Appendix 4D

Cochlear Limited
Half Yearly Report
As at 31 December 2019

Results for announcement to the market

		Movement from 31 December 2018		$m
Sales Revenue	up	9%	to	777.6
Total Revenue	up	7%	to	755.7
Earnings before interest and taxes (EBIT)	up	24%	to	219.5
Net profit for the period attributable to members	**up**	**23%**	**to**	**157.7**
Basic earnings per share (cents)	up	22%	to	272.9
Dividend (dollars)	up	3%	to	$1.60

Net tangible assets per share at 31 December 2019 (cents)[1]	up	32%	to	653.2
Net tangible assets per share at 31 December 2018 (cents)				493.3

Dividends	Amount per security	Franked amount per security	Conduit foreign income per security
Interim dividend per share (dollars)	$1.60	$1.60	$0.00
Previous corresponding period (dollars)	$1.55	$1.55	$0.00

Record date for determining entitlements to the dividend	Wednesday 25 March 2020
Dividend payment date	Friday 17 April 2020

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 2019 Interim financial report lodged with this document. This report is based on the 31 December 2019 Interim financial report which has been reviewed by KPMG with the Independent auditor's review report included in the 31 December 2019 Interim financial report.

[1] Net tangible assets are net assets less intangible assets.

Cochlear Limited and its controlled entities

ACN 002 618 073
Consolidated Interim Financial Report
31 December 2019

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 2019 and the independent auditor's 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
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, AC	Director since December 2016
Mr Abbas Hussain	Director since December 2018
Mr Michael Daniell	Director since January 2020
Executive directors	
Mr Dig Howitt, *CEO & 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 2019 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 2019.

	31 Dec 2019 $m	31 Dec 2018 $m
Total Revenue	**755.7**	**703.8**
Sales revenue[1]	777.6	711.9
Net profit (reported) [2]	**157.7**	**128.6**
Net profit (underlying)[3]	132.7	132.1
Basic earnings per share (cents)	272.9	223.1
Diluted earnings per share (cents)	272.9	223.0
Interim dividend per share (dollars)	$1.60	$1.55

[1] Sales revenue is the primary revenue reporting measure used by Cochlear for the purpose of assessing revenue performance of the Consolidated Entity. It represents total revenue excluding foreign exchange (FX) contract losses on hedged sales of $21.9m (31 December 2018: $8.1m).
[2] This represents net profit attributable to members as per Appendix 4D.
[3] Excludes non cash after tax gain/(loss) from the revaluation of innovation fund investments. Underlying profit represents the performance of Cochlear's core business.

Product and service highlights

	31 Dec 2019 $m	31 Dec 2018 $m	Change % (Reported)	Change % (CC)[1]
Cochlear implants (units)	18,894	16,740	⬆ 13%	
Sales revenue				
Cochlear implants	469.9	413.9	⬆ 14%	⬆ 9%
Services (sound processor upgrades and other)	225.5	207.2	⬆ 9%	⬆ 5%
Acoustics (bone conduction and acoustic implants)	82.2	90.8	⬇ 9%	⬇ 13%
Total sales revenue	**777.6**	**711.9**	**⬆ 9%**	**⬆ 5%**

[1] Constant currency (CC) removes the impact of foreign exchange (FX) rate movements and FX contract gains/(losses) to facilitate comparability. See Notes on page 11 for further detail.

Cochlear implants – 60% of sales revenue

Cochlear implant revenue grew by 14% (up 9% in CC) with units growing 13%. The Nucleus Profile™ Plus Series cochlear implant has been well-received by the market since its launch late in FY19 with developed market units growing by 7%. The US rebounded strongly, growing units by over 10%, with improvements in market share since the launch. Western Europe also experienced an improvement in momentum with availability of the new implant expanding across the half. Units increased by 5% with growth weighted to the second quarter.

While market share is growing in Western Europe, market growth continues to be challenging with many countries limited by funding caps or restrictive indications, which will take many years to change. Cochlear continues to build our market access capability to assist in removing barriers to growth. Over the past few years there has been an expansion of clinical indications and reimbursement for cochlear implants across many countries including Japan (Oct17), the UK (Mar19) and Belgium (Aug19), more than doubling the total addressable market for implants in each market. While these changes take time to flow through to referral behaviour, the business is experiencing a strong lift in demand in Japan.

Emerging market units increased by over 20%, with growth delivered across many regions including the Middle East and China. Emerging markets provide a long-term growth opportunity as awareness of and affordability for cochlear implants expands. The result reflects the benefits of investments made over many years to strengthen Cochlear's presence across all regions.

Services (sound processor upgrades and other) – 29% of sales revenue

Services revenue grew by 9% (5% in CC), with sound processor upgrade revenue increasing by 5% in CC. Services continues to benefit from the uptake of the Nucleus® 7 Sound Processor albeit at a slower rate as penetration rates reach high levels across the developed markets. The business also had a very strong HY19 result in which revenue grew 21% in CC.

Acoustics (bone conduction and acoustic implants) – 11% of sales revenue

Acoustics revenue declined by 9% (13% in CC) with some loss of market share from competitor product launches. The market also slowed more than expected in anticipation of the launch of the next generation bone conduction implant, the Cochlear™ Osia® 2 System.

Regional review

Sales revenue	31 Dec 2019 $m	31 Dec 2018 $m	Change % (Reported)	Change % (CC)
Americas	381.9	350.5	⬆ 9%	⬆ 3%
EMEA (Europe, Middle East and Africa)	262.4	248.4	⬆ 6%	⬆ 3%
Asia Pacific	133.3	113.0	⬆ 18%	⬆ 13%
Total sales revenue	**777.6**	**711.9**	**⬆ 9%**	**⬆ 5%**

Americas (US, Canada & Latin America) – 49% of sales revenue

Sales revenue increased by 9% (up 3% in CC) with strong cochlear implant revenue growth moderated by low growth in Services revenue and a decline in Acoustics revenue. The US recorded an uplift of over 10% in cochlear implant units. The launch of the Nucleus Profile Plus Series cochlear implant in late June has been well-received by the market, driving an uplift in market share since launch.

Services revenue in the US was flat as the business cycled very strong sales in HY19, with penetration rates now reaching high levels. Acoustics sales declined with some loss of share from competitor product launches and a slowdown in surgeries in anticipation of the launch of the Osia 2 System.

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

Canada reported a decline in units driven in part by timing. The highlight in Latin America was solid growth in Services revenue driven by improved funding.

EMEA (Europe, Middle East and Africa) – 34% of sales revenue

Sales revenue increased by 6% (3% in CC) with strong cochlear implant revenue growth moderated by low growth in Services revenue and a decline in Acoustics revenue. Western Europe experienced an improvement in momentum with availability of the new implant expanding across the half. Units increased by 5% with growth weighted to the second quarter.

In August, Riziv, the Belgian Medicines Verification Organisation, announced the expansion of reimbursement criteria for cochlear implants to also include candidates with a severe hearing loss, a major milestone that is expected to support growth in Belgium over the coming years.

Like the US, Services revenue growth slowed as the business cycled very strong sales in HY19, with penetration rates now reaching high levels and Acoustics revenue declined.

Units and sales revenue across EMEA's emerging markets grew as a result of the timing of a number of tenders and is underpinned by investments in the organisation in recent years.

Asia Pacific (Australasia & Asia) – 17% of sales revenue

Sales revenue increased by 18% (13% in CC). Japan and Korea experienced strong growth across both cochlear implant units and sound processor upgrades. China recorded strong growth in sales revenue, benefitting from increased investment in sales and marketing capability over the past few years.

Financial review

Profit & loss

	31 Dec 2019 $m	31 Dec 2018 $m	Change % (Reported)	Change % (CC)
Sales revenue	**777.6**	**711.9**	**9%**	**5%**
Costs of sales	192.2	179.5	7%	4%
% gross margin	*75%*	*75%*	*0 pts*	*0 pts*
Selling, marketing and general expenses	243.5	216.1	13%	9%
Research and development expenses	94.4	88.2	7%	6%
% of sales revenue	*12%*	*12%*		
Administration expenses	47.9	47.5	1%	0%
Total expenses	**578.0**	**531.3**	**9%**	**6%**
Other net income	6.0	8.0		
FX contract losses	(21.9)	(8.1)		
Earnings before interest and tax (EBIT)*	**183.7**	**180.5**	**2%**	**2%**
% of sales revenue	*24%*	*25%*		
Net finance expense	4.8	2.7	78%	
Income tax expense	46.2	45.7	1%	
% effective tax rate	*26%*	*26%*		
Net profit (underlying)*	**132.7**	**132.1**	**0%**	**0%**
*% net profit margin**	*17%*	*19%*		
Revaluation of innovation fund (after-tax)	25.0	(3.5)		
Net profit (reported)	**157.7**	**128.6**	**23%**	**22%**

* Excluding revaluation of innovation fund

Sales revenue increased by 9% (5% in CC) to $777.6 million. Reported net profit increased by 23% (22% in CC) to $157.7 million and includes $25.0 million in non-cash gains after-tax from the revaluation of innovation fund investments. Underlying net profit, which excludes the revaluation, was in line with HY19 (flat in CC), with the net profit margin declining by 2 percentage points to 17%.

Key points of note:

- Cost of sales increased by 7% (4% in CC) to $192.2 million, reflecting growing sales. The gross margin remained stable at 75% with a higher mix of lower margin sales from emerging markets offset by benefits from lower warranty costs, the result of manufacturing more reliable products that require less warranty repairs;
- Selling, marketing and general expenses increased by 13% (9% in CC) to $243.5 million. The increase reflects the continued investment in the sales force and direct-to-consumer marketing, with a growing investment in longer-term market growth activities including standard of care and market access initiatives. It also includes one-off costs associated with Brexit preparations;
- Investment in R&D increased 7% (6% in CC) to $94.4 million, representing 12% of sales revenue;
- Other net income of $6.0 million includes $6.9 million relating to a release in the contingent consideration value of Sycle ($5.3 million in HY19);
- FX contract losses increased by $13.8 million to $21.9 million;
- The $25.0 million after-tax revaluation of innovation fund investments reflects non-cash gains from the revaluation of the Nyxoah shareholding. The innovation fund consists of investments in companies with novel technologies that may, over the longer term, enhance or leverage the Company's core technology; and
- Net finance expenses increased by 78% and includes $2.8 million in interest expense resulting from the adoption of new leasing accounting standard AASB 16 (see separate AASB 16 note on page 7). Net finance expenses (excluding the lease-related expense) declined by 26% to $2.0 million with the business benefitting from lower interest rates.

Impact to income statement of adoption of AASB 16

From 1 July 2019, Cochlear's accounts include the impact of the new lease accounting standard, AASB 16, which changes the way that companies account for leased assets. For 31 December 2019, AASB 16 has reduced Cochlear's net profit after tax by $0.5 million when compared to the prior accounting standard, AASB 117. For 30 June 2020, Cochlear estimates a $1.0-1.5 million post-tax earnings impact from the introduction of AASB 16. The following table summarises the impact to Cochlear's income statement of AASB 16 for 31 December 2019 by highlighting lease expenses based on AASB 16 versus the impact using the prior accounting standard, AASB 117.

	31 Dec 2019 (AASB 16) $m	31 Dec 2019 (AASB 117) $m	Change $m
Operating lease expenses	-	(15.0)	15.0
Depreciation and amortisation (lease-related)	(12.9)	-	(12.9)
EBIT	**(12.9)**	**(15.0)**	**2.1**
Interest expense (lease-related)	(2.8)	-	(2.8)
Net profit before tax	**(15.7)**	**(15.0)**	**(0.7)**
Income tax expense (lease-related)	4.7	4.5	0.2
Net impact of leases to income statement	**(11.0)**	**(10.5)**	**(0.5)**

Cash Flow

	31 Dec 2019 $m	31 Dec 2018 $m	Change $m
EBIT (excluding revaluation of innovation fund)	183.7	180.5	3.2
Depreciation and amortisation (excl AASB 16 impact) [1]	21.3	17.5	3.8
Changes in working capital and other	(15.1)	15.5	(30.6)
Net interest paid	(4.8)	(2.7)	(2.1)
Income taxes paid	(58.3)	(46.7)	(11.6)
Operating cash flow	**126.8**	**164.1**	**(37.3)**
Capital expenditure	(49.8)	(36.0)	(13.8)
Acquisition of other intangible assets	(10.8)	(8.7)	(2.1)
Other investments	-	(20.9)	20.9
Free cash flow	**66.2**	**98.5**	**(32.3)**

[1] Depreciation and amortisation excludes the impact of the adoption of AASB 16 to provide a like for like comparison to HY19

Operating cash flow decreased by $37.3 million to $126.8 million, with free cash flow reducing by $32.3 million to $66.2 million driven by increases in working capital and capital expenditure.

Key points of note:

- Changes in working capital and other decreased by $30.6 million due to an increase in inventory to support business growth, a reduction in trade payables, an increase in insurance prepayments and an increase in payments related to short-term incentives due to a change in policy from biannual to annual payments; and
- Capital expenditure (capex) increased by $13.8 million to $49.8 million, reflecting stay in business capex, the continued development of the China manufacturing facility, fitout of the new, larger Denver office and IT platform development.

Capital employed

	31 Dec 2019 $m	30 Jun 2019 $m	Change $m
Trade receivables	295.6	299.5	(3.9)
Inventories	204.0	195.4	8.6
Less: Trade payables	(147.4)	(160.8)	13.4
Working capital	352.2	334.1	18.1
Working capital / sales revenue[1]	*23%*	*23%*	
Property, plant and equipment	190.9	166.5	24.4
Intangible assets	428.2	424.4	3.8
Investments	83.0	47.8	35.2
Other net liabilities	(104.0)	(143.9)	39.9
Capital employed	**950.3**	**828.9**	**121.4**

[1] Based on doubling HY20 sales revenue.

Capital employed increased by $121.4 million to $950.3 million since June 2019 reflecting an increase in working capital, property, plant & equipment, investments and a reduction in other net liabilities.

Key points of note:

- Working capital increased by $18.1 million due to an increase in inventory to support business growth, including safety stock carried in case of a hard Brexit, and a reduction in trade payables;
- Property, plant and equipment increased by $24.4 million and includes the partly-constructed China manufacturing facility and fitout of the new Denver office;
- The increase in investments includes a $35.8 million pre-tax increase in the value of Cochlear's investment in Nyxoah;
- Other net liabilities reduced by $39.9 million to $104.0 million reflecting movements across a number of net liabilities including a $20.3 million net reduction in the value of forward foreign exchange contracts, resulting from the $21.9 million loss on foreign exchange contracts in the income statement; the establishment of a net lease liability of $19.9 million from the introduction of AASB 16; a reduction in the Sycle earn out provision; a reduction in tax liabilities and a reduction in the warranty provision reflecting improved sound processor manufacturing that has resulted in lower warranty repairs.

Net debt

	31 Dec 2019 $m	30 Jun 2019 $m	Change $m
Loans and borrowings:			
Current	3.3	3.3	-
Non-current	230.4	178.3	52.1
Total debt	233.7	181.6	52.1
Less: Cash and cash equivalents	(89.4)	(78.6)	(10.8)
Net debt	**144.3**	**103.0**	**41.3**

Net debt increased by $41.3 million to $144.3 million since June 2019, driven by increased working capital and capital investment.

Dividends

	31 Dec 2019	31 Dec 2018	Change %
Interim ordinary dividend (per share)	$1.60	$1.55	3%
Payout ratio % (excluding revaluation of innovation fund investments)	70%	68%	
% Franking	100%	100%	

An interim dividend of $1.60 per share has been declared, an increase of 3%, franked at 100%. The interim dividend is franked at 100% and represents a payout of 70% of underlying net profit.

The record date for determining dividend entitlements is 25 March 2020 and the interim dividend will be paid on 17 April 2020.

The Board has updated the dividend policy from a target payout of around 70% of net profit to around 70% of underlying net profit. Underlying net profit excludes after-tax gains or losses from innovation fund investments.

Patent dispute contingent liability

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

AMF and AB have subsequently asked the District Court to award USD 123 million in prejudgment interest. The Defendants have opposed both the application and the calculation methodology. The Judge has reserved his decision until further notice. The Defendants have arranged a facility to enable the procurement of another insurance bond, if necessary, to stay any prejudgment interest award pending the outcome of the appeal against damages. Any interest award will be contingent on the appeal against damages. A decision on the appeal is expected in 2020.

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

There is significant uncertainty on the final damages award following a retrial. Given the inherent uncertainties in assessing the likely damages amount of this case following the appeal, the Board is unable to make a reliable estimate of the amount that will ultimately be paid to AMF and AB. As a result, the patent dispute continues to be disclosed as a contingent liability.

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

If the appeal is unsuccessful, Cochlear has committed bank loan facilities available to fund the existing Judgment and any subsequent award of interest and costs.

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.

FY20 financial outlook
For FY20, Cochlear expects to deliver underlying net profit of $270-290 million, a 2-9% increase on underlying net profit for FY19. The guidance outlook was reduced from $290-300 million on 11 February due to an expected impact from the novel coronavirus (2019-nCoV). While the business is delivering strong results from the cochlear implant business, profit growth will be lower than original expectations due to the impact of the coronavirus on sales in Greater China.

For the second half, Cochlear expects strong growth in cochlear implant units to continue across the developed markets, driven by growing uptake of the Nucleus Profile Plus Series cochlear implant and the continued investment in market awareness and access activities.

Services revenue is expected to grow for the full year although at a lower rate than previous years as penetration rates of the Nucleus 7 Sound Processor reach high levels across the developed markets and the business cycles a strong FY19 result.

Acoustics revenue is expected to decline for the full year following a decline in the first half. While the second half will benefit from the launch of the Osia 2 System in the US, the European launch is now not expected during FY20.

Cochlear expects an impact to sales from the coronavirus in Greater China in the second half with hospitals currently deferring surgeries, including cochlear implants, to limit the risk of infection from the virus. While Cochlear cannot predict how long surgeries will be delayed, the low end of guidance factors in a significant decline in sales for Greater China for the second half. Cochlear is confident that many of the delayed surgeries will progress once hospitals resume normal operations.

As the global leader in implantable hearing solutions, Cochlear continues to be excited by the long-term opportunity to grow the hearing implant market. While the business faces some near-term challenges with the coronavirus and with delays to the approval for the Osia 2 System in Europe, the view to the longer-term opportunity to grow in Cochlear's markets remains unchanged.

Cochlear's strategy to retain market leadership and grow the hearing implant market has clear priorities that drive investment decisions and capital allocation. And the business has a strong financial position that enables the business to fund its growth activities while rewarding shareholders along the way with a growing dividend stream.

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

Additional considerations for FY20:

- Emerging market growth rates over time continue to be strong, however, annual growth rates can be variable driven by the timing of tender based activity, macro-economic conditions and political instability;
- Expecting foreign exchange contract losses for the second half to be around $10 million lower than the first half;
- Includes an estimated $1.0-1.5 million decline in net profit from the introduction of the new Australian leasing accounting standard (AASB 16);
- Capital expenditure and investments to increase to around $180 million, including the continued development of the China manufacturing facility, fitout of the new, larger Denver office as well as investment in IT platforms. Capital expenditure is expected to drop to around $100 million in FY21;
- Underlying net profit excludes after-tax gains or losses from innovation fund investments. As the Nyxoah transaction increases Cochlear's ownership of Nyxoah above 20%, the investment will be equity-accounted from the second half of FY20; and
- Forecasting a weighted average AUD/USD exchange rate of 68 cents for FY20 (72 cents in FY19) and AUD/EUR of 0.62 EUR (0.63 EUR in FY19).

Non-International Financial Reporting Standards (IFRS) financial measures
Given the significance of foreign exchange rate movements, the directors believe the presentation of the non-IFRS financial measure, constant currency, is useful for the users of this document as it reflects the underlying financial performance of the business. This non-IFRS financial measure has not been subject to review or audit. However, KPMG has separately undertaken a set of procedures to agree the non-IFRS financial measures disclosed to the books and records of the group.

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

Reconciliation of constant currency net profit

	31 Dec 2019	31 Dec 2018	% Change
Net profit (underlying)	132.7	132.1	0%
FX contract movement		(13.8)	
Spot exchange rate effect to sales and expenses[1]		17.1	
Balance sheet revaluation[1]		(2.9)	
Net profit (underlying) (CC)	**132.7**	**132.5**	**0%**
Revaluation of innovation fund (after-tax)	25.0	(3.5)	
Net profit (reported) (CC)	**157.7**	**129.0**	**22%**

[1] HY20 actual v HY19 at HY20 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 $1.75 per share, franked to 100% with Class C (100%) franking credits, in respect of the year ended 30 June 2019, paid on 14 October 2019.	101.2

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 2019. Since the end of the financial half-year, the directors declared an interim dividend of $1.60 100% franked amounting to a total of $92.7m.

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

The lead auditor's independence declaration is set out on page 13 and forms part of the Directors' Report for the half year ended 31 December 2019.

Rounding off

The Company is of a kind referred to in Australian Securities and Investments Commission (ASIC) (Rounding in Financial/Directors' Reports) Instrument 2016/191 (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 18th day of February 2020.

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 of Cochlear Limited for the half-year ended 31 December 2019 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 | Julian McPherson, *Partner*

Sydney, 18 February 2020

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Interim Income Statement
For the half year ended 31 December 2019

	Note	31 Dec 2019 $m	31 Dec 2018 $m
Revenue	2.2	755.7	703.8
Cost of sales	2.3	(192.2)	(179.5)
Gross profit		**563.5**	**524.3**
Selling, marketing and general expenses		(243.5)	(216.1)
Research and development expenses		(94.4)	(88.2)
Administration expenses		(47.9)	(47.5)
Other income	2.4	45.9	9.2
Other expense	2.3	(4.1)	(4.7)
Results from operating activities		**219.5**	**177.0**
Finance income - interest		0.2	0.3
Finance expense - interest		(5.0)	(3.0)
Net finance expense		**(4.8)**	**(2.7)**
Profit before income tax		**214.7**	**174.3**
Income tax expense	3	(57.0)	(45.7)
Net profit		**157.7**	**128.6**
Basic earnings per share (cents)	2.5	272.9	223.1
Diluted earnings per share (cents)	2.5	272.9	223.0

The Consolidated Entity has initially applied AASB 16 at 1 July 2019. Under the transition methods chosen, comparative information is not restated. See Note 1.5

The notes on pages 19 to 28 are an integral part of these consolidated interim financial statements.

Cochlear Limited and its controlled entities
Consolidated Interim Financial Report
Interim Statement of Comprehensive Income
For the half year ended 31 December 2019

	31 Dec 2019 $m	31 Dec 2018 $m
Net profit	**157.7**	**128.6**
Other comprehensive income/**(loss)**		
Items that will not be reclassified subsequently to the income statement:		
Financial investments measured at fair value through other comprehensive income, net of tax	(0.6)	(1.8)
Total items that will not be reclassified subsequently to the income	(0.6)	(1.8)
Items that may be reclassified subsequently to the income statement:		
Foreign currency translation differences	7.5	15.0
Effective portion of changes in fair value of cash flow hedges, net of tax	(1.0)	(18.8)
Net change in fair value of cash flow hedges transferred to the income statement, net of tax	15.4	5.7
Total items that may be reclassified subsequently to the income statement	21.9	1.9
Other comprehensive income, net of tax	**21.3**	**0.1**
Total comprehensive income	**179.0**	**128.7**

The Consolidated Entity has initially applied AASB 16 at 1 July 2019. Under the transition methods chosen, comparative information is not restated. See Note 1.5

The notes on pages 19 to 28 are an integral part of these consolidated interim financial statements.

Cochlear Limited and its controlled entities
Consolidated Interim Financial Report
Interim Balance Sheet
For the half year ended 31 December 2019

	Note	31 Dec 2019 $m	30 Jun 2019 $m
Assets			
Cash and cash equivalents		89.4	78.6
Trade and other receivables		317.0	319.7
Forward exchange contracts		5.0	2.2
Inventories		204.0	195.4
Current tax assets		7.7	12.2
Prepayments		30.8	26.9
Total current assets		**653.9**	**635.0**
Other receivables		3.4	3.3
Forward exchange contracts		6.4	2.1
Property, plant and equipment		190.9	166.5
Intangible assets		428.2	424.4
Investments		83.0	47.8
Deferred tax assets		108.3	100.1
Right of use asset		168.8	-
Total non-current assets		**989.0**	**744.2**
Total assets		**1,642.9**	**1,379.2**
Liabilities			
Trade and other payables		158.6	160.8
Forward exchange contracts		13.0	20.9
Loans and borrowings	5.1	3.3	3.3
Current tax liabilities		22.7	34.8
Employee benefit liabilities		63.0	69.5
Provisions		23.1	27.3
Deferred revenue		37.5	42.9
Lease liability		28.5	-
Total current liabilities		**349.7**	**359.5**
Trade and other payables		24.1	42.4
Forward exchange contracts		2.3	7.6
Loans and borrowings	5.1	230.4	178.3
Employee benefit liabilities		13.5	13.1
Provisions		39.4	44.2
Deferred tax liabilities		15.8	5.5
Deferred revenue		1.5	2.7
Lease liability		160.2	-
Total non-current liabilities		**487.2**	**293.8**
Total liabilities		**836.9**	**653.3**
Net assets		**806.0**	**725.9**
Equity			
Share capital		189.7	182.3
Reserves		13.0	(15.3)
Retained earnings		603.3	558.9
Total equity		**806.0**	**725.9**

The Consolidated Entity has initially applied AASB 16 at 1 July 2019. Under the transition methods chosen, comparative information is not restated. See Note 1.5

The notes on pages 19 to 28 are an integral part of these consolidated interim financial statements.

Cochlear Limited and its controlled entities
Consolidated Interim Financial Report
Interim Statement of Changes in Equity
For the half year ended 31 December 2019

Amounts $m	Issued capital	Translation reserve	Hedging reserve	Fair value reserve	Share based payment reserve	Retained earnings	Total equity
Balance at 1 July 2018 (restated)	173.0	(59.8)	(12.8)	0.2	39.0	464.2	603.8
Total comprehensive income/(loss)							
Net profit	-	-	-	-	-	128.6	128.6
Other comprehensive income/(loss)							
Foreign currency translation differences	-	15.0	-	-	-	-	15.0
Effective portion of changes in fair value of cash flow hedges, net of tax	-	-	(18.8)	-	-	-	(18.8)
Net change in fair value of cash flow hedges transferred to the income statement, net of tax	-	-	5.7	-	-	-	5.7
Financial investments measured at fair value through other comprehensive income, net of tax	-	-	-	(1.8)	-	-	(1.8)
Total other comprehensive income/(loss)	**-**	**15.0**	**(13.1)**	**(1.8)**	**-**	**-**	**0.1**
Total comprehensive income/(loss)	**-**	**15.0**	**(13.1)**	**(1.8)**	**-**	**128.6**	**128.7**
Transactions with owners, recorded directly in equity							
Performance rights vested	-	-	-	-	(0.1)	-	(0.1)
Share options exercised	9.2	-	-	-	(1.0)	-	8.2
Share based payment transactions	-	-	-	-	5.3	-	5.3
Deferred tax recognised in equity	-	-	-	-	(0.1)	-	(0.1)
Dividends paid to shareholders	-	-	-	-	-	(92.3)	(92.3)
Balance at 31 December 2018	**182.2**	**(44.8)**	**(25.9)**	**(1.6)**	**43.1**	**500.5**	**653.5**
Balance at 1 July 2019 (as reported)	182.3	(47.2)	(17.0)	(1.1)	50.0	558.9	725.9
Change on initial application of AASB 16, net of tax	-	-	-	-	-	(12.1)	(12.1)
Balance at 1 July 2019 (restated)	**182.3**	**(47.2)**	**(17.0)**	**(1.1)**	**50.0**	**546.8**	**713.8**
Total comprehensive income/(loss)							
Net profit	-	-	-	-	-	157.7	157.7
Other comprehensive income/(loss)							
Foreign currency translation differences	-	7.5	-	-	-	-	7.5
Effective portion of changes in fair value of cash flow hedges, net of tax	-	-	(1.0)	-	-	-	(1.0)
Net change in fair value of cash flow hedges transferred to the income statement, net of tax	-	-	15.4	-	-	-	15.4
Financial investments measured at fair value through other comprehensive income, net of tax	-	-	-	(0.6)	-	-	(0.6)
Total other comprehensive income/(loss)	**-**	7.5	14.4	(0.6)	-	**-**	21.3
Total comprehensive income/(loss)	**-**	**7.5**	**14.4**	**(0.6)**	**-**	**157.7**	**179.0**
Transactions with owners, recorded directly in equity							
Performance rights vested	-	-	-	-	(0.5)	-	(0.5)
Share options exercised	7.4	-	-	-	(0.6)	-	6.8
Share based payment transactions	-	-	-	-	5.6	-	5.6
Deferred tax recognised in equity	-	-	-	-	2.5	-	2.5
Dividends paid to shareholders	-	-	-	-	-	(101.2)	(101.2)
Balance at 31 December 2019	**189.7**	**(39.7)**	**(2.6)**	**(1.7)**	**57.0**	**603.3**	**806.0**

The Consolidated Entity has initially applied AASB 16 at 1 July 2019. Under the transition methods chosen, comparative information is not restated. See Note 1.5
The notes on pages 19 to 28 are an integral part of these consolidated interim financial statements.

Cochlear Limited and its controlled entities
Consolidated Interim Financial Report
Interim Statement of Cash Flows
For the half year ended 31 December 2019

	31 Dec 2019 $m	31 Dec 2018 $m
Cash flows from operating activities		
Cash receipts from customers	751.6	740.7
Cash paid to suppliers and employees	(564.9)	(529.4)
Grant and other income received	3.2	2.2
Interest received	0.2	0.3
Interest paid	(2.2)	(3.0)
Interest paid lease liability	(2.8)	-
Income taxes paid	(58.3)	(46.7)
Net cash from operating activities	**126.8**	**164.1**
Cash flows from investing activities		
Acquisition of leasehold improvements and plant and equipment	(38.8)	(22.7)
Acquisition of IT system costs	(11.0)	(13.3)
Acquisition of other intangibles	(10.8)	(8.7)
Acquisition of investments	-	(20.9)
Net cash used in investing activities	**(60.6)**	**(65.6)**
Cash flows from financing activities		
Repayment of borrowings	(100.0)	(285.0)
Proceeds from borrowings	152.1	301.1
Payment of lease liability	(12.6)	-
Proceeds from exercise of share options, net	6.3	8.1
Dividends paid	(101.2)	(92.3)
Net cash used in financing activities	**(55.4)**	**(68.1)**
Net increase in cash and cash equivalents	**10.8**	**30.4**
Cash and cash equivalents at 1 July	78.6	61.5
Effect of exchange rate fluctuation on cash held	-	0.4
Cash and cash equivalents at 31 December	**89.4**	**92.3**

The Consolidated Entity has initially applied AASB 16 at 1 July 2019. Under the transition methods chosen, comparative information is not restated. See Note 1.5

The notes on pages 19 to 28 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 2019 comprises the Company and its controlled entities (together referred to as Cochlear or the Consolidated Entity). Cochlear is a for-profit entity and operates in the implantable hearing device industry. Cochlear's Consolidated Annual Financial Report as at and for the year ended 30 June 2019 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 2019. This report should also be read in conjunction with any public announcements made by Cochlear Limited during the half year ended 31 December 2019 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 18 February 2020.

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 2019.

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 judgements 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 2019, except for new significant judgements and key sources of estimation uncertainty related to the application of AASB 16 which are described in Note 1.5.

1.5 Changes in accounting policies

Cochlear has initially adopted AASB 16 *Leases* from 1 July 2019, this has replaced AASB 117 *Leases*. Cochlear adopted AASB 16 using the modified retrospective approach. Under this approach, the cumulative impact of adoption was recognised as an adjustment to opening retained earnings with no restatement of comparative periods.

Cochlear leases assets including premises, office equipment and motor vehicles.

Under AASB 117, Cochlear classified leases as either operating leases or finance leases based on its assessment of whether the lease transferred substantially all the risks and rewards of ownership. Under AASB 16, Cochlear recognises a right-of-use asset and a corresponding lease liability for most leases i.e. these leases are on balance sheet.

Significant accounting policies under AASB 16

A lease liability is recognised at lease commencement date, initially measured at the present value of future lease payments, discounted using Cochlear's incremental borrowing rate.

The lease liability is subsequently remeasured when there is a modification in future lease payments arising from a change in an index or rate, a change in the estimate of the amount expected to be payable under a residual value guarantee, or changes in the assessment of whether a purchase or extension option is reasonably certain to be exercised or a termination option is reasonably certain not to be exercised. The right-of-use asset is initially measured at cost and subsequently adjusted for certain remeasurements of the lease liability.

Over the life of the lease, the lease liability will be increased by interest costs and will be reduced as lease payments are made. The right-of-use asset is amortised on a straight-line basis over its useful life. As compared to AASB 117, the pattern of expense recognition changes with a higher expense at lease commencement due to a higher lease liability at that time.

The Group has applied judgement to determine the lease term for some lease contracts in which it is a lessee that include renewal options. The assessment of whether the Group is reasonably certain to exercise such options impacts the lease term, which significantly affects the amount of lease liabilities and right of use assets recognised.

Cochlear has elected not to recognise a right-of-use asset and a corresponding lease liability for leases with a term of less than 12 months or for leases of low-value assets. Cochlear recognises the lease payments associated with these leases as an expense on a straight-line basis over the lease term.

Transition to AASB 16

Lease liabilities were measured at the present value of the remaining lease payments at 1 July 2019, discounted at the Group's incremental borrowing rate as at 1 July 2019. Right of use assets were measured at their carrying amount as if AASB 16 had been applied since the commencement date, discounted using Cochlear's incremental borrowing rate at the date of initial application.

Cochlear has elected to apply practical expedients allowed under the modified retrospective approach not to recognise right of use assets or lease liabilities for leases with less than 12 months of lease term remaining at the transition date or leases of low-value assets.

The change in accounting policy, outlined above, resulted in the following change in the balance sheet on 1 July 2019:

	$m
Increase in right-of-use assets	178.2
Increase in deferred tax assets	5.6
Increase in lease liabilities (current and non current)	(197.8)
Decrease in other liabilities	1.9
Decrease in retained earnings	12.1

The following table reconciles the differences between the non-cancellable lease commitments as disclosed in the FY19 Annual Financial Statements under AASB 117 and the lease liability recognised on transition to AASB 16:

	$m
Operating lease commitments disclosed at 30 June 2019	220.8
Add: Adjustments as a result of different treatment of extension options	112.5
Less: Lease executed but not yet effective on transition date	(84.5)
Less: Other	(7.8)
Discounted using incremental borrowing rate at the date of initial application	(43.2)
Lease liability recognised as at 1 July 2019	**197.8**

Lease terms range from one to 25 years. The weighted average incremental borrowing rate applied is 3.0%.

Following the adoption of AASB 16, Cochlear recognised $12.9 million in depreciation expense and $2.8 million in interest expense instead of the operating lease expense recognised under the previous standard. Similar to AASB 117, right-of-use asset depreciation is recognised in “cost of sales”, “selling, marketing and general expenses”, “research and development expenses” and “administration expenses” in the income statement depending on the function of associated activities. Interest expense incurred on the lease liability is recognised in “finance expense – interest” in the income statement.

For purposes of presentation of the cash flow statement, the lease payments are separated into principal payments (financing activities) of $12.6 million and interest payments (operating activities) of $2.8 million.

1.6 New standards and interpretations not yet adopted

A number of new standards, amendments to standards and interpretations are effective for financial years beginning on or after 1 July 2019 and have not been applied in preparing these consolidated financial statements. These new standards are not expected to have an effect on the consolidated financial statements of Cochlear.

2. Performance for the half year

2.1 Operating segments

	Americas		EMEA(i)		Asia Pacific		**Total**	
	2019	2018	2019	2018	2019	2018	**2019**	**2018**
	$m	$m	$m	$m	$m	$m	**$m**	**$m**
Reportable segment revenue	381.9	350.5	262.4	248.4	133.3	113.0	**777.6**	**711.9**
Reportable segment EBIT	211.8	190.5	112.8	114.8	41.2	35.0	**365.8**	**340.3**

(i) Europe, Middle East and Africa

Reconciliations of reportable segment revenues and profit or loss

Revenues	Cochlear implants	Services (sound processor upgrades and other)	**Total Cochlear implants**	Acoustics (bone conduction and acoustic implants)	**Reportable segment revenue**	Foreign exchange losses on hedged sales	**Consolidated revenue**
	$m	$m	**$m**	$m	**$m**	$m	**$m**
31 Dec 2019	469.9	225.5	695.4	82.2	777.6	(21.9)	755.7
31 Dec 2018	413.9	207.2	621.1	90.8	711.9	(8.1)	703.8

Profit or loss	Reportable segment EBIT	Corporate and other net expenses	Foreign exchange losses on hedged sales	Net finance expense	**Consolidated profit before income tax**
	$m	$m	$m	$m	**$m**
31 Dec 2019	365.8	(124.4)	(21.9)	(4.8)	**214.7**
31 Dec 2018	340.3	(155.2)	(8.1)	(2.7)	**174.3**

2.2 Revenue

	31 Dec 2019	31 Dec 2018
	$m	$m
Sale of goods revenue before hedging	760.9	695.9
Foreign exchange losses on hedged sales	(21.9)	(8.1)
Revenue from the sale of goods	**739.0**	**687.8**
Rendering of services revenue	16.7	16.0
Total revenue	**755.7**	**703.8**

2.3 Expenses

	31 Dec 2019 $m	31 Dec 2018 $m
Cost of sales		
Carrying amount of inventories recognised as an expense	186.9	174.4
Write-down in value of inventories	1.6	1.7
Other	3.7	3.4
Total cost of sales	**192.2**	**179.5**
Other expense		
Net foreign exchange loss	4.1	1.2
Fair value change in investments measured at fair value through profit or loss	-	3.5
Total other expense	**4.1**	**4.7**

2.4 Other income

	31 Dec 2019 $m	31 Dec 2018 $m
Grant received or due and receivable	0.9	0.9
Release of contingent consideration	6.9	5.3
Fair value change in investments measured at fair value through profit or loss	35.8	-
Other	2.3	3.0
Total other income	**45.9**	**9.2**

Cochlear has recognised a $35.8 million fair value gain from an investment. The fair value determined at 31 December 2019, is consistent with a capital raising conducted by the investee in February 2020.

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 2019	31 Dec 2018
Net profit attributable to equity holders of the parent entity	$157,737,000	$128,630,000
Weighted average number of ordinary shares (basic):		
Issued ordinary shares at 1 July (number)	57,715,821	57,547,820
Effect of options and performance shares exercised (number)	70,677	109,908
Effect of shares issued under Employee Share Plan (number)	3,329	3,341
Weighted average number of ordinary shares (basic)	**57,789,827**	**57,661,069**
Basic earnings per share (cents)	**272.9**	**223.1**

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 2019	31 Dec 2018
Net profit attributable to equity holders of the parent entity	$157,737,000	$128,630,000
Weighted average number of ordinary shares (diluted):		
Weighted average number of shares (basic) (number)	57,789,827	57,661,069
Effect of options, performance shares and rights unvested (number)	14,438	23,032
Weighted average number of ordinary shares (diluted)	**57,804,265**	**57,684,101**
Diluted earnings per share (cents)	**272.9**	**223.0**

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 2019.

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
September 2019[1]	N/A	N/A	33,136	2 years
October 2019[2]	$217.28	24,231	3,994	3-4 years
October 2019[3]	$217.28	57,074	10,516	4-5 years

1. Performance rights offered under deferred short-term incentives.
2. Options and performance rights offered under the long-term incentive plan - transitional arrangement for plan change from a 3 to 4 year vesting period from FY20.
3. Options and performance rights offered under the long-term incentive plan - plan change to a 4 year vest period from FY20.

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 2019				
Final – ordinary	1.75	101.2	100% Franked	14 October 2019
31 December 2018				
Final – ordinary	1.60	92.3	100% Franked	10 October 2018

Subsequent event

Since the end of the reporting period, the directors declared the following dividend:				
Interim – ordinary	1.60	92.7	100% Franked	17 April 2020

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 2019 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 2019 $m	31 Dec 2018 $m
Net profit	157.7	128.6
Income tax expense	57.0	45.7
Profit before income tax	**214.7**	**174.3**
Tax at the Australian tax rate of 30% (Dec 2018: 30%)	64.4	52.3
(Decrease)/Increase in income tax expense due to:		
Research and development allowances	(4.7)	(4.9)
(Non-assessable income)/Non-deductible expenses	(1.0)	2.4
Effect of tax rate in foreign jurisdictions	(1.3)	(2.2)
	57.4	47.6
Adjustment for prior years	(0.4)	(1.9)
Income tax expense on profit before income tax	**57.0**	**45.7**

4. Operating assets and liabilities

4.1 Contingent liabilities

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

Patent dispute

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

AMF and AB have subsequently asked the District Court to award USD 123 million in prejudgment interest. The Defendants have opposed both the application and the calculation methodology. The Judge has reserved his decision until further notice. The Defendants have arranged a facility to enable the procurement of another insurance bond, if necessary, to stay any prejudgment interest award pending the outcome of the appeal against damages. Any interest award will be contingent on the appeal against damages. A decision on the appeal is expected in 2020.

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

There is significant uncertainty on the final damages award following a retrial. Given the inherent uncertainties in assessing the likely damages amount of this case following the appeal, the Board is unable to make a reliable estimate of the amount that will ultimately be paid to AMF and AB. As a result, the patent dispute continues to be disclosed as a contingent liability.

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

If the appeal is unsuccessful, Cochlear has committed bank loan facilities available to fund the existing Judgment and any subsequent award of interest and costs.

Product liability claims

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

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

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

Regulatory Actions

Cochlear operates in multiple overseas jurisdictions and is currently, and/or is likely from time to time to be, subject to tax, customs and regulatory reviews, audits and investigations. Individually significant confidential investigation(s) by an authority are not disclosed, as disclosure may prejudice Cochlear.

5. Financial and capital structure

5.1 Loans and Borrowings

	31 Dec 2019 $m	30 Jun 2019 $m
Loans and borrowings:		
Current	3.3	3.3
Non-current	230.4	178.3
Total loans and borrowings	233.7	181.6
Less: Cash and cash equivalents	(89.4)	(78.6)
Net debt	**144.3**	**103.0**

Multi-option bank facilities - Unsecured bank loan

As at December 2019, Cochlear's bank loan facilities are as follows:

Debt Facility	2 year term $m	3 year term $m	4 year term $m	Total facilities $m
Committed Debt including Guarantees	100.0	100.0	207.2	407.2

In December 2019, the maturity of the SEK 300 million facility limit was extended from July 2020 to January 2023.

Subsequent to 31 December 2019, Cochlear has entered into a committed bridge facility for USD 268 million with a one year term to provide debt cover for the contingency of a worst case decision in the appeal of the patent damages award disclosed in Note 4.1 to the financial statements.

All facilities are unsecured and have interlocking guarantees provided by certain controlled entities. Interest on the facilities is variable and changed 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 no secured bank loans.

Bank guarantees

As at 31 December 2019, Cochlear had contingent liability facilities denominated in United States dollars, Euros, Sterling, Indian rupees and New Zealand dollars totalling AUD 14.9 million (June 2019: AUD 9.7 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 financial assets measured at fair value through other comprehensive income are valued where available using quoted prices (Level 1), or where not available using unobservable market inputs (Level 3).

The fair value gains in Note 2.4 were measured using Level 3 inputs. Investments includes $82.3 million (30 June 2019 $46.4 million) measured using Level 3 inputs. During the period, no transfers were made into or out of Level 3 of the fair value hierarchy.

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 2019, see Note 2.7.

Cochlear Limited and its controlled entities
Directors' Declaration
For the half year ended 31 December 2019

In the opinion of the directors of Cochlear Limited:

1. The consolidated financial statements and notes set out on pages 14 to 28 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 2019, 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 18th day of February 2020.

Director	Director

Independent auditor's review report

To the Members of Cochlear Limited

Report on the consolidated interim financial report

Conclusion

We have reviewed the accompanying consolidated 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 consolidated 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 2019 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 consolidated Interim Financial Report comprises:

- the consolidated interim balance sheet as at 31 December 2019;
- the 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 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.

Emphasis of matter – Patent dispute

We draw attention to Note 4.1, to the consolidated Interim Financial Report, which describes the inherent uncertainty in the final future outcome related to the patent infringement lawsuit filed against Cochlear Limited and its US subsidiary Cochlear Americas (the lawsuit).

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

In our judgement, this issue is fundamental to the users' understanding of the consolidated 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 consolidated interim financial report

The Directors of the Company are responsible for:

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

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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 consolidated 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 consolidated 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 2019 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 a half-year 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, 18 February 2020

Julian McPherson, *Partner*

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