Appendix 4D

Cochlear Limited
Half Yearly Report
As at 31 December 2017

Results for announcement to the market

		Movement from 31 December 2016		$m
Sales Revenue	**up**	**6%**	**to**	**639.6**
Total Revenue	up	7%	to	649.6
Earnings before interest and taxes (EBIT)	up	3%	to	160.4
Net profit for the period attributable to members	**down**	**1%**	**to**	**110.8**
Basic earnings per share (cents)	down	1%	to	192.7
Dividend (dollars)	up	8%	to	$1.40

Net tangible assets per share at 31 December 2017 (cents)	down	16%	to	401.1
Net tangible assets per share at 31 December 2016 (cents)				480.0

Dividends	Amount per security	Franked amount per security	Conduit foreign income per security
Interim dividend per share (dollars)	$1.40	$1.40	$0.00
Previous corresponding period (dollars)	$1.30	$1.30	$0.00

Record date for determining entitlements to the dividend	Tuesday 20 March 2018
Dividend payment date	Thursday 12 April 2018

No dividend reinvestment plans were in operation during or since the half-year.

Additional Appendix 4D disclosure requirements can be found in the 31 December 2017 Interim financial report lodged with this document. This report is based on the 31 December 2017 Interim financial report which has been reviewed by KPMG with the Independent auditor’s review report included in the 31 December 2017 Interim financial report.

Cochlear Limited and its controlled entities

ACN 002 618 073
Interim financial report
31 December 2017

The directors present their report, together with the consolidated interim financial report of the Consolidated Entity (Cochlear), being Cochlear Limited (the Company) and its controlled entities, for the half year ended 31 December 2017 and the auditors' review report thereon.

Directors

The directors of the Company during or since the end of the interim period are:

Name	Period of directorship
Non-executive directors	
Mr Rick Holliday-Smith, *Chairman*	Director since March 2005
Mrs Yasmin Allen	Director since August 2010
Mr Glen Boreham, AM	Director since January 2015
Professor Edward Byrne, AC	Director since July 2002
Ms Alison Deans	Director since January 2015
Mr Andrew Denver	Director since February 2007
Mr Donal O'Dwyer	Director since August 2005
Professor Bruce Robinson, AM	Director since December 2016
Executive directors	
Mr Chris Smith, *Chief Executive Officer & President*	Managing Director from September 2015 to 2 January 2018
Mr Dig Howitt, *Chief Executive Officer & President*	Director since November 2017 Managing Director since 3 January 2018

Principal activities and review of operations and results

Other than as discussed in this report, there were no significant changes in the nature of operating activities during the half year ended 31 December 2017 and the results of those operations are set out below.

Review of operations

The following provides a summary of Cochlear's performance for the half year ended 31 December 2017.

	31 Dec 2017 $m	31 Dec 2016 $m
Total Revenue	**649.6**	**609.2**
Sales revenue	639.6	604.4
Earnings before interest and tax (EBIT)	160.4	156.4
Profit attributable to members	**110.8**	**111.4**
Basic earnings per share (cents)	192.7	194.2
Diluted earnings per share (cents)	192.5	193.9
Interim dividend per share (dollars)	$1.40	$1.30

Product and service highlights

	31 Dec 2017 $m	31 Dec 2016 $m	Change % (Reported)	Change % (CC)[1]
Cochlear implants (units)	15,972	16,234	⬇ 2%	
Sales revenue				
Cochlear implants	393.3	377.1	⬆ 4%	⬆ 6%
Services (sound processor upgrades and other)	161.6	144.8	⬆12%	⬆12%
Acoustics (bone conduction and acoustic implants)	84.7	82.5	⬆ 3%	⬆ 5%
Total Sales revenue	**639.6**	**604.4**	⬆ **6%**	⬆ **7%**

1 Constant currency (CC) removes the impact of exchange rate movements to facilitate comparability. See Notes on page 9 for further detail.

Cochlear implants – 62% of sales revenue

Reported Cochlear implant revenue grew 4% (6% in CC) with unit growth down by 2% (up 5% excluding the impact of Chinese Central Government tender units).

Across the developed world, the cochlear implant market continues to experience robust growth, with improving awareness and growing uptake in the over 65 age demographic. Cochlear's developed markets business, which represents around 80% of revenue, grew units by 12% with highlights including continued strong performances from the US and Western Europe.

The Nucleus 7 Sound Processor, the world's first Made for iPhone cochlear implant sound processor, was launched across key markets during the second quarter and has performed strongly, driving market share gains for Cochlear.

The increase in sales revenue also reflects continued investments in market growth initiatives including direct-to-consumer activities and sales force expansion. These initiatives help build awareness of implantable hearing solutions and support further penetration into the adult segment.

The emerging markets have been growing strongly over the past five years, often experiencing inconsistent rates of growth over the shorter term. Emerging markets units reduced this half, primarily as a result of the timing of a number of tenders. In particular, the HY17 result included 1,100 Chinese Central Government tender units.

Services (sound processor upgrades and other) – 25% of sales revenue

Reported Services sales revenue increased by 12% (12% in CC) driven by the release of the Nucleus 7 Sound Processor during the second quarter and first time inclusion of revenue from Sycle, the audiology practice management software business acquired in May 2017.

Sound processor upgrade revenue increased by 9% in CC with the Nucleus 7 Sound Processor available as an upgrade in key markets from October. Cochlear continues to invest to provide customers with a world class customer experience with increased connectivity and engagement to its more than 475,000 recipients. Cochlear's recipient membership program, Cochlear Family, continues to grow rapidly, with membership growing by over 27%, to around 76,000 recipients since June.

Acoustics (bone conduction and acoustic implants) – 13% of sales revenue

Reported Acoustics revenue grew 3% (5% in CC), following 20% growth in CC in HY17, with solid demand continuing for the Baha® 5 range of sound processors.

Regional review

Sales revenue	31 Dec 2017 $m	31 Dec 2016 $m	Change % (Reported)	Change % (CC)
Americas	317.2	285.2	⬆ 11%	⬆ 15%
EMEA (Europe, Middle East and Africa)	221.7	207.9	⬆ 7%	⬆ 5%
Asia Pacific	100.7	111.3	⬇ 10%	⬇ 7%
Total Sales revenue	**639.6**	**604.4**	⬆ **6%**	⬆ **7%**

Americas (US, Canada and Latin America) – 50% of sales revenue

Reported sales revenue increased by 11% (15% in CC). The highlight was the growth in the US with cochlear implant unit growth of 15%, the result of market growth as well as market share gains. Growth has been driven by new product introductions and the success of awareness building initiatives which continue to drive overall market growth rates, particularly in the seniors segment. Services revenue also grew strongly, particularly in the second quarter, following the successful introduction of the Nucleus 7 Sound Processor as an upgrade option in October.

The expanded field sales organisation, direct-to-consumer marketing and improvements in sales force effectiveness have continued to contribute to market growth in the US.

EMEA (Europe, Middle East and Africa) – 35% of sales revenue

Reported sales revenue increased by 7% (5% in CC). Western Europe unit growth was 9% with market growth and market share gains delivered across many countries including the UK and Germany. Like the US, Western Europe is benefitting from the expanded field sales organisation and direct-to-consumer marketing which are building awareness of cochlear implants and driving demand at clinics.

Expansion of indications for cochlear implantation in Western Europe continues to be a key opportunity and focus area with much of the region restricting access and funding to candidates with a profound hearing loss. Germany leads the region with indications extending to severe hearing loss, an important factor for driving growth in adults, and is in line with indications in the US, Australia and Japan.

Units and sales revenue across EMEA's emerging markets, including Central and Eastern Europe and the Middle East and Africa, reduced primarily as a result of the timing of a number of tenders.

Asia Pacific (Australasia and Asia) – 15% of sales revenue

Reported sales revenue was down 10% (7% in CC). Australia experienced solid unit growth while private pay surgeries in China continue to grow strongly. During the half, Japan announced the expansion of indications for cochlear implantation to include candidates with severe hearing loss, a major milestone that is expected to support growth of the Japanese market over the coming years. The Kanso Sound Processor is being progressively launched across the region with a number of markets experiencing a strong preference for the off-the-ear processor.

Growth at the regional level was however materially impacted by the 1,100 Chinese Central Government tender units in the HY17 result. Cochlear expects to start shipping the 1,491 China tender units awarded in October 2017 during the second half.

Financial review

Profit and loss

	31 Dec 2017 $m	31 Dec 2016 $m	Change % (Reported)	Change % (CC)[1]
Sales revenue	**639.6**	**604.4**	**6%**	**7%**
Costs of goods sold	176.4	176.2	0%	1%
% of sales revenue	*28%*	*29%*		
Selling and general expenses	189.1	165.2	14%	16%
Administration expenses	44.2	44.3	0%	0%
Research and development expenses	80.6	72.2	12%	11%
% of sales revenue	*13%*	*12%*		
Total expenses	**490.3**	**457.9**	**7%**	**8%**
Other income	1.2	5.1		
Other expense	0.1	-		
FX contract gains	10.0	4.8		
EBIT	**160.4**	**156.4**	**3%**	**4%**
% of sales revenue	*25%*	*26%*		
Net finance costs	3.8	3.4	12%	
Taxation expense	45.8	41.6	10%	
% effective tax rate	*29%*	*27%*		
Net profit	**110.8**	**111.4**	**(1%)**	**1%**

1 Constant currency (CC) removes the impact of exchange rate movements and FX contract gains/(losses) to facilitate comparability. See Notes on page 9 for further detail.

Reported sales revenue increased by 6% (7% in CC) to $639.6 million while total expenses increased by 7% (8% in CC) to $490.3 million. As a result, the business generated an EBIT increase of 3% (4% in CC) to $160.4 million with the EBIT margin decreasing by one point to 25%.

Key points of note:

- Reported cost of goods sold (COGS) remained in line with HY17 (increasing by 1% in CC) to $176.4 million, reflecting relatively stable volumes. COGS as a percentage of sales revenue reduced by one point to 28%;
- Selling and general expenses increased by 14% (16% in CC) to $189.1 million. The increase reflects the continued investment in the sales force and expanded marketing activities, the launch of the Nucleus 7 Sound Processor which was launched in September, and the first time inclusion of expenses related to Sycle, which was acquired in May;
- Investment in R&D increased 12% (11% in CC) to $80.6 million, representing 13% of sales revenue;
- FX contract gains on hedged sales were $10.0 million, reflecting the impact of the AUD appreciation against many of the major currencies compared to HY17 rates;
- Net finance costs increased by 12% to $3.8 million, reflecting higher average net debt levels; and
- The effective tax rate increased from 27% to 29%, reflecting the $5.5 million one-off non-cash impact from the revaluation of deferred tax assets following the recently announced reduction in US corporate tax rates. The revaluation reduced reported net profit growth by 5%.

Cash flow

	31 Dec 2017 $m	31 Dec 2016 $m	Change $m
EBIT	160.4	156.4	4.0
Depreciation and amortisation	15.4	15.9	(0.5)
Changes in working capital and other	(24.2)	(29.0)	4.8
Net interest paid	(3.7)	(3.3)	(0.4)
Income taxes paid	(55.2)	(37.7)	(17.5)
Operating cash flow	**92.7**	**102.3**	**(9.6)**
Capital expenditure	(16.5)	(17.2)	0.7
Other investments	(3.4)	-	(3.4)
Free cash flow	**72.8**	**85.1**	**(12.3)**

The business generated $92.7 million in operating cash flows and $72.8 million in free cash flow. Key points of note:

- Income taxes paid increased by $17.5 million to $55.2 million reflecting the impact of the timing of cash tax payments; and
- Capital expenditure reduced by $0.7 million to $16.5 million.

Capital employed

	31 Dec 2017 $m	30 Jun 2017 $m	Change $m
Trade receivables	275.2	275.4	(0.2)
Inventories	177.3	160.0	17.3
Less: Trade and other payables	(116.7)	(130.9)	14.2
Working capital	335.8	304.5	31.3
Debtor days	*71*	*74*	*(3)*
Inventory days	*182*	*164*	*18*
Property, plant and equipment	121.0	120.1	0.9
Intangible assets	343.9	340.0	3.9
Other net liabilities	(88.8)	(91.6)	2.8
Capital employed	**711.9**	**673.0**	**38.9**

Capital employed increased by $38.9 million to $711.9 million since June 2017, primarily as a result of an increase in working capital.

Key points of note:

- Inventories increased by $17.3 million to $177.3 million driven by additional raw materials to cater for growing volumes as well as inventory build ahead of delivery of Chinese Central Government tender units during the second half;
- Trade and other payables reduced by $14.2 million to $116.7 million, reflecting a return to normalised levels. There was an increase in current payables in June 2017 relating to the Sycle acquisition and the gearing up of the supply chain for production of the Nucleus 7 Sound Processor; and
- Other net liabilities includes a reduction of $5.5 million in the value of US deferred tax assets. The reduction was a consequence of the legislated reduction in US corporate tax rates, which required a revaluation of US deferred tax assets as at 31 December 2017.

Net debt

	31 Dec 2017 $m	30 Jun 2017 $m	Change $m
Loans and borrowings:			
Current	59.6	84.7	(25.1)
Non-current	184.4	134.2	50.2
Total debt	244.0	218.9	25.1
Cash and cash equivalents	(106.9)	(89.5)	(17.4)
Net debt	**137.1**	**129.4**	**7.7**

Net debt increased by $7.7 million to $137.1 million.

Dividends

	31 Dec 2017	31 Dec 2016	% Change
Interim ordinary dividends (dollars)	$1.40	$1.30	8%
Payout ratio %	73%	67%	
Franking %	100%	100%	

Strong free cash flow and the continued strength of the balance sheet have supported the payment of an interim dividend of $1.40 per share, franked at 100%, representing a payout of 73% of first half net profit.

The record date for determining dividend entitlements is 20 March 2018 and the interim dividend will be paid on 12 April 2018.

Notes

Forward looking statements

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

2018 Financial outlook

For FY18, Cochlear reaffirms its expectations of delivering reported net profit of $240-250 million, with currency headwinds expected to moderate strong underlying business growth.

Cochlear continues to experience positive momentum across the developed markets with significant investments made in product development and market growth initiatives over the previous few years expected to underpin growth in FY18. The balance sheet position and free cash flow generation remain strong and Cochlear continues to target a dividend payout ratio of around 70% of net profit.

Key guidance considerations for the second half of FY18:
- expect solid momentum in developed market unit growth to continue, which will be supported by investment in market access and market growth activities;
- expect to start shipping the 1,491 China tender units awarded in October 2017;
- expect full year R&D expenditure to be $160-170 million;
- expect the full year net impact of the change in US tax legislation to reduce net profit by $3-4 million;
- forecasting a weighted average AUD/USD exchange rate of around 79 cents for FY18 versus 75 cents in FY17.

Non-International Financial Reporting Standards (IFRS) financial measures

Given the significance of FX movements, the directors believe the presentation of non-IFRS financial measure, constant currency, is useful for the users of this document as it reflects the underlying financial performance of the business. The non-IFRS financial measure has not been subject to review or audit. However, KPMG has separately undertaken a set of procedures to agree the non-IFRS financial measures disclosed to the books and records of the Consolidated Entity.

Constant currency

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

Reconciliation of constant currency net profit to the reported net profit

	31 Dec 2017	31 Dec 2016	% Change
Net profit (reported)	110.8	111.4	(1%)
FX contract gains		5.2	
Spot exchange rate effect to sales and expenses[1]		(4.0)	
Balance sheet revaluation[1]		(2.7)	
Net profit (CC)	**110.8**	**109.9**	**1%**

1 HY18 actual v HY17 at HY18 rates

Dividends

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

	$m
In respect of the previous year:	
A final ordinary dividend of $1.40 per share, franked to 100% with Class C (100%) franking credits, in respect of the year ended 30 June 2017, paid on 11 October 2017.	80.5

The interim dividend in respect of the current financial year has not been provided for in this financial report as it was not declared until after 31 December 2017. Since the end of the financial half-year, the directors declared an interim dividend of $1.40 100% franked amounting to a total of $80.6m.

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

The lead auditor's independence declaration is set out on page 11 and forms part of the Directors' Report for the half year ended 31 December 2017.

Rounding off

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

Dated at Sydney this 13th day of February 2018.

Signed in accordance with a resolution of the directors:

Director

Director

Lead Auditor's Independence Declaration under Section 307C of the Corporations Act 2001

To: the directors of Cochlear Limited

I declare that, to the best of my knowledge and belief, in relation to the review for the half-year ended 31 December 2017 there have been:

(i) no contraventions of the auditor independence requirements as set out in the Corporations Act 2001 in relation to the review; and

(ii) no contraventions of any applicable code of professional conduct in relation to the review.

KPMG

KPMG | Cameron Slapp, *Partner*

Sydney, 13 February 2018

Cochlear Limited and its controlled entities
Interim Income Statement
For the half year ended 31 December 2017

	Note	31 Dec 2017	31 Dec 2016
		$m	$m
Revenue	2.2	649.6	609.2
Cost of sales	2.3	(176.4)	(176.2)
Gross profit		**473.2**	**433.0**
Selling and general expenses		(189.1)	(165.2)
Administration expenses		(44.2)	(44.3)
Research and development expenses		(80.6)	(72.2)
Other income	2.4	1.2	5.1
Other expense	2.3	(0.1)	-
Results from operating activities		**160.4**	**156.4**
Finance income - interest		0.2	0.3
Finance expense - interest		(4.0)	(3.7)
Net finance expense		**(3.8)**	**(3.4)**
Profit before income tax		**156.6**	**153.0**
Income tax expense	3	(45.8)	(41.6)
Net profit		**110.8**	**111.4**
Basic earnings per share (cents)	2.5	192.7	194.2
Diluted earnings per share (cents)	2.5	192.5	193.9

The notes on pages 17 to 25 are an integral part of these consolidated interim financial statements.

Cochlear Limited and its controlled entities
Interim Statement of Comprehensive Income
For the half year ended 31 December 2017

	31 Dec 2017 $m	31 Dec 2016 $m
Net profit	**110.8**	**111.4**
***Other comprehensive income/*(loss)**		
Items that may be reclassified subsequently to the income statement:		
Foreign currency translation differences	3.3	(15.7)
Effective portion of changes in fair value of cash flow hedges, net of tax	1.6	3.6
Net change in fair value of cash flow hedges transferred to the income statement, net of tax	(7.0)	(3.4)
Net change in fair value of available for sales financial assets, net of tax	(0.1)	-
Total items that may be reclassified subsequently to the income statement	(2.2)	(15.5)
Other comprehensive loss, net of tax	**(2.2)**	**(15.5)**
Total comprehensive income	**108.6**	**95.9**

The notes on pages 17 to 25 are an integral part of these consolidated interim financial statements.

Cochlear Limited and its controlled entities
Interim Balance Sheet
For the half year ended 31 December 2017

	Note	31 Dec 2017 $m	30 Jun 2017 $m
Assets			
Cash and cash equivalents		106.9	89.5
Trade and other receivables		288.7	292.1
Forward exchange contracts		16.0	18.4
Inventories		177.3	160.0
Current tax assets		10.6	7.3
Prepayments		21.5	18.6
Total current assets		**621.0**	**585.9**
Other receivables		0.6	0.8
Forward exchange contracts		5.5	7.8
Property, plant and equipment		121.0	120.1
Intangible assets		343.9	340.0
Investments		17.6	15.1
Deferred tax assets		74.8	66.6
Total non-current assets		**563.4**	**550.4**
Total assets		**1,184.4**	**1,136.3**
Liabilities			
Trade and other payables		116.7	130.9
Foreign exchange contracts		3.8	2.0
Loans and borrowings	5.1	59.6	84.7
Current tax liabilities		26.6	26.3
Employee benefit liabilities		49.0	52.4
Provisions		29.9	25.0
Deferred revenue		26.6	25.3
Total current liabilities		**312.2**	**346.6**
Trade and other payables		33.5	33.9
Foreign exchange contracts		5.4	3.2
Loans and borrowings	5.1	184.4	134.2
Employee benefit liabilities		11.0	11.0
Provisions		52.6	54.7
Deferred tax liabilities		8.6	5.8
Deferred revenue		1.9	3.3
Total non-current liabilities		**297.4**	**246.1**
Total liabilities		**609.6**	**592.7**
Net assets		**574.8**	**543.6**
Equity			
Share capital		172.9	169.4
Reserves		(15.5)	(12.9)
Retained earnings		417.4	387.1
Total equity		**574.8**	**543.6**

The notes on pages 17 to 25 are an integral part of these consolidated interim financial statements.

Cochlear Limited and its controlled entities
Interim Statement of Changes in Equity
For the half year ended 31 December 2017

Amounts $m	Issued capital	Treasury reserve	Translation reserve	Hedging reserve	Fair value reserve	Share based payment reserve	Retained earnings	Total equity
Balance at 1 July 2016	159.3	(0.4)	(48.4)	4.2	-	29.5	304.3	448.5
Total comprehensive (loss)/income								
Net profit	-	-	-	-	-	-	111.4	111.4
Other comprehensive (loss)/income								
Foreign currency translation	-	-	(15.7)	-	-	-	-	(15.7)
Effective portion of changes in fair value of cash flow hedges, net of tax	-	-	-	3.6	-	-	-	3.6
Net change in fair value of cash flow hedges transferred to the income statement, net of tax	-	-	-	(3.4)	-	-	-	(3.4)
Total other comprehensive (loss)/income	**-**	**-**	**(15.7)**	**0.2**	**-**	**-**	**-**	**(15.5)**
Total comprehensive (loss)/income	**-**	**-**	**(15.7)**	**0.2**	**-**	**-**	**111.4**	**95.9**
Transactions with owners, recorded directly in equity								
Share options exercised	10.1	0.3	-	-	-	(1.4)	-	9.0
Share based payment transactions	-	-	-	-	-	4.6	-	4.6
Deferred tax recognised in equity	-	-	-	-	-	(1.5)	-	(1.5)
Dividends to shareholders	-	-	-	-	-	-	(68.9)	(68.9)
Balance at 31 December 2016	**169.4**	**(0.1)**	**(64.1)**	**4.4**	**-**	**31.2**	**346.8**	**487.6**
Balance at 1 July 2017	169.4	-	(63.5)	15.2	(0.3)	35.7	387.1	543.6
Total comprehensive income/(loss)								
Net profit	-	-	-	-	-	-	110.8	110.8
Other comprehensive income/(loss)								
Foreign currency translation	-	-	3.3	-	-	-	-	3.3
Effective portion of changes in fair value of cash flow hedges, net of tax	-	-	-	1.6	-	-	-	1.6
Net change in fair value of cash flow hedges transferred to the income statement, net of tax	-	-	-	(7.0)	-	-	-	(7.0)
Net change in fair value of available for sales financial assets, net of tax	-	-	-	-	(0.1)	-	-	(0.1)
Total other comprehensive income/(loss)	**-**	**-**	**3.3**	**(5.4)**	**(0.1)**	**-**	**-**	**(2.2)**
Total comprehensive income/(loss)	**-**	**-**	**3.3**	**(5.4)**	**(0.1)**	**-**	**110.8**	**108.6**
Transactions with owners, recorded directly in equity								
Performance rights vested	-	-	-	-	-	(1.4)	-	(1.4)
Share options exercised	3.5	-	-	-	-	(1.8)	-	1.7
Share based payment transactions	-	-	-	-	-	5.6	-	5.6
Deferred tax recognised in equity	-	-	-	-	-	(2.8)	-	(2.8)
Dividends to shareholders	-	-	-	-	-	-	(80.5)	(80.5)
Balance at 31 December 2017	**172.9**	**-**	**(60.2)**	**9.8**	**(0.4)**	**35.3**	**417.4**	**574.8**

The notes on pages 17 to 25 are an integral part of these consolidated interim financial statements.

Cochlear Limited and its controlled entities
Interim Statement of Cash Flows
For the half year ended 31 December 2017

	31 Dec 2017 $m	31 Dec 2016 $m
Cash flows from operating activities		
Cash receipts from customers	641.8	583.4
Cash paid to suppliers and employees	(491.4)	(442.6)
Grant and other income received	1.2	2.5
Interest received	0.2	0.3
Interest paid	(3.9)	(3.6)
Income taxes paid	(55.2)	(37.7)
Net cash from operating activities	**92.7**	**102.3**
Cash flows from investing activities		
Acquisition of leasehold improvements and plant and equipment	(10.0)	(15.0)
Acquisition of enterprise resource planning system	(5.1)	(2.2)
Acquisition of other intangibles	(1.4)	-
Acquisition of investments	(3.7)	-
Proceeds of sale of non-current assets	0.3	-
Net cash used in investing activities	**(19.9)**	**(17.2)**
Cash flows from financing activities		
Repayment of borrowings	(65.0)	(128.0)
Proceeds from borrowings	90.0	108.0
Proceeds from exercise of share options, net	0.3	9.0
Dividends paid	(80.5)	(68.9)
Net cash used in financing activities	**(55.2)**	**(79.9)**
Net increase in cash and cash equivalents	**17.6**	**5.2**
Cash and cash equivalents at 1 July	89.5	75.4
Effect of exchange rate fluctuation on cash held	(0.2)	(1.2)
Cash and cash equivalents at 31 December	**106.9**	**79.4**

The notes on pages 17 to 25 are an integral part of these consolidated interim financial statements.

1 Basis of preparation

1.1 Reporting entity

Cochlear Limited (the Company) is a company domiciled in Australia. The Consolidated Interim financial report of the Company as at and for the half year ended 31 December 2017 comprises the Company and its subsidiaries (together referred to as Cochlear or the Consolidated Entity). Cochlear's Consolidated Annual Financial Report as at and for the year ended 30 June 2017 is available upon request from the Company's registered office at 1 University Avenue, Macquarie University NSW 2109, Australia or at www.cochlear.com.

1.2. Statement of compliance

The Consolidated Interim financial report is a general purpose financial report which has been prepared in accordance with AASB134 *Interim financial reporting* and the *Corporations Act 2001*, and with IAS 34 *Interim financial reporting*.

The Consolidated Interim financial report does not include all of the information required for a full annual financial report, and should be read in conjunction with Cochlear's Consolidated Annual Financial Report as at and for the year ended 30 June 2017. This report should also be read in conjunction with any public announcements made by Cochlear Limited during the half year ended 31 December 2017 in accordance with continuous disclosure obligations arising under the Corporations Act 2001.

The Consolidated Interim financial report was approved by the Board of Directors on 13 February 2018.

The Consolidated Entity is of a kind referred to in ASIC Corporations (Rounding in Financial/Directors' Reports) Instrument 2016/191 (Rounding instrument) dated 24 March 2016 and in accordance with that Instrument, all financial information presented in Australian dollars (AUD) has been rounded to the nearest one hundred thousand dollars unless otherwise stated.

1.3 Significant accounting policies

The accounting policies applied by the Consolidated Entity in this Consolidated Interim financial report are the same as those applied by the Consolidated Entity in the Consolidated Annual Financial Report as at and for the year ended 30 June 2017.

1.4 Estimates and judgements

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

In preparing this Consolidated Interim financial report, the significant judgments made by management in applying Cochlear's accounting policies and the key sources of estimation uncertainty were the same as those that applied to the Consolidated Annual Financial Report as at and for the year ended 30 June 2017.

1.5 New Standards

A number of new standards, amendments to standards and interpretations are effective for financial years beginning on or after 1 July 2018, and have not been applied in preparing these consolidated financial statements. Of the new standards, only the below are expected to have an effect on the consolidated financial statements of Cochlear.

- AASB 9 Financial Instruments, which becomes mandatory for Cochlear's 2019 consolidated financial statements. Whilst Cochlear has yet to undertake a detailed assessment of the classification and measurement impact of the new standard, Cochlear expects the following:
  - there will be no significant impact on the classification and measurement of its financial assets and financial liabilities;

  - existing hedge relationships would qualify as continuing hedge relationships upon the adoption of the new standard; and
  - the new impairment model requires the recognition of impairment provisions based on expected credit losses rather than only incurred credit losses. Whilst Cochlear has not yet finalised its detailed assessment of the impact of AASB 9 and its interaction with AASB 15 Revenue from Contracts with Customers, it may result in earlier recognition of credit loss provisions.

- AASB 15 Revenue from Contracts with Customers, which becomes mandatory for Cochlear's 2019 consolidated financial statements. Based on the guidance, Cochlear does not expect the recognition and measurement of revenue to materially change under the new standard but has not yet completed its final assessment.
- AASB 16 Leases, which becomes mandatory for Cochlear's 2020 consolidated financial statements. Cochlear has yet to complete a detailed assessment on the potential impact on its consolidated financial statements resulting from the application of AASB 16; however, the following impacts are expected:
  - the total assets and liabilities on the balance sheet will increase with a decrease in net total assets, due to the depreciation of right of use assets being on a straight-line basis whilst the lease liability reduces by the principal amount of repayments;
  - interest expense will increase due to the unwinding of the effective interest rate implicit in the lease liability. Interest expense will be greater earlier in a lease's life, due to the higher principal value, causing profit variability over the term of lease. This effect may be partially mitigated due to the number of leases held by Cochlear at various stages of their terms; and
  - operating cash flows will be higher and financing cash flows will be lower, as repayment of the principal portion of all lease liabilities will be classified as financing activities.

Cochlear does not plan to adopt these standards early.

2. Performance for the half year

2.1 Operating segments

	Americas		EMEA(i)		Asia Pacific		**Total**	
	2017	2016	2017	2016	2017	2016	**2017**	**2016**
	$m	$m	$m	$m	$m	$m	**$m**	**$m**
Reportable segment revenue	317.2	285.2	221.7	207.9	100.7	111.3	**639.6**	**604.4**
Reportable segment EBIT	166.7	149.8	96.0	88.9	29.7	35.4	**292.4**	**274.1**

(i) Europe, Middle East and Africa

Reconciliations of reportable segment revenues and profit or loss

Revenues	Cochlear implants	Services	**Total Cochlear implants**	Acoustics	**Reportable segment revenue**	Foreign exchange gains on hedged sales	**Consolidated revenue**
	$m	$m	**$m**	$m	**$m**	$m	**$m**
31 Dec 2017	393.3	161.6	**554.9**	84.7	**639.6**	10.0	**649.6**
31 Dec 2016	377.1	144.8	**521.9**	82.5	**604.4**	4.8	**609.2**

Profit or loss	Reportable segment EBIT	Corporate and other net expenses	Foreign exchange gains on hedged sales	Net finance expense	**Consolidated profit before income tax**
	$m	$m	$m	$m	**$m**
31 Dec 2017	292.4	(142.0)	10.0	(3.8)	**156.6**
31 Dec 2016	274.1	(122.5)	4.8	(3.4)	**153.0**

2.2 Revenue

	31 Dec 2017	31 Dec 2016
	$m	$m
Sale of goods revenue before hedging	626.2	598.3
Foreign exchange gains on hedged sales	10.0	4.8
Revenue from the sale of goods	**636.2**	**603.1**
Rendering of services revenue	13.4	6.1
Total revenue	**649.6**	**609.2**

2.3 Expenses

	31 Dec 2017 $m	31 Dec 2016 $m
Cost of sales		
Carrying amount of inventories recognised as an expense	172.5	169.0
Write-down in value of inventories	1.0	3.2
Other	2.9	4.0
Total cost of sales	**176.4**	**176.2**
Other expense		
Net foreign exchange loss	0.1	-
Total other expense	**0.1**	**-**

2.4 Other income

	31 Dec 2017 $m	31 Dec 2016 $m
Grant received or due and receivable	0.5	1.0
Net foreign exchange gain	-	2.6
Other	0.7	1.5
Total other income	**1.2**	**5.1**

2.5 Earnings per share

Basic earnings per share

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

	31 Dec 2017	31 Dec 2016
Net profit attributable to equity holders of the parent entity	$110,805,000	$111,367,000
Weighted average number of ordinary shares (basic):		
Issued ordinary shares at 1 July (number)	57,426,649	57,199,264
Effect of options and performance shares exercised (number)	76,896	146,849
Effect of shares issued under Employee Share Plan (number)	4,582	4,647
Weighted average number of ordinary shares (basic)	**57,508,127**	**57,350,760**
Basic earnings per share (cents)	**192.7**	**194.2**

Diluted earnings per share

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

	31 Dec 2017	31 Dec 2016
Net profit attributable to equity holders of the parent entity	$110,805,00	$111,367,000
Weighted average number of ordinary shares (diluted):		
Weighted average number of shares (basic) (number)	57,508,127	57,350,760
Effect of options, performance shares and rights unvested (number)	65,437	79,882
Weighted average number of ordinary shares (diluted)	**57,573,564**	**57,430,642**
Diluted earnings per share (cents)	**192.5**	**193.9**

2.6 Options and performance rights

The Company has granted options and performance rights to certain employees and key management personnel under the Cochlear Executive Incentive Plan (CEIP). The terms and conditions of the plan are disclosed in the Consolidated Annual Financial Report as at and for the year ended 30 June 2017.

Grants made in the current period to certain employee and key management personnel under the CEIP are set out below.

Grant date	Exercise price per option	Number of options	Number of performance rights	Contractual life
August 2017[1]	N/A	N/A	39,485	2 years
October 2017[2]	$154.73	106,713	12,751	3-4 years

1. Performance rights offered under deferred short-term incentives.
2. Options and performance rights offered under long-term incentives.

2.7 Dividends

Dividends recognised in the current and prior financial period by Cochlear Limited are:

	Dollars per share	Total amount $m	Franked/ unfranked	Date of payment
31 December 2017				
Final – ordinary	1.40	80.5	100% Franked	11 October 2017
31 December 2016				
Final – ordinary	1.20	68.9	100% Franked	29 September 2016

Subsequent event

Since the end of the reporting period, the directors declared the following dividend:				
Interim – ordinary	1.40	80.6	100% Franked	12 April 2018

The financial effect of these dividends has not been brought to account in the Consolidated Interim financial report for the half year ended 31 December 2017 and will be recognised in subsequent financial statements.

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

3. Income taxes

Numerical reconciliation between income tax expense and profit before income tax

	31 Dec 2017 $m	31 Dec 2016 $m
Net profit	110.8	111.4
Income tax expense	45.8	41.6
Profit before income tax	**156.6**	**153.0**
Tax at the Australian tax rate of 30% (Dec 2016: 30%)	47.0	45.9
Increase in income tax expense due to:		
Effect of change in US tax rate on deferred tax balances- refer below	5.5	-
Non-deductible expenses	-	0.4
Effect of tax rate in foreign jurisdictions	-	0.1
Decrease in income tax expense due to:		
Research and development allowances	(4.9)	(4.4)
Non-assessable income	(0.6)	-
Effect of tax rate in foreign jurisdictions	(0.4)	-
	46.6	42.0
Adjustment for prior years	(0.8)	(0.4)
Income tax expense on profit before income tax	**45.8**	**41.6**

Individually significant tax item

On 22 December 2017, US tax reform legislation was enacted which reduced the US Federal Tax rate from 35% to 21%. The initial impact of this change in tax rate was to reduce the Group's net deferred tax assets and increase the tax expense by $5.5m.

4. Operating assets and liabilities

4.1 Patent dispute

In a trial of the patent infringement lawsuit by the Alfred E. Mann Foundation for Scientific Research ("AMF") and Advanced Bionics LLC ("AB") in January 2014, a Jury found that Cochlear Limited and its US subsidiary Cochlear Americas (collectively "Cochlear") infringed four claims across two patents, the infringement was "willful" and awarded USD 131,216,325 in damages.

On 1 April 2015, a Judge in the United States District Court in Los Angeles, California held that three of the four patent claims were invalid and Cochlear's infringement of the remaining claim was not "willful". The Judge overturned the damages awarded because three of the four claims were held to be invalid. On 21 April 2015, the Court entered Judgment on liability only and stayed a new trial on damages pending the outcome of the appeals by all parties from the Judgment to the United States Court of Appeals for the Federal Circuit.

On 18 November 2016, the Court of Appeals affirmed the Judgment as to infringement, affirmed the Judgment as to invalidity of two claims in one patent and reversed the Judgment of invalidity of one claim in the remaining patent. The Court of Appeals then remanded to the District Court the issue of damages and wilfulness of infringement of two claims in the remaining patent at issue.

AMF and AB has asked the Judge in the District Court to enter Judgment against Cochlear for USD$131,216,325 based upon the Jury award in January 2014 and to increase those damages for willful infringement. Cochlear has asked the judge to find non-infringement of claim 1 of the '616 Patent, to hold a second jury trial on damages on claim 10 of the '616 Patent, and to decline to increase damages for willful infringement. The parties await the decision by the Judge on these applications.

As the patents have expired, the trial Judgment and the Court of Appeals decision will not disrupt Cochlear's business or customers in the United States.

The nature of the above legal process is such that final future outcomes are uncertain. The directors have made judgements and assumptions relating to their best estimate of the outcome of this litigation and actual outcomes may differ from the estimated liability.

A provision was expensed in the half year ended 31 December 2013 in relation to this dispute. For the purpose of determining this provision, Cochlear considered its independent damages expert's assessment prepared for the trial to estimate the liability that could result from the infringement of four claims. No additional amount has been provided since that initial provision. The provision at 31 December 2017 is $21.3m (30 June 2017: $21.3m).

4.2 Contingent liabilities

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

Product liability claims

Cochlear is currently and/or is likely from time to time to be involved in claims and lawsuits incidental to the ordinary course of business, including claims for damages relating to its products and services.
In addition, Cochlear has received legal claims and lawsuits in various countries including the United States by recipients who have had Cochlear implant CI500 series devices stop functioning for the reason that led to the September 2011 voluntary recall of unimplanted CI500 series devices.

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

5. Financial and capital structure

5.1 Loans and Borrowings

	31 Dec 2017 $m	30 Jun 2017 $m
Loans and borrowings:		
Current	59.6	84.7
Non-current	184.4	134.2
Total loans and borrowings	244.0	218.9
Less: Cash and cash equivalents	(106.9)	(89.5)
Net debt	**137.1**	**129.4**

Multi-option bank facilities - Secured bank loan

Cochlear has three bank loan facilities.

In June 2013, Cochlear negotiated a loan facility for a period of five years to 26 June 2018. The facility has a total commitment limit of AUD 115.0 million, made up of an AUD 100.0 million loan sub-facility limit and incorporates an AUD 15.0 million letter of credit facility.

In June 2016 a facility with a total commitment limit of AUD 250.0 million was established for a three year period to 14 June 2019. The facility had a letter of credit sub-facility limit of up to AUD 5.0 million for the purpose of drawing either letters of credit or bank guarantees which was transferred to the new facility in April 2017.

In April 2017, a facility with a total commitment limit of AUD 100.0 million was established for a four year period to 12 April 2021. This facility includes the letter of credit sub-facility of up to AUD 5.0 million transferred from the facility established in June 2016.

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

Other credit facilities

Unsecured bank overdrafts

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

Secured bank loan

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

Bank guarantees

As at 31 December 2017, Cochlear had contingent liability facilities denominated in United States dollars, Euros, Sterling, Indian rupees and New Zealand dollars totalling AUD 3.2 million (June 2017: AUD 3.3 million).

5.2 Financial Instruments

Fair values

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

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

Valuation of financial assets and liabilities

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

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

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

The equity securities classified as available for sale financial assets are valued where available using quoted prices (Level 1), or where not available using unobservable market inputs (Level 3). Unobservable inputs are those not readily available in an active market. These inputs are generally derived from other observable inputs that match the risk profile of the financial instruments and validated against current market assumptions and historical transactions where available.

6 Other notes

6.1 Events subsequent to reporting date

Other than reported below, there has not arisen in the interval between the reporting date and the date of this financial report, any item, transaction or event of a material and unusual nature likely, in the opinion of the directors of the Company, to affect significantly the operations of Cochlear, the results of those operations, or the state of affairs of Cochlear in future financial years.

Dividends

For dividends declared after 31 December 2017, see Note 2.7.

Cochlear Limited and its controlled entities
Directors' Declaration
For the half year ended 31 December 2017

In the opinion of the directors of Cochlear Limited:

1. The consolidated financial statements and notes set out on pages 12 to 25 are in accordance with the *Corporations Act 2001*, including:

   a. giving a true and fair view of the Consolidated Entity's financial position as at 31 December 2017, and of its performance, for the six month period ended on that date; and

   b. complying with Australian Accounting Standard AASB 134 *Interim financial reporting* and the *Corporations Regulations 2001*; and

2. There are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

Signed in accordance with a resolution of the directors:

Dated at Sydney this 13th day of February 2018.

Director

Director

Independent auditor's review report

To the Members of Cochlear Limited

Report on the interim financial report

Conclusion

We have reviewed the accompanying interim financial report of Cochlear Limited.

Based on our review, which is not an audit, we have not become aware of any matter that makes us believe that the Interim financial report of Cochlear Limited is not in accordance with the *Corporations Act 2001*, including:

- Giving a true and fair view of the Consolidated Entity's financial position as at 31 December 2017 and of its performance for the Half-year ended on that date; and
- Complying with *Australian Accounting Standard AASB 134 Interim financial reporting* and the *Corporations Regulations 2001.*

The interim financial report comprises:

- the consolidated interim balance sheet as at 31 December 2017;
- consolidated interim income statement, consolidated interim statement of comprehensive income, consolidated interim statement of changes in equity and consolidated interim statement of cash flows for the half-year ended on that date;
- notes 1 to 6.1 comprising a summary of significant accounting policies and other explanatory information; and
- the Directors' Declaration.

The Consolidated Entity comprises Cochlear Limited (the Company) and the entities it controlled at the half-year's end or from time to time during the half-year.

The interim period is the 6 months ended on 31 December 2017.

Emphasis of matter – Patent dispute

We draw attention to Note 4.1 in the Interim financial report, which describes the inherent uncertainty in the final future outcome related to the patent infringement lawsuit filed against the Consolidated Entity (the lawsuit).

The uncertainty relates to the outcome of the lawsuit remanded to the United States District Court regarding the issue of damages and wilfulness of infringement of two claims. There remains significant uncertainty in the range of possible financial outflows associated with the lawsuit, the resolution of which may significantly impact the Consolidated Entity.

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

Responsibilities of the Directors for the half-year financial report

The Directors of the Company are responsible for:

- the preparation of the interim financial report that gives a true and fair view in accordance with *Australian Accounting Standards* and the *Corporations Act 2001*; and
- for such internal control as the Directors determine is necessary to enable the preparation of the interim financial report that is free from material misstatement, whether due to fraud or error.

Independent auditor's review report

Auditor's responsibility for the review of the half-year financial report

Our responsibility is to express a conclusion on the Interim financial report based on our review. We conducted our review in accordance with *Auditing Standard on Review Engagements ASRE 2410 Review* of *a Financial Report Performed by the Independent Auditor of the Entity*, in order to state whether, on the basis of the procedures described, we have become aware of any matter that makes us believe that the interim financial report is not in accordance with the *Corporations Act 2001* including: giving a true and fair view of the Consolidated Entity's financial position as at 31 December 2017 and its performance for the half-year ended on that date; and complying with *Australian Accounting Standard AASB 134 Interim financial reporting* and the *Corporations Regulations 2001*. As auditor of Cochlear Limited, *ASRE 2410* requires that we comply with the ethical requirements relevant to the audit of the annual financial report.

A review of an Interim financial report consists of making enquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with *Australian Auditing Standards* and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

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

KPMG

KPMG
Sydney, 13 February 2018

Cameron Slapp, *Partner*