2018 COCHLEAR LIMITED

Annual Report

Hear now. And always

Cochlear®

Contents

Shareholder reports

Cochlear publishes a number of online shareholder reports aimed at improving transparency and making information easier to access. They are a great companion to the Annual Report and are all available at the Investor Centre of the website, www.cochlear.com.

Tax Contribution Report

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

Corporate Governance Statement

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

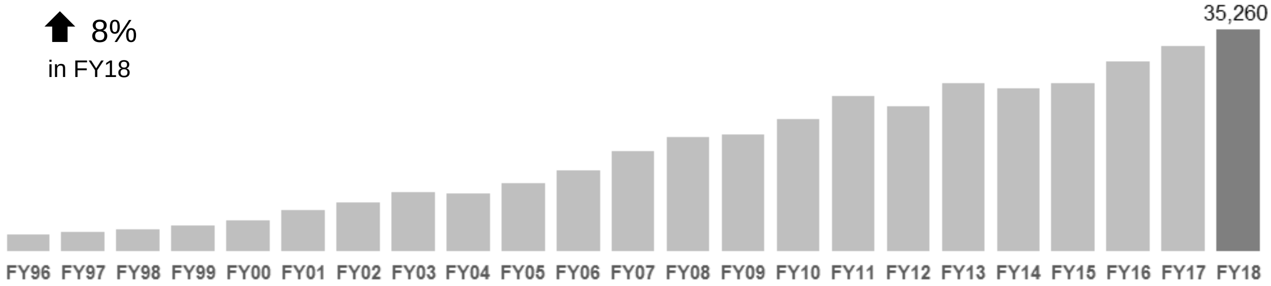
Investor Handbook

The Investor Handbook is an all-in-one reference for shareholders covering the market for implantable devices, Cochlear’s strategy, global footprint and product portfolio.

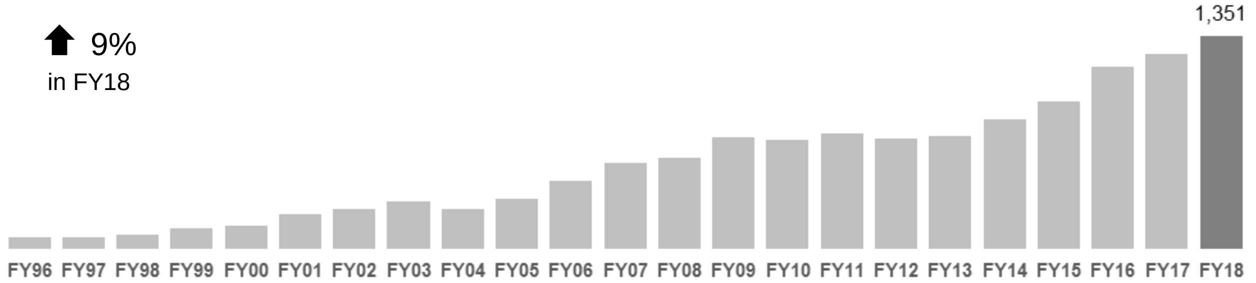
Financial history

Hear now. And always

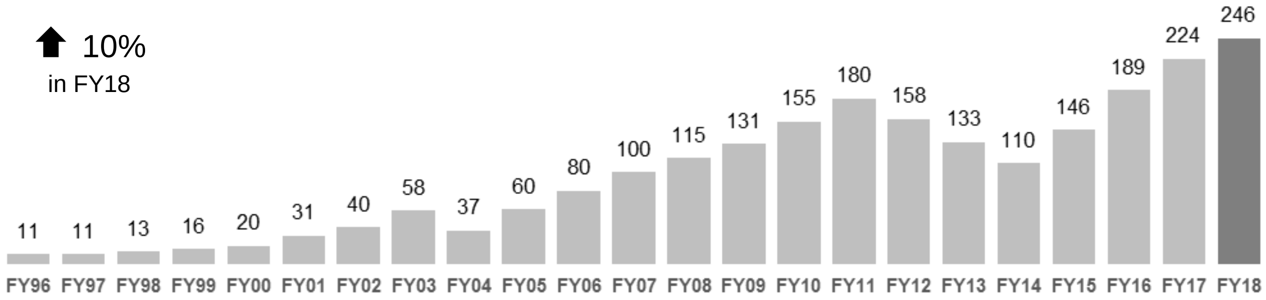
Cochlear implants
units



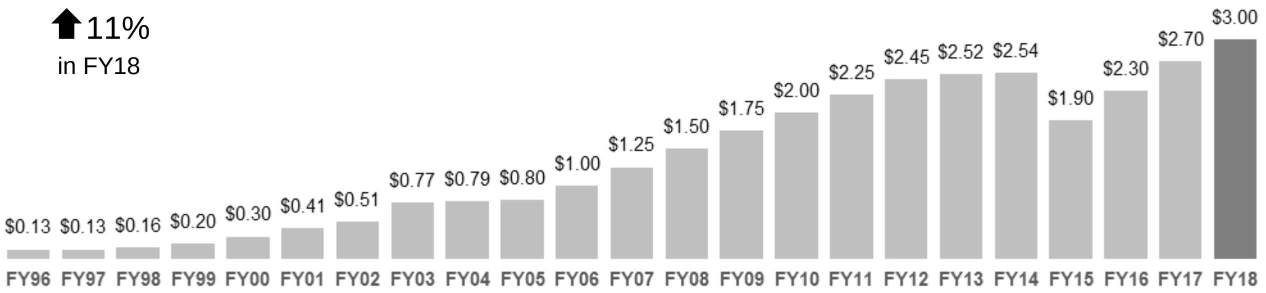
Sales revenue
$million



Net profit
$million – adjusted*



Dividends
per share



* FY12 excludes product recall costs of $101 million after tax and FY14 excludes patent dispute provision of $16 million after tax.

Cochlear reported a record net profit of $246 million, an increase of 10% on the FY17 result. FY18 has been a big year, with a focus on building awareness and market access to cochlear implants, up-weighting our marketing activities and customer servicing capability while maintaining our commitment to product innovation through our extensive investment in research and development (R&D).

Steady progress was made throughout the year, with the successful launch of the Nucleus® 7 Sound Processor and Baha® SoundArc underpinning our solid sales and earnings growth.

It has been an important year for Cochlear milestones, reaching our 500,000th implant sale, and for hearing awareness, with the World Health Organization (WHO) advocating for public health actions to prevent and treat hearing loss.

We have been increasing our investment in health economics, our market access capability and the collaborative partnerships we have with the medical research community to build on the clinical evidence that demonstrates the effectiveness of our products and the importance of hearing for healthy ageing.

Finally, we made a number of small investments in early stage innovation that seek to enhance or leverage our own R&D in the coming years.

Growing dividends

Earnings growth, combined with strong free cash flow generation, has supported the 14% increase in the fully franked final dividend to $1.60 per share. This takes dividends paid for the year to $3.00 per share, fully franked, an increase of 11% on FY17, and represents a payout of 70% of net profit.

The board policy of paying out around 70% of net profit as dividends to shareholders has been maintained.

Over 500,000 implants sold

Cochlear reached a major milestone in early FY18, selling its 500,000th implant. We have now provided more than 550,000 of our cochlear implants, bone conduction implants and acoustic implants, helping a growing number of people hear with one – or two – of our implantable devices.

While a wonderful milestone for the Company, it is also a reminder of the challenge, and opportunity, for Cochlear with fewer than 5% of the people who could benefit from an implantable hearing solution currently being treated.

40th anniversary of the first multi-channel cochlear implant surgery

Cochlear also celebrates the 40th anniversary of Rod Saunders receiving his cochlear implant. In a surgical procedure conducted by Graeme Clark, assisted by Dr Brian Pyman, at the Royal Victorian Eye and Ear Hospital in Melbourne on 1 August 1978, Rod made history, becoming the first person to have his hearing restored and to understand speech with the aid of a multi-channel cochlear implant. This day marked the beginning of a new era in implantable hearing solutions and paved the way for many hundreds of thousands of people to hear today thanks to cochlear implant technology.

The growing global burden of hearing loss

Hearing loss affects a significant number of people. The WHO has revised up its figures this year, revealing that over 466 million people suffer from disabling hearing loss globally. The vast majority affected are adults, with one third of people over 65 years of age affected by disabling hearing loss.

Hearing loss is now the fourth biggest contributor to years lived with disability globally, with the WHO estimating the cost of untreated hearing loss to be over US$750 billion per annum.

With the rise and ageing of the global population, the number of people with hearing loss is growing at a rapid pace. WHO projections suggest that unless action is taken, there will be 630 million people living with disabling hearing loss by the year 2030, with that number expected to grow to over 900 million by 2050.

The WHO is advocating for public health actions to prevent and treat hearing loss through control of risk factors and ensuring that the needs of those who experience hearing loss can be addressed adequately.

It will take a collaborative effort from governments, academia, industry, health professionals and the general public to improve future hearing health outcomes. At Cochlear, we are driven by our mission to improve the lives of people with hearing loss, and as a hearing health expert, we join with other global stakeholders to play our part in tackling this global health issue.

Healthy hearing for healthy ageing

Cochlear implantation for seniors is an important trend, especially as we begin to better understand the connection between high levels of hearing loss and cognitive decline, social isolation and depression.

Developing evidence of the impact of untreated hearing loss on people's health, on our communities and the economy is critical to ensuring hearing loss is treated appropriately.

Cochlear is making an investment to build collaborative partnerships within the global medical research community and to be actively involved in delivering evidence-based research so we can better understand, address and provide access to treatment options for individuals and communities impacted by hearing loss.

Establishment of long-term research collaborations

In March 2018, we pledged to gift US$10 million over 10 years to the Johns Hopkins Bloomberg School of Public Health to establish the ‘Cochlear Center for Hearing and Public Health’. The Center will be a first of its kind at any academic institution focused on addressing hearing loss as a global public health priority, led by Frank Lin, MD, PhD.

The Center will address hearing loss’ global impact by conducting research studies to determine the gravity of hearing loss, particularly among older adults, to public health, developing and testing interventions to mitigate the effects of hearing loss, and helping craft policies and strategies to ensure successful implementation of hearing loss interventions at the local, national and global levels.

In October 2017, we announced the establishment of the co-funded Cochlear Chair in Hearing and Healthy Ageing at Macquarie University.

The Chair will oversee the implementation of collaborative research and education strategies, with the long-term goal of developing a leading platform for further impactful research in hearing in Australia.

Macquarie University is home to the Australian Hearing Hub, and Cochlear continues to lead the market with innovative new hearing technologies. Together, we exemplify the strategic industry-academic engagement called for in the Australian Government's National Innovation and Science Agenda, and we are in a good position for further impactful research in the hearing space.

As well as supporting research into hearing and healthy ageing, we aim to encourage research into alternative models for delivering hearing care in growing economies to provide lower cost access. In China we are collaborating with the Government and local universities on the establishment of an international hearing research centre. The centre aims to host a range of hearing health related organisations to facilitate collaboration and to assist in improving access to hearing healthcare in China. It will be located next to our new manufacturing facility in Chengdu, which is currently being constructed.

Investments in advanced innovation

Cochlear continues to lead the market with innovative new technology that improves the quality of life of so many people around the globe and contributes to the growth of the industry. We are also actively monitoring the world around us for novel technologies that may enhance or leverage our own innovation.

Over the past 18 months, we made a number of small investments in early-stage innovation. Otoconsult provides technology that is expected to enable a faster and more consistent fitting of cochlear implants to deliver the best possible patient outcomes. A collaboration with Sensorion, a French biotech company, will evaluate therapeutic approaches in combination with cochlear implants focused on improving hearing outcomes. And Epi-Minder is developing a breakthrough monitoring device aimed at improving the treatment of patients suffering from epileptic seizures.

Changes to the R&D tax concession

Cochlear welcomed the Australian Government’s decision in May 2018 to support R&D intensive companies like Cochlear, by changing the way tax incentives are structured.

The announced changes will increase the cap on eligible expenditure from $100 million to $150 million, as well as increase the effective tax concession rate.

The new scheme is expected to provide Cochlear with a small incremental benefit to net profit in the initial years and, importantly, an incentive to continue to invest in R&D locally. This will mean more high paying jobs in Australia, more valuable intellectual property held in Australia and more spill-overs for the Australian hearing sector and broader medical technology industry.

Inquiry into impediments to business investment

In May 2018, Cochlear and CSL made a joint submission to the House of Representatives Standing Committee on Economics' 'Inquiry into Impediments to Business Investment'. As the nation's two largest and most successful innovation-focussed advanced manufacturing companies, actively and successfully competing globally from an Australian base, we are united in urging the Australian Government to more actively compete for investment and maximise the social and economic benefits flowing from innovation.

The submission articulates some of the current policy challenges Australia faces in retaining existing innovation-based enterprises and building the CSLs and Cochlears of the future. It also makes several recommendations for enhancing Australia's international competitiveness including considering targeted tax and other investment incentives, ensuring access to global talent, improving regulatory timeframes and improving consistency and coordination of Commonwealth and State policy. A copy of the full submission is available on the website, www.cochlear.com.

Retirement of Prof Edward Byrne, AC as director

Long-serving non-executive director Prof Edward Byrne, AC will be retiring from the Company's board at the end of the 2018 annual general meeting. Ed has provided invaluable counsel in his 16 years of service to Cochlear's board. His extensive experience in medicine and clinical neurology and research, as well as his dedication to Cochlear, have contributed greatly to Cochlear's strategic direction and success over many years.

On behalf of the board, I would like to sincerely thank Ed for his service and contribution to Cochlear and wish him well for the future.

The Board had anticipated Ed's retirement and appointed Prof Bruce Robinson, AM in December 2016 to allow for an orderly transition and ensure the Board will continue to be well served in the areas of research, healthcare and medicine, and tertiary education.

Remuneration

We need to ensure our remuneration practices are evolving to keep us competitive, ensure we can attract the best people, and effectively contribute to aligning performance and effort to our key business objectives.

Remuneration oversight of the CEO & President, the other key management personnel, and employees generally, is an important aspect of the Board's responsibilities. The role is carried out by the People & Culture Committee. The Remuneration report sets out our approach to remuneration and provides the FY18 details.

Our employees

Cochlear has a diverse global workforce focused on our business and on transforming the lives of people with hearing loss. We employ over 3,500 people from over 75 nationalities, with products sold into over 100 countries. The knowledge, expertise and passion of our employees are key to our future and the focus on delivering excellence for our customers is an important part of our success and our market leadership position.

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

Rick Holliday-Smith
Chairman

The growth we have experienced over the past few years has continued in FY18. The business delivered strong growth in cochlear implant units and sales revenue, with net profit growing by 10% (10% in CC)*.

We continued to execute on our strategy of investing to retain market leadership and drive market growth. Our market leadership position was enhanced by new product launches and improvements in the service offering to our customers. Market growth continued as awareness, indications and funding grew. And the expansion of direct-to-consumer marketing and focus on sales force expansion and effectiveness continued to support overall growth.

The cochlear implant business grew strongly with CC revenue growth of 8% and unit growth of 8% (up 11% excluding Chinese Central Government tender units).

Developed markets continued to perform well with unit growth increasing by 9%. Highlights include strong performances from the US and UK and solid unit growth across much of Western Europe, Australia and Japan. Emerging market units grew by over 15% (adjusted for the impact of lower Chinese Central Government tender units), with strong growth in the Middle East and the China private pay market.

The Nucleus® 7 Sound Processor, the world's first Made for iPhone cochlear implant sound processor, was launched during the second quarter across key markets including the US, Western Europe and Australia, performing well in its first nine months. In June, the Nucleus Smart App for Android™ smartphone users was released, allowing recipients with a compatible Android device to control their hearing with the Nucleus Smart App. And the Baha® SoundArc was launched, providing a non-surgical bone conduction solution that works with all of Cochlear's Baha 5 sound processors.

* Constant currency (CC) removes the impact of foreign exchange (FX) rate movements and FX contract gains/(losses) to facilitate comparability. See the Operating and financial review on page 24 for further detail.

The Services business performed strongly, delivering CC revenue growth of 15% driven by the release of the Nucleus 7 Sound Processor and the first full year of Sycle revenue. Sound processor upgrade revenue increased by 12% in CC and Cochlear Family membership exceeded 100,000 members.

The Acoustics business delivered CC sales in line with last year, following 26% CC growth last year, with demand continuing for the Baha 5 sound processor range.

Strategic priorities focused on building awareness and market access, particularly for seniors

Cochlear's priorities are centred on the customer, with activities aimed at growing awareness and access to the industry for implant candidates. And with a growing recipient base, the Company is actively strengthening its servicing capability to provide products, programs and services to support the lifetime relationship with recipients.

Cochlear has prioritised three market segments – adults and seniors in developed markets; children in developed markets; and children in emerging markets – with strategies to improve awareness and access tailored by segment.

The adults and seniors in the developed markets provide the biggest opportunity for Cochlear given the large, and growing, market size as the population ages. The segment is however challenging to penetrate as most candidates suffer from a progressive hearing loss and, together with their care providers, either do not know about cochlear and bone conduction implants, or do not understand the indications for them.

While penetration rates are currently very low, at around 3%, the seniors segment has been the fastest growing segment for Cochlear over the past few years as awareness increases.

Cochlear has an important role to play in supporting cochlear implants becoming the standard of care for adults and seniors with severe to profound hearing loss. We have been increasing our investment in health economics, our market access capability and the collaborative partnerships we have with the medical research community to build on the clinical evidence that demonstrates the effectiveness of our products, particularly for seniors.

We will continue to invest in driving referrals via our successful direct-to-consumer marketing activities as well as through the hearing aid channel. And there continue to be opportunities to expand indications and reimbursement in many markets.

Strong financial position

Cochlear delivered net profit of $245.8 million, an increase of 10% on FY17 (10% in CC), which was within the guidance range of $240-250 million. Cochlear continues to deliver on its objective of delivering consistent revenue and earnings growth over time.

Our investment in sales and marketing activities is building awareness of and access to implantable solutions and driving market growth. The investment in R&D continues to strengthen our leadership position through the development of market-leading technology. And by delivering a world-class customer experience, we empower our recipients to connect with others and live a full life.

In FY18, the business delivered manufacturing efficiencies from improvements in its warranty and repair functions. These gains were reinvested into our market growth activities with the net profit margin maintained.

We have a strong balance sheet and delivered operating cash flows in excess of net profit, enabling the business to fund capital investment, reduce debt and increase dividends to shareholders.

FY19 financial outlook

For FY19, Cochlear expects to deliver reported net profit of $265-275 million, an 8-12% increase on FY18.

Growth is expected to continue across the business in FY19, underpinned by the significant investments made in product development and market growth initiatives over the previous few years.

We will continue to invest operating cash flows in activities aimed at building awareness and market access, with the objective of delivering consistent revenue and earnings growth over the long-term. Through disciplined investment, we are targeting to maintain the net profit margin, reinvesting any efficiency gains, currency or tax benefits into market growth activities.

Over the next few years, we have a number of large long-term investment projects including the development of our China manufacturing facility, with the construction phase expected to be complete by the end of FY20, and investments in IT platforms to strengthen our connected health, digital and cyber security capabilities. These projects are expected to increase capital expenditure levels to $80-100 million per annum over the next few years.

The balance sheet and free cash flow generation remain strong and we continue to target a dividend payout ratio of around 70% of net profit.

Key guidance considerations for FY19:

- Expect growth across the developed markets, which represent around 80% of cochlear implant revenue, to continue;
- Emerging market growth rates over time continue to be strong, however, annual growth rates can be variable driven by the timing of tender based activity and macro-economic conditions;
- Continued investment to retain market leadership and drive long-term market growth with the target of maintaining the net profit margin; and
- Forecasting a weighted average AUD/USD exchange rate of 75 cents for FY19 (77 cents in FY18) and AUD/EUR of 0.63 EUR (0.65 EUR in FY18).

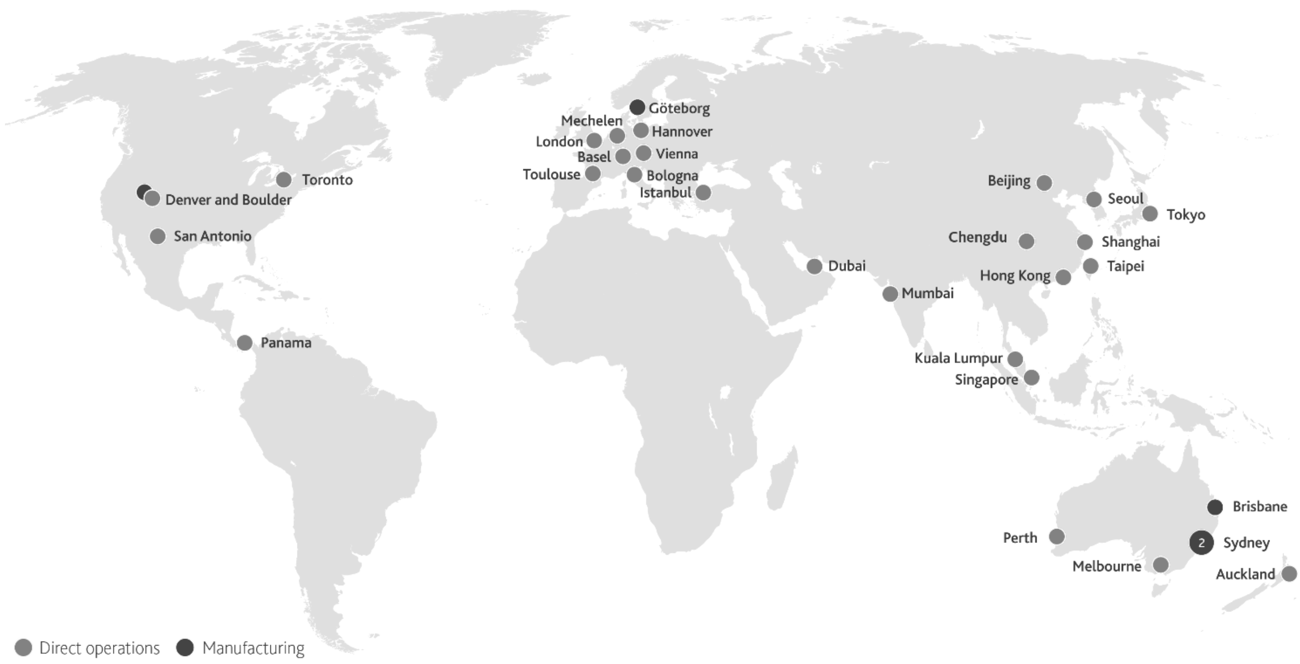
Dig Howitt
CEO & President

Company overview

Cochlear is the global leader in implantable hearing solutions with products including cochlear implants, bone conduction implants and acoustic implants. Cochlear commenced operations in 1981 as part of the Nucleus group and in 1995, listed on the Australian Securities Exchange. Today, Cochlear is a Top 50 listed Australian company with a market capitalisation of over A$10 billion.

Cochlear aims to support cochlear implantation becoming the standard of care for people with severe to profound hearing loss and provide bone conduction implants for patients with conductive hearing loss, mixed hearing loss and single sided deafness. The Company has provided more than 550,000 implant solutions to recipients who benefit from one – or two – of the Company's implantable devices. Whether these hearing solutions were implanted today or many years ago, Cochlear provides new technologies and innovations for all recipients. Cochlear invests more than $160 million each year in R&D and currently participates in over 100 collaborative research programs worldwide.

Cochlear's global headquarters are on the campus of Macquarie University in Sydney, with regional headquarters in Asia Pacific, Europe and the Americas. Cochlear has a deep geographical reach, selling in over 100 countries, with a direct presence in over 30 countries and a global workforce of over 3,500 employees.



550,000+ implants sold

A$160m+ in annual R&D investments

A$1.3b+ in annual sales revenue

3,500+ employees around the world

100+ countries where products are available

100+ collaborative research programs worldwide

5 key manufacturing sites

Operating and financial review

Cochlear's mission

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

Cochlear's investment proposition

Cochlear provides shareholders with a long-term opportunity to invest in the global leader in implantable hearing devices, in an industry that has the potential to grow over the long term. Cochlear has a clear strategy to drive market growth and a strong financial position which enables it to fund its growth activities while rewarding shareholders along the way with a growing dividend stream.

- ✓ **Global leader** in implantable hearing devices with more than 550,000 implants sold, supporting the majority of the global base of hearing implant recipients
- ✓ **Long-term market growth opportunity** with a significant, unmet and addressable clinical need for implantable hearing solutions and less than 5% market penetration
- ✓ Unrivalled **commitment to product innovation**, bringing innovative new products to market as well as upgrades for all generations of Cochlear's recipient base
- ✓ **Growing annuity income stream** from servicing of the expanding recipient base
- ✓ **Strong free cash flow generation** provides funding for market growth activities and R&D as well as the ability to reward shareholders with a growing dividend stream

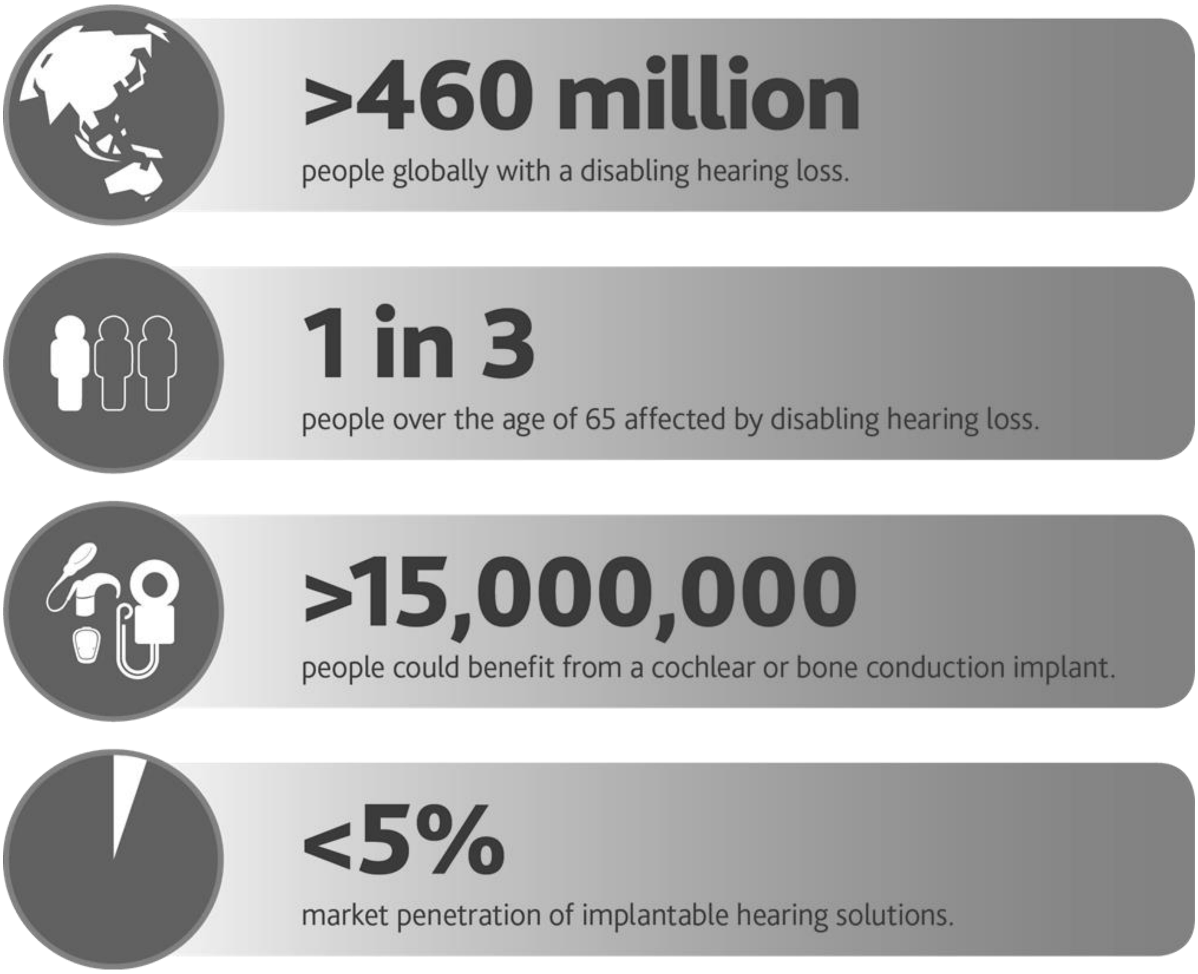
Hearing loss is prevalent and under-treated

Cochlear competes in the hearing loss category. The World Health Organization (WHO) estimates that there are over 460 million people worldwide – over 5% of the world's population – who experience disabling[1] hearing loss. By 2050, this is expected to rise to over 900 million people – or 1 in every 10 people[2].

Hearing loss affects people of all ages and is particularly prevalent in people over the age of 65, with one in three people over 65 suffering a disabling hearing loss. It affects communication and can contribute to social isolation, anxiety, depression and cognitive decline[3].

Cochlear estimates that more than 15 million people could benefit from a cochlear or bone conduction implant to treat moderate to profound hearing loss across its target segments of children globally and adults and seniors in the developed world[4].

Cochlear's challenge, and opportunity, is that less than 5% of the people that could benefit from an implantable hearing solution are being treated[5]. There remains a significant, unmet and addressable clinical need that is expected to continue to underpin the long-term sustainable growth of the business.



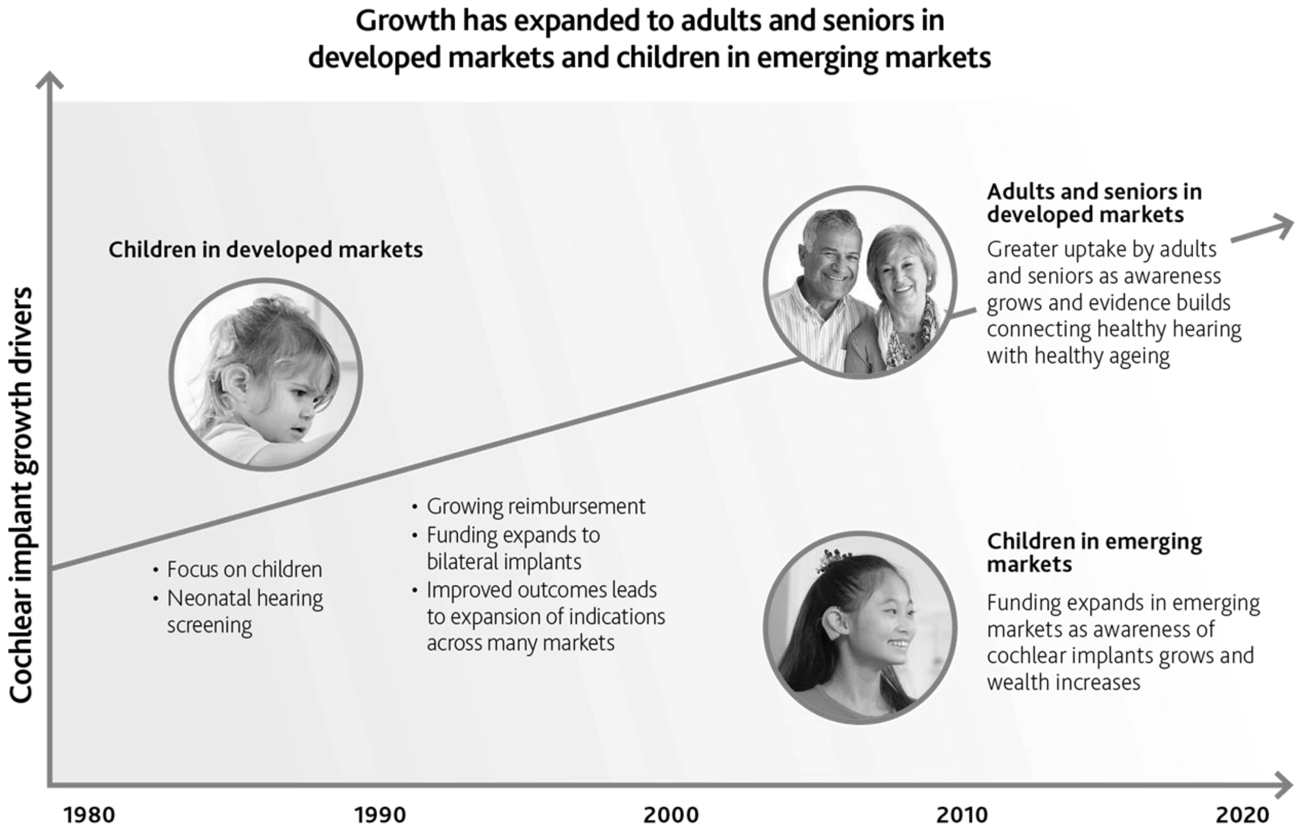
Note: References on page 111.

Growing demand for cochlear implants

Cochlear implants started as a solution for people with a profound hearing loss, equivalent to a greater than 90 decibel (dB) hearing loss, almost 40 years ago. Adoption of cochlear implantation for children grew rapidly, driven by the wide spread implementation of neonatal screening which allowed for early detection of hearing loss in newborns. As a result, cochlear implantation has been established as the standard of care for newborns across many developed markets, with bilateral implants indicated across most markets as evidence supports the benefit of binaural hearing.

Cochlear's investment in innovation over many years has materially improved the hearing outcomes and quality of life of recipients and this has driven an expansion of the indications, as well as the addressable market, for cochlear implants. Today, while indications still vary by country, the US, Germany, Australia and, since December 2017, Japan effectively indicate cochlear implants for people with a severe to profound hearing loss, equivalent to a hearing loss of more than 70dB.

More recently, there has been a greater uptake of cochlear implantation by older adults, particularly seniors, as awareness of the intervention has grown and the body of evidence builds connecting healthy hearing with healthy ageing. At the same time, funding has expanded in emerging markets as awareness of cochlear implants grows and wealth increases, driving implantation of children across the emerging world.



Company strategy

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

Cochlear's priorities are centred on the customer with activities aimed at growing awareness and access to the industry for implant candidates. And with a growing recipient base, the Company is actively strengthening its servicing capability to provide products, programs and services to support the lifetime relationship with recipients.

Cochlear is committed to being the technology leader in the industry by investing in R&D to improve hearing outcomes and expand the indications for implantable solutions.

Cochlear's strategic priorities aim to:

Retain market leadership

Cochlear continues to be the global leader in implantable hearing solutions. The investment in R&D aims to strengthen our leadership position through the development of **market-leading technology**. And by delivering a **world-class customer experience**, we aim to empower our recipients to connect with others and live a full life.

Market-leading technology

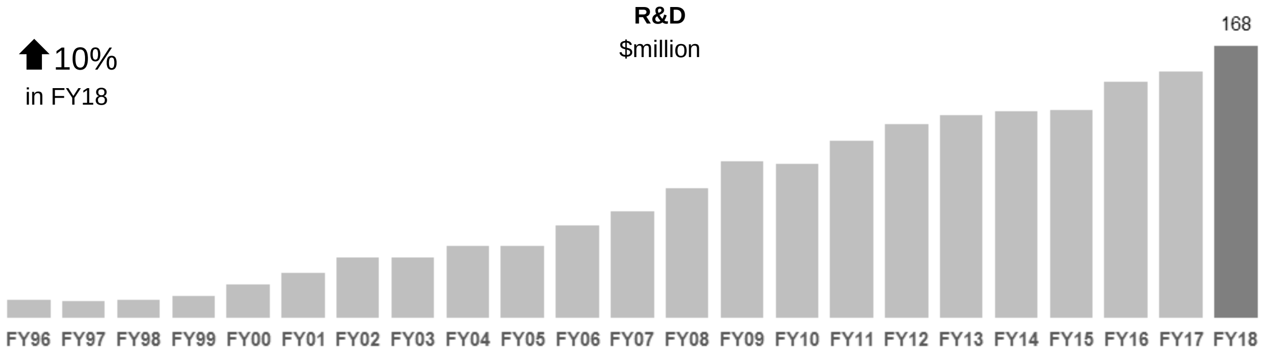
We **innovate** to bring to market a range of implantable hearing solutions that deliver a lifetime of hearing outcomes.

Cochlear has a global innovation network with over 350 R&D employees in international locations. Primary R&D is co-located with the Australian Hearing Hub in Sydney, with the Cochlear Technology Centre in Belgium focused on advanced innovation. The Company has over 100 research partners in over 20 countries and a global network of design partners and suppliers.

Product and service R&D spans implants and sound processors; sound coding; and clinical and surgical tools. R&D investment priorities are focused on hearing indications; hearing outcomes; lifestyle; and connected care. Over the past few years, Cochlear has launched market-leading products including:

- Nucleus® 7 Sound Processor, the world's first Made for iPhone cochlear implant sound processor;
- Nucleus Smart App for Android™ smartphone users, allowing recipients with a compatible Android device to control their hearing with the Nucleus Smart App;
- Baha® SoundArc, providing a non-surgical bone conduction solution that works together with all of Cochlear's Baha 5 sound processors;
- Kanso® Sound Processor, our first off-the-ear sound processor;
- Nucleus® Profile Slim Modiolar (CI532) electrode, the world's slimmest electrode; and
- Baha® 5 Power and SuperPower sound processors, Made for iPhone and designed for people with greater levels of hearing loss.

Cochlear has invested over $1.7 billion in R&D since listing in FY96 and currently invests more than $160 million per annum, or 12% of sales revenue, on R&D.



Retain market leadership

Cochlear's implantable hearing solution portfolio

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

Cochlear implants (88% of sales revenue)


Cochlear™ Nucleus® Profile with Slim Modiolar Electrode (CI532)


Cochlear™ Nucleus® Kanso® Sound Processor (CP950)

Cochlear™ Nucleus® 7 Sound Processor (CP1000)

Cochlear™ Nucleus® Smart App

Acoustic implants (12% of sales revenue)

Bone conduction implants

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


Cochlear™ Baha® SoundArc

Cochlear™ Baha® Smart App

Acoustic implants


Cochlear™ Carina® System

Retain market leadership

World-class customer experience

Providing a world-class customer experience **empowers** people to connect with others and live a full life and creates a brand halo for candidates. Cochlear is focused on providing its recipients with convenience and confidence, direct engagement and a commitment to providing an ongoing pipeline of market-leading products and services.

Convenience and confidence

- Wireless connectivity;
- Easy to use products and services;
- Ease of access for support; and
- Rehabilitation tools.

Engagement

- Cochlear Family connecting recipients with Cochlear;
- Growing volunteer network building awareness and increasing candidate confidence; and
- Recipient engagement improves upgrade penetration.

Market-leading products and services

- Improving technology with each generation of sound processor; and
- Backward compatibility of sound processors with prior generation implants.

Grow the hearing implant market

Awareness and market access

There is a significant, unmet and addressable clinical need for cochlear and acoustic implants with less than 5% global market penetration.

As the global leader, Cochlear is focused on meeting this long-term market growth opportunity by **transforming** the way people understand and treat hearing loss through its awareness and access activities.

Three key market segments have been prioritised with strategies to improve awareness and access tailored by segment. The segments comprise:

Adults and seniors in developed markets	**Children in developed markets**	**Children in emerging markets**
		
Biggest market potential and the most challenging to penetrate	Cochlear implants have been established as the standard of care for newborns[7] across many developed markets	Long-term growth potential as wealth increases
Current penetration[6]: **~3%**	Current penetration[6]: **~60%**	Current penetration[6]: **~10%**

Note: References on page 111.

Grow the hearing implant market

Adults and seniors in developed markets

Adults and seniors in the developed markets provide the biggest opportunity for Cochlear given the large, and growing, market size as the population ages. The segment is however challenging to penetrate as most candidates suffer from a progressive hearing loss and, together with their care providers, either do not know about cochlear and bone conduction implants, or do not understand the indications for them.

While penetration rates are currently very low, at around 3%, the seniors segment has been the fastest growing segment for Cochlear over the past few years as awareness begins to improve.

The key priority for the adult and seniors segment is to continue to build awareness and market access. This includes initiatives to:

- Support cochlear implants becoming the standard of care for adults and seniors with severe to profound hearing loss by demonstrating:
  - Hearing is an essential part of healthy ageing;
  - Effectiveness of implantable solutions relative to hearing aids; and
  - Treating age related hearing loss creates economic value;
- Increase referrals via direct-to-consumer marketing activities and through the hearing aid channel; and
- Expand indications and reimbursement in some markets.

Children in developed markets

Cochlear implants started as a solution for children with a profound hearing loss. Over the last 30 years, neonatal screening has been successfully established across the developed world. Today, cochlear implantation has been established as the standard of care for newborns across many developed markets, with bilateral implants indicated across most markets as evidence supports the benefit of binaural hearing.

The key priority for this segment is to maintain our leadership position while aiming to deepen our penetration in a few markets where rates of implantation for profoundly deaf newborns, and uptake of bilateral implantation, are below average.

There is also an opportunity to strengthen the treatment pathway for acquired or progressive hearing loss in older children. Poor screening rates for hearing loss in older children mean that intervention for children who lose hearing after birth is materially lower than that of newborns.

Children in emerging markets

Cochlear's emerging markets business has been growing rapidly as wealth grows across many of the countries. China has been a leading market with a continuing commitment from the government to fund implants for children.

Cochlear's priorities for this segment are focused around market expansion with activities targeted at:

- Building awareness – public education campaigns, direct-to-consumer marketing and hearing screening;
- Expanding funding – driven by the compelling health economics of implantation in children;
- Expanding our presence – distributor relationships combined with an expanding direct presence;
- Developing professional capability – surgeon training and audiology education; and
- Maximising penetration through a tiered product offering.

Grow the hearing implant market

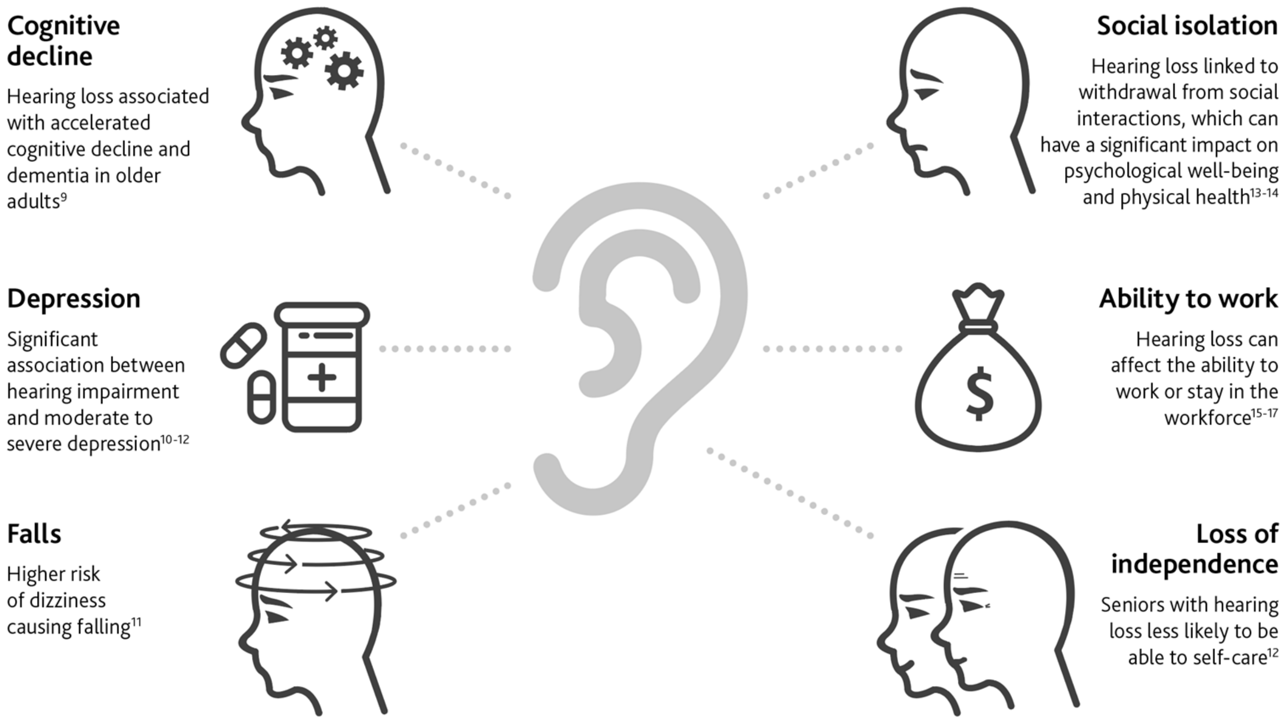
Clinical evidence

The adults and seniors segment is a key growth segment for Cochlear, and forms a major part of Cochlear's business in developed markets like Australia, North America and Western Europe. Over the past decade, we have experienced a shift in these markets to cochlear implantation in seniors – the over 65 year olds – driven in part by the ageing population and the higher incidence of hearing loss in this age group.

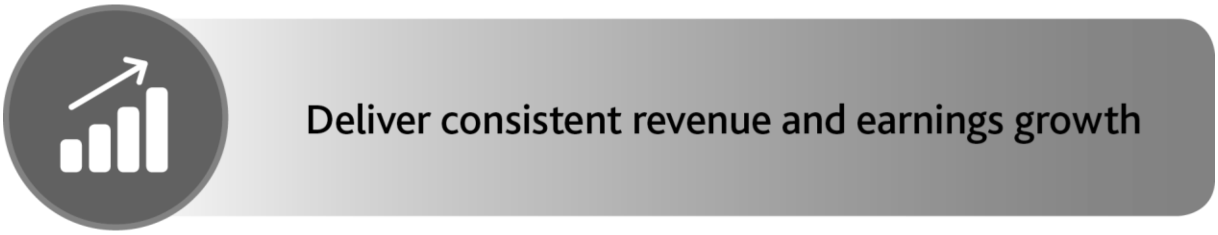
Cochlear implantation for seniors is an important trend, especially as we begin to better understand the link between high levels of hearing loss and cognitive decline, social isolation and depression. There is also a growing body of evidence of the superior outcomes of cochlear implants over hearing aids for many people with a severe hearing loss (>70dB)[8].

We have been increasing our investment in health economics, our market access capability and the collaborative partnerships we have with the medical research community to build on the clinical evidence that demonstrates the effectiveness of our products, particularly for seniors. Over the past 12 months, Cochlear has pledged funds to the Johns Hopkins Bloomberg School of Public Health to establish the 'Cochlear Center for Hearing and Public Health'. The Center will be a first of its kind at any academic institution focused on addressing hearing loss as a global public health priority.

Growing understanding of the link between healthy hearing and healthy ageing



Note: References on page 111.



Cochlear has achieved growth across all business units over time and expects each business unit to contribute to growth in the coming years. The key revenue growth drivers for each business unit include:

Cochlear implants

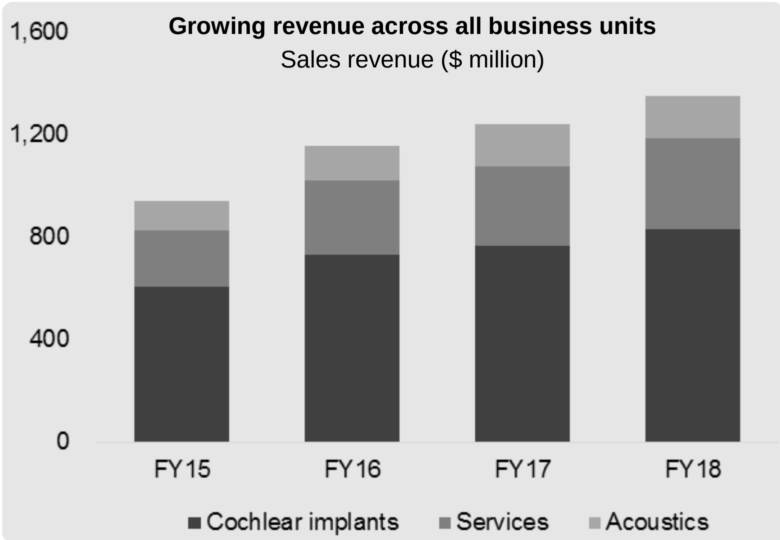
- Awareness and uptake by adults and seniors; and
- Emerging market expansion.

Services

- Growing recipient base; and
- Upgrade penetration.

Acoustics

- Market expansion; and
- Upgrade penetration.



To meet Cochlear's objectives of driving market growth while maintaining market leadership, Cochlear is investing operating cash flows into sales, marketing and R&D activities. Investment priorities are focused around:

Investing to grow

- Building awareness and access to our products requires multi-year investment in sales, marketing and R&D activities; and
- Through disciplined investment, we will aim to maintain the net profit margin.

Delivering operational improvement

- Optimising cost of production strengthens our competitive position; and
- We will use our scale to generate efficiency gains to reinvest in market growth activities.

Maintaining the strong financial position

- Strong cash flow generation funds growth; and
- We aim to maintain the strong balance sheet position and continue to target a dividend payout of around 70% of net profit.

Results of operations

Product and service highlights

	2018 $m	2017 $m	Change % (reported)	Change % (CC)[1]
Cochlear implants (units)	35,260	32,554	⬆ 8%	
Sales revenue				
Cochlear implants	831.0	767.8	⬆ 8%	⬆ 8%
Services (sound processor upgrades and other)	355.2	305.6	⬆ 16%	⬆ 15%
Acoustics (bone conduction and acoustic implants)	165.2	166.3	⬇ 1%	0%
Total sales revenue	**1,351.4**	**1,239.7**	**⬆ 9%**	**⬆ 9%**

[1] Constant currency (CC) removes the impact of exchange rate movements and foreign exchange (FX) contract gains/(losses) to facilitate comparability. See Notes on page 24 for further detail.

Cochlear implants – 62% of sales revenue

Cochlear implant revenue grew 8% (8% in CC) with unit growth of 8% (up 11% excluding the impact of Chinese Central Government tender units). Reported average selling prices were stable in constant currency driven by country mix. However, there was continued downward pressure in prices in some markets, particularly Western Europe.

Across the developed world, the cochlear implant market continues to experience robust growth, with improving awareness and growing uptake in the adults and seniors segment. Cochlear's developed markets business, which represents around 80% of revenue, grew units by 9%, with highlights including continued strong performances from the US and UK.

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.

Emerging markets units grew by over 15% (adjusted for the impact of lower Chinese Central Government tender units), with highlights including strong unit growth in the Middle East and the China private pay market. The FY18 result included around 1,100 Chinese Central Government tender units compared to around 1,900 in FY17.

Services (sound processor upgrades and accessories) – 26% of sales revenue

Reported Services sales revenue increased by 16% (15% in CC) driven by the release of the Nucleus 7 Sound Processor during the second quarter and first full year of revenue from Sycle, the audiology practice management software business acquired in May 2017.

Sound processor upgrade revenue increased by 12% in CC, with the Nucleus 7 Sound Processor available as an upgrade in key markets from October. Cochlear continues to invest to provide its growing customer base with a world-class customer experience with increased connectivity and engagement. Cochlear's recipient membership program, Cochlear Family, continues to grow rapidly, with membership growing by 70% this year to now exceed 100,000 members.

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

Reported Acoustics revenue declined by 1% (0% in CC), following 26% growth in CC in FY17, with solid demand continuing for the Baha 5 sound processor range.

Regional review

Sales revenue	2018 $m	2017 $m	Change % (reported)	Change % (CC)
Americas	648.5	595.0	⬆ 9%	⬆ 11%
EMEA (Europe, Middle East and Africa)	478.9	428.5	⬆ 12%	⬆ 7%
Asia Pacific	224.0	216.2	⬆ 4%	⬆ 5%
Total sales revenue	**1,351.4**	**1,239.7**	⬆ **9%**	⬆ **9%**

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

Reported sales revenue increased by 9% (11% in CC). The highlight was the growth in the US with cochlear implant unit growth of around 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.

The expanded field sales organisation, direct-to-consumer marketing, increased referrals from hearing aid retailers and improvements in sales force effectiveness have continued to contribute to growth in the US.

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

Reported sales revenue increased by 12% (7% in CC). Unit growth in the UK was the highlight, with solid growth across many countries in Western Europe. Like the US, Western Europe is benefiting 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 and funding 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.

After a soft start to the year, units and sales revenue across EMEA's emerging markets, including Central & Eastern Europe and the Middle East & Africa, grew strongly primarily as a result of the timing of a number of tenders.

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

Reported sales revenue increased by 4% (5% in CC). Australia and Japan experienced solid unit growth, with private pay and non-tender business in Greater China growing strongly. Solid unit growth was delivered across a number of smaller countries in the region driven by a combination of tender activity, expanded indications and Cochlear's growing presence.

Overall sales revenue at the regional level was impacted by Chinese Central Government tender units. The FY18 result includes around 1,100 Chinese Central Government tender units compared to around 1,900 in FY17.

Financial review

Profit and loss

	2018 $m	2017 $m	Change % (reported)	Change % (CC)[1]
Sales revenue	**1,351.4**	**1,239.7**	**9%**	**9%**
Cost of goods sold	361.2	358.4	1%	1%
% gross margin	*73%*	*71%*		
Selling, marketing and general expenses	397.0	347.2	14%	14%
Administration expenses	97.4	85.2	14%	14%
Research and development expenses	167.7	151.9	10%	9%
% of sales revenue	*12%*	*12%*		
Total expenses	**1,023.3**	**942.7**	**9%**	**8%**
Other net income	8.0	4.5		
FX contract gains	12.3	14.1		
Earnings before interest and tax (EBIT)	**348.4**	**315.6**	**10%**	**11%**
% of sales revenue	*26%*	*25%*		
Net finance expense	7.9	6.8	16%	
Income tax expense	94.7	85.2	11%	
% effective tax rate	*28%*	*28%*		
Net profit	**245.8**	**223.6**	**10%**	**10%**

[1] Constant currency (CC) removes the impact of exchange rate movements and FX contract gains/(losses) to facilitate comparability. See Notes on page 24 for further detail.

Reported sales revenue increased by 9% (9% in CC) to $1,351.4 million while total expenses increased by 9% (8% in CC) to $1,023.3 million. As a result, the business generated an EBIT increase of 10% (11% in CC) to $348.4 million, with the EBIT margin increasing by one percentage point to 26%.

Key points of note:

- Reported cost of goods sold increased by 1% (1% in CC) to $361.2 million, reflecting manufacturing efficiencies, lower warranty costs and lower repair expenses resulting from the centralisation of repairs. As a result, gross margin increased by two percentage points to 73%;
- Selling, marketing and general expenses increased by 14% (14% in CC) to $397.0 million. The increase reflects the continued investment in the sales force and expanded marketing activities and the first full year inclusion of expenses related to Sycle, which was acquired in May 2017;
- Administration expenses increased by 14% (14% in CC) to $97.4 million with additional corporate investment required to support business growth;
- Investment in R&D increased 10% (9% in CC) to $167.7 million, and was in line with FY17 at 12% of sales revenue;
- Other net income of $8.0 million includes $5.3 million relating to a reduction in the contingent consideration value of Sycle; and
- Income tax expense includes a $4.6 million net impact resulting from the change to the US federal corporate tax rate (see next note for details).

Impact of changes to US tax legislation

The US Government passed the Tax Cuts and Jobs Act which contained significant tax reform measures. The major change in legislation to affect Cochlear is from the reduction in the US federal corporate tax rate from 35% to 21%, effective 1 January 2018.

As a consequence of the reduction in corporate tax rates, Cochlear was required to revalue its US deferred tax assets as at 31 December 2017, resulting in a reduction in the value of the asset. The first half result included a one-time non-cash expense of $5.5 million, reflecting the revaluation of the deferred tax assets. There was a further $0.8 million adjustment in the second half, taking the FY18 impact to $6.3 million.

From 1 January 2018, Cochlear generated an ongoing annual cash tax benefit from the lower corporate tax rate and this amounted to $1.7 million in the second half.

Cash flow

	2018 $m	2017 $m	Change $m
EBIT	348.4	315.6	32.8
Depreciation and amortisation	34.2	31.2	3.0
Changes in working capital and other	(15.3)	(0.6)	(14.7)
Net interest paid	(7.9)	(7.9)	-
Income taxes paid	(101.3)	(78.5)	(22.8)
Operating cash flow	**258.1**	**259.8**	**(1.7)**
Capital expenditure	(42.0)	(35.3)	(6.7)
Acquisition of land and buildings	(2.6)	(27.5)	24.9
Acquisition of subsidiary (Sycle)	-	(63.7)	63.7
Acquisition of other intangible assets	(5.1)	(8.2)	3.1
Other net investments	(5.7)	(0.9)	(4.8)
Free cash flow	**202.7**	**124.2**	**78.5**

The business generated $258.1 million in operating cash flow, with free cash flow increasing by $78.5 million to $202.7 million.

Key points of note:

- EBIT increased by $32.8 million driven by the 9% increase in sales revenue;
- Income taxes paid increased by $22.8 million to $101.3 million, reflecting higher earnings and the impact of the timing of cash tax payments;
- Capital expenditure increased by $6.7 million to $42.0 million, primarily driven by additional investment in plant and equipment and IT systems; and
- Other net investments of $5.7 million includes investments made in Sensorion, a French biotech company pioneering novel treatments for inner ear diseases, and Epi-Minder, a new Australian venture launched to develop a breakthrough monitoring device aiming to improve treatment of patients suffering with epileptic seizures and related conditions.

Capital employed

	2018 $m	2017 $m	Change $m
Trade receivables	299.1	275.4	23.7
Inventories	167.4	160.0	7.4
Less: Trade and other payables	(140.5)	(130.9)	(9.6)
Working capital	326.0	304.5	21.5
Working capital / sales revenue	*24%*	*25%*	
Debtor days	*69*	*74*	*(5)*
Inventory days	*171*	*164*	*7*
Property, plant and equipment	128.4	120.1	8.3
Intangible assets	345.3	340.0	5.3
Other net liabilities	(102.7)	(91.6)	(11.1)
Capital employed	**697.0**	**673.0**	**24.0**

Capital employed increased by $24.0 million to $697.0 million since June 2017, primarily as a result of an increase in working capital.

Key points of note:

- Working capital increased by $21.5 million, reflecting increased sales revenue. Working capital as a percentage of sales revenue declined by one percentage point to 24%, with debtor days reducing by 5 days to 69 days; and
- Other net liabilities increased by $11.1 million to $102.7 million. Other net liabilities include a reduction of $6.3 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

	2018 $m	2017 $m	Change $m
Loans and borrowings:			
Current	3.7	84.7	(81.0)
Non-current	144.0	134.2	9.8
Total debt	147.7	218.9	(71.2)
Less: Cash and cash equivalents	(61.5)	(89.5)	28.0
Net debt	**86.2**	**129.4**	**(43.2)**

Net debt decreased by $43.2 million to $86.2 million, driven by improved earnings and initiatives to improve cash management.

Dividends

	2018	2017	Change %
Interim ordinary dividend (per share)	$1.40	$1.30	8%
Final ordinary dividend (per share)	$1.60	$1.40	14%
Total ordinary dividends (per share)	$3.00	$2.70	11%
Payout ratio %	70%	69%	
Franking %	100%	100%	

Strong free cash flow and the continued strength of the balance sheet have supported the declaration of a final dividend of $1.60 per share, an increase of 14%. Full year dividends increased by 11% to $3.00 per share, franked at 100% and representing a payout of 70% of net profit.

The record date for determining dividend entitlements is 18 September 2018 and the final dividend will be paid on 10 October 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.

Non-International Financial Reporting Standards (IFRS) financial measures

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

Constant currency

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

Reconciliation of constant currency net profit to reported net profit

	2018 $m	2017 $m	Change %
Net profit (reported)	**245.8**	**223.6**	**10%**
FX contract gains		(1.8)	
Spot exchange rate effect to sales and expenses[1]		1.4	
Balance sheet revaluation[1]		(0.3)	
Net profit (CC)	**245.8**	**222.9**	**10%**

[1] FY18 actual v FY17 at FY18 rates.

Business risks

Cochlear has a sound and robust Risk Management Framework to identify, assess and appropriately manage risks. Details of Cochlear's Risk Management Framework can be found in the 2018 Corporate Governance Statement, which is available on the website.

Cochlear's principal business risks are outlined below. These are significant risks that may materially adversely affect Cochlear's business strategy, financial position or future performance. It is not possible to identify every risk that could affect Cochlear's business, and the actions taken to mitigate the risks described below cannot provide absolute assurance that a risk will not materialise.

Risk	**Description and potential consequences**	**Strategies used by Cochlear to mitigate the risk**
Product innovation and competition	Cochlear is exposed to the risk of failing to develop and produce innovative products for customers. Increased competition exposes Cochlear to the risk of losing market share as well as a decrease in average selling prices in the industry. Cochlear is also exposed to the risk of medical, biological and/or technological advancement by third parties where alternative products or treatments are developed and commercialised that render Cochlear's products obsolete for future candidates. This could result in a loss of new business.	In FY18, Cochlear invested 12% of sales revenue in R&D. Cochlear also works with over 100 external research partners. The creation of new intellectual property and the protection of new and existing intellectual property are a key focus for Cochlear. Cochlear has plans to launch a series of new products across all categories of the business over the coming years, focused on both market share and market growth.
Infringement litigation	Cochlear operates in an industry that has substantial intellectual property and patents, designs and trademarks protecting that intellectual property. Cochlear is exposed to the risk of litigation for alleged infringement. This could result in Cochlear paying royalties to be able to continue to manufacture product, or paying damages and/or receiving injunctions preventing Cochlear selling products it had developed.	Cochlear has a comprehensive patent portfolio across its technologies. Cochlear conducts freedom to operate searches as part of its internal processes before launching new products. Cochlear has a Legal department and utilises internal and external legal resources to deal with any litigation issues.
Misappropriation of know-how and intellectual property	Cochlear is exposed to the risk of its know-how and intellectual property being misappropriated either through hacking of its systems or by employees, consultants and third parties who from time to time have access to Cochlear's know-how and intellectual property. This could result in competitors using this information and increasing their competitiveness. Cochlear could lose market share as a result.	Cochlear monitors its systems and considers that it has appropriate safeguards and processes in place. Confidentiality agreements are in place with key employees and third parties that are exposed to Cochlear's know-how and intellectual property.

Risk	Description and potential consequences	Strategies used by Cochlear to mitigate the risk
Medical device regulations	Cochlear operates in a highly regulated industry. Medical devices are subject to strict regulations, including data security, of regulatory bodies in the US, Europe, Asia and Australia as well as many other local bodies in countries where Cochlear's products are sold. Regulatory bodies periodically perform audits at Cochlear's manufacturing sites. If Cochlear or a third-party supplier fails to satisfy regulatory requirements or the regulations change and modifications are not made, this could result in the imposition of sanctions or Cochlear's products being subject to recall and/or the loss of sales and reputational harm. Changes to medical device regulations or delays in achieving regulatory approval can impact Cochlear's ability to sell its latest technology.	Cochlear has a worldwide quality assurance system in place.
Reimbursement	The majority of Cochlear's customers rely on a level of reimbursement from insurers and government health authorities to fund their purchases. There is increasing pressure on healthcare budgets globally which may lead to pressure on reimbursed prices. Cochlear may also be subject to healthcare related taxes imposed by government agencies and this could negatively impact the ability of candidates to access Cochlear's products.	Cochlear continues to work with reimbursement and government agencies throughout the world to emphasise the health and economic benefits and cost effectiveness of intervention to restore hearing.
Product liability	The manufacturing, testing, marketing and sale of Cochlear's products involve product liability risk. As the developer, manufacturer, marketer and distributor of certain products, Cochlear may be held liable for damages arising from use of its products during development or after the product has been approved for sale.	Cochlear maintains product liability insurance and operates a worldwide quality assurance system related to the design, testing and manufacture of its products.
Interruption to product supply	Cochlear relies on third-party suppliers for the supply of key materials and services. This carries the risk of delays and disruptions in supplies. Certain materials are available from a single source only and regulatory requirements make substitution costly, time-consuming or commercially unviable. Cochlear manufactures its latest generation products across five sites globally. There is the potential risk of disruption to sales should a manufacturing facility be unable to operate. Any new manufacturing facility will require regulatory approval prior to being able to produce and sell product made at this facility. This approval could take many months.	Cochlear monitors its suppliers and identifies any available second-source supply. Inventories are managed and purchased in sufficient quantities for continued product supply in the short term. Where appropriate, lifetime buys, strategic raw materials purchases and supply chain interventions are made. Cochlear also regularly reviews its disaster recovery plans for its manufacturing sites and maintains business interruption insurance.

Risk	Description and potential consequences	Strategies used by Cochlear to mitigate the risk
Political, economic or social instability	Cochlear sells in over 100 countries. Several of the emerging markets are heavily biased to tender sales, including the Chinese Central Government tenders. The future outcome of tender sales is uncertain. Regional political, economic or social instability could negatively impact sales and the receipt of payment for sales.	Cochlear assesses the countries it sells into and does not have a significant concentration of sales in countries impacted by political, economic or social instability. Cochlear utilises global scanning software to assess partners, distributors and suppliers against sanctions checklists on an ongoing basis.
Foreign exchange rates	Cochlear is exposed to currency risk on sales and purchases that are denominated in a currency other than the respective functional currencies of the legal entities. The currencies in which these transactions primarily are denominated are Australian dollars (AUD), US dollars (USD), Euros (EUR), Japanese yen (JPY), Sterling (GBP), Swedish kroner (SEK) and Swiss francs (CHF). Over 90% of Cochlear's revenues and over 50% of costs are denominated in currencies other than AUD.	Currency risk is hedged in accordance with the Board approved treasury risk policy. The treasury risk policy aims to manage the impact of short-term fluctuations on Cochlear's cash flow. Over the longer term, permanent changes in market rates will have an impact on earnings. Derivative financial instruments (forward exchange contracts) are used to hedge exposure to fluctuations in foreign exchange rates in a declining level of cover out to three years.
Credit	Cochlear's exposure to credit risk is influenced by the geographical location and characteristics of individual customers. Cochlear does not have a significant concentration of credit risk with a single customer. The majority of significant debtors are governments, government-supported universities and clinics or major hospital chains.	Policies and procedures for credit management and administration of receivables are established and executed at a regional level. In monitoring customer credit risk, the ageing profile of total receivables balances and individually significant debtors is reported by geographic region to the Board on a monthly basis. Regional management is responsible for identifying high risk customers and placing potential restrictions on future trading, including suspending future shipments and administering dispatches on a prepayment basis. In addition, where appropriate, absolute country limits are in place and Chief Financial Officer approval is required to increase a limit. These limits are periodically reviewed by the Audit Committee.

Risk	Description and potential consequences	Strategies used by Cochlear to mitigate the risk
Operations	Operational risk is the risk of direct and indirect loss arising from a wide variety of causes associated with Cochlear's processes, personnel (including executive transitions), technology and infrastructure and generally accepted standards of corporate behaviour. Operational risks arise from all of Cochlear's operations. These risks could result in the loss of sales and reputational harm.	Standards for the management of operational risk are in place in the following areas: • Requirements for appropriate segregation of duties, including the independent authorisation of transactions; • Requirements for the reconciliation and monitoring of transactions; • Appropriate insurance programs; • Documentation of controls and procedures; • Requirements for the periodic assessment of operational risks faced, and the adequacy of controls and procedures to address the risks identified; • Internal and external audit programs; • Development of contingency plans; • Succession planning for key management personnel; • Training and professional development; • Employee health and safety programs; and • Ethical and business standards.
Information security	Cochlear handles and stores personal information, including health information, for its customers and employees. With expanding information privacy and security regulations, and an increasingly hostile cyber environment, Cochlear recognises information privacy and cyber security as an increasing risk.	Cochlear regularly assesses its information governance and cyber security controls in light of emerging technological threats and expanding privacy laws. These assessments are used to determine any appropriate corrective actions. In addition to the ongoing assessment and remediation of operational privacy and security activities, Cochlear maintains cyber insurance as part of its overall risk mitigation strategy for information privacy and security risk.
Talent management	Cochlear operates in a very competitive environment, particularly in relation to attracting scientific talent into the group.	Talent management programs are in place, both within Australia and in our key international markets.

Environment, social and governance

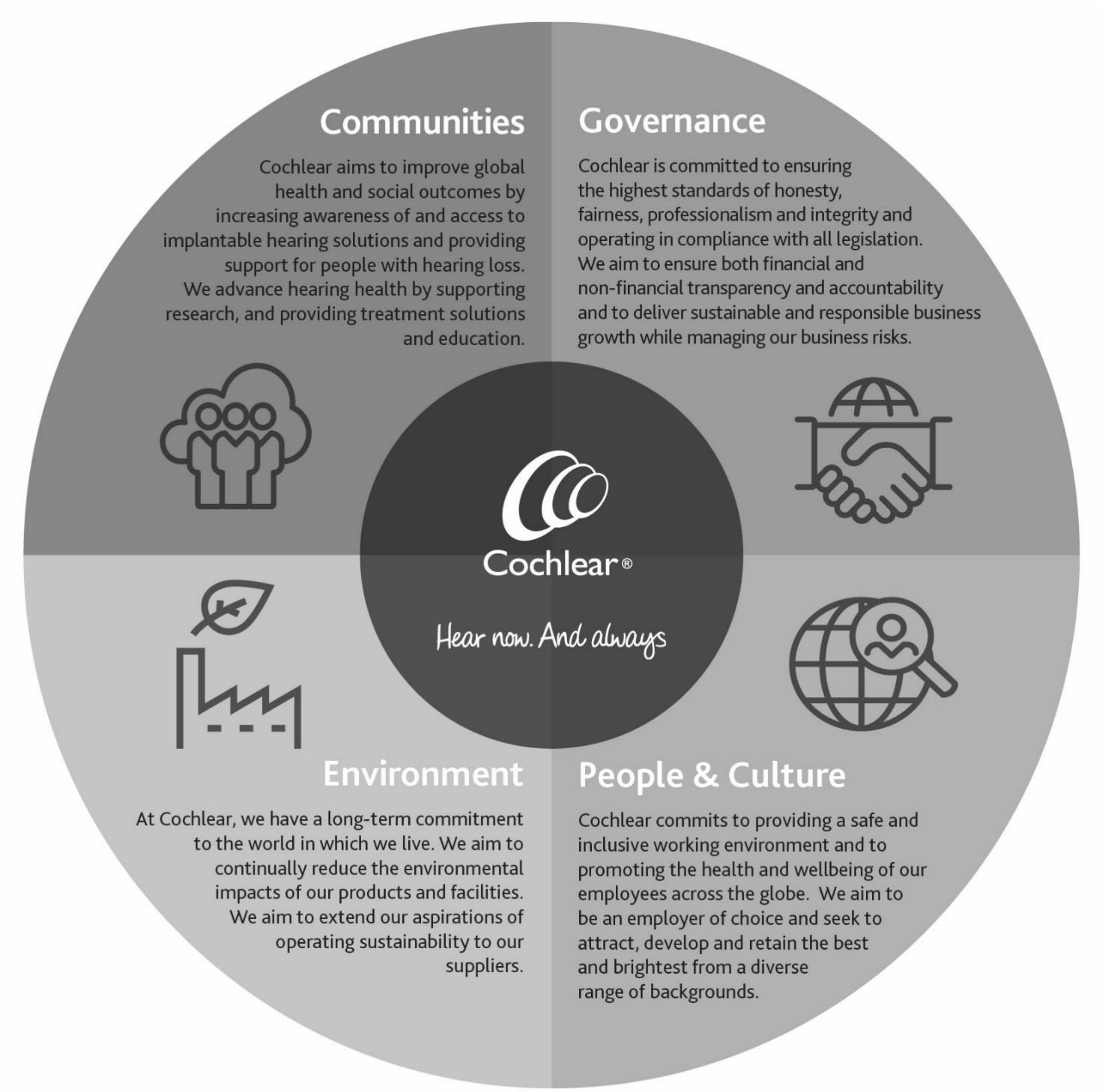
Hear now. And always

Cochlear®

‘Hear now. And always’ embodies Cochlear’s commitment to providing its customers with the best possible hearing support, and also reflects the long-term commitment to global communities and environments.

Cochlear products are available in over 100 countries worldwide, and Cochlear also has a direct presence in over 30 countries, supporting the medical community and thousands of employees in delivering essential hearing health services to communities worldwide.

We continue to improve the monitoring and documentation of our environmental performance, the impact we have on communities and our employees, and the governance of our global operations. We have developed objectives in the following areas:



Communities

Cochlear is committed to improving global health and social outcomes through the supply of implantable hearing solutions to those in need.

Hearing loss has a social and an economic cost. Cochlear recognises the WHO recommendation of integrating holistic hearing care into health care systems[1], and supports this by seeking to deliver solutions that directly benefit people with hearing loss and their communities through the following objectives:

- Increasing access and raising awareness about hearing loss and hearing health;
- Funding and supporting research studies with clinical partners to lead advancements in hearing technology; and
- Partnering and providing education opportunities to increase skills and capacity to deliver hearing health services.

Awareness and access

We strive to broaden global understanding of hearing loss and availability of hearing loss treatments. This commitment is demonstrated through our alliances with organisations and causes that promote advocacy, education, access to care and research. Cochlear has many professional staff involved in helping relevant research and community programs in their regions, partnering with academic, industry and health professionals to assist Cochlear's recipients and their families gain access to services and support, while advocating for resources for the institutions that support them. This is particularly important in emerging markets.

Research

Cochlear is contributing to the global body of knowledge about hearing loss and its treatment, by funding or supporting research studies which result in peer reviewed, publicly available findings. Cochlear aims to help fill research and knowledge gaps, contributing to the advancement of hearing loss treatment. Globally, Cochlear-funded research and clinical trials resulted in more than 25 scientific publications in FY18, primarily reporting on performance outcomes for hearing impaired individuals of all ages treated with hearing implant solutions. Cochlear currently has over 100 projects and trials in collaboration with clinical, business and research partners.

Education opportunities

Cochlear is committed to advancing the level of skills and knowledge around hearing loss and treatment, contributing to further education for Cochlear implant recipients, and contributing to science, technology, engineering and mathematics (STEM) education. For over 15 years we have been providing scholarships for cochlear implant and bone conduction implant recipients. In FY18, we awarded 12 scholarships to recipients in North America, Australia, the UK and Central Europe. These scholarships provide recipients with financial support for their university degrees. Around the globe, Cochlear provided practical training courses to thousands of public and private health professionals including surgeons, audiologists and speech pathologists.

Governance

Cochlear is committed to operating with integrity and in compliance with relevant laws and regulations. Furthermore, Cochlear aims to:

- Provide financial and non-financial transparency and accountability;
- Deliver sustainable and responsible growth; and
- Safeguard the security and privacy of all customer data.

We have global policies and procedures to ensure compliance, transparency and accountability. Our Global Code of Conduct provides every Cochlear representative with clear expectations of the way in which we conduct business to ensure the highest standards of honesty, fairness, professionalism and integrity. We also have policies covering Anti-Bribery, Sanctions, Whistle-blower Protection, IT Security, and Privacy, to outline requirements and expected behaviours. We conduct regular training and independent assessments to ensure knowledge of, and compliance with, all obligations.

For more information on Cochlear's governance reporting, see our Corporate Governance Statement 2018, Global Code of Conduct and company policies which are available at www.cochlear.com.

Environment

Cochlear's Environmental Policy (which is available at www.cochlear.com) demonstrates our commitment to respecting our planet. It guides our decision making to reduce the environmental impact of our operations, products and supply chain.

Cochlear has assessed its main environmental impacts and is working to improve its environmental performance through achieving the following global objectives:

- Reduce greenhouse gas (GHG) emissions;
- Reduce waste to landfill; and
- Improve screening of supplier environmental performance.

Environmental management system and performance measurement

In FY18, Cochlear began implementation of an Environmental Management System (EMS). The EMS is modelled on ISO 14001, covering the main manufacturing, service and research sites, and head offices. The sites covered by the EMS make up close to 80% of our global footprint and we have commenced reporting on the main environmental impacts at these sites. Further environmental reporting data will be available later this year, when we publish our Environmental, Social and Governance Report.

Greenhouse gas emissions

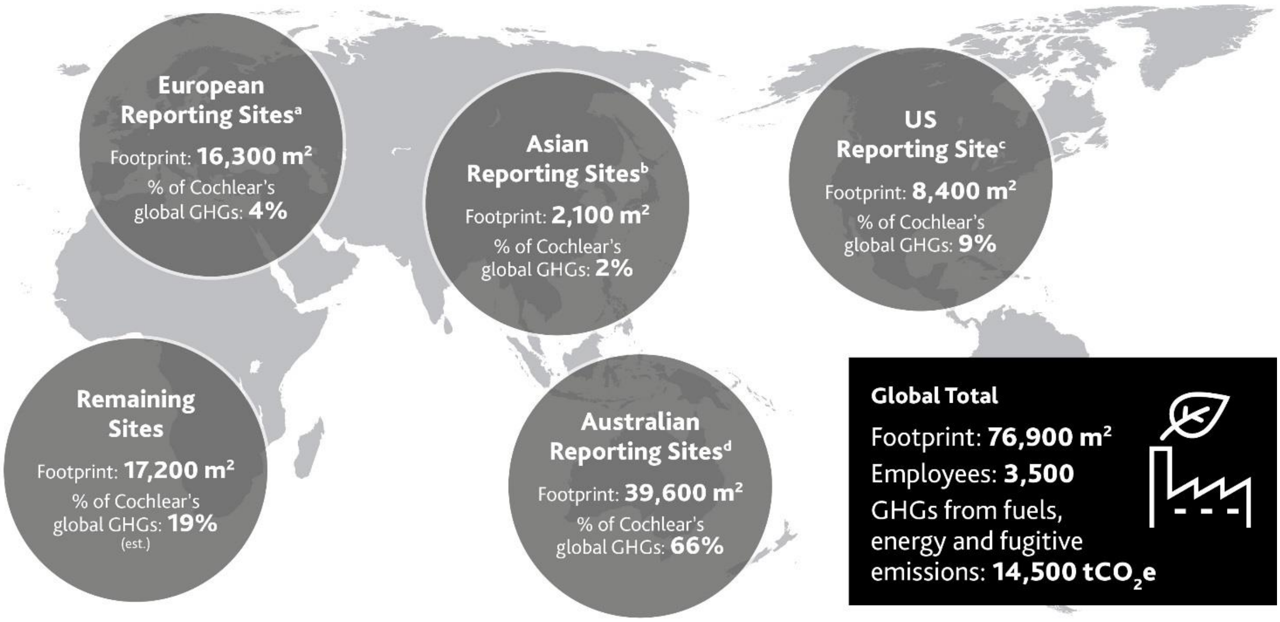
Our reported emissions consist of those from natural gas and other fuel use, and fugitive CO_2 emissions (scope 1) and GHG emissions from purchased energy use (scope 2). GHG emissions from employee business flights (scope 3) are also being monitored to support identification of reduction initiatives. Cochlear is well under the thresholds that require mandatory reporting of energy use and GHG emissions under Australian, UK or USA law. Cochlear's global scope 1 and 2 GHG emissions are less than those generated by 1000 average Australian households per annum (based on Victorian Environmental Protection Authority estimates).

Cochlear is a growing organisation that continues to develop, manufacture and expand its global operations. FY18 is the first baseline year for measuring GHG emissions at our key sites. In order to better measure our environmental impact as we produce more life-changing devices, we use intensity measurements. This will enable year-on-year comparison of GHG emissions.

Environmental measurements	Cochlear EMS sites	Global Cochlear estimate
Annual energy use (MWh)[a]	17,354	22,000
GHGs from fuels, energy and other direct emissions (tCO_2e)[b]	11,491	14,500
GHG emissions intensity ($kgCO_2e$/units)[c]	n/a	90

a directly purchased natural gas and electricity.
b Total scope 1 and 2 GHG emissions.
c Total scope 1 and 2 GHG emissions per unit of production output.

In FY18, Cochlear continued to work to reduce the impacts of its operational activities through new technologies and systems and better management and monitoring of existing assets. Key environmental initiatives centred on energy-efficiency upgrades to existing building fixtures and fittings. Cochlear's main manufacturing operations, and the majority of GHG emissions, currently occur in Australia. For this reason, sustainability initiatives currently centre on our Australian sites.



a European Reporting Sites: Weybridge (UK), Mechelen (Belgium) and Göteborg (Sweden)
b Asian Site: Kuala Lumpur (Malaysia)
c American Reporting Site: Denver (Colorado, USA)
d Australian Reporting sites: Macquarie University (NSW), Lane Cove (NSW), Brisbane (QLD) and Melbourne (VIC)

Initiatives planned over the next year to help reduce greenhouse gas emissions, include:

- Installation of solar panels and energy-efficient lighting upgrades at our Macquarie University headquarters;
- Heating, ventilation and air conditioning energy-efficiency initiatives and installation of solar panels at our Lane Cove manufacturing facility;
- Installation of power correction at our Brisbane manufacturing plant; and
- Installation of energy-efficient fixtures and fittings in our office expansion in Belgium.

Waste reduction

In FY18, Cochlear commenced implementation of improved education and infrastructure to encourage increased recycling of paper, cardboard, glass, plastic and metal at most sites. Reduction of waste, and an increased recycling rate, will continue to be a focus in the coming year.

Supplier screening

Our environmental impact extends beyond our operations to those in our supply chain. In recognition of this, we have established a Supplier Code of Conduct and we are currently improving our supplier due diligence assessments to support sustainable and ethical procurement.

We will be publishing an Environment, Social and Governance Report later this year, which will provide more information on Cochlear's environmental sustainability metrics and activities.

People & Culture

People and culture are pivotal to Cochlear successfully delivering its business strategy. With an ambitious growth agenda, we must not only attract and recruit the best talent, we must also optimise and develop the talented and diverse global workforce we already have. We believe that building a safe, healthy, high performance culture where our employees are valued, engaged and rewarded, strengthens our ability to deliver on our business goals. This will allow us to continue to innovate and offer an life-changing experience to our customers.

Attract and recruit talent

In FY18, Cochlear grew to over 3,500 employees with significant growth in the sales, customer service and marketing segments to support business growth. We believe that a workforce with a wide range of experiences and perspectives will best support delivery of the Company's strategic priorities. Through our Hiring Manager Excellence program, which over 150 of our managers have now attended, we continue to focus on building a diverse workforce throughout our business, with a particular focus on increasing female representation at all stages of the hiring process.

Female participation in technical careers in science, technology, engineering and maths (STEM) is comparatively low in many of our markets despite the great potential benefit. Cochlear works closely with a number of schools, colleges and universities, to promote the benefits of pursuing study and careers in these fields and this year hosted over 1,000 students at open days across Australia.

We highly value the pipeline of future talent we build through our graduate and intern programs which continue to attract a high standard of applicants. We also work in partnership with The Smith Family and the Business Council of Australia to support the Cadetship to Career program where the aim is to provide disadvantaged students with work experience to help them explore their future career options.

Optimise and develop our talent

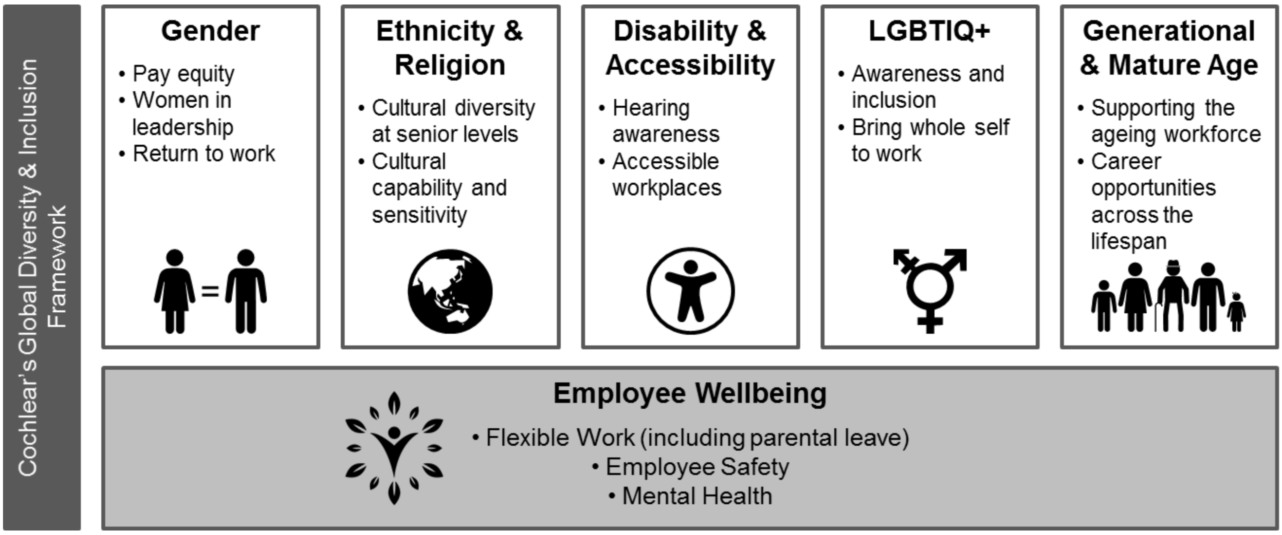
The continual development of our workforce is a critical part of our business strategy. Our talent development initiatives focus on all stages of careers, ensuring employees, regardless of tenure, are able to develop both the knowledge and skills to be successful in their role and fulfil their potential. We have introduced a new global onboarding pathway to set all new employees up for success in their new roles, whether they are entering the workforce for the first time as a student or joining us as an experienced professional.

We continue to embed our Leading the Way leadership competency framework built around the four pillars of Leading Self, Leading Teams, Leading Results and Leading Strategy. The focus for FY18 has been Leading Self and Leading Teams and in our global roll-out, over 800 employees have attended a program, including 60% of our manager population.

Build a diverse and inclusive workplace

At Cochlear, we believe in fostering a supportive environment, one that values and encourages the ideas, capabilities and experiences of our global workforce. We focus on creating a safe and inclusive workplace where everyone feels they can contribute and realise their full potential. Cochlear's workforce is ethnically diverse, with employees from more than 75 nationalities working in the Company's offices around the globe.

This year saw the launch of our new global diversity and inclusion strategy focusing on the five pillars of Gender, Ethnicity & Religion, Disability & Accessibility, LGBTIQ+ and Generational & Mature Age, all underpinned by our overarching goal to ensure and support employee wellbeing. As a priority, Cochlear promotes gender equality and supports the equal participation of men and women in the workplace.



Our ongoing commitment towards increasing female representation at all levels of our organisation remains a core focus of our recruitment and talent management processes as we recognise gender equality in the workplace is instrumental to driving change in the broader community. Our workforce is currently 52% female and in FY18, 56% of our new hires were female.

Support the health and wellbeing of our workforce

Cochlear has a comprehensive approach to safety and wellness and works towards providing a safe, healthy and supportive workplace for all employees in all of Cochlear's workplaces. The safety and wellness strategy and plan are aligned to Cochlear's overall business strategy.

During FY18, there was a substantial shift towards ensuring that we have consistent standards of safety and wellness globally with the establishment of a Global Safety and Wellness Framework, providing a platform for consistent and best practice in safety and wellness across all areas of Cochlear. We developed strategies to support the sustainability of our ageing workforce with a focus on holistic health promotion and injury prevention.

We also delivered improvements in our key risk areas of musculoskeletal stress and psychological stress with a focus on injury prevention, with the development of an early intervention program for musculoskeletal risks, and continuing programs such as psychological first responder training and initiatives focused on supporting good mental health.

Reward and engage our talent

Our H.E.A.R. (Hear the Customer; Embrace Change and Innovate; Aspire to Win; and Remove Boundaries) behaviours are integral to the way we behave and how we do business. We continue to embed them in our systems, policies and processes from recruitment of our talent, through to our performance management processes, leadership development and employee recognition and reward programs.

The success of our mission depends on our ability to inspire and engage our employees and their feedback is important to us. In FY18, more than 91% of our employees completed our global engagement survey, our best ever participation rate. Our overall engagement score was 78%, with 91% of employees feeling proud to tell people they work for Cochlear.

Cochlear is also committed to building a high performance culture, an important element of which is setting clear goals and expectations in line with business strategy. We have made significant progress in this regard, with responses from our engagement survey demonstrating that employees have a clear understanding of how their individual role contributes to our business strategy (91%) and to the satisfaction of our end customers (93%). A strong emphasis on encouraging open and honest communication and supporting our employees to own and drive engagement is a focus area for the coming year.

Board of directors

Rick Holliday-Smith

Chairman Age 68

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

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

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

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

Qualifications: BA (Hons), FAICD, CA

Dig Howitt

CEO & President and Managing Director Age 50

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

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

Qualifications: BE (Hons), MBA

Yasmin Allen

Non-executive Director Age 54

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

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

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

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

Qualifications: BCom, FAICD

Prof Edward Byrne, AC

Non-executive Director Age 66

Appointed to the Board 1 July 2002: Member of the Medical Science, Nomination and Technology & Innovation Committees.

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

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

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

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

Andrew Denver

Non-executive Director Age 69

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

Background: Extensive experience in the life sciences industry. Former director of Principals Cornerstone Management Pty Limited. Former Managing Director of Memtec Limited and President Asia for Pall Corporation.

Other boards: Chairman, SpeeDx Pty Ltd and Director, Vaxxas and QBiotics.

Former directorships: Executive Chairman, Universal Biosensors.

Qualifications: BSc (Hons), MBA, FAICD

Donal O'Dwyer

Non-executive Director Age 64

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

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

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

Qualifications: BE Civil, MBA

Glen Boreham, AM

Non-executive Director Age 53

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

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

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

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

Qualifications: BEc, FAICD

Alison Deans

Non-executive Director Age 50

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

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

Other boards: Director, Westpac Banking Corporation, Senior Advisor to McKinsey & Company, member of Investment Committee, Main Sequence Ventures, Director of SCEGGS Darlinghurst Limited.

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

Qualifications: BA, MBA, GAICD

Prof Bruce Robinson, AM

Non-executive Director Age 61

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

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

Other boards: Chairman, National Health and Medical Research Council and Medical Benefits Schedule Review Taskforce. Director, MaynePharma, QBiotics and Digital Health Agency CRC Pty Limited.

Former directorships: Director of Firefly.

Qualifications: MD, MSc, FRACP, FAAHMS, FAICD

Executive team

Dig Howitt

CEO & President

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

Qualifications: BE (Hons), MBA

Brent Cubis

Chief Financial Officer

Brent joined Cochlear in February 2017 and has over 30 years' experience working in senior finance roles across a broad range of companies and industries. He is responsible for accounting, corporate finance, treasury, audit, and investor relations. Prior to joining Cochlear, Brent worked for companies including National Home Doctor Service, Fitness First, Chris O'Brien Lifehouse, PBL Media (Nine Network and ACP Magazines), Bankers Trust, Westfield, Sheraton Hotels and Deloitte.

Qualifications: BComm, CA

Jan Janssen

Chief Technology Officer

Jan leads a team of over 300 highly qualified engineers and scientists who implement the R&D strategy. This includes responsibility for identifying and developing cutting-edge technologies and commercial products.

Jan joined Cochlear in 2000 as Head of the Cochlear Technology Centre based in Belgium, having previously worked with Philips Electronics where he was involved in R&D in the fields of high-tech electronics and cochlear implants. Jan was promoted to Senior Vice President, Design and Development of Cochlear in 2005 and became the Chief Technology Officer in 2017.

Qualifications: MScEE

Tony Manna

President,
Americas Region

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

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

Qualifications: BS EET

Richard Brook

President, EMEA & Latin American Region

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

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

Qualifications: BSc Management, MBA

Anthony Bishop

President,
Asia Pacific Region

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

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

Qualifications: BBus (Hons), MManagement

Rom Mendel

President, Acoustics

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

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

Qualifications: MSc International Business, BSc

Stu Sayers

President, Services

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

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

Qualifications: BEc (Hons), MBA

Dean Phizacklea

Senior Vice President, Global Marketing

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

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

Qualifications: BSc Microbiology, MBA

David Cade

Chief Medical Officer

David joined Cochlear in October 2017 as Chief Medical Officer. Prior to joining Cochlear, he worked at Sirtex Medical Ltd, an ASX listed oncology company where he held positions in the USA, Europe and Australia. David was the Chief Medical Officer for Sirtex Medical Ltd, a position he held since 2012. Earlier in his career, David trained in general and plastic surgery at Monash Medical Centre in Melbourne Australia and worked at management consultancy, Booz & Company.

Qualifications: MBBS, MBA, GAICD

David Hackshall

Chief Information Officer

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

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

Qualifications: DipFN, MIT, MBA

Greg Bodkin

Senior Vice President, Supply Chain & Operational Excellence

Greg has responsibility for around 1,000 Cochlear employees who work in the supply chain functional areas of new product industrialisation, procurement, manufacturing, logistics and warranty & repair. These functions have responsibility for enabling the technologies developed in design and development to be supplied as commercial products in Cochlear global markets. In addition to these functions, he also has responsibility for the Cochlear program office and management of the global property portfolio.

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

Qualifications: BE (Hons), MComm (UNSW)

Jennifer Hornery

Senior Vice President, People & Culture

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

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

Qualifications: BComm, MBA

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

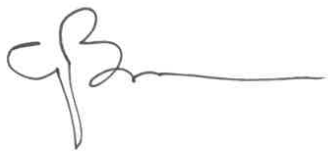
Dear Shareholders,

On behalf of the Cochlear Board, I am pleased to present Cochlear's FY18 Remuneration report where we outline Cochlear's remuneration strategy, summarise the performance outcomes of this past year, and the associated remuneration outcomes for Cochlear's executives. This report also covers the fee arrangements for non-executive directors (NEDs).

The Board remains committed to a strong growth focus and designs its executive remuneration strategies to direct behaviours towards achieving sustainable growth in shareholder value over the long term. Cochlear's policies must also be flexible enough to enable the Company to attract, motivate and retain high performing executives across many locations in a dynamic environment. In FY18, the P&CC reviewed Cochlear's executive remuneration framework to ensure it continues to align with business objectives, performance and shareholder expectations. No significant changes have been planned for FY19, however, a review is underway in relation to Cochlear's long-term incentive (LTI) plan for implementation in future years.

The Board views that it was another successful year for Cochlear and is satisfied that key performance targets were met for FY18. Cochlear has achieved strong growth in sales revenue and earnings before interest and tax (EBIT), relative total shareholder return (TSR) against the ASX 100 at the 97th percentile and growth in basic earnings per share (EPS) representing a 18.6% compound annual growth rate (CAGR) over the last three years. As a result of these strong results, incentives were awarded to the CEO & President (CEO&P) and executives under the FY18 short-term incentive (STI) and the FY16-18 LTI plans. Further detail on this year's remuneration outcomes are provided in this report.

The Board believes Cochlear's approach to Board and executive remuneration remains balanced, fair and equitable and rewards and motivates a successful and experienced executive team to deliver ongoing business growth and manage the risks of the business, which meets the expectations of shareholders over the long term.



Glen Boreham, AM
Chairman, People & Culture Committee

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Cochlear is a complex and geographically diverse business, subject to rapid and changing competitive forces, technical innovation and with a long history of growth. Cochlear's remuneration policies must be flexible enough to enable the Company to attract, motivate and retain high performing executives across many locations in a dynamic environment.

This report covers:

1. KEY MANAGEMENT PERSONNEL

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

Name	Position	Term as KMP
Non-Executive Directors		
Rick Holliday-Smith	Chairman	Full year
Yasmin Allen	Non-executive Director	Full year
Glen Boreham, AM	Non-executive Director	Full year
Edward Byrne, AC	Non-executive Director	Full year
Alison Deans	Non-executive Director	Full year
Andrew Denver	Non-executive Director	Full year
Donal O'Dwyer	Non-executive Director	Full year
Bruce Robinson, AM	Non-executive Director	Full year
Executive KMP		
Dig Howitt	CEO & President (CEO&P) (appointed 3 January 2018) President (31 July 2017 to 2 January 2018) Chief Operating Officer (until 30 July 2017)	Full year
Anthony Bishop	President, Asia Pacific Region	Full year
Richard Brook	President, EMEA & Latin American Region	Full year
Brent Cubis	Chief Financial Officer	Full year
Jan Janssen	Chief Technology Officer (appointed 1 October 2017) Senior Vice President, Design and Development, Clinical and Regulatory (1 July 2017 to 30 September 2017)	Full year
Tony Manna	President, Americas Region	Full year
Former executive KMP		
Chris Smith	Former CEO & President	Part year until 2 January 2018

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

2. EXECUTIVE KMP REMUNERATION RECEIVED IN FY18 (UNAUDITED)

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

The figures presented below are different to the statutory disclosures in section 5 which are prepared in accordance with the accounting standards and therefore include the accounting value for all unvested deferred STI and LTI awards expensed in the year. The table below has been provided voluntarily to ensure shareholders are able to clearly understand the remuneration outcomes and actual 'take-home pay' of executive KMP for FY18.

Amounts $	Year	Fixed remuneration[1]	Cash STI[2]	Vested deferred STI[3]	Vested LTI[4]	End of service	Total
Executive KMP							
Dig Howitt	**FY18**	**1,547,833**	**1,135,893**	**167,895**	**1,084,544**	**-**	**3,936,165**
	FY17	675,381	415,368	99,774	1,428,167	-	2,618,690
Anthony Bishop[5]	**FY18**	**496,754**	**222,571**	**-**	**-**	**-**	**719,325**
	FY17	448,010	217,735	-	-	-	665,745
Richard Brook	**FY18**	**1,077,831**	**374,457**	**228,060**	**981,182**	**-**	**2,661,530**
	FY17	1,003,249	370,182	138,762	869,316	-	2,381,509
Brent Cubis[5]	**FY18**	**605,656**	**304,304**	**-**	**-**	**-**	**909,960**
	FY17	166,765	97,857	-	-	-	264,622
Jan Janssen	**FY18**	**672,817**	**370,955**	**185,378**	**1,100,132**	**-**	**2,329,282**
	FY17	588,976	347,930	101,312	729,195	-	1,767,413
Tony Manna	**FY18**	**767,602**	**379,388**	**242,865**	**-**	**-**	**1,389,855**
	FY17	708,418	332,891	189,907	-	-	1,231,216
Former executive KMP							
Chris Smith[6]	**FY18**	**1,388,677**	**517,468**	**319,253**	**1,523,883**	**1,452,589**	**5,201,870**
	FY17	1,769,960	1,445,173	167,548	1,320,878	-	4,703,559

1. Fixed remuneration earned in the year (base salary, superannuation and non-monetary benefits which may include insurances and car allowances). For FY17, fixed remuneration has been restated to remove the long service leave accrual previously included.
2. Cash STI earned and relating to performance during the financial year. For example, FY18 is reported as first half STI payments received in March 2018, and second half STI payments which are accrued at year end, and received in August 2018, after the reporting year end.
3. Vested deferred STI is the value of the deferred STI from prior years that vested in August of the reported financial year (calculated as the number of rights that vested multiplied by the share price on the vesting date). For example, FY18 is reported as the FY15 deferred STI grant which vested in August 2017.
4. Vested LTI is the value of performance rights and options that vested in August of the reported financial year (rights are calculated as the number of rights that vested multiplied by the share price on the vesting date and options are calculated as the number of options multiplied by the share price on the date of vesting/exercise less the exercise price). For example, FY18 is reported as the FY15 LTI grant which vested in August 2017.
5. Anthony Bishop was promoted to a KMP role on 18 July 2016 and Brent Cubis became a KMP on 13 March 2017. Values included in this table relate to the period they were KMP.
6. The end of service payment provided to Chris Smith is per the terms of the retirement arrangements disclosed to the market on 31 July 2017 and relate to a payment in lieu of notice of AUD 1,452,588.89. Refer to section 6.2 for further detail.

3. OUR REMUNERATION STRATEGY AND FRAMEWORK

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

Our mission

We help people hear and be heard. We empower people to connect with others and live a full life.
We innovate and bring to market a range of implantable hearing solutions that deliver a lifetime of hearing outcomes.

We deliver this through our corporate strategy…

Retain market leadership

Grow the hearing implant market

Deliver consistent revenue and earnings growth

…which is reflected in performance measures across Cochlear's incentive plans…

Earnings before interest and tax (EBIT)

Sales revenue

Achievement of business priorities and growth initiatives

Relative total shareholder return (TSR)

Compound annual growth in earnings per share (EPS)

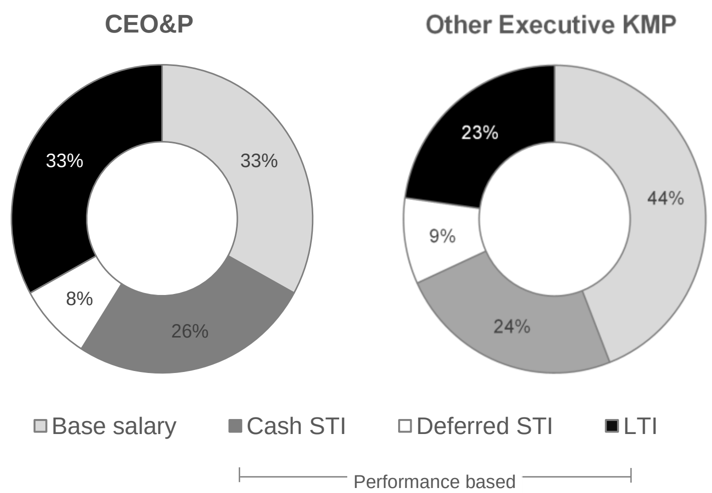
…and actual outcomes directly drive executive remuneration

Fixed remuneration + **Short-term incentive** + **Long-term incentive** = **Total remuneration**

3.1 Target remuneration mix

The remuneration mix for executive KMP is weighted towards at-risk performance based remuneration to ensure a strong focus on short, medium and long-term performance. A portion of executive remuneration is paid in equity (approximately, 40% for the CEO&P and 32% for other executive KMP) to align our executives with shareholder interests.

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



3.2 Fixed remuneration

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

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

3.3 Short-term incentive

<table>
<tr><td>Purpose</td><td>To reward executives for the achievement of group (for group executives) and regional (for regional executives) sales revenue, EBIT and strategic performance targets set by the Board at the beginning of the performance period.</td></tr>
<tr><td>Performance measures</td><td>STI is dependent on meeting financial and strategic performance measures:
<table>
<tr><th>Performance measure and weighting</th><th>Description</th></tr>
<tr><td>Sales revenue and EBIT (60%)</td><td>

Sales revenue and EBIT were selected as they represent the key measures of short-term financial success of Cochlear.
Financial targets are set by the Board, having regard to prior year performance, global market conditions, competitive environment, future prospects and the Board approved budgets. The specific targets are not disclosed to the market due to their commercial sensitivity.
The weighting between Cochlear group and regional financial goals depends on the responsibilities and scope of influence of the individual.
Validation of performance against the measures set for:

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

Any anomalies or discretionary elements are validated and approved by the Board.
</td></tr>
<tr><td>Strategic measures (40%)</td><td>

Strategic measures were selected to recognise that in addition to short-term financial results, a number of strategic initiatives are required to enable sustained growth over time.
Measures are agreed with the P&CC at the commencement of each financial year and are aligned to the delivery of initiatives that support Cochlear's strategic priorities.
Each executive's contribution against the strategic measures is assessed at an individual level at the end of the performance period. This assessment determines the level at which awards will be made for the strategic measures component of the award.
</td></tr>
</table>
Refer to section 4 for further detail on measures for FY18.</td></tr>
<tr><td>Opportunity</td><td>CEO&P: target opportunity is 100% of base salary, and maximum is up to 180% of base salary.
Other executive KMP: target opportunity ranges from 70% to 75% of base salary, and maximum is up to 126% to 135% of base salary.</td></tr>
<tr><td>Delivery</td><td>A portion of the award is paid in cash twice a year, with the remainder deferred into service rights for a period of two years (subject to a service condition) in order to reinforce alignment to longer-term shareholder interests and for retention purposes. For the CEO&P, 24% of the award is deferred and for other executive KMP, 27% to 29% of the award is deferred.
The number of rights to be allocated is calculated using the 'gross contract value', which refers to a Black-Scholes-Merton pricing model without discounting for service or performance hurdles. The model uses Cochlear's five day volume-weighted average share price following the announcement of full year results in August each year.</td></tr>
<tr><td>Cessation of employment</td><td>Prior to STI payment date: if an executive ceases employment with Cochlear prior to any awards being paid, unless the Board determines otherwise, the executive will forfeit any awards to be paid for the performance period.
Post STI payment date: if an executive is dismissed for serious misconduct or resigns from their position after STI (equity) awards have been allocated but prior to the relevant vesting date, any unvested rights will generally be forfeited.</td></tr>
</table>

3.4 Long-term incentive

<table>
<tr><td>Purpose</td><td>To align executive remuneration opportunity with shareholder value and provide a stimulus for the retention of executives within the Company.</td></tr>
<tr><td>Award vehicle</td><td>LTI is delivered in the form of options and performance rights.

A minimum 30% of the LTI value must be taken as options. This ensures that the share price at vesting/exercise must be greater than share price at grant in order for any reward to be delivered for at least 30% of the LTI. The remaining 70% of the LTI value is at the election of each executive to choose either options or performance rights.</td></tr>
<tr><td>Opportunity</td><td>CEO&P: maximum opportunity is 100% of base salary.
Other executive KMP: maximum opportunity ranges from 30% to 50% of base salary.</td></tr>
<tr><td>Allocation method</td><td>The LTI opportunity is calculated using the ‘gross contract value’, which refers to a Black-Scholes-Merton pricing model without discounting for service or performance hurdles.

Cochlear has considered feedback from shareholders and maintains that the methodology of using the gross contract value for allocating options and performance rights remains appropriate considering the current design of Cochlear’s LTI plan. Gross contract value discounts for dividends, share price volatility and the risk free rate of return. There is no discount for the likelihood of service or performance conditions. The model uses Cochlear’s five day volume-weighted average price following the announcement of full year results in August each year.</td></tr>
<tr><td>Performance period</td><td>Performance is measured over a three year performance period.
Post vesting, options expire seven months after the vesting date if they have not been exercised.
There is no retesting of performance hurdles under the LTI plan.</td></tr>
<tr><td>Performance measures and hurdles</td><td>Awards are subject to:
• 50% weighting on relative TSR against the constituents of the ASX 100 index; and
• 50% weighting on CAGR in EPS.

These measures have been selected to incentivise executives towards long-term sustainable growth of the business and are generally accepted proxies for the creation of shareholder value.

The proportion of awards that vest for performance are:
<table>
<tr><th colspan="2">Relative TSR</th></tr>
<tr><th>Performance</th><th>% of instruments that vest</th></tr>
<tr><td>Less than 50th percentile</td><td>0%</td></tr>
<tr><td>At the 50th percentile</td><td>40%</td></tr>
<tr><td>50th percentile to 75th percentile</td><td>40% to 100% (pro-rata)</td></tr>
<tr><td>Above 75th percentile</td><td>100%</td></tr>
</table>
<table>
<tr><th colspan="2">EPS</th></tr>
<tr><th>Performance (CAGR)</th><th>% of instruments that vest</th></tr>
<tr><td>Less than 10%</td><td>0%</td></tr>
<tr><td>10%</td><td>50%</td></tr>
<tr><td>10% to 20%</td><td>50% to 100% (pro-rata)</td></tr>
<tr><td>Above 20%</td><td>100%</td></tr>
</table>
Cochlear’s performance hurdles are high compared to market practice (ASX 100 companies). Further, any LTI awards in equity grants will only have value to the executive if the performance hurdles are met to enable vesting to occur. LTI awards delivered in options will only have value to the executive if the share price on vesting exceeds the exercise price.</td></tr>
<tr><td>Dividends</td><td>No dividends are attached to options or performance rights.</td></tr>
<tr><td>Cessation of employment</td><td>If an executive ceases employment before the end of the performance period, unvested LTI awards will be forfeited.

In exceptional circumstances such as in the case of redundancy and retirement, the Board may in its discretion, determine that all or a portion of the award will vest in line with the original performance criteria and vesting date.</td></tr>
</table>

Further detail on the remuneration framework is provided in Cochlear’s Remuneration Policy, available in the Corporate Governance section of the Cochlear website (www.cochlear.com > About Us > Investor Centre > Corporate Governance > Company Policies > Learn More > Remuneration Policy).

4. EXECUTIVE KMP REMUNERATION AND LINK TO PERFORMANCE

4.1 FY18 STI outcomes

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

In FY18, Cochlear's sales revenue grew by 9% and EBIT grew by 10%. In addition to financial measures, the Board also considered progress against strategic measures which are critical to the achievement of Cochlear's longer-term goals.

The table below provides a summary and achievement against each of the financial measures and strategic measures of the STI plan.

	Strategic priority	Business priority	Description	Achievement
Strategic measures (40%)	Retain market leadership	• Launch new products • Build the upgrade business • Continue to develop new products • Develop organisational talent and capability • Implement the digital strategy • Develop partnerships and alliances • Implement One Cochlear • Increase recipient engagement	• Launched Nucleus 7 and Baha SoundArc • Implemented campaigns to increase upgrades • Developed new products in line with the roadmap • Increased organisational capability through skill and leadership development • Developed the connected health strategy • Leveraged commercial and technology relationships, and realised value from investments • Improved customer service and efficiency by standardising and improving processes/systems and continuing global alignment of corporate functions • Implemented initiatives to improve the customer experience	
	Grow the hearing implant market	• Increase access and public policy • Implement direct-to-consumer	• Developed a plan to increase access and public policy • Generated demand from new candidates	
Financial measures (60%)	Deliver consistent revenue and earnings growth	• Achieve the FY18 financial targets	• Met guidance provided to the market (net profit of $240-$250 million) • Sales revenue grew by 9% • EBIT grew by 10%	

= Below expectations = Met expectations = Exceeded expectations

In FY18, performance was strong, reflecting the achievement across financial measures and strategic measures. These performance outcomes resulted in an average actual STI of 98.9% of target for executive KMP.

The FY18 STI earned is outlined in the table below.

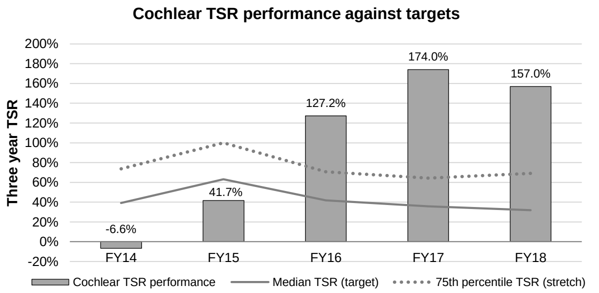
	STI target as a % of base salary	STI maximum as a % of base salary	Actual as a % of target	Actual as a % of maximum	STI forfeited as a % of maximum	Actual STI (total)
Executive KMP						
Dig Howitt	100%	180%	97.8%	54.3%	45.7%	$1,135,893
Anthony Bishop	70%	126%	94.2%	52.3%	47.7%	$222,571
Richard Brook	75%	135%	100.9%	56.1%	43.9%	$374,457
Brent Cubis	75%	135%	95.8%	53.2%	46.8%	$304,304
Jan Janssen	75%	135%	99.8%	55.4%	44.6%	$370,955
Tony Manna	75%	135%	105.1%	58.4%	41.6%	$379,388

A portion of the actual STI will be delivered in cash in August 2018, and a portion deferred into service rights, and subject to service conditions until August 2020.

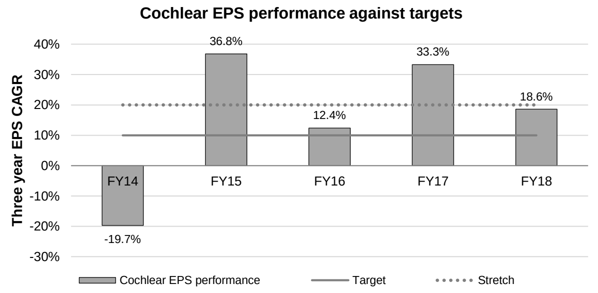
4.2 FY16-18 LTI vesting outcomes

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

For FY18, Cochlear's TSR performance was 157.0%, which was ranked at the 97th percentile of the ASX 100 comparator group. As a result, 100.0% of the TSR portion of the LTI vested.



Cochlear's EPS in FY18 was 427.3 cents, which is a 18.6% CAGR over the three year performance period. This resulted in performance between target and stretch and as a result, 93.0% of the EPS portion of the LTI vested.



For the FY16-18 LTI, 96.5% vests based on performance over the three year period, from 1 July 2015 to 30 June 2018.

4.3 Financial performance history (FY14 to FY18)

	FY14[1]	FY15	FY16	FY17	FY18
Sales revenue ($million)	820.9	941.9	1,158.1	1,239.7	1,351.4
Earnings before interest and tax (EBIT) ($million)	127.1	206.4	262.6	315.6	348.4
Net profit after tax ($million)	93.7	145.8	188.9	223.6	245.8
Basic earnings per share (EPS) (cents)	164.6	256.1	330.6	389.7	427.3
EPS growth (3 year compound annual growth rate)	-19.7%	36.8%	12.4%	33.3%	18.6%
Total dividend per share ($)	2.54	1.90	2.30	2.70	3.00
Share price as at 30 June ($)	61.70	80.15	121.25	155.45	200.17
Relative total shareholder return (TSR) (3 years)	-6.6%	41.7%	127.2%	174.0%	157.0%
TSR percentile ranking[2]	32nd	38th	94th	96th	97th

1. FY14 includes the patent dispute provision of $22.5 million before tax and $15.8 million after tax.
2. TSR ranking is shown over three financial years to 30 June. For LTI, performance is compared to the TSR of the constituents of the ASX 100.

For further explanation of details on Cochlear performance, see the Operating and financial review section on pages 7 to 28 of this Annual Report.

5. EXECUTIVE KMP STATUTORY REMUNERATION DISCLOSURE

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

Amounts $	Year	Short-term benefits			Post-employment	Other long-term benefits	Share based payments			End of service	Total	% of performance related remuneration
		Salary	Cash STI	Non-monetary benefits[1]	Super-annuation contributions	Long service leave	Deferred STI[2]	LTI performance rights[3]	LTI options[3]			
Executive KMP												
Dig Howitt	**FY18**	**1,526,654**	**1,135,893**	**1,130**	**20,049**	**208,620**	**193,952**	**86,856**	**289,019**	**-**	**3,462,173**	**49.27%**
	FY17	654,635	415,368	1,130	19,616	30,074	108,171	81,194	167,851	-	1,478,039	52.30%
Anthony Bishop[4]	**FY18**	**476,065**	**222,571**	**640**	**20,049**	**3,509**	**92,901**	**29,221**	**15,030**	**-**	**859,986**	**41.83%**
	FY17	428,886	217,735	640	18,484	1,838	61,435	22,207	9,579	-	760,804	40.90%
Richard Brook	**FY18**	**686,850**	**374,457**	**252,578**	**138,403**	**-**	**126,234**	**113,054**	**98,182**	**-**	**1,789,758**	**39.78%**
	FY17	665,624	370,182	206,511	131,114	-	119,049	162,060	106,589	-	1,761,129	43.00%
Brent Cubis[4]	**FY18**	**584,967**	**304,304**	**640**	**20,049**	**2,039**	**50,323**	**19,745**	**13,444**	**-**	**995,511**	**38.96%**
	FY17	158,654	97,857	193	7,918	271	11,857	-	-	-	276,750	39.60%
Jan Janssen	**FY18**	**651,638**	**370,955**	**1,130**	**20,049**	**29,297**	**120,001**	**82,666**	**95,900**	**-**	**1,371,636**	**48.81%**
	FY17	568,230	347,930	1,130	19,616	4,274	106,693	109,055	119,446	-	1,276,374	53.50%
Tony Manna	**FY18**	**669,798**	**379,388**	**79,195**	**18,609**	**-**	**121,813**	**37,666**	**116,044**	**-**	**1,422,513**	**46.04%**
	FY17	598,375	332,891	92,122	17,921	-	117,163	34,833	85,037	-	1,278,342	44.60%
Former executive KMP												
Chris Smith[5]	**FY18**	**1,243,327**	**517,468**	**128,547**	**16,803**	**-**	**418,960**	**632,290**	**502,779**	**1,452,589**	**4,912,763**	**42.17%**
	FY17	1,639,249	1,445,173	95,201	35,510	-	318,226	454,134	477,958	-	4,465,451	60.40%
Total	**FY18**	**5,839,299**	**3,305,036**	**463,860**	**254,011**	**243,465**	**1,124,184**	**1,001,498**	**1,130,398**	**1,452,589**	**14,814,340**	**44.29%**
	FY17	4,713,653	3,227,136	396,927	250,179	36,457	842,594	863,483	966,460	-	11,296,889	51.80%

The total remuneration for FY17 of $11,296,889 in this table is less than the total for FY17 in the 2017 Remuneration report of $12,386,865 as it does not include $1,089,476 for the former CFO, Neville Mitchell. Neville Mitchell ceased to be KMP on 13 March 2017 and retired on 1 July 2017, and did not hold a KMP position during FY18 and is therefore not reported in the statutory table above.

1. Non-monetary benefits include housing allowances for expatriate KMP, car allowances and insurances which are market based payments.
2. Deferred STI is granted in service rights and deferred for a further two years. The cost of the plan is expensed across three years. The FY18 amount represents the portion of the FY16, FY17 and FY18 deferred STI expensed in FY18. The FY17 amount represents the portion of the FY15, FY16 and FY17 deferred STI expensed in FY17.
3. LTI is granted in performance rights and options are expensed evenly over the period from grant date to vesting date. The value is calculated at the date of grant using the Black-Scholes-Merton pricing model discounted for vesting probabilities of non-market performance criteria. The amount expensed each reporting period includes adjustments to the life-to-date expense of grants based on the reassessed estimate of achieving non-market performance criteria and final vesting amounts for the non-market performance criteria of performance rights and options. The value disclosed above is the portion of the value of the performance rights and options recognised as an expense in the financial year. The ability to exercise the performance rights and options is conditional on Cochlear achieving certain performance hurdles. Further details of performance rights and options granted during the financial year are set out in this report.
4. Anthony Bishop was promoted to a KMP role on 18 July 2016 and Brent Cubis became a KMP on 13 March 2017. Values included in this table relate to the period they were KMP.
5. Chris Smith retired on 2 January 2018. The share based payment values presented for Chris Smith include an expense of $144,500 for deferred STI, $270,538 for LTI performance rights and $116,759 for LTI options that would normally have been amortised over future years for awards that remain subject to vesting hurdles and timeframes, and LTI may not be paid out if conditions are not met. The end of service payment provided to Chris Smith is per the terms of the retirement arrangements disclosed to the market on 31 July 2017 and relate to a payment in lieu of notice of AUD 1,452,588.89. Refer to section 6.2 for further detail.

6. EXECUTIVE SERVICE AGREEMENTS

6.1 Summary table of service contract details for executives

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

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

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

6.2 End of service for Chris Smith

Chris Smith's retirement arrangements were disclosed to the market on 31 July 2017. On retirement, and per the terms of his contract, the following were provided:

- a payment in lieu of notice of AUD 1,452,588.89;
- payment of accrued but unused annual leave; and
- payment of any unpaid base salary.

The Board applied its discretion to allow prior equity grants to remain on-foot subject to the original terms of those awards (both time and performance hurdles). The awards are detailed in section 8 and are eligible for vesting in August 2018 and August 2019.

7. REMUNERATION GOVERNANCE

7.1 Governance framework for remuneration at Cochlear

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

Management

- Makes recommendations to the P&CC with respect to individual remuneration arrangements for executive KMP and implements talent management and remuneration policies and practices

People & Culture Committee

- The P&CC is empowered to source any internal resources and obtain external independent professional advice it considers necessary to enable it to review management proposals and make decisions on behalf of the Board on:
  - remuneration policy, composition, quantum and performance targets for executive KMP;
  - remuneration policy in respect of NEDs;
  - talent management policies and practices; and
  - design features of employee and executive STI and LTI awards.

Board

- Reviews, applies judgement and, as appropriate, approves recommendations from the P&CC

7.2 Advice from external advisors

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

During FY18, the P&CC appointed Godfrey Remuneration Group (GRG) to provide remuneration advisory services that included a remuneration recommendation for executive remuneration structure and design, and market remuneration information, used as input to the annual review of NED fees and executive KMP remuneration. GRG was paid $110,000 (excluding GST) for these services.

In addition, GRG provided other remuneration advisory services and was paid a total of $48,500 (excluding GST) for these additional services during the year.

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

7.3 Share ownership requirements

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

7.4 Clawback Policy

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

8. EXECUTIVE KMP EQUITY DISCLOSURES

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

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

8.1 Equity granted as remuneration

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

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

	Plan	Grant date	Options		Performance rights		Vesting date[2]	Vested	Forfeited
			Number	Maximum value to be expensed ($)[1]	Number	Maximum value to be expensed ($)[1]			
Executive KMP									
Dig Howitt	FY15 LTI	14-Oct-14	10,970	-	2,133	-	Aug-17	100%	0%
	FY15 deferred STI	18-Aug-15	-	-	1,066	-	Aug-17	100%	0%
	FY16 LTI	20-Oct-15	18,682	-	-	-	Aug-18		
	FY16 deferred STI	16-Aug-16	-	-	785	-	Aug-18		
	FY17 LTI	19-Oct-16	10,375	43,033	1,537	42,709	Aug-19		
	FY17 deferred STI	24-Aug-17	-	-	949	46,172	Aug-19		
	FY18 LTI	18-Oct-17	46,842	347,724	3,372	93,775	Aug-20		
	Total		**86,869**	**390,757**	**9,842**	**182,656**			
Anthony Bishop	FY16 deferred STI	16-Aug-16	-	-	752	-	Aug-18		
	FY17 LTI	19-Oct-16	2,171	9,005	751	20,868	Aug-19		
	FY17 deferred STI	24-Aug-17	-	-	596	28,997	Aug-19		
	FY18 LTI	18-Oct-17	1,778	13,199	697	19,384	Aug-20		
	Total		**3,949**	**22,204**	**2,796**	**69,249**			
Richard Brook	FY15 LTI	14-Oct-14	7,256	-	3,293	-	Aug-17	100%	0%
	FY15 deferred STI	18-Aug-15	-	-	1,448	-	Aug-17	100%	0%
	FY16 LTI	20-Oct-15	12,601	-	2,402	-	Aug-18		
	FY16 deferred STI	16-Aug-16	-	-	833	-	Aug-18		
	FY17 LTI	19-Oct-16	5,622	23,319	1,944	54,019	Aug-19		
	FY17 deferred STI	24-Aug-17	-	-	944	45,929	Aug-19		
	FY18 LTI	18-Oct-17	6,965	51,704	1,170	32,538	Aug-20		
	Total		**32,444**	**75,023**	**12,034**	**132,486**			
Brent Cubis	FY17 deferred STI	24-Aug-17	-	-	243	11,823	Aug-19		
	FY18 LTI	18-Oct-17	3,622	26,887	1,420	39,490	Aug-20		
	Total		**3,622**	**26,887**	**1,663**	**51,313**			
Jan Janssen	FY15 LTI	14-Oct-14	11,127	-	2,164	-	Aug-17	100%	0%
	FY15 deferred STI	18-Aug-15	-	-	1,177	-	Aug-17	100%	0%
	FY16 LTI	20-Oct-15	9,736	-	1,856	-	Aug-18		
	FY16 deferred STI	16-Aug-16	-	-	775	-	Aug-18		
	FY17 LTI	19-Oct-16	7,900	32,767	1,171	32,539	Aug-19		
	FY17 deferred STI	24-Aug-17	-	-	867	42,182	Aug-19		
	FY18 LTI	18-Oct-17	7,060	52,409	1,186	32,983	Aug-20		
	Total		**35,823**	**85,176**	**9,196**	**107,704**			
Tony Manna	FY15 deferred STI	18-Aug-15	-	-	1,542	-	Aug-17	100%	0%
	FY16 LTI	20-Oct-15	10,216	-	834	-	Aug-18		
	FY16 deferred STI	16-Aug-16	-	-	743	-	Aug-18		
	FY17 LTI	19-Oct-16	9,414	39,047	598	16,617	Aug-19		
	FY17 deferred STI	24-Aug-17	-	-	995	48,410	Aug-19		
	FY18 LTI	18-Oct-17	10,385	77,091	436	12,125	Aug-20		
	Total		**30,015**	**116,138**	**5,148**	**77,152**			
Former executive KMP									
Chris Smith	FY15 LTI	14-Oct-14	15,412	-	2,998	-	Aug-17	100%	0%
	FY15 deferred STI	18-Aug-15	-	-	2,027	-	Aug-17	100%	0%
	FY16 LTI	20-Oct-15	69,047	-	5,641	-	Aug-18		
	FY16 deferred STI	16-Aug-16	-	-	2,787	-	Aug-18		
	FY17 LTI	19-Oct-16	28,150	-	9,736	-	Aug-19		
	FY17 deferred STI	24-Aug-17	-	-	2,970	-	Aug-19		
	Total		**112,609**	**-**	**26,159**	**-**			

1. The options granted in FY18 have an exercise price of $154.73 and an expiry date of 23 March 2021. Fair values (IFRS-2) of FY18 options and performance rights under the LTI plan as at the date of grant are as follows: options (EPS growth: $23.91; relative TSR: $22.27) and performance rights (EPS growth: $142.31; relative TSR: $83.43). This valuation is for accounting purposes only and reflects the expense in future years. Further detail on the allocation methodology is provided in section 3.4.
2. To ensure plans vest as close to the end of the performance period as possible, from FY18, vesting will be aligned to the day following the full year results announcement in August each year.

8.2 Executive KMP equity holdings and minimum shareholding

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

Shares held during the year

During the year, the FY15 LTI plan and FY15 deferred STI plan vested and executives' options/rights converted into shares under these plans.

	Balance 1 July 2017	Purchases	Received on exercise of options/rights	Sales	Balance 30 June 2018
Executive KMP					
Dig Howitt	22,112	-	14,169	(5,000)	31,281
Anthony Bishop	-	-	-	-	-
Richard Brook	8,000	-	11,997	(14,997)	5,000
Brent Cubis	-	-	-	-	-
Jan Janssen	20,684	-	14,468	(23,366)	11,786
Tony Manna	817	-	1,542	(1,303)	1,056
Former executive KMP					
Chris Smith	18,000	-	20,437	(25,437)	N/A
Total	**69,613**	**-**	**62,613**	**(70,103)**	**49,123**

Rights held during the year

Rights are acquired by executive KMP under the deferred STI and LTI plan. During the year, the FY17 STI deferral grant was made in August 2017 (based on the FY17 performance year), the FY18 LTI grant was made in October 2017 and 100% of the FY15 LTI grant and FY15 deferred STI grant vested in August 2017.

	Balance 1 July 2017	Deferred STI			LTI performance rights			Balance 30 June 2018
		Granted	Vested	Forfeited	Granted	Vested	Forfeited	
Executive KMP								
Dig Howitt	5,521	949	(1,066)	-	3,372	(2,133)	-	6,643
Anthony Bishop	1,503	596	-	-	697	-	-	2,796
Richard Brook	9,920	944	(1,448)	-	1,170	(3,293)	-	7,293
Brent Cubis	-	243	-	-	1,420	-	-	1,663
Jan Janssen	7,143	867	(1,177)	-	1,186	(2,164)	-	5,855
Tony Manna	3,717	995	(1,542)	-	436	-	-	3,606
Former executive KMP								
Chris Smith	23,189	2,970	(2,027)	-	-	(2,998)	-	N/A
Total	**50,993**	**7,564**	**(7,260)**	**-**	**8,281**	**(10,588)**	**-**	**27,856**

Options held during the year

Options over ordinary shares are acquired by executive KMP under the LTI plan. During the year, the FY18 LTI grant was made in October 2017 and 100% of the FY15 LTI grant vested in August 2017.

All options held at the end of the year are unvested. Under the current structure of the LTI plan, it is no longer possible to hold options at year end which are vested but unexercised.

	Balance	LTI options			Balance
	1 July 2017	Granted	Vested/exercised	Forfeited	30 June 2018
Executive KMP					
Dig Howitt	40,027	46,842	(10,970)	-	75,899
Anthony Bishop	2,171	1,778	-	-	3,949
Richard Brook	25,479	6,965	(7,256)	-	25,188
Brent Cubis	-	3,622	-	-	3,622
Jan Janssen	28,763	7,060	(11,127)	-	24,696
Tony Manna	19,630	10,385	-	-	30,015
Former executive KMP					
Chris Smith	112,609	-	(15,412)	-	N/A
Total	**228,679**	**76,652**	**(44,765)**	**-**	**163,369**

Executive minimum shareholding

Executive KMP are requested to retain vested equity until they hold and maintain a holding of Cochlear shares equivalent to their annual salary in the previous year. The Board considers the minimum shareholding guidelines to be best practice to strengthen the alignment of executives' interests to those of shareholders.

As at 30 June 2018, all executive KMP are compliant with the Share Ownership Policy (minimum shareholding requirements). For new KMP, it is expected that executives will achieve the minimum shareholding requirement over time. The table below presents a summary of executive KMP holdings and compliance with minimum shareholding requirements.

	Shareholding			Unvested awards					Total shareholding and unvested awards	
	Ordinary shares	Value of Cochlear shares at year end ($)[1]	% of base salary[2]	Unvested deferred STI rights	Unvested LTI rights	Unvested LTI options	Intrinsic value of unvested awards ($)[1]	% of base salary[2]	Intrinsic value ($)[1]	% of base salary[2]
Executive KMP										
Dig Howitt	31,281	5,448,145	357%	1,734	4,909	75,899	3,823,204	250%	9,271,349	607%
Anthony Bishop	-	-	-	1,348	1,448	3,949	669,902	141%	669,902	141%
Richard Brook	5,000	870,839	127%	1,777	5,516	25,188	2,537,839	369%	3,408,678	496%
Brent Cubis	-	-	-	243	1,420	3,622	415,175	71%	415,175	71%
Jan Janssen	11,786	2,052,742	315%	1,642	4,213	24,696	2,157,421	331%	4,210,163	646%
Tony Manna	1,056	183,921	27%	1,738	1,868	30,015	1,859,628	278%	2,043,549	305%
Total	**49,123**	**8,555,647**	**186%**	**8,482**	**19,374**	**163,369**	**11,463,169**	**249%**	**20,018,816**	**435%**

1. The intrinsic value of awards is calculated as:
   - shares: calculated using the average daily share price over the previous 12 months ($174.17, rounded to two decimal places), as at closing on the ASX up to 30 June 2018, times the number of shares. The numbers presented in the table above are based on the unrounded average share price;
   - performance rights/deferred rights: calculated as the closing share price on the ASX on 30 June 2018 ($200.17) times the number of rights; and
   - options: calculated as the closing share price on the ASX on 30 June 2018 ($200.17) less the applicable exercise price, times the number of options (negative values are treated as zero in the totals). 50% of the intrinsic value of options is counted.
2. The % of base salary is calculated as the value divided by the actual base salary for the preceding 12 months to 30 June 2018.

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

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

At the date of this report, the number of ordinary shares that would be issued if all options were vested, having met the service and performance conditions, and exercised and assuming ordinary shares were issued, is as follows:

	Grant date	Number of options			Exercise price per share ($)	Exercise period	Current net value of outstanding options as at 30 June 2018 ($)[2]
		Issued	Forfeited/ lapsed[1]	At report date			
FY16 LTI	20-Oct-15	162,451	27,606	134,845	82.89	Aug-18 to Mar-19	15,814,621
FY17 LTI	19-Oct-16	95,586	16,580	79,006	135.84	Aug-19 to Mar-20	5,082,456
FY18 LTI	18-Oct-17	106,713	2,337	104,376	154.73	Aug-20 to Mar-21	4,742,845
Total		**364,750**	**46,523**	**318,227**			**25,639,922**

1. Forfeited/lapsed options from unvested grants relate to plan participants who have departed Cochlear.
2. Closing share price as at 30 June 2018 was $200.17.

Total unvested equity currently accounts for approximately 0.77% of the total number of issued shares, as set out below:

Instrument	Number of equivalent shares at 30 June 2018
Unvested LTI options	318,227
Unvested LTI rights	49,157
Unvested deferred STI rights	70,226
Service rights under the APAC Employee Equity Plan[1]	3,439
Total	**441,049**
as % of total shares	0.77%
Number of issued shares[2]	**57,547,820**

1. Refer to Note 4.3 in the Notes to the Financial Statements for further information on the APAC Employee Equity Plan.
2. 31,268 shares are in a holding lock under the Cochlear Employee Share Plan.

8.4 Transactions and loans with KMP

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

9. NON-EXECUTIVE DIRECTOR FEES

NEDs are paid from an aggregate annual fee pool of $3,000,000, as approved by shareholders at the Annual General Meeting on 17 October 2017. Total remuneration paid during the year was $2,265,233 which is within the fee pool limit (represents 75.5% of fee pool). NEDs do not receive any performance-related remuneration, options or performance rights. NEDs receive reimbursement for costs directly related to Cochlear business.

9.1 Fee policy and changes during the year

Board fees must recognise the effort required to fulfil the responsibilities of a director. Reflecting the increasing governance requirements and the work of the Board, the Board considered it appropriate to increase annual base fees by 4%, and increase annual fees for the P&CC chair and members, effective 1 July 2017. This decision was made with reference to external remuneration benchmarking of companies of a similar market capitalisation to Cochlear.

The table below outlines the policy fees for FY17 and FY18.

Amounts $	FY17[1]		FY18[1]	
	Chair[2]	Member	Chair[2]	Member
Cochlear Board	472,274	154,760	491,165	160,950
Committees				
Audit	50,000	25,000	50,000	25,000
People & Culture	30,000	15,000	40,000	20,000
Medical Science	30,000	15,000	30,000	15,000
Technology and Innovation	40,000	20,000	40,000	20,000
Nomination	No fee	No fee	No fee	No fee

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

9.2 NED statutory remuneration

The table below presents the total remuneration for NEDs.

Amounts $	Year	Short-term benefits	Post-employment benefits		Total
		Fees	Accrued interest[1]	Superannuation	
Rick Holliday-Smith	**FY18**	**490,802**	**-**	**20,049**	**510,851**
	FY17	471,747	-	19,616	491,363
Yasmin Allen	**FY18**	**250,735**	**-**	**20,049**	**270,784**
	FY17	239,625	-	19,616	259,241
Glen Boreham	**FY18**	**245,639**	**-**	**20,049**	**265,688**
	FY17	229,625	-	19,616	249,241
Edward Byrne	**FY18**	**202,754**	**8,366**	**18,890**	**230,010**
	FY17	204,625	7,996	18,786	231,407
Alison Deans	**FY18**	**225,735**	**-**	**19,931**	**245,666**
	FY17	214,625	-	19,224	233,849
Andrew Denver	**FY18**	**240,831**	**-**	**20,049**	**260,880**
	FY17	234,625	-	19,616	254,241
Donal O'Dwyer	**FY18**	**220,831**	**-**	**19,712**	**240,543**
	FY17	214,625	-	19,224	233,849
Bruce Robinson[2]	**FY18**	**220,985**	**-**	**19,826**	**240,811**
	FY17	101,448	-	9,064	110,512
Total[3]	**FY18**	**2,098,312**	**8,366**	**158,555**	**2,265,233**
	FY17	1,910,945	7,996	144,762	2,063,703

1. Amounts accrued for interest during the financial year relating to the directors' retirement scheme. Prior to 2003, Cochlear operated a directors' retirement scheme which provided retirement benefits of three times a NED's average annual remuneration over the previous three years. In 2006, the Board resolved to discontinue the ongoing accrual of benefits subject to a transition period to 2011. The benefits accrued are indexed by reference to the bank bill rate. At 30 June 2018, Edward Byrne was the only NED entitled to this benefit. The accrued entitlement for Edward Byrne under the Cochlear directors' retirement scheme as at 30 June 2018 was $458,397.
2. Bruce Robinson was appointed to the Board on 13 December 2016.
3. The year-on-year changes in Board fees reflect the appointment of an additional director half way through FY17, changes in Board committee membership and increases to Board NED base fees.

9.3 Minimum shareholding requirement for NEDs

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

As at 30 June 2018, all NEDs are compliant with the Share Ownership Policy which allows three years to build their shareholdings. The table below presents Cochlear Limited shareholdings for each NED.

	Balance 1 July 2017	Purchases	Sales	Balance 30 June 2018	Policy value of shares as at 30 June 2018 ($)[1]	% of fees
Rick Holliday-Smith	10,000	-	-	10,000	1,741,679	341%
Yasmin Allen	3,500	-	-	3,500	609,588	225%
Glen Boreham	2,800	-	-	2,800	487,670	184%
Edward Byrne	3,250	-	-	3,250	566,046	246%
Alison Deans	2,000	1,000	-	3,000	522,504	213%
Andrew Denver	4,000	-	-	4,000	696,671	267%
Donal O'Dwyer	6,000	-	-	6,000	1,045,007	434%
Bruce Robinson[2]	-	322	-	322	56,082	23%
Total	**31,550**	**1,322**	**-**	**32,872**	**5,725,247**	**253%**

1. In line with the Share Ownership Policy (available on the Cochlear website), the value of Cochlear Limited ordinary shares is calculated using the average daily share price over the previous 12 months ($174.17, rounded to two decimal places), as at closing on the ASX up to 30 June 2018, times the number of shares. The numbers presented in the table above are based on the unrounded average share price,
2. Bruce Robinson was appointed to the Board on 13 December 2016, and in accordance with the policy has until 13 December 2019 to build his shareholding.

The directors present their report, together with the Consolidated Financial report of the Consolidated Entity (Cochlear), being Cochlear Limited (the Company) and its controlled entities, for the year ended 30 June 2018, and the Auditor's Report thereon.

DIRECTORS

The directors of the Company at any time during or since the end of the financial year were Mr R Holliday-Smith (Chairman), Mrs YA Allen, Mr G Boreham, AM, Prof E Byrne, AC, Ms A Deans, Mr A Denver, Mr D Howitt, Mr DP O'Dwyer, Prof B Robinson, AM and Mr C Smith.

Information on the current directors is presented in the Annual Report. This information includes the qualifications, experience and special responsibilities of each director. It also gives details of the directors' other directorships.

COMPANY SECRETARY

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

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

DIRECTORS' MEETINGS

The number of directors' meetings (including meetings of committees of directors) and number of meetings attended by each of the directors of the Company during the financial year are:

	Board of directors		Audit Committee		People & Culture Committee		Medical Science Committee		Nomination Committee		Technology and Innovation Committee	
	Held	Attended	Held	Attended	Held	Attended	Held	Attended	Held	Attended	Held	Attended
Mr R Holliday-Smith	9	9	5	5	5	5	-	-	3	3	-	-
Mrs YA Allen	9	9	5	5	5	5	-	-	3	3	4	4
Mr G Boreham, AM	9	9	5	5	5	5	-	-	3	3	4	4
Prof E Byrne, AC[1,2]	9	9	-	-	-	-	2	2	3	2	4	4
Ms A Deans	9	9	5	5	5	5	-	-	3	3	4	4
Mr A Denver	9	9	5	5	-	-	2	2	3	3	4	4
Mr D Howitt[3]	9	5	-	-	-	-	2	1	-	-	4	3
Mr DP O'Dwyer	9	9	5	5	-	-	2	2	3	3	4	4
Prof B Robinson, AM[4]	9	9	-	-	5	3	2	2	3	3	4	4
Mr C Smith[5]	9	6	-	-	-	-	2	2	-	-	4	2

1. Prof E Byrne passed chairmanship of the Medical Science Committee to Prof B Robinson, effective from 11 December 2017.
2. Prof E Byrne remains a member of the Medical Science Committee until his retirement.
3. Mr D Howitt was appointed to the Board of Directors on 14 November 2017.
4. Prof B Robinson was appointed to the People & Culture Committee on 17 August 2017.
5. Mr C Smith retired on 2 January 2018.

PRINCIPAL ACTIVITIES

Information on the principal activities, operations and financial position of Cochlear Limited and its business strategies and prospects is set out in the Operating and financial review on pages 7 to 28 of this Annual Report.

DIVIDENDS

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

	Dollars per share	Total amount $m	Franked/ unfranked	Date of payment
Interim 2018 ordinary	1.40	80.6	100% Franked	12 April 2018
Final 2017 ordinary	1.40	80.5	100% Franked	11 October 2017
Total amount	**2.80**	**161.1**		
Subsequent event				
Since the end of the financial year, the directors declared the following dividends:				
Final 2018 ordinary	1.60	92.3	100% Franked	10 October 2018
Total amount	**1.60**	**92.3**		

The financial effect of the 2018 final dividend will be recognised in the subsequent financial year as it was declared after 30 June 2018. Franked dividends paid or declared during the financial year were franked at the tax rate of 30% (2017: 30%).

ENVIRONMENTAL REGULATIONS

Cochlear's operations are subject to environmental regulations under the Commonwealth of Australia and State/Territory legislation. The Board believes that Cochlear has adequate systems in place to manage its environmental obligations and is not aware of any breach of those environmental requirements as they apply to Cochlear.

NON-AUDIT SERVICES

During the year, KPMG, the Company's auditor, performed certain other services in addition to its statutory duties. The Board has considered the non-audit services provided during the year by the auditor and in accordance with written advice provided by resolution of the Audit Committee, is satisfied that the provision of those non-audit services during the year by the auditor is compatible with, and did not compromise, the auditor independence requirements of the *Corporations Act 2001* for the following reasons:

- all non-audit services were subject to the corporate governance procedures adopted by the Company and have been reviewed by the Audit Committee to ensure that they do not impact the integrity and objectivity of the auditor; and
- the non-audit services provided do not undermine the general principles relating to auditor independence as set out in APES 110 Code of Ethics for Professional Accountants, as they did not involve reviewing or auditing the auditor's own work, acting in a management or decision-making capacity for the Company, acting as an advocate for the Company or jointly sharing risks and rewards.

Details of the amounts paid to the auditor of the Company, KPMG, and its related practices for audit and non-audit services during the year are set out below:

	Consolidated	
	2018	2017
	$	$
Audit services		
Audit and review of financial reports	1,780,268	1,539,847
Other regulatory compliance services	100,866	70,801
Total audit services	**1,881,134**	**1,610,648**
Non-audit services		
Taxation compliance and advisory services	1,031,640	1,361,901
IT advisory	673,000	-
Acquisition due diligence services	-	581,843
Other	147,973	202,001
Total non-audit services	**1,852,613**	**2,145,745**

STATE OF AFFAIRS

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

REMUNERATION REPORT

Information on Cochlear's remuneration framework and the outcomes for FY18 for the Cochlear Limited Board, the CEO&P and other KMP, and changes for FY19, is included in the Remuneration report on pages 40 to 56 of this Annual Report.

INDEMNIFICATION OF OFFICERS

Under the terms of Article 35 of the Company's Constitution, and to the extent permitted by law, the Company has indemnified the directors of the Company named in this Directors' report, the Company Secretary, Mr R Jarman, and other persons concerned in or taking part in the management of the Consolidated Entity. The indemnity applies when persons are acting in their capacity as officers of the Company in respect of:

- liability to third parties (other than the Company or related bodies corporate), if the relevant officer has acted in good faith; and
- costs and expenses of successfully defending legal proceedings in which relief under the *Corporations Act 2001* is granted to the relevant officer.

INSURANCE PREMIUMS

During the financial year, the Company paid a premium for a Directors' and Officers' Liability Insurance policy. The insurance provides cover for the directors named in this Directors' report, the Company Secretary, and officers and former directors and officers of the Company. The insurance also provides cover for present and former directors and officers of other companies in the Consolidated Entity. The directors have not included in this report details of the nature of the liabilities covered and the amount of the premium paid in respect of the Directors' and Officers' Liability and Supplementary Legal Expenses Insurance policies, as such disclosure is prohibited under the terms of the contract.

EVENTS SUBSEQUENT TO THE REPORTING DATE

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

Dividends

For dividends declared after 30 June 2018, see Note 2.6 to the financial statements.

LEAD AUDITOR'S INDEPENDENCE DECLARATION

The lead auditor's independence declaration is set out on page 61 and forms part of the Directors' report for the financial year ended 30 June 2018.

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 14th day of August 2018.

Signed in accordance with a resolution of the directors:

Director

Director

Auditor's independence declaration

Lead auditor's independence declaration under section 307C of the *Corporations Act 2001*

To: the directors of Cochlear Limited

I declare that, to the best of my knowledge and belief, in relation to the audit for the year ended 30 June 2018 there have been:

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

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

KPMG

KPMG | Cameron Slapp, Partner

Sydney, 14 August 2018

Income statement

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	Note	2018 $m	2017 $m
Revenue	2.2	1,363.7	1,253.8
Cost of sales	2.3	(361.2)	(358.4)
Gross profit		**1,002.5**	**895.4**
Selling, marketing and general expenses		(397.0)	(347.2)
Administration expenses		(97.4)	(85.2)
Research and development expenses		(167.7)	(151.9)
Other income	2.4	10.2	4.5
Other expenses	2.3	(2.2)	-
Results from operating activities		**348.4**	**315.6**
Finance income - interest		0.6	0.7
Finance expense - interest		(8.5)	(7.5)
Net finance expense		**(7.9)**	**(6.8)**
Profit before income tax		**340.5**	**308.8**
Income tax expense	3.1	(94.7)	(85.2)
Net profit		**245.8**	**223.6**
Basic earnings per share (cents)	2.5	427.3	389.7
Diluted earnings per share (cents)	2.5	426.7	389.1

The notes on pages 67 to 101 are an integral part of these consolidated financial statements.

Statement of comprehensive income

	2018 $m	2017 $m
Net profit	**245.8**	**223.6**
Other comprehensive (loss)/income		
Items that will not be reclassified subsequently to the income statement:		
Defined benefit plan actuarial (losses)/gains	(0.2)	2.7
Total items that will not be reclassified subsequently to the income statement	(0.2)	2.7
Items that may be reclassified subsequently to the income statement:		
Foreign currency translation differences	3.7	(15.1)
Effective portion of changes in fair value of cash flow hedges, net of tax	(19.4)	20.9
Net change in fair value of cash flow hedges transferred to the income statement, net of tax	(8.6)	(9.9)
Net change in fair value of available for sale financial assets, net of tax	0.1	(0.3)
Total items that may be reclassified subsequently to the income statement	(24.2)	(4.4)
Other comprehensive loss, net of tax	**(24.4)**	**(1.7)**
Total comprehensive income	**221.4**	**221.9**

The notes on pages 67 to 101 are an integral part of these consolidated financial statements.

Balance sheet

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	Note	2018 $m	2017 $m
Assets			
Cash and cash equivalents		61.5	89.5
Trade and other receivables	6.4(b)	316.7	292.1
Forward exchange contracts		3.7	18.4
Inventories	5.1	167.4	160.0
Current tax assets	3.2	9.6	7.3
Prepayments		25.3	18.6
Total current assets		**584.2**	**585.9**
Other receivables		2.1	0.8
Forward exchange contracts		0.4	7.8
Property, plant and equipment	5.2	128.4	120.1
Intangible assets	5.3	345.3	340.0
Investments	5.5	15.8	15.1
Deferred tax assets	3.2	80.7	66.6
Total non-current assets		**572.7**	**550.4**
Total assets		**1,156.9**	**1,136.3**
Liabilities			
Trade and other payables		140.5	130.9
Forward exchange contracts		13.1	2.0
Loans and borrowings	6.3(a)	3.7	84.7
Current tax liabilities	3.2	22.1	26.3
Employee benefit liabilities	4.2	57.3	52.4
Provisions	5.6	24.5	25.0
Deferred revenue		26.5	25.3
Total current liabilities		**287.7**	**346.6**
Trade and other payables		28.1	33.9
Forward exchange contracts		9.2	3.2
Loans and borrowings	6.3(a)	144.0	134.2
Employee benefit liabilities	4.2	12.0	11.0
Provisions	5.6	54.4	54.7
Deferred tax liabilities	3.2	8.1	5.8
Deferred revenue		2.6	3.3
Total non-current liabilities		**258.4**	**246.1**
Total liabilities		**546.1**	**592.7**
Net assets		**610.8**	**543.6**
Equity			
Share capital		173.0	169.4
Reserves		(33.8)	(12.9)
Retained earnings		471.6	387.1
Total equity		**610.8**	**543.6**

The notes on pages 67 to 101 are an integral part of these consolidated financial statements.

Statement of changes in equity

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Amounts $m	Issued capital	Treasury reserve	Translation reserve	Hedging reserve	Fair value reserve	Share based payment reserve	Retained earnings	Total equity
2017								
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	-	-	-	-	-	-	223.6	223.6
Other comprehensive income/(loss)								
Defined benefit plan actuarial gains	-	-	-	-	-	-	2.7	2.7
Foreign currency translation differences	-	-	(15.1)	-	-	-	-	(15.1)
Effective portion of changes in fair value of cash flow hedges, net of tax	-	-	-	20.9	-	-	-	20.9
Net change in fair value of cash flow hedges transferred to the income statement, net of tax	-	-	-	(9.9)	-	-	-	(9.9)
Net change in fair value of available for sale financial assets, net of tax	-	-	-	-	(0.3)	-	-	(0.3)
Total other comprehensive (loss)/income	**-**	**-**	**(15.1)**	**11.0**	**(0.3)**	**-**	**2.7**	**(1.7)**
Total comprehensive (loss)/income	**-**	**-**	**(15.1)**	**11.0**	**(0.3)**	**-**	**226.3**	**221.9**
Transactions with owners, recorded directly in equity								
Share options exercised	10.1	0.4	-	-	-	(0.9)	-	9.6
Performance rights vested	-	-	-	-	-	(0.5)	-	(0.5)
Share based payment transactions	-	-	-	-	-	8.1	-	8.1
Deferred tax recognised in equity	-	-	-	-	-	(0.5)	-	(0.5)
Dividends to shareholders	-	-	-	-	-	-	(143.5)	(143.5)
Balance at 30 June 2017	**169.4**	**-**	**(63.5)**	**15.2**	**(0.3)**	**35.7**	**387.1**	**543.6**
2018								
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	-	-	-	-	-	-	245.8	245.8
Other comprehensive (loss)/income								
Defined benefit plan actuarial losses	-	-	-	-	-	-	(0.2)	(0.2)
Foreign currency translation differences	-	-	3.7	-	-	-	-	3.7
Effective portion of changes in fair value of cash flow hedges, net of tax	-	-	-	(19.4)	-	-	-	(19.4)
Net change in fair value of cash flow hedges transferred to the income statement, net of tax	-	-	-	(8.6)	-	-	-	(8.6)
Net change in fair value of available for sale financial assets, net of tax	-	-	-	-	0.1	-	-	0.1
Total other comprehensive income/(loss)	**-**	**-**	**3.7**	**(28.0)**	**0.1**	**-**	**(0.2)**	**(24.4)**
Total comprehensive income/(loss)	**-**	**-**	**3.7**	**(28.0)**	**0.1**	**-**	**245.6**	**221.4**
Transactions with owners, recorded directly in equity								
Share options exercised	3.6	-	-	-	-	(2.5)	-	1.1
Performance rights vested	-	-	-	-	-	(1.5)	-	(1.5)
Share based payment transactions	-	-	-	-	-	8.5	-	8.5
Deferred tax recognised in equity	-	-	-	-	-	(1.2)	-	(1.2)
Dividends to shareholders	-	-	-	-	-	-	(161.1)	(161.1)
Balance at 30 June 2018	**173.0**	**-**	**(59.8)**	**(12.8)**	**(0.2)**	**39.0**	**471.6**	**610.8**

The notes on pages 67 to 101 are an integral part of these consolidated financial statements.

Statement of cash flows

	Note	2018 $m	2017 $m
Cash flows from operating activities			
Cash receipts from customers		1,350.3	1,220.7
Cash paid to suppliers and employees		(987.8)	(878.6)
Grant and other income received		4.8	4.1
Interest received		0.6	0.7
Interest paid		(8.5)	(8.6)
Income taxes paid	3.1	(101.3)	(78.5)
Net cash provided by operating activities	2.7(b)	**258.1**	**259.8**
Cash flows from investing activities			
Acquisition of land and buildings	5.2	(2.6)	(27.5)
Acquisition of leasehold improvements and plant and equipment	5.2	(25.8)	(26.0)
Proceeds from sale of non-current assets		0.3	0.6
Acquisition of enterprise resource planning system	5.3	(16.2)	(9.3)
Acquisition of other intangible assets	5.3	(5.1)	(8.2)
Acquisition of investments		(6.0)	(1.5)
Acquisition of subsidiary, net of cash acquired	5.4	-	(63.7)
Net cash used in investing activities		**(55.4)**	**(135.6)**
Cash flows from financing activities			
Repayments of borrowings		(321.2)	(193.0)
Proceeds from borrowings		250.0	219.1
Net (outlay)/proceeds from exercise of share options and performance rights		(0.4)	9.1
Dividends paid	2.6	(161.1)	(143.5)
Net cash used in financing activities		**(232.7)**	**(108.3)**
Net (decrease)/increase in cash and cash equivalents		**(30.0)**	**15.9**
Cash and cash equivalents, net of overdrafts at 1 July		89.5	75.4
Effect of exchange rate fluctuations on cash held		2.0	(1.8)
Cash and cash equivalents, net of overdrafts at 30 June		**61.5**	**89.5**

The notes on pages 67 to 101 are an integral part of these consolidated financial statements.

1. BASIS OF PREPARATION

This section sets out the Company's accounting policies that relate to the financial statements as a whole. Where an accounting policy is specific to one note, the policy is described in the note to which it relates.

1.1 Reporting entity

Cochlear Limited (the Company) is a company domiciled in Australia. The consolidated financial statements of the Company as at and for the year ended 30 June 2018 comprise the Company and its controlled entities (together referred to as Cochlear or the Consolidated Entity). Cochlear is a for-profit entity and operates in the implantable hearing device industry.

1.2 Basis of preparation

(a) Statement of compliance

The Financial report is a general purpose financial report which has been prepared in accordance with Australian Accounting Standards (AASBs) adopted by the Australian Accounting Standards Board and the *Corporations Act 2001*. The consolidated financial statements comply with International Financial Reporting Standards (IFRS) and Interpretations adopted by the International Accounting Standards Board.

The Board approved the consolidated financial statements on 14 August 2018.

(b) Basis of measurement

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

(c) Functional and presentation currency

These consolidated financial statements are presented in Australian dollars (AUD), which is the Company's functional currency.

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

(d) Foreign currency

Foreign currency transactions

Transactions in foreign currencies are translated to the respective functional currencies of entities at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated to the functional currency at the foreign exchange rate ruling at that date. Non-monetary assets and liabilities denominated in foreign currencies that are stated at historical cost are translated using the exchange rate at the date of the transaction. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to the functional currency at the foreign exchange rates ruling at the date the fair value was determined.

Foreign exchange differences arising on translation are recognised in the income statement.

Financial statements of foreign operations

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

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

Foreign currency differences arising from translation of controlled entities are recognised in the foreign currency translation reserve (translation reserve) in equity. When a foreign operation is disposed of, in part or in full, the relevant amount of its translation reserve is transferred to the income statement and reported as part of the gain or loss on disposal.

Foreign exchange gains and losses arising from a monetary item receivable from or payable to a foreign operation, the settlement of which is neither planned nor likely in the foreseeable future, are considered to form part of a net investment in a foreign operation and are recognised in other comprehensive income, and presented in the translation reserve.

(e) Use of judgements and estimates

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

Estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the financial year in which the estimate is revised and in any future years affected.

Management discussed with the Audit Committee the development, selection and disclosure of Cochlear's critical accounting policies and estimates and the application of these policies and estimates.

Information about critical judgements in applying accounting policies that have the most significant effect on the amounts recognised in the consolidated financial statements is included in the following notes:

Note 4.2 – Employee benefit liabilities

Note 4.3 – Share based payments

Note 5.3 – Intangible assets

Note 5.4 – Business combinations

Note 5.6 – Provisions

Note 5.7 – Contingent liabilities

Note 6.4 – Financial risk management.

(f) Basis of consolidation

Controlled entities

The Consolidated Entity controls an entity when it is exposed to, or has rights to, variable returns from its involvement with the entity and has the ability to affect those returns through its power over the entity. The financial statements of controlled entities are included in the consolidated financial statements from the date that control commences until the date that control ceases.

Transactions eliminated on consolidation

Intra-group balances and transactions, and any unrealised income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

Special purpose entities

Cochlear has established special purpose entities (SPEs) for investment purposes. A SPE is consolidated if Cochlear concludes that it controls the SPE. SPEs controlled by Cochlear were established under terms that impose strict limitations on decision-making powers of the SPE's management.

(g) Goods and services tax (GST)

Revenues, expenses and assets are recognised net of the amount of GST. Where the amount of GST incurred is not recoverable from the taxation authority, the GST is recognised as part of the cost of acquisition of the asset or as part of the expense.

Receivables and payables are stated with the amount of GST included. The net amount of GST recoverable from, or payable to, the relevant taxation authority is included as a current asset or liability in the balance sheet.

Cash flows are included in the statement of cash flows on a gross basis. The GST components of cash flows arising from investing and financing activities which are recoverable from, or payable to, the relevant taxation authority are classified as operating cash flows.

2. PERFORMANCE FOR THE YEAR

2.1 Operating segments

Cochlear's three reportable segments, determined on a geographical basis, are the strategic business units of Cochlear. Segment results, assets and liabilities include items directly attributable to a segment, as well as those that can be allocated on a reasonable basis. Unallocated items comprise corporate and other net expenses and corporate and manufacturing assets and liabilities.

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

Information about reportable segments

	Americas		EMEA[1]		Asia Pacific		**Total**	
	2018	2017	2018	2017	2018	2017	**2018**	**2017**
	$m	$m	$m	$m	$m	$m	**$m**	**$m**
Reportable segment revenue	648.5	595.0	478.9	428.5	224.0	216.2	**1,351.4**	**1,239.7**
Reportable segment EBIT	349.4	314.6	213.7	181.5	71.3	67.1	**634.4**	**563.2**
Reportable segment assets	215.2	215.7	245.2	225.0	125.0	117.7	**585.4**	**558.4**
Reportable segment liabilities	81.2	72.4	54.2	44.5	37.0	28.5	**172.4**	**145.4**
Other material items								
Depreciation and amortisation	1.4	1.1	1.0	1.7	1.0	1.0	**3.4**	**3.8**
Write-down in value of inventories	0.7	0.6	1.6	0.6	0.4	0.2	**2.7**	**1.4**
Acquisition of non-current assets	6.0	1.2	1.9	1.1	0.7	0.5	**8.6**	**2.8**

1. Europe, Middle East and Africa.

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

Revenues	Cochlear implants	Services	**Total Cochlear implants**	Acoustics	**Reportable segment revenue**	Foreign exchange gain on hedged sales	**Consolidated revenue**
	$m	$m	**$m**	$m	**$m**	$m	**$m**
2018	831.0	355.2	**1,186.2**	165.2	**1,351.4**	12.3	**1,363.7**
2017	767.8	305.6	**1,073.4**	166.3	**1,239.7**	14.1	**1,253.8**

Profit or loss	Reportable segment EBIT	Corporate and other net expenses	Foreign exchange gain on hedged sales	Net finance expense	**Consolidated profit before income tax**
	$m	$m	$m	$m	**$m**
2018	634.4	(298.3)	12.3	(7.9)	**340.5**
2017	563.2	(261.7)	14.1	(6.8)	**308.8**

Assets and liabilities	Reportable segment assets	Corporate and manufacturing assets	**Consolidated total assets**	Reportable segment liabilities	Corporate and manufacturing liabilities	**Consolidated total liabilities**
	$m	$m	**$m**	$m	$m	**$m**
2018	585.4	571.5	**1,156.9**	172.4	373.7	**546.1**
2017	558.4	577.9	**1,136.3**	145.4	447.3	**592.7**

Other material items	Reportable segment total		Corporate and manufacturing total		**Consolidated total**	
	2018	2017	2018	2017	**2018**	**2017**
	$m	$m	$m	$m	**$m**	**$m**
Depreciation and amortisation	3.4	3.8	30.8	27.4	**34.2**	**31.2**
Write-down in value of inventories	2.7	1.4	0.1	5.2	**2.8**	**6.6**
Acquisition of non-current assets	8.6	2.8	47.1	69.7	**55.7**	**72.5**

2.2 Revenue

Sales revenue is revenue earned from the provision of products or services, net of returns, discounts and allowances.

Revenue from the sale of goods is recognised when the significant risks and rewards of ownership have been transferred to the buyer, recovery of the consideration is probable, the associated costs and possible return of goods can be estimated reliably, there is no continuing management involvement with the goods and the amount of revenue can be measured reliably.

Revenue from the sale of services is recognised when the service has been provided to the customer and where there are no continuing unfulfilled service obligations.

The accounting policy for foreign exchange gains/losses arising from hedges of forecast sales transactions is set out in Note 6.4(a).

	2018	2017
	$m	$m
Sale of goods before hedging	1,324.9	1,227.2
Foreign exchange gain on hedged sales	12.3	14.1
Revenue from sale of goods	**1,337.2**	**1,241.3**
Rendering of services	26.5	12.5
Total revenue	**1,363.7**	**1,253.8**

2.3 Expenses

	2018 $m	2017 $m
(a) Cost of sales		
Carrying amount of inventories recognised as an expense	352.7	344.6
Other	5.7	7.2
Write-down in value of inventories	2.8	6.6
Total cost of sales	**361.2**	**358.4**
(b) Profit before income tax has been arrived at after charging the following item:		
Operating lease rental expense	27.0	22.3

Other expenses

	2018 $m	2017 $m
Impairment of available for sale financial assets	2.2	-
Total other expenses	**2.2**	-

2.4 Other income

Other income, including government grants, is recognised on a systematic basis over the years necessary to match it with the related costs for which it is intended to compensate. If the costs have already been incurred, the amount is recognised in the year the entitlement is confirmed. Foreign exchange gains/losses are recognised in accordance with the accounting policy at Note 1.2(d).

Changes to the contingent consideration value recognised for the Sycle, LLC business acquisition were considered at 30 June 2018. Based on FY18 revenue growth relative to the performance hurdle, $5.3 million has been released to the income statement and $28 million remains as contingent consideration (2017: $33.3 million).

	2018 $m	2017 $m
Grant received or due and receivable	2.3	2.4
Release of contingent consideration	5.3	-
Foreign exchange gain	0.1	0.4
Other income	2.5	1.7
Total other income	**10.2**	**4.5**

2.5 Earnings per share

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

Basic earnings per share

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

	2018	2017
Net profit attributable to equity holders of the parent entity	$245,792,000	$223,616,000
Weighted average number of ordinary shares (basic):		
Issued ordinary shares at 1 July (number)	57,426,649	57,199,264
Effect of options, performance shares and performance rights exercised (number)	94,306	181,834
Effect of shares issued under Employee Share Plan (number)	6,710	7,216
Weighted average number of ordinary shares (basic) at 30 June	**57,527,665**	**57,388,314**
Basic earnings per share (cents)	**427.3**	**389.7**

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:

	2018	2017
Net profit attributable to equity holders of the parent entity	$245,792,000	$223,616,000
Weighted average number of ordinary shares (diluted):		
Weighted average number of shares (basic) (number)	57,527,665	57,388,314
Effect of options, performance shares and performance rights unvested (number)	73,803	78,352
Weighted average number of ordinary shares (diluted) at 30 June	**57,601,468**	**57,466,666**
Diluted earnings per share (cents)	**426.7**	**389.1**

2.6 Dividends

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

	Dollars per share	Total amount $m	Franked/unfranked	Date of payment
Dividends recognised in the current financial year by the Company are:				
2018				
Interim 2018 ordinary	1.40	80.6	100% Franked	12 April 2018
Final 2017 ordinary	1.40	80.5	100% Franked	11 October 2017
Total amount	**2.80**	**161.1**		
2017				
Interim 2017 ordinary	1.30	74.6	100% Franked	6 April 2017
Final 2016 ordinary	1.20	68.9	100% Franked	29 September 2016
Total amount	**2.50**	**143.5**		

	Dollars per share	Total amount $m	Franked/unfranked	Date of payment
Subsequent event				
Since the end of the financial year, the directors declared the following dividends:				
Final 2018 ordinary	1.60	92.3	100% Franked	10 October 2018
Total amount	**1.60**	**92.3**		

The financial effect of the 2018 final dividend will be recognised in the subsequent financial year as it was declared after 30 June 2018.

Dividend franking account

Franked dividends paid during the financial year were franked at the tax rate of 30% (2017: 30%). There are no further tax consequences as a result of paying dividends other than a reduction in the franking account.

At 30 June 2018, there are $39.2 million of franking credits (2017: $27.6 million) available to shareholders of Cochlear Limited for subsequent financial years.

The dividend franking account at year end is adjusted for:

- franking credits that will arise from the payment of the current tax liability;
- franking debits that will arise from the payment of dividends recognised as a liability at the year end; and
- franking credits that the Company may be prevented from distributing in subsequent financial years.

The ability to utilise the franking account credits is dependent upon the ability to declare dividends. The impact on the dividend franking account of dividends proposed after the balance sheet date but not recorded as a liability is to reduce it by $39.5 million (2017: $34.5 million).

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

2.7 Notes to the statement of cash flows

(a) Cash and cash equivalents

Cash and cash equivalents comprise cash balances and call deposits with an original maturity of three months or less. Bank overdrafts that are repayable on demand and form an integral part of Cochlear's cash management are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

The operating cash account received an average interest rate of 0.73% (2017: 0.77%) per annum.

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

	2018 $m	2017 $m
Net profit	245.8	223.6
Add item classified as investing activities:		
Loss on disposal of property, plant and equipment	0.6	0.5
Add/(less) non-cash items:		
Depreciation and amortisation	34.2	31.2
Release of contingent consideration	(5.3)	-
Impairment of available for sale financial assets	2.2	-
Equity settled share based payment transactions	8.5	8.1
Net cash provided by operating activities before changes in assets and liabilities	**286.0**	**263.4**
Changes in assets and liabilities:		
Change in trade and other receivables	(25.9)	(5.9)
Change in inventories	(7.4)	(5.9)
Change in prepayments	(6.7)	(4.7)
Change in deferred tax assets/liabilities	(11.8)	5.8
Change in trade and other payables	3.8	(24.6)
Change in current tax assets/liabilities	(6.5)	11.0
Change in employee benefit liabilities	5.9	2.9
Change in provisions	(0.8)	2.0
Change in deferred revenue	0.5	(7.8)
Effects of movements in foreign exchange	21.0	23.6
Net cash provided by operating activities	**258.1**	**259.8**

3. INCOME TAXES

The Company and its wholly owned Australian resident entities are part of a tax-consolidated group. As a consequence, all members of the tax-consolidated group are taxed as a single entity. The head entity within the tax-consolidated group is Cochlear Limited.

3.1 Income tax expense

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

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

Income tax expense recognised in the income statement

	Current year	Adjustment for prior years	**Total current tax expense**	Origination and reversal of temporary differences	**Total deferred tax (benefit)/ expense**	**Total income tax expense**
	$m	$m	**$m**	$m	**$m**	**$m**
2018	103.1	(1.6)	**101.5**	(6.8)	**(6.8)**	**94.7**
2017	81.3	0.4	**81.7**	3.5	**3.5**	**85.2**

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

	2018 $m	2017 $m
Profit before income tax	**340.5**	**308.8**
Tax at the Australian tax rate of 30% (2017: 30%)	102.1	92.6
Increase in income tax expense due to:		
Non-deductible expenses, net	0.1	0.8
Effect of tax rate in foreign jurisdictions	-	0.6
Restatement of US deferred tax asset[1]	6.3	-
Decrease in income tax expense due to:		
Research and development allowances	(9.8)	(9.2)
Effects of different tax rates in foreign jurisdictions	(2.4)	-
	96.3	84.8
Adjustment for prior years	(1.6)	0.4
Income tax expense on profit before income tax	**94.7**	**85.2**

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

Tax expense for items relating to other comprehensive (loss)/income or equity

	Note	2018 $m	2017 $m
Total deferred tax recognised in other comprehensive (loss)/income relating to derivative financial instruments	3.2	(12.0)	4.7
Total deferred tax recognised directly in equity relating to share based payments	3.2	1.2	0.5

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

	2018 $m	2017 $m
Income tax expense on profit before income tax	94.7	85.2
Timing differences recognised in deferred tax	0.4	5.3
Effect of tax rate in foreign jurisdictions	0.1	0.1
Current year tax instalments payable next year	(15.0)	(21.1)
Prior year tax instalments paid this year	21.1	9.0
Cash taxes paid per statement of cash flows	**101.3**	**78.5**

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

	2018 $m	2017 $m
Profit before income tax (excluding dividends from wholly owned foreign subsidiaries)	**274.2**	**240.4**
Add: Dividends from wholly owned foreign subsidiaries	47.1	1.5
Profit before income tax	**321.3**	**241.9**
Tax at the Australian tax rate of 30% (2017: 30%)	96.4	72.6
Increase in income tax expense due to:		
Controlled foreign company income	1.0	2.4
Other non-deductible expenses	2.1	1.7
Decrease in income tax expense due to:		
Research and development allowances	(8.5)	(8.1)
Exempt foreign sourced dividends from wholly owned subsidiaries	(14.1)	(0.5)
	76.9	68.1
Adjustment for prior years	(1.0)	(0.1)
Income tax expense on profit before income tax	**75.9**	**68.0**

3.2 Current and deferred tax assets and liabilities

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

The measurement of deferred tax mirrors the tax consequences that the Consolidated Entity expects to recover or settle the carrying amount of its assets and liabilities.

Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse.

A deferred tax asset is recognised to the extent that it is probable that future taxable profits will be available against which they can be utilised. Deferred tax assets are reviewed at each reporting date and are reduced if it is no longer probable that the related tax benefit will be realised.

Recognised deferred tax assets and liabilities

	Assets		Liabilities		Net	
	2018 $m	2017 $m	2018 $m	2017 $m	2018 $m	2017 $m
Property, plant and equipment	0.3	0.1	(2.6)	(2.7)	(2.3)	(2.6)
Intangible assets	0.4	-	(6.2)	(8.1)	(5.8)	(8.1)
Inventories	25.7	26.6	-	-	25.7	26.6
Provisions	32.8	33.3	-	-	32.8	33.3
Deferred revenue	1.6	2.1	-	-	1.6	2.1
Forward exchange contracts	5.6	-	-	(6.5)	5.6	(6.5)
Other	19.9	21.3	(4.9)	(5.3)	15.0	16.0
Deferred tax assets/(liabilities)	**86.3**	**83.4**	**(13.7)**	**(22.6)**	**72.6**	**60.8**
Set off tax	(5.6)	(16.8)	5.6	16.8	-	-
Deferred tax assets/(liabilities)	**80.7**	**66.6**	**(8.1)**	**(5.8)**	**72.6**	**60.8**

Unrecognised deferred tax liabilities

At 30 June 2018, a deferred tax liability of $32.5 million (2017: $37.8 million) relating to investments in subsidiaries has not been recognised because the Company controls whether the asset will be recovered or the liability will be incurred and it is satisfied that it will not be incurred in the foreseeable future.

Movement in temporary differences during the year

	Note	2018 $m	2017 $m
Carrying amount at beginning of financial year		60.8	70.0
Recognised in the income statement	3.1	6.8	0.5
Deferred tax arising from business acquisition	3.1	-	(4.0)
Recognised in other comprehensive (loss)/income	3.1	12.0	(4.7)
Recognised directly in equity	3.1	(1.2)	(0.5)
Restatement of US deferred tax asset	3.1	(6.3)	-
Effects of movements in foreign exchange		0.5	(0.5)
Carrying amount at end of financial year		**72.6**	**60.8**

Current tax assets and liabilities

The current tax assets for the Consolidated Entity of $9.6 million (2017: $7.3 million) represent the amount of income taxes recoverable in respect of current and prior years and arise from the payment of tax in excess of the amounts due to the relevant taxation authority. The current tax liabilities for the Consolidated Entity of $22.1 million (2017: $26.3 million) represent the amount of income taxes payable in respect of current and prior financial years.

4. EMPLOYEE BENEFITS

4.1 Employee expenses

	2018 $m	2017 $m
Wages and salaries	338.0	300.1
Contributions to superannuation plans	25.3	22.7
Increase in leave liabilities	4.7	4.7
Equity settled share based payment transactions	8.5	8.1
Total employee expenses	**376.5**	**335.6**

4.2 Employee benefit liabilities

Wages, salaries and annual leave

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

Long service leave

The provision for long service leave is the present value of the estimated future cash outflows as a result of services provided by the employee up to the reporting date.

The provision is calculated using expected future increases in remuneration rates, including related on-costs, and expected settlement dates based on turnover history, and is discounted using the corporate bond rates which most closely match the terms to maturity of the related liabilities.

Defined benefit plans

The defined benefit obligations are calculated annually by a qualified actuary using the projected unit credit method. Remeasurements of the net defined benefit liability (excluding interest) are recognised immediately in other comprehensive income.

The Company determines the net interest expense (income) on the net defined benefit liability (asset) for the period by applying the discount rate used to measure the defined benefit obligation at the beginning of the period to the opening net defined benefit liability (asset), adjusted for any changes in the net defined benefit liability (asset) during the period resulting from contributions and benefit payments. Net interest expense related to defined benefit plans is recognised in the income statement.

These defined benefit plans cover, in aggregate, 80 employees (2017: 78 employees). Cochlear contributed cash of $1.2 million (2017: $1.4 million) to defined benefit plans in the year ended 30 June 2018 and expects to contribute $1.3 million in the year ending 30 June 2019.

Directors' retirement scheme

Non-executive directors appointed prior to 2003 were entitled to retirement benefits of up to three times their annual remuneration over the previous three years once they had more than five years' service. The ongoing accrual of benefits under the directors' retirement scheme ceased from 30 June 2007. The benefits accrued to that date are indexed by reference to the bank bill rate. As at 30 June 2018, Prof E Byrne, AC is the only non-executive director entitled to this benefit.

	2018 $m	2017 $m
Current		
Provision for long service leave	11.0	9.5
Provision for annual leave	26.5	23.7
Provision for short-term incentives	19.8	19.2
Total current employee benefit liabilities	**57.3**	**52.4**
Non-current		
Provision for long service leave	5.9	5.5
Defined benefit plan	5.6	5.1
Provision for directors' retirement scheme	0.5	0.4
Total non-current employee benefit liabilities	**12.0**	**11.0**
Total employee benefit liabilities	**69.3**	**63.4**

4.3 Share based payments

From 1 July 2013, the Company grants options and performance rights to certain employees under the Cochlear Executive Incentive Plan (CEIP). Prior to July 2013, the Company granted options and performance shares to certain employees under the Cochlear Executive Long Term Incentive Plan (CELTIP).

The fair value of options, performance shares and performance rights granted is recognised as an employee expense, with a corresponding increase in equity. The expense is adjusted by the actual number of options, shares and rights that are expected to vest except where forfeiture is due to market related conditions.

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

When the Company grants options over its shares to employees of controlled entities, the fair value at grant date is recognised as an increase in the investment in subsidiaries, with a corresponding increase in equity over the vesting period of the grant in the Company's accounts.

The Company operates the Cochlear Executive Long Term Incentive Plan (Performance Shares) Trust (Trust). The main purpose of the Trust is to hold unvested performance shares as part of the CELTIP. Under IFRS, the Trust qualifies as an equity compensation plan special purpose entity and its results are included in those for the Company and the Consolidated Entity. Any shares held by the Trust are accounted for as treasury shares and treated as a reduction in the share capital of the Company and the Consolidated Entity.

At 30 June 2018, there were no issued shares held in the Trust. The unissued ordinary shares of the Company under option and rights and the terms and conditions of the grants and issues are as follows:

Grant date	Exercise price of options	Number of options	Number of performance rights	Contractual life
November 2015[1]	$82.89	134,845	16,596	4 years
August 2016[2]	N/A	-	32,001	2 years
October 2016[1]	$135.84	79,006	20,726	4 years
August 2017[2]	N/A	-	38,225	2 years
October 2017[1]	$154.73	104,376	11,835	4 years
Total		**318,227**	**119,383**	

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

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

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

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

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

The grant date fair value of options and performance rights was measured based on the Black-Scholes-Merton pricing model. Expected volatility is estimated by considering historic average share price volatility. The inputs used in the measurement of the fair values at the grant date are the following:

	18 October 2017		24 August 2017	19 October 2016		16 August 2016
	TSR based conditions	EPS performance based conditions	Deferred STI service based conditions	TSR based conditions	EPS performance based conditions	Deferred STI service based conditions
Fair value of options at grant date	$22.27	$23.91	N/A	$14.46	$18.65	N/A
Fair value of performance rights at grant date	$83.43	$142.31	$145.96	$96.40	$125.82	$129.27
Share price at valuation date	$155.18	$155.18	$155.18	$138.43	$138.43	$137.72
Option exercise price	$154.73	$154.73	N/A	$135.84	$135.84	N/A
Expected volatility (weighted average volatility)	24.91%	24.91%	24.91%	23.15%	23.15%	23.15%
Option life	3-4 years	3-4 years	2 years	3-4 years	3-4 years	2 years
Expected dividend yield	2.95%	2.95%	2.95%	3.29%	3.29%	3.29%
Risk free interest rate (based on government bonds)	2.00%	2.00%	2.00%	1.39%	1.39%	1.39%

The number and weighted average exercise prices of options are as follows:

	Weighted average exercise price 2018	Number of options 2018	Weighted average exercise price 2017	Number of options 2017
Outstanding at 1 July	$93.51	292,934	$68.67	456,253
Forfeited	$149.52	(3,228)	$80.93	(71,727)
Exercised	$68.56	(78,192)	$59.40	(187,178)
Granted	$154.73	106,713	$135.84	95,586
Outstanding at 30 June	**$119.60**	**318,227**	**$93.51**	**292,934**
Exercisable at 30 June	$82.89	134,845	$68.56	78,192

78,192 options were exercised in 2018 (2017: 187,178 options were exercised). The weighted average market share price on the Australian Securities Exchange (ASX) at date of exercise was $160.23 (2017: $134.53). The weighted average remaining contractual life of options outstanding at the end of the year is two years (2017: three years).

Employee Share Plan

Cochlear's Employee Share Plan (Plan) was approved by special resolution at the Annual General Meeting held on 19 October 1999. Under the Plan, the directors can at their discretion, allocate at nil consideration up to a maximum of $2,000 worth of shares per eligible employee in any one year. In practice, the directors issue shares worth up to the tax concessional limit, currently $1,000 per eligible employee each year. The fair value of shares issued during the financial year is the market price of the Company's shares on the ASX as at the start of trading on the issue date.

Shares under the Plan vest with the employee immediately but are non-transferable for a period of up to three years. For the year ended 30 June 2018, the Company issued 8,874 shares under the Plan; see Note 6.2.

APAC Employee Equity Plan

The APAC Employee Equity Plan aligns with the Cochlear Employee Share Plan and provides up to $1,000 of service rights annually per eligible employee in selected Asian countries. Upon vesting, each service right converts to one share. The plan was established in 2016 and the first vesting under this plan will occur in FY19.

4.4 Key management personnel

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

Non-executive directors

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

Executive KMP

Mr D Howitt[1], Mr A Bishop, Mr R Brook, Mr B Cubis, Mr J Janssen and Mr T Manna

Former executive KMP

Mr C Smith[2]

1. Appointed as Chief Operating Officer for the period from 1 July 2017 to 30 July 2017, President on 31 July 2017 and became CEO&P on 3 January 2018.

2. Retired on 2 January 2018, therefore only a KMP for the period 1 July 2017 to 2 January 2018.

Key management personnel disclosures

The KMP compensation is included in employee expenses as follows:

	Short-term employee benefits	Post-employment benefits	Other long-term benefits	Directors' retirement benefits	Share based payments	End of service	**Total**
	$	$	$	$	$	$	$
2018	11,706,507	412,566	243,465	8,366	3,256,080	1,452,589	**17,079,573**
2017	10,956,867	538,236	48,707	7,996	2,898,262	-	**14,450,068**

Information regarding individual KMP remuneration and some equity instruments disclosures as permitted by section 300A of the *Corporations Act 2001* is provided in the Remuneration report of this Annual Report on pages 40 to 56.

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

5. OPERATING ASSETS AND LIABILITIES

5.1 Inventories

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

Cost is based on the first-in-first-out principle including expenditure incurred in acquiring the inventories and bringing them to their existing condition and location. In the case of manufactured inventories and work in progress, cost includes an appropriate share of production overheads based on normal operating capacity.

Net realisable value is the estimated selling price in the ordinary course of business less estimated costs of completion and selling, marketing and distribution expenses.

	Raw materials	Work in progress	Finished goods	**Total inventories**
	$m	$m	$m	**$m**
2018	68.3	22.1	77.0	**167.4**
2017	60.5	27.2	72.3	**160.0**

5.2 Property, plant and equipment

Owned assets

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

The value of internally-constructed assets includes the cost of material and direct labour and any other costs directly attributable to bringing the asset to a working condition for its intended use.

Subsequent costs in relation to replacing a part of property, plant and equipment are capitalised in the carrying amount of the item if it is probable that future economic benefits will flow to Cochlear and its cost can be measured reliably. All other costs are recognised in the income statement as incurred.

Leased assets

Payments made under operating leases are expensed on a straight-line basis over the term of the lease, except where an alternative basis is more representative of the pattern of benefits to be derived from the leased property. Minimum lease payments include fixed rate increases.

Depreciation

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

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

Depreciation rates and methods, useful lives and residual values are reviewed at each balance sheet date. When changes are made, adjustments are reflected prospectively in current and future financial years only.

Total property, plant and equipment at net book value

	Leasehold improvements		Plant and equipment		Land and buildings		**Total net book value**	
	2018 $m	2017 $m	2018 $m	2017 $m	2018 $m	2017 $m	**2018 $m**	**2017 $m**
At cost	38.6	35.0	221.8	201.9	30.1	27.5	**290.5**	**264.4**
Accumulated depreciation	(25.3)	(22.2)	(136.5)	(121.9)	(0.3)	(0.2)	**(162.1)**	**(144.3)**
Net book value	**13.3**	**12.8**	**85.3**	**80.0**	**29.8**	**27.3**	**128.4**	**120.1**
Reconciliations of the carrying amounts are:								
Opening balance	12.8	12.9	80.0	74.0	27.3	-	**120.1**	**86.9**
Acquisition of subsidiary	-	-	-	0.2	-	-	**-**	**0.2**
Additions	3.0	2.5	22.8	23.5	2.6	27.5	**28.4**	**53.5**
Disposals	-	-	(0.6)	(0.5)	-	-	**(0.6)**	**(0.5)**
Depreciation	(2.7)	(2.4)	(17.7)	(16.7)	(0.1)	(0.2)	**(20.5)**	**(19.3)**
Effect of movements in foreign exchange	0.2	(0.2)	0.8	(0.5)	-	-	**1.0**	**(0.7)**
Net book value	**13.3**	**12.8**	**85.3**	**80.0**	**29.8**	**27.3**	**128.4**	**120.1**

5.3 Intangible assets

Goodwill

All business combinations are accounted for by applying the acquisition method. Goodwill represents the difference between the cost of the acquisition and the fair value of the net identifiable assets acquired.

Goodwill is stated at cost less any accumulated impairment losses. Goodwill is tested annually for impairment.

Enterprise resource planning system

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

Other intangible assets

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

Amortisation

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

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

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

	Intangible assets with indefinite useful life		Intangible assets with finite useful life			**Intangible assets**
	Goodwill	Technology relationship	Enterprise resource planning system	Acquired technology, patents and licences	Other intangible assets	**Total**
	$m	$m	$m	$m	$m	**$m**
2018						
At cost	263.6	1.8	82.3	74.3	37.9	**459.9**
Accumulated amortisation	-	-	(49.4)	(45.3)	(19.9)	**(114.6)**
Net book value	**263.6**	**1.8**	**32.9**	**29.0**	**18.0**	**345.3**
Reconciliations of the carrying amounts are:						
Opening balance	267.1	1.8	24.1	32.1	14.9	**340.0**
Additions	-	-	16.2	1.5	3.6	**21.3**
Amortisation	-	-	(7.6)	(4.6)	(1.5)	**(13.7)**
Effect of movements in foreign exchange	(3.5)	-	0.2	-	1.0	**(2.3)**
Net book value	**263.6**	**1.8**	**32.9**	**29.0**	**18.0**	**345.3**
2017						
At cost	267.1	1.8	66.0	72.9	33.2	**441.0**
Accumulated amortisation	-	-	(41.9)	(40.8)	(18.3)	**(101.0)**
Net book value	**267.1**	**1.8**	**24.1**	**32.1**	**14.9**	**340.0**
Reconciliations of the carrying amounts are:						
Opening balance	171.4	1.8	23.0	27.4	0.8	**224.4**
Acquisition of subsidiary	101.5	-	0.2	-	14.3	**116.0**
Additions	-	-	9.3	8.0	0.2	**17.5**
Amortisation	-	-	(8.3)	(3.2)	(0.4)	**(11.9)**
Effect of movements in foreign exchange	(5.8)	-	(0.1)	(0.1)	-	**(6.0)**
Net book value	**267.1**	**1.8**	**24.1**	**32.1**	**14.9**	**340.0**

Impairment

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

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

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

An impairment loss is recognised in the income statement when the carrying amount of an asset or CGU exceeds its recoverable amount. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised. An impairment loss in respect of goodwill is not reversed.

Impairment tests for CGUs

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

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

	Americas $m	EMEA $m	Asia Pacific $m	**Total** **$m**
2018	181.6	72.4	9.6	**263.6**
2017	183.8	73.7	9.6	**267.1**

The recoverable amount of each CGU is based on value-in-use calculations. Those calculations use five year cash flow projections based on actual operating results, the next year's budget and the mid-term business plan. Cash flows for year 6 onwards are extrapolated using a conservative terminal growth rate of 3.0% (2017: 3.0%) per annum which is consistent with long-term economic growth rates. The pre-tax discount rate for each CGU is as follows: Americas 10.4% (2017: 13.7%), EMEA 9.4% (2017: 12.3%) and Asia Pacific 10.5% (2017: 13.1%).

The key assumptions and the approach to determining their value in the current year are:

Assumption	**How determined**
Discount rate	Based on weighted average cost of capital reflecting current market assessments of the time value of money and risks specific to the CGU.
Sales volume growth rate	Based on a five year cash flow projection taking into account historical growth rates and product lifecycle.
Terminal value growth rate	Based on long-term economic growth rates.

The recoverable amount of each CGU including unallocated corporate assets is in excess of the carrying amount and therefore no impairment charge was required. The excess of recoverable amount over carrying amount is such that a reasonably possible change in assumptions is unlikely to reduce the recoverable amount below the carrying amount.

5.4 Business combinations

On 11 May 2017, Cochlear acquired 100% of the shares in Sycle, LLC (Sycle) for $107.2 million comprising a cash outflow of $64.4 million ($63.7 million net of cash acquired), $9.5 million of deferred consideration and $33.3 million of contingent consideration. Sycle is the world's largest provider of audiology practice management software, based in San Francisco. Cochlear acquired Sycle to strengthen its service offering to its clinical partners to support their practice management capabilities. At the date of acquisition, the fair value of net identifiable assets acquired for Sycle was $5.7 million, resulting in $101.5 million of goodwill being recognised.

5.5 Investments

The available for sale equity securities are initially measured at fair value, plus any directly attributable transaction costs. Subsequent to initial recognition, they are measured at fair value and changes therein, other than impairment losses which are recognised in the income statement, are recognised in other comprehensive income and accumulated in the fair value reserve. When these assets are derecognised, the gain or loss accumulated in equity is reclassified to the income statement.

5.6 Provisions

A provision is recognised in the balance sheet when:

- Cochlear has a present obligation (legal or constructive) as a result of a past event;
- a reliable estimate can be made of the amount of the obligation; and
- it is probable that an outflow of economic benefits will be required to settle the obligation.

Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risk specific to the liability.

2018	Warranties	Legal and insurance	Product recall	Make good lease costs	Patent dispute	**Total**
	$m	$m	$m	$m	$m	**$m**
Opening balance	41.1	3.2	12.5	1.6	21.3	**79.7**
Provision made	16.1	2.4	-	0.1	-	**18.6**
Provision used	(18.4)	(0.7)	(1.4)	-	-	**(20.5)**
Effect of movements in foreign exchange	1.0	-	-	0.1	-	**1.1**
Total provisions	**39.8**	**4.9**	**11.1**	**1.8**	**21.3**	**78.9**
Represented by:						
Current	17.7	4.9	1.9	-	-	**24.5**
Non-current	22.1	-	9.2	1.8	21.3	**54.4**
Total provisions	**39.8**	**4.9**	**11.1**	**1.8**	**21.3**	**78.9**

Warranties

A provision for warranty claims is recognised in relation to sales made prior to the reporting date, based on historical claim rates and respective product populations. Warranty periods on hardware products extend for three to 10 years.

Legal and insurance

Self-insurance

Cochlear self-insures certain risks associated with operating in its line of business. Claims are recognised when an incident occurs that may give rise to a claim. They are measured at the cost that Cochlear expects to incur in defending or settling the claims, discounted using a rate that reflects current market assessments of the time value of money and the risks specific to the liability.

Product recall

On 11 September 2011, the Company initiated a worldwide voluntary recall of its unimplanted Nucleus CI500 cochlear implant range. Management has made judgements, estimates and assumptions related to probable costs arising from the recall which affect the reported amounts of assets, liabilities, income and expenses. Actual outcomes may differ from these estimates as further information is identified.

No amount has been recognised as a charge or released as a credit in the year ended 30 June 2018.

Make good lease costs

Cochlear has a number of operating leases over its offices that require the premises to be returned to the lessor in their original condition. The operating lease payments do not include an element for the repairs and overhauls.

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 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 Limited and Cochlear Americas 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 willfulness of infringement of two claims in the remaining patent at issue.

AMF and AB have asked the Judge in the District Court to enter Judgment against Cochlear Limited and Cochlear Americas for USD 131,216,325 based upon the Jury award in January 2014 and to increase those damages for willful infringement. Cochlear Limited and Cochlear Americas have 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 Judge has notified the parties that he intends to make his decision by 31 August 2018.

As the patents have expired, the trial Judgment and the Court of Appeals decision will not disrupt Cochlear Americas 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, the directors considered the 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.

5.7 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.

6. CAPITAL AND FINANCIAL STRUCTURE

6.1 Capital management

Cochlear's capital management objectives are to safeguard its ability to continue as a going concern, provide returns to shareholders, provide benefits to other stakeholders and maintain an optimal capital structure to reduce the cost of capital.

The Board aims to maintain and develop a capital base appropriate to Cochlear's objectives and monitors a number of qualitative metrics as follows:

- net gearing ratio – defined as net debt as a proportion of net debt plus total equity;
- dividend payout ratio – defined as dividends as a proportion of net profit after tax for a given period;
- growth in EPS – defined as the compound annual growth percentage in EPS over a three year period; and
- TSR – defined as the percentage growth in share price over a three year period plus the cumulative three year dividend return calculated against the opening share price in the same three year period.

Senior management tracks, manages and reports against these capital management metrics periodically as part of broader corporate governance responsibilities. The Board undertakes periodic reviews to assess whether the metrics continue to be appropriate and whether the capital management structure is appropriate to meet Cochlear's medium and long-term strategic requirements.

In order to maintain or adjust the capital structure, Cochlear may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares or sell assets to reduce debt.

Neither the Company nor any of its subsidiaries is subject to externally imposed capital requirements. There were no significant changes in Cochlear's approach to capital management during the year.

Cochlear's net gearing ratio was as follows:

	Note	2018 $m	2017 $m
Net debt	6.3(a)	86.2	129.4
Total equity		610.8	543.6
Net gearing ratio at 30 June		**12%**	**19%**

6.2 Capital and reserves

Share capital

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

	Number of issued shares in market circulation		Number of shares held in Trust		Total number of issued shares	
	2018	2017	2018	2017	2018	2017
On issue 1 July – fully paid	57,426,649	57,199,264	-	5,373	57,426,649	57,204,637
Issued for nil consideration under Employee Share Plan	8,874	9,828	-	-	8,874	9,828
Issued from the exercise of options	52,046	169,707	-	-	52,046	169,707
Issued from the exercise of performance rights	60,251	42,477	-	-	60,251	42,477
Options vesting from Trust	-	5,373	-	(5,373)	-	-
On issue 30 June – fully paid	**57,547,820**	**57,426,649**	**-**	**-**	**57,547,820**	**57,426,649**

During 2018, Cochlear purchased 35,706 shares (2017: 15,884 shares) on market to satisfy exercise of options and performance rights.

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

Ordinary shares are classified as equity and incremental costs directly attributable to the issue of ordinary shares and share options are recognised as a deduction from equity, net of any income tax benefit.

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at shareholders' meetings.

Repurchase of share capital (treasury shares)

When share capital recognised as equity is repurchased, the amount of the consideration paid, including directly attributable costs, is recognised as a deduction from equity, net of any tax effects. Shares purchased by the Trust are classified as treasury shares and are presented as a deduction from total equity. When treasury shares are subsequently sold or reissued, the amount received is recognised as an increase in equity, and the surplus or deficit on the transaction is transferred to or from the share based payment reserve.

Treasury reserve

The treasury reserve comprises the cost of shares acquired by the Trust at the date of purchase.

Translation reserve

The translation reserve records the foreign currency differences arising from the translation of the financial statements of foreign operations as well as from the translation of liabilities that hedge the Company's net investment in a foreign subsidiary, where their functional currency is different to the presentation currency of the reporting entity. See Note 1.2(d) for further details.

Hedging reserve

The hedging reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to underlying transactions that have not yet occurred.

Fair value reserve

The fair value reserve comprises the cumulative net change in the fair value of available for sale investments until the assets are derecognised or impaired.

Share based payment reserve

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

6.3 Net debt and finance costs

(a) Net debt

Loans and borrowings are recognised initially at fair value less attributable transaction costs. Subsequently, loans and borrowings are stated at amortised cost, with any difference between amortised cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest rate basis.

Debt establishment costs are capitalised and recognised as a reduction in loans and borrowings. They are recorded initially at cost and are amortised over the period of the loan. Included within loans and borrowings is an amount of $1.0 million (2017: $0.8 million) in relation to unamortised loan establishment fees.

	2018 $m	2017 $m
Loans and borrowings:		
Current	3.7	84.7
Non-current	144.0	134.2
Total loans and borrowings	147.7	218.9
Less: Cash and cash equivalents	(61.5)	(89.5)
Net debt	**86.2**	**129.4**

(b) Financing arrangements

	Multi-option bank facilities		Other credit facilities		
	Unsecured bank loan	Bank guarantees[1]	Unsecured bank overdrafts	Unsecured bank loan	Bank guarantees
	$m	$m	$m	$m	$m
2018					
Utilised at reporting date	145.0	6.5	-	3.7	2.9
Not utilised at reporting date	205.0	8.5	2.7	1.8	1.5
Total facilities	**350.0**	**15.0**	**2.7**	**5.5**	**4.4**
2017					
Utilised at reporting date	215.0	4.9	-	4.7	2.1
Not utilised at reporting date	230.0	15.1	0.3	0.6	1.2
Total facilities	**445.0**	**20.0**	**0.3**	**5.3**	**3.3**

1. Bank guarantees include standby letters of credit.

Multi-option bank facilities - Unsecured bank loan

In June 2018, Cochlear refinanced its bank loan facilities as follows:

Facility type	2 year term	3 year term	4 year term	5 year term	Total facilities
	$m	$m	$m	$m	$m
Committed debt including guarantees	50.0	100.0	100.0	115.0	365.0

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

Other credit facilities

Unsecured bank overdrafts

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

Unsecured bank loan

Cochlear has a Japanese yen (JPY) 450.0 million loan facility. It is an unsecured bank loan, reviewed annually. Interest is charged at prevailing market rates.

Bank guarantees/Standby letters of credit

As at 30 June 2018, Cochlear had additional contingent liability facilities denominated in United States dollars (USD), Euros (EUR), Sterling (GBP), Indian rupees and New Zealand dollars totalling AUD 4.4 million (2017: AUD 3.3 million).

(c) Finance costs

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

6.4 Financial risk management

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

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

A Treasury Management Committee has been established to administer aspects of risk management involving currency exposure, cash and funding, to manage the impact of short-term fluctuations on Cochlear's earnings.

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

(a) Market risk

Market risk is the risk that changes in market prices, such as foreign exchange rates, interest rates and equity prices will affect Cochlear's net profit or the value of its holdings of financial instruments.

The objective of market risk management is to manage and control market risk exposures by buying and selling forward exchange contracts and incurring financial liabilities, within acceptable parameters, whilst optimising the return, all in accordance with the treasury risk policy.

Currency risk

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

Over 90% of Cochlear's revenues and over 50% of costs are denominated in currencies other than AUD. Currency risk is hedged in accordance with the treasury risk policy. Risk resulting from the translation of assets and liabilities of foreign operations into Cochlear's reporting currency is not hedged.

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

Amounts local currency/millions	CHF	EUR	GBP	JPY	SEK	USD
2018						
Trade receivables	0.4	58.3	5.3	928.1	7.2	82.7
Unsecured bank loan	-	-	-	(300.0)	-	-
Trade payables	(1.8)	(7.7)	(7.3)	(104.5)	(61.2)	(22.0)
Gross balance sheet exposure	**(1.4)**	**50.6**	**(2.0)**	**523.6**	**(54.0)**	**60.7**
2017						
Trade receivables	0.7	49.8	5.7	654.3	4.3	83.0
Unsecured bank loan	-	-	-	(400.0)	-	-
Trade payables	(2.0)	(7.5)	(5.3)	(44.5)	(60.5)	(47.8)
Gross balance sheet exposure	**(1.3)**	**42.3**	**0.4**	**209.8**	**(56.2)**	**35.2**

Derivative assets and liabilities - Forward exchange contracts

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

In the year ended 30 June 2018, Cochlear designated the majority of forward exchange contracts as cash flow hedges. These are hedges of forecast future transactions to manage the currency risk arising from exchange rate fluctuations. The hedged items were highly probable foreign currency transactions.

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

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

If the forward exchange contract no longer meets the criteria for hedge accounting, expires or is sold, terminated or exercised, then hedge accounting is discontinued prospectively. The cumulative gain or loss previously recognised in equity remains there until the forecast transaction occurs or when cash flows arising from the transaction are received.

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

For the year ended 30 June 2018, all cash flow hedges were effective at the reporting date.

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

	Weighted average rate	< 1 year $m	1 - 2 years $m	2 - 5 years $m
2018				
Sell CHF	0.742	17.8	-	-
Sell EUR	0.633	125.7	77.5	13.4
Sell GBP	0.554	19.3	12.7	1.9
Sell JPY	80.510	14.7	10.6	2.7
Sell SEK	6.367	41.7	1.5	-
Sell USD	0.761	305.6	184.9	32.5
2017				
Sell EUR	0.646	154.9	87.5	27.6
Sell JPY	79.844	15.3	8.3	2.3
Sell USD	0.734	256.2	131.2	12.5

Currency risk - Sensitivity analysis

An analysis based on a 10% strengthening of foreign currencies would have decreased Cochlear’s profit for the year ended 30 June 2018 after tax, by approximately AUD 6.5 million (2017: AUD 4.7 million) and increased Cochlear’s equity by AUD 33.9 million (2017: decrease by AUD 12.9 million). A 10% weakening of the foreign currencies would have increased Cochlear’s profit after tax by $7.6 million (2017: AUD 9.4 million) and decreased equity by $69.5 million (2017: increase by AUD 18.7 million).

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

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

	Average rate		Reporting date spot rate	
AUD 1 =	2018	2017	2018	2017
CHF	0.749	0.746	0.735	0.730
EUR	0.649	0.689	0.635	0.670
GBP	0.575	0.592	0.564	0.594
JPY	85.288	81.988	81.765	85.345
SEK	6.453	6.614	6.629	6.529
USD	0.772	0.753	0.739	0.761

Interest rate risk

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

At the reporting date, the interest rate profile of Cochlear's interest-bearing financial instruments is financial assets of $61.5 million (2017: $89.5 million) and financial liabilities of $147.7 million (2017: $218.9 million).

For the year ended 30 June 2018, it is estimated that a general increase of one percent in interest rates would have decreased Cochlear's profit after income tax and equity by approximately $1.0 million (2017: $1.5 million). A one percent general decrease in interest rates would have had the equal but opposite effect on Cochlear's profit and equity.

(b) Credit risk

Credit risk is the risk of financial loss to Cochlear if a customer or counterparty to a financial instrument fails to meet its contractual obligations. Cochlear is exposed to credit risk from its operating activities (primarily from trade and other receivables) and from financing activities, including deposits with financial institutions and foreign exchange contracts. The carrying amounts of these financial assets at year end represent Cochlear's maximum exposure to credit risk.

Credit risk management - Trade and other receivables

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

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

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

	Americas	EMEA	Asia Pacific	**Total**
	$m	$m	$m	**$m**
2018	95.1	131.5	72.5	**299.1**
2017	94.5	118.1	62.8	**275.4**

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

At each reporting date, Cochlear assesses the collectability of trade and other receivables by reference to historical collection trends and timing of recoveries and makes an adjustment if current economic and credit conditions are such that the actual losses are likely to be greater or lesser than suggested by historical trends.

Cochlear has established an allowance for impairment that represents its estimate of incurred losses in respect of trade receivables based on individually significant exposures, a collective loss component established for groups of assets meeting certain ageing profiles and customer types which have been assessed as impaired under Cochlear's accounting policy.

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

	2018 $m	2017 $m
Trade receivables		
Not past due	247.3	206.3
Past due 1 - 60 days	34.8	37.5
Past due 61 - 180 days	18.0	17.0
Past due 181 - 360 days	2.6	12.1
Past due 361 days and over	6.3	20.2
	309.0	**293.1**
Impairment losses	(9.9)	(17.7)
Trade receivables net of allowance for impairment losses	**299.1**	**275.4**
Other receivables - current	17.6	16.7
Trade and other receivables	**316.7**	**292.1**

Credit risk management - Cash deposits and forward exchange contracts

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

(c) Liquidity risk

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

Non-derivative liabilities

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

	Effective interest rate	Carrying amount	Contractual cash flows	< 1 year	1 - 2 years	2 - 5 years	More than 5 years
	Per annum	$m	$m	$m	$m	$m	$m
2018							
AUD floating rate loan	2.99%	144.0	159.3	4.3	4.3	109.3	41.4
JPY floating rate loan	0.55%	3.7	3.7	3.7	-	-	-
Trade and other payables	-	168.6	168.6	140.5	12.0	16.1	-
Total		**316.3**	**331.6**	**148.5**	**16.3**	**125.4**	**41.4**
2017							
AUD floating rate loan	3.26%	214.2	226.2	87.0	139.2	-	-
JPY floating rate loan	0.53%	4.7	4.7	4.7	-	-	-
Trade and other payables	-	164.8	164.8	130.9	7.0	26.9	-
Total		**383.7**	**395.7**	**222.6**	**146.2**	**26.9**	**-**

It is not expected that the cash flows included in the maturity analysis could occur significantly earlier or at significantly different amounts.

Derivative assets and liabilities - Forward exchange contracts

The following table indicates the periods in which the cash flows associated with Cochlear's derivatives are expected to occur:

	Carrying amount	Contractual cash flows	< 1 year	1 - 2 years	2 - 5 years
	$m	$m	$m	$m	$m
2018					
Assets	4.1	4.3	3.8	0.4	0.1
Liabilities	(22.3)	(22.9)	(13.3)	(8.2)	(1.4)
Total	**(18.2)**	**(18.6)**	**(9.5)**	**(7.8)**	**(1.3)**
2017					
Assets	26.2	28.5	19.0	8.3	1.2
Liabilities	(5.2)	(3.7)	(1.9)	(1.2)	(0.6)
Total	**21.0**	**24.8**	**17.1**	**7.1**	**0.6**

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

(d) Fair value

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

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

Valuation of financial assets and liabilities

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

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

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

The equity securities classified as available for sale financial assets are valued 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.

7. OTHER NOTES

7.1 Auditors' remuneration

	2018 $	2017 $
Audit services		
Auditors of the Company - KPMG:		
- audit and review of financial reports	1,780,268	1,539,847
- other regulatory compliance services	100,866	70,801
Total audit services	**1,881,134**	**1,610,648**
Non-audit services		
Auditors of the Company - KPMG:		
- taxation compliance and advisory services	1,031,640	1,361,901
- IT advisory	673,000	-
- acquisition due diligence services	-	581,843
- other	147,973	202,001
Total non-audit services	**1,852,613**	**2,145,745**

7.2 Commitments

Operating lease commitments

Cochlear leases property under non-cancellable operating leases expiring from one to 15 years. Leases generally provide Cochlear with a right of renewal at which time all terms are renegotiated.

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

	2018 $m	2017 $m
Not later than one year	30.3	22.1
Later than one year but not later than five years	77.9	70.0
Later than five years	63.6	58.9
Total operating lease commitments	**171.8**	**151.0**

Capital expenditure commitments

As at 30 June 2018, Cochlear entered into contracts to purchase property, plant and equipment for $40.2 million (2017: $4.8 million).

7.3 Controlled entities

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

	Interest held		Country of incorporation/formation
	2018 %	2017 %	
Company			
Cochlear Limited			Australia
Controlled entities			
Acoustic Implants Limited	100	100	UK
Cochlear AG	100	100	Switzerland
Cochlear Americas	100	100	USA
Cochlear Austria GmbH	100	100	Austria
Cochlear Benelux NV	100	100	Belgium
Cochlear Bone Anchored Solutions AB	100	100	Sweden
Cochlear Boulder LLC	100	100	USA
Cochlear Canada Inc	100	100	Canada
Cochlear Clinical Services LLC	100	100	USA
Cochlear Deutschland GmbH & Co KG	100	100	Germany
Cochlear Employee Share Trust	100	100	Australia
Cochlear Europe Finance GmbH	100	100	Germany
Cochlear Europe Limited	100	100	UK
Cochlear Executive Long Term Incentive Plan (Performance Shares) Trust	100	100	Australia
Cochlear Finance Pty Limited	100	100	Australia
Cochlear France SAS	100	100	France
Cochlear German Holdings Pty Limited	100	100	Australia
Cochlear Holdings NV	100	100	Belgium
Cochlear Incentive Plan Pty Ltd	100	100	Australia
Cochlear Investments (No. 2) Pty Ltd	100	100	Australia
Cochlear Investments Pty Ltd	100	100	Australia
Cochlear Italia SRL	100	100	Italy
Cochlear Korea Limited	100	100	Korea
Cochlear Latinoamerica S.A.	100	100	Panama

		Interest held		Country of incorporation/formation
		2018 %	2017 %	
Cochlear Malaysia Sdn. Bhd.		100	100	Malaysia
Cochlear Manufacturing Corporation		100	100	USA
Cochlear Medical Device (Beijing) Co., Ltd		100	100	China
Cochlear Medical Device (Chengdu) Co Ltd		100	-	China
Cochlear Medical Device Company India Private Limited		100	100	India
Cochlear Middle East FZ-LLC		100	100	UAE
Cochlear Nordic AB		100	100	Sweden
Cochlear Norway AS	(i)	100	100	Norway
Cochlear NZ Limited		100	100	New Zealand
Cochlear Research and Development Limited		100	100	UK
Cochlear Shared Services S.A.		100	100	Panama
Cochlear Sweden Holdings AB		100	100	Sweden
Cochlear Technology Innovation Fund LP		99	99	Australia
Cochlear Technology Innovation Fund Pty Limited	(ii)	100	100	Australia
Cochlear Tibbi Cihazlar ve Saglik Hizmetleri Limited Sirketi		100	100	Turkey
Cochlear Verwaltungs GmbH		100	100	Germany
Cochlear (HK) Limited		100	100	Hong Kong
Cochlear (UK) Limited	(iii)	100	100	UK
Medical Insurance Pte Limited		100	100	Singapore
Nihon Cochlear Co Limited		100	100	Japan
Sichuan Keli ShuangChuang Technology Co Ltd		51	-	China
Sycle, LLC		100	100	USA
Sycle.Net Technologies (Canada) Ltd		100	100	Canada

(i) Name changed in 2018, previously Medisan Hørselsimplantater AS
(ii) Name changed in 2017, previously Lachlan Project Development Pty Ltd.
(iii) Dormant.

7.4 Parent entity disclosure

At, and throughout the financial year ended, 30 June 2018, the parent company of Cochlear was Cochlear Limited.

	2018 $m	2017 $m
Result of the parent entity:		
Net profit	244.0	176.0
Other comprehensive (loss)/income	(28.3)	11.0
Total comprehensive income	**215.7**	**187.0**
Financial position of the parent entity at year end:		
Current assets	451.0	459.3
Total assets	935.0	923.2
Current liabilities	158.0	223.9
Total liabilities	481.0	532.2

	2018 $m	2017 $m
Total equity of the parent entity comprising:		
Issued capital	173.0	169.4
Translation reserve	-	0.1
Hedging reserve	(13.0)	15.2
Share based payment reserve	39.0	34.2
Retained earnings	255.0	172.1
Total equity	**454.0**	**391.0**

Dividend income from subsidiaries is recognised by the parent entity when the dividends are declared by the subsidiary.

Parent entity contingencies

The details of all contingent liabilities in respect to Cochlear Limited are disclosed in Note 5.7.

Parent entity capital commitments for acquisition of plant and equipment

As at 30 June 2018, the parent entity entered into contracts but had not provided for or paid to purchase plant and equipment for $10.2 million (2017: $4.8 million).

7.5 Changes in accounting policies

There have been no changes to accounting standards materially impacting Cochlear in the current financial year.

7.6 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 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 will be effective for Cochlear's 2019 consolidated financial statements replacing the existing AASB 139 Financial Instruments: Recognition and Measurement. AASB 9 contains a new classification and measurement approach for financial assets that reflects the business model in which assets are managed and their cash flow characteristics.

  AASB 9 contains three classification categories for financial assets: measured at Amortised Cost, Fair Value through Other Comprehensive Income and Fair Value through Profit or Loss. The new standard eliminates the existing AASB 139 categories of Held to Maturity, Loans and Receivables and Available for Sale.

  AASB 9 also changes the requirements for hedge accounting and the approach for assessing hedge effectiveness. Based on procedures completed to date, Cochlear expects the following impacts on adoption of AASB 9:

  - there will be no significant impact on the classification and measurement of its financial assets and financial liabilities;
  - investments which are currently classified as Available for Sale investments will be classified as Fair Value through Other Comprehensive Income under AASB 9. Under AASB 139 fair value gains or losses are recognised in Other Comprehensive Income whilst impairment losses are recognised in the Income Statement. Under AASB 9 all gains or losses from these investments, including impairment losses, will be recognised in Other Comprehensive Income. In addition, any realised gains or losses on disposal will no longer be recycled through the Income Statement;
  - impairment losses on financial assets, including trade receivables, are now required to be measured using an expected credit losses model rather than the incurred credit losses. Under the new model, Cochlear is required to recognise the expected credit loss from possible future default events rather the credit losses arising from counterparties that are currently in default. This is expected to result in an increase in the impairment losses for trade receivables. Based on the work performed to date, the adoption of AASB 9 is

expected to result in a $2 million (before tax) increase to the impairment losses on trade receivables effective from 1 July 2018. Other financial assets held by Cochlear are not expected to be impacted by the new standard; and

- existing hedge relationships will qualify as continuing hedge relationships upon the adoption of the new standard.

As permitted under AASB 9, on transition Cochlear plans to adopt the cumulative effect method, with the effect of initially applying the standard recognised at the date of initial application (i.e. 1 July 2018). As a result, Cochlear will not apply the requirements of AASB 9 to the comparative period and any impacts on adoption will result in an offsetting (after tax) change in the opening retained earnings as at 1 July 2018.

Whilst Cochlear's analysis is still ongoing, the adoption of AASB 9 is expected to have an immaterial impact on financial asset and liability recognition with an opening retained earnings adjustment of $2 million (before tax). All impacts are based on current estimates which are subject to finalisation prior to final implementation.

- AASB 15 Revenue from Contracts with Customers will be effective for Cochlear's 2019 consolidated financial statements replacing existing revenue recognition guidance including AASB 118 Revenue.

  The core principle of AASB 15 is that an entity recognises revenue related to the transfer of goods or services when control of the goods or services passes to the customer. It also requires the identification of discrete performance obligations within a transaction and an allocation of a portion of the transaction price to each of these obligations.

  In preparation for AASB 15, Cochlear has established a project team including representatives from each geographical region. The project team has reviewed a representative sample of sales contracts to identify potential impacts from the adoption of AASB 15 including possible changes in timing of revenue recognition, measurement of the amount of revenue and note disclosures.

  Cochlear plans to adopt AASB 15 using the cumulative effect method, with the effect of initially applying the standard recognised at the date of initial application (i.e. 1 July 2018). As a result, Cochlear will not apply the requirements of AASB 15 to the comparative period and any impacts on adoption will result in an offsetting (after tax) change in the opening retained earnings as at 1 July 2018.

  Whilst Cochlear's analysis is still ongoing, the adoption of AASB 15 is expected to have an immaterial impact on revenue recognition with an opening retained earnings adjustment of $5 million (before tax). All impacts are based on current estimates which are subject to finalisation prior to final implementation.

- 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.

7.7 Events subsequent to the reporting date

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

Dividends

For dividends declared after 30 June 2018, see Note 2.6.

Directors' declaration

1. In the opinion of the directors of Cochlear Limited (the Company):

   (a) the consolidated financial statements and notes and the Remuneration report are in accordance with the *Corporations Act 2001*, including:

   (i) giving a true and fair view of the Consolidated Entity's financial position as at 30 June 2018 and of its performance for the financial year ended on that date; and

   (ii) complying with Australian Accounting Standards and the *Corporations Regulations 2001*; and

   (b) there are reasonable grounds to believe that the Company will be able to pay its debts as and when they become due and payable.

2. The directors have been given the declarations required by section 295A of the *Corporations Act 2001* from the Chief Executive Officer & President and Chief Financial Officer for the financial year ended 30 June 2018.

3. The directors draw attention to Note 1.2(a) to the consolidated financial statements, which includes a statement of compliance with International Financial Reporting Standards.

Signed in accordance with a resolution of the directors:

Dated at Sydney this 14th day of August 2018.

Director

Director

Independent audit report to the shareholders of Cochlear Limited

Report on the audit of the Financial report

Opinion

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

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

- giving a true and fair view of the Consolidated Entity's financial position as at 30 June 2018 and of its financial performance for the year ended on that date; and
- complying with *Australian Accounting Standards* and the *Corporations Regulations 2001*.

The Financial report comprises:

- The Consolidated Balance Sheet as at 30 June 2018;
- The Consolidated Income Statement, Consolidated Statement of Comprehensive Income, Consolidated Statement of Changes in Equity and Consolidated Statement of Cash Flows for the year then ended;
- Notes including a summary of significant accounting policies; and
- The Directors' Declaration.

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

Basis for opinion

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

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

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

Emphasis of matter – Patent dispute

We draw attention to Note 5.6 in the Financial report which describes the inherent uncertainty in the final future outcome related to the patent infringement lawsuit filed against 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 significant uncertainty is fundamental to users' understanding of the Financial report, the financial position and performance of the Consolidated Entity. Our opinion is not modified in respect of this matter.

In concluding there is significant uncertainty we evaluated the extent of uncertainty regarding the outcome of the lawsuit remanded to the District Court and its impact on the Financial report. This included checking the following against our detailed audit work performed when the Consolidated Entity originally determined and recognised their best estimate of the patent dispute provision:

- enquiries of management and the directors regarding updates to the lawsuit and quantifications of outcomes;
- confirmation from the Consolidated Entity's external lawyers regarding the lawsuit and quantification of outcomes;
- correspondence between the Consolidated Entity and external lawyers, in particular relating to the Court of Appeals and remand order to the District Court;

- consistency to facts and conditions gathered across our work;
- the Consolidated Entity's disclosures in relation to the patent dispute provision, against the requirements of the accounting standards.

Key audit matters	
The key audit matters we identified are: • Recoverability of trade receivables; and • Warranty provision.	Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the Financial report of the current period. These matters were addressed in the context of our audit of the Financial report as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Recoverability of trade receivables $299.1 million

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

The key audit matter	How the matter was addressed in our audit
Recoverability of trade receivables was considered a key audit matter due to: • The wide ranging characteristics of individual customers; • The large number of different geographic locations of customers each with a unique political and economic environment that may restrict the timely recoverability of certain receivables; • Some customers and locations having experienced higher days sales outstanding than the Consolidated Entity's average days sales outstanding, increasing their inherent exposure to credit risk; • The inherent subjectivity involved in the Consolidated Entity making judgements in relation to credit risk exposures. These conditions gave rise to additional audit effort to gather evidence across the unique profiles of customers and their accounts receivable, including greater involvement by our senior team members.	Our procedures included: • Testing key controls within the credit control process including credit account application approvals, credit limit assessments, trade receivables aging and management review of overdue trade receivables; • Assessing the recoverability of a sample of outstanding trade receivable balances across different geographies. We compared the Consolidated Entity's views of recoverability of amounts outstanding to historical patterns of receipts and our understanding of the impact of the political and economic environment. This is done in conjunction with assessing cash received subsequent to year end for its effect in reducing amounts outstanding at year end; • Challenging the Consolidated Entity's view of credit risk and recoverability in certain locations by selecting a sample of overdue customer balances and: - noting the historical patterns for long outstanding trade receivables in those locations; - assessing cash received subsequent to year end for its effect in reducing amounts outstanding at year end; - evaluating other evidence including customer correspondence; and - questioning the Consolidated Entity's knowledge of future conditions which may impact expected customer receipts. • Assessing the Consolidated Entity's disclosures of the quantitative and qualitative considerations in relation to trade receivables credit risk, by comparing these disclosures to our understanding of the matter and the requirements of the accounting standards.

Independent audit report to the shareholders of Cochlear Limited

Warranty provision $39.8 million

Refer to note 5.6 Provisions

The key audit matter	How the matter was addressed in our audit
The warranty provision was considered a key audit matter due to the estimation uncertainty inherent in the Consolidated Entity's key assumptions applied, due to: • The constantly evolving product portfolio where each product has different design and quality attributes; • These different products have different warrantable periods; • The impact of the Global Repair Centre intended to reduce repair costs; and • The inherent unpredictability of future failures resulting in claims under warranty. The key assumptions used in the calculation model of the warranty provision subject to the greatest estimation uncertainty are: • The warrantable population; • The forecast product failure rate; • The ratio of repairing to replacing failed product; • The forecast repair cost; and • The forecast replacement cost These assumptions required greater involvement by our senior team members to challenge the key assumptions adopted by the Consolidated Entity in their calculation that determined the amount provided.	Our procedures included: • Obtaining an understanding of the evolving product portfolio, each product's different warrantable period and history of failure rates, and the different attributes that impact the key assumptions used in the calculation of the warranty provision; • Performing sensitivity analysis by varying key assumptions within a reasonably possible range, to focus our further procedures; • Assessing the integrity of the Consolidated Entity's calculation model, for the warranty provision. This included the accuracy of the underlying calculation formulas; • Comparing key assumptions used in the warranty provision calculation such as the warrantable population, forecast product failure rates, ratio of repairing to replacing failed product and forecast repair and replacement cost to historical actuals; • Challenging key assumptions which have been based on historical actuals as the best estimate for forecast failure rates, repair replacement ratios and cost. We did this by enquiring with management to understand the strategy and the impact of the Global Repair Centre. Specifically, improvements in design and quality assurance over repairs and how these factors are built into the assumptions and interlink with other assumptions (i.e. failure rates); • Assessing the warranty provision methodology against the requirements of the accounting standards; • Assessing the disclosures of the quantitative and qualitative considerations in relation to the warranty provision, by comparing these to our understanding of the matter and the requirements of the accounting standards.

Other information

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

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

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

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

Responsibilities of the Directors for the Financial report

The Directors are responsible for:

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

Auditor's responsibilities for the audit of the Financial report

Our objective is:

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

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

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

A further description of our responsibilities for the Audit of the Financial report is located at the Auditing and Assurance Standards Board website at: http://www.auasb.gov.au/auditors_responsibilities/ar1.pdf. This description forms part of our Auditor's report.

Independent audit report to the shareholders of Cochlear Limited

Report on the Remuneration report

Opinion

In our opinion, the Remuneration report of Cochlear Limited for the year ended 30 June 2018, complies with *Section 300A* of the *Corporations Act 2001*.

Directors' responsibilities

The Directors of the Company are responsible for the preparation and presentation of the Remuneration report in accordance with *Section 300A* of the *Corporations Act 2001*.

Our responsibilities

We have audited the Remuneration report included in pages 40 to 56 of the Annual Report for the year ended 30 June 2018.

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

KPMG

KPMG
Sydney, 14 August 2018

Cameron Slapp, Partner

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Shareholder information

Additional information required by Australian Securities Exchange Listing Rules and not disclosed elsewhere in this report – the information presented is as at 31 July 2018.

Substantial shareholders

Investor	Number of ordinary shares	%
Baillie Gifford & Co	4,532,973	7.9
BlackRock Group	3,457,684	6.0
Total	**7,990,657**	**13.9**

Distribution of shareholders

Number of shares held	Number of ordinary shareholders
1 - 1,000	27,904
1,001 - 5,000	2,313
5,001 - 10,000	130
10,001 - 100,000	65
100,001 and over	13
Total	**30,425**

Non-marketable parcels – 134 shareholders held less than a marketable parcel of ordinary shares.

Twenty largest shareholders

Shareholder	Number of ordinary shares	%
HSBC Custody Nominees (Australia) Limited	24,424,805	42.44
J P Morgan Nominees Australia Limited	11,343,441	19.71
Citicorp Nominees Pty Limited	3,320,635	5.77
National Nominees Limited	1,858,401	3.23
BNP Paribas Nominees Pty Ltd <Agency Lending DRP A/C>	798,454	1.39
BNP Paribas Noms Pty Ltd <DRP>	705,759	1.23
HSBC Custody Nominees (Australia) Limited - A/C 2	352,105	0.61
Citicorp Nominees Pty Limited <Colonial First State Inv A/C>	317,150	0.55
AMP Life Limited	212,132	0.37
HSBC Custody Nominees (Australia) Limited <NT- Comnwlth Super Corp A/C>	193,276	0.34
Mr Christopher Graham Roberts	161,745	0.28
Australian Foundation Investment Company Limited	137,000	0.24
BNP Paribas Nominees Pty Ltd <Arbitage SNC DRP>	109,566	0.19
PGA (Investments) Pty Ltd	100,000	0.17
Merrill Lynch (Australia) Nominees Pty Limited <MLPRO A/C>	88,382	0.15
HSBC Custody Nominees (Australia) Limited - GSCO ECA	76,770	0.13
Netwealth Investments Limited <Wrap Services A/C>	76,356	0.13
National Nominees Limited <DB A/C>	70,267	0.12
National Nominees Limited <N A/C>	63,000	0.11
HSBC Custody Nominees (Australia) Limited	58,086	0.10
	44,467,330	**77.26**

The 20 largest shareholders held 77.26% of the ordinary shares of the Company.

On market buy-back

There is no current on market buy-back.

Contact information

Hear now. And always

Cochlear®

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Shareholder enquiries

Access to shareholding information is available to investors through Computershare.

Computershare Investor Services Pty Limited

GPO Box 2975

Melbourne VIC 3001

Australia

Telephone: 1300 850 505

Email: web.queries@computershare.com.au

Website: www.computershare.com.au

Calendar of events

14 August 2018	FY18 results announced
18 September 2018	Dividend record date (final dividend)
10 October 2018	Payment date (final dividend)
16 October 2018	Annual general meeting
19 February 2019	HY19 results announced*
14 August 2019	FY19 results announced*

* Indicative dates only.

Annual general meeting

The annual general meeting of Cochlear Limited will be held on 16 October 2018 at 10.00am at the Australian Securities Exchange, Exchange Square Auditorium, 20 Bridge Street, Sydney.

Hear now. And always

As the global leader in implantable hearing solutions, Cochlear is dedicated to bringing the gift of sound to people with moderate to profound hearing loss. We have provided more than 550,000 implantable devices to recipients of all ages, helping them live full and active lives by reconnecting them with family, friends and community.

We aim to give our recipients the best lifelong hearing experience and access to innovative future technologies. For our professional partners, we offer the industry's largest clinical, research and support networks.

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

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

www.cochlear.com

The Cochlear Nucleus 7 Sound Processor and Baha 5 sound processors are compatible with iPhone, iPad and iPod touch. The Cochlear Nucleus Smart App and Baha 5 Smart App are available on App Store and Google Play. For compatibility information visit www.cochlear.com/compatibility.

Please seek advice from your medical practitioner or health professional about treatments for hearing loss. They will be able to advise on a suitable solution for the hearing loss condition. All products should be used only as directed by your medical practitioner or health professional. Not all products are available in all countries. Please contact your local Cochlear representative.

Cochlear®