www.phonak.ch](http://www.phonak.ch)

### Phonak Communications AG

Länggasse 17  
CH-3280 Murten  
Phone +41 26 672 96 72  
Fax +41 26 672 96 77  
E-Mail: [info@phonakcom.ch](mailto:info@phonakcom.ch)  
[www.phonakcom.ch](http://www.phonakcom.ch)

## Companies in Europe

### Phonak GmbH

Max-Eyth-Strasse 20  
DE-70736 Fellbach-Oeffingen  
Phone +49 711 51 07 00  
Fax +49 711 51 070 70  
E-Mail: [info@phonak.de](mailto:info@phonak.de)  
[www.phonak.de](http://www.phonak.de)

### Unitron Hearing GmbH

Daimlerstrasse 22  
DE-70736 Fellbach-Oeffingen  
Phone +49 711 658 538 0  
Fax +49 711 658 538 99  
E-Mail: [info@unitronhearing.de](mailto:info@unitronhearing.de)  
[www.unitronhearing.de](http://www.unitronhearing.de)

### Hansaton Akustische Geräte GmbH

Josef-Lindner-Strasse 4 / Top 4  
AT-5073 Wals-Himmelreich  
Phone +43 662 451 26 20  
Fax +43 662 451 262 99  
E-Mail: [office@hansaton.at](mailto:office@hansaton.at)  
[www.hansaton.at](http://www.hansaton.at)

### Phonak France SA

5, rue Maryse Bastié  
FR-69500 Bron  
Phone +33 4 72 14 50 00  
Fax +33 4 78 26 98 97  
E-Mail: [info@phonak.fr](mailto:info@phonak.fr)  
[www.phonak.fr](http://www.phonak.fr)

### Unitron Hearing France

2, rue Maryse Bastié  
FR-69500 Bron  
Phone +33 4 26 23 22 00  
Fax +33 4 26 23 22 01  
E-Mail: [paulmichel.vahanian@unitron.com](mailto:paulmichel.vahanian@unitron.com)  
[www.unitronhearing.fr](http://www.unitronhearing.fr)

### Phonak Italia Srl

Via Jacopo dal Verme, 7  
IT-20159 Milano  
Phone +39 02 69 00 81 82  
Fax +39 02 69 00 87 84  
E-Mail: [info@phonak.it](mailto:info@phonak.it)  
[www.phonak.it](http://www.phonak.it)

### Lapperre BHAC NV

Stationsstraat 22  
BE-1702 Groot-Bijgaarden  
Phone +32 2 700 77 77  
Fax +32 2 700 77 70  
E-Mail: [info@lapperre.be](mailto:info@lapperre.be)  
[www.lapperre.be](http://www.lapperre.be)

### Phonak B.V.

Archimedesbaan 19  
NL-3439 ME Nieuwegein  
Phone +31 30 600 88 50  
Fax +31 30 600 88 51  
E-Mail: [info@phonak.nl](mailto:info@phonak.nl)  
[www.phonak.nl](http://www.phonak.nl)

### Unitron Hearing B.V.

Archimedesbaan 19  
P.O. Box 1214  
NL-3430 ME Nieuwegein  
Phone +31 30 604 93 25  
Fax +31 30 604 45 89  
E-Mail: [info@unitronhearing.nl](mailto:info@unitronhearing.nl)  
[www.unitronhearing.nl](http://www.unitronhearing.nl)

#### **Phonak Group Limited**

Cygnets Court  
Lakeside Drive  
GB-Warrington, Cheshire, WA1 1PP  
Phone +44 1925 62 36 00  
Fax +44 1925 24 57 00  
E-Mail: [info@phonak.co.uk](mailto:info@phonak.co.uk)  
[www.phonak.co.uk](http://www.phonak.co.uk)

#### **Unitron Hearing UK**

St. George House  
Cygnets Court  
Centre Park  
GB-Warrington, Cheshire, WA1 1PD  
Phone +44 1925 24 78 10  
Fax +44 1925 24 78 18  
E-Mail: [info@unitronhearing.co.uk](mailto:info@unitronhearing.co.uk)  
[www.unitronhearing.co.uk](http://www.unitronhearing.co.uk)

#### **Phonak Ibérica SA**

Urbanización El Palmeral  
Bloque 9, no. 17-27  
ES-03008 Alicante  
Phone +34 902 33 11 22  
Fax +34 965 11 16 72  
E-Mail: [info@phonak.es](mailto:info@phonak.es)  
[www.phonak.es](http://www.phonak.es)

#### **Phonak Danmark A/S**

Multi Medie Hus  
Nitivej 10  
DK-2000 Frederiksberg  
Phone +45 38 10 85 86  
Fax +45 38 10 46 86  
E-Mail: [info.frederiksberg@phonak.dk](mailto:info.frederiksberg@phonak.dk)  
[www.phonak.dk](http://www.phonak.dk)

#### **Phonak AB**

Hornsbruksgatan 28  
SE-117 34 Stockholm  
Phone +46 8 442 46 60  
Fax +46 8 429 89 80  
E-Mail: [info@phonak.se](mailto:info@phonak.se)  
[www.phonak.se](http://www.phonak.se)

#### **Phonak AS**

Akersgaten 8  
Postboks 525 Sentrum  
NO-0105 Oslo  
Phone +47 23 00 32 60  
Fax +47 22 41 66 44  
E-Mail: [info@phonak.no](mailto:info@phonak.no)  
[www.phonak.no](http://www.phonak.no)

## **Companies in North America**

#### **Phonak LLC**

4520 Weaver Parkway  
US-Warrenville, IL 60555-3927  
Phone +1 630 821 5000  
Fax +1 630 393 7400  
E-Mail: [info@phonak.com](mailto:info@phonak.com)  
[www.phonak-us.com](http://www.phonak-us.com)

#### **Unitron Hearing, Inc.**

2300 Berkshire Lane North  
US-Plymouth, MN 55441  
Phone +1 763 744 3300  
Fax +1 763 557 8828  
E-Mail: [info@unitronhearing.com](mailto:info@unitronhearing.com)  
[www.unitronhearing.us](http://www.unitronhearing.us)

#### **Phonak Canada Ltd.**

7895 Tranmere Drive, Suite 207  
CA-Mississauga, ON L5S 1V9  
Phone +1 905 677 1167  
Fax +1 905 677 8425  
E-Mail: [info@phonak.on.ca](mailto:info@phonak.on.ca)  
[www.phonak-canada.com](http://www.phonak-canada.com)

#### **Unitron Hearing Ltd.**

20 Beasley Drive,  
P.O. Box 9017  
CA-Kitchener, ON N2G 4X1  
Phone +1 519 895 0100  
Toll Free +1 877 492 6244  
Fax +1 519 895 0108  
E-Mail: [info@unitron.com](mailto:info@unitron.com)  
[www.unitronhearing.com](http://www.unitronhearing.com)

#### **Unitron Hearing Ltd. - Canada**

5 Cherry Blossom Road, Unit 2  
CA-Cambridge, ON N3H 4R7  
Phone +1 519 650 9111  
Toll Free +1 800 265 8255  
Fax +1 800 949 6663  
E-Mail: [info@unitronhearing.ca](mailto:info@unitronhearing.ca)  
[www.unitronhearing.ca](http://www.unitronhearing.ca)



## Company Information

### Companies in Asia / Pacific and Middle East

#### **Phonak Pty. Ltd.**

Level 2, Norwest Quay  
21 Solent Circuit  
Norwest Business Park  
AU-Baulkham Hills NSW 2153  
Phone +61 2 8858 1800  
Fax +61 2 9634 8373  
E-Mail: [info@phonak.com.au](mailto:info@phonak.com.au)  
[www.phonak.com.au](http://www.phonak.com.au)

#### **Unitron Hearing Australia**

Level 2, Norwest Quay  
21 Solent Circuit  
Norwest Business Park  
AU-Baulkham Hills NSW 2153  
Phone +61 2 9659 8012  
Fax +61 2 9659 5932  
E-Mail: [info@unitron.com](mailto:info@unitron.com)  
[www.unitronhearing.com.au](http://www.unitronhearing.com.au)

#### **Phonak New Zealand Ltd.**

1st Floor, JD Edwards Building  
159 Hurstmere Road,  
P.O. Box 33-349  
NZ-Takapuna, Auckland 9  
Phone +64 9 486 1849  
Fax +64 9 486 1895  
E-Mail: [info@phonak.co.nz](mailto:info@phonak.co.nz)  
[www.phonak.co.nz](http://www.phonak.co.nz)

#### **Unitron Hearing New Zealand**

10/215 Rosedale Road  
M277 Private Bag, 300987  
NZ-Albany, Auckland  
Phone: +64 800 864 8766  
Fax: +64 9 488 9842  
E-Mail: [info@unitron.co.nz](mailto:info@unitron.co.nz)  
[www.unitronhearing.co.nz](http://www.unitronhearing.co.nz)

#### **Phonak Japan Co., Ltd.**

Kanda Park Plaza Building 9th Fl.  
2-2-2 Kajicho, Chiyoda-ku  
JP-Tokyo 101-0044  
Phone +81 3 52 94 40 79  
Fax +81 3 52 94 40 80  
E-Mail: [info@phonak.jp](mailto:info@phonak.jp)  
[www.phonak.jp](http://www.phonak.jp)

#### **Unitron Hearing (Suzhou) Co., Ltd.**

No. 200 Suhong Road  
Export Processing Zone 4D  
Suzhou Industrial Park  
CN-215021 Suzhou  
Phone +86 512 6258 2258  
Fax +86 512 6258 5258  
E-Mail: [info@unitron.cn](mailto:info@unitron.cn)

#### **Phonak (Sichuan) Co., Ltd.**

Room 105, Hua Li Building  
No. 25 Xi Er Duan,  
No. 1 Ring Road  
Chengdu City  
CN-610071 Sichuan  
Phone +86 28 8611 3055  
Fax +86 28 8611 3022

#### **Jordan Hearing Aids**

#### **Manufacturing Co. Ltd.**

Jabel Amman  
Across Showman Est.  
P.O. Box 2208  
JO-11181 Amman  
Phone +962 64 611 331  
Fax +962 64 611 332  
E-Mail: [info@phonak.com.jo](mailto:info@phonak.com.jo)  
[www.phonak.com](http://www.phonak.com)

#### **Phonak AG (India)**

155 Et 156, Maruthi Towers  
T.T.K. Road, Alwarpet  
IN-Chennai 600 018  
Phone: +91 44 520 759 94  
Fax: +91 44 520 759 94  
E-Mail: [info@phonak.in](mailto:info@phonak.in)  
[www.phonak.in](http://www.phonak.in)

## Impressum

Concept

Althaus Et Weil AG, Basel

Photos

Angelo Hornak (Indian sandstone sculpture)

Richard Rutledge (woman wearing earring and necklace)

Brian A. Vikander (Samburu warrior)

Image 100 (young Asian man)

Robert van der Hilst (Yao girl in Bac Ha, Vietnam)

© by SO Appenzeller Käse GmbH (Appenzeller)

Dan Gair (woman, Kerala, India)

Fotosearch (portrait of an elderly woman)

Asy Asendorf, Zurich

Lithography

NC AG, Urdorf

Printing

Neidhart + Schön AG, Zurich

# The Art and Science of Better Hearing



Phonak Holding AG  
Laubisrütistrasse 28  
CH-8712 Stäfa  
Phone +41 44 928 01 01  
Fax +41 44 928 06 84  
Internet: [www.phonak.com](http://www.phonak.com)  
E-Mail: [ir@phonak.ch](mailto:ir@phonak.ch)

The Annual Report is also available in German.  
The English version is the governing text.

**PHONAK**  
hearing systems