RESMED INC
Form 10-Q
October 26, 2018
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2018

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission File Number: 001-15317

ResMed Inc.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

98-0152841

(I.R.S. Employer Identification No.)

9001 Spectrum Center Blvd.

San Diego, CA 92123

United States of America

(Address of principal executive offices)

(858) 836-5000

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company
Emerging growth company	

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Yes No

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

At October 22, 2018, there were 142,499,749 shares of Common Stock ($0.004 par value) outstanding. This number excludes 41,836,234 shares held by the registrant as treasury shares.

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PART I – FINANCIAL INFORMATION Item 1

Item 1. Financial Statements

RESMED INC. AND SUBSIDIARIES

Condensed Consolidated Balance Sheets (Unaudited)

(In US$ thousands, except share and per share data)

	September 30, 2018	June 30, 2018
Assets		
Current assets:		
Cash and cash equivalents	$ 230,188	$ 188,701
Accounts receivable, net of allowance for doubtful accounts of $21,928 and $19,258 at September 30, 2018 and June 30, 2018, respectively	463,743	483,681
Inventories (note 2)	282,555	268,701
Prepaid expenses and other current assets	111,757	124,634
Total current assets	1,088,243	1,065,717
Non-current assets:		
Property, plant and equipment, net (note 3)	381,822	386,550
Goodwill (note 4)	1,192,030	1,068,944
Other intangible assets, net (note 5)	242,193	215,184
Deferred income taxes	46,226	53,818
Prepaid taxes and other non-current assets	117,024	273,710
Total non-current assets	1,979,295	1,998,206
Total assets	$ 3,067,538	$ 3,063,923
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	$ 98,709	$ 92,723
Accrued expenses	169,465	185,805
Deferred revenue	64,822	60,828
Income taxes payable (note 7)	76,137	160,427
Short-term debt, net (note 9)	11,975	11,466
Total current liabilities	421,108	511,249
Non-current liabilities:		
Deferred revenue	73,810	71,596
Deferred income taxes	16,091	13,084

Other long-term liabilities	534	924
Long-term debt, net (note 9)	517,637	269,988
Long-term income taxes payable (note 7)	138,102	138,102
Total non-current liabilities	746,174	493,694
Total liabilities	1,167,282	1,004,943
Commitments and contingencies (note 13)		
Stockholders’ equity: (note 10)		
Preferred stock, $0.01 par value, 2,000,000 shares authorized; none issued	-	-
Common stock, $0.004 par value, 350,000,000 shares authorized; 184,330,350 issued and 142,494,116 outstanding at September 30, 2018 and 184,315,866 issued and 142,679,632 outstanding at June 30, 2018	570	571
Additional paid-in capital	1,463,669	1,450,821
Retained earnings	2,296,473	2,432,328
Treasury stock, at cost, 41,836,234 shares at September 30, 2018 and 41,636,234 shares at June 30, 2018	(1,623,256)	(1,600,412)
Accumulated other comprehensive loss	(237,200)	(224,328)
Total stockholders’ equity	1,900,256	2,058,980
Total liabilities and stockholders’ equity	$ 3,067,538	$ 3,063,923

See the accompanying notes to the unaudited condensed consolidated financial statements.

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RESMED INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Income (Unaudited)

(In US$ thousands, except per share data)

	Three Months Ended September 30, 2018	Three Months Ended September 30, 2017
Net revenue	$ 588,279	$ 523,659
Cost of sales (excluding amortization of acquired intangible assets)	245,186	218,054
Gross profit	343,093	305,605
Operating expenses:		
Selling, general and administrative	147,303	143,849
Research and development	38,791	37,415
Amortization of acquired intangible assets	12,867	11,783
Total operating expenses	198,961	193,047
Income from operations	144,132	112,558
Other income (loss), net:		
Interest income	922	4,870
Interest expense	(3,708)	(7,785)
Other, net	(2,465)	(1,158)
Total other income (loss), net	(5,251)	(4,073)
Income before income taxes	138,881	108,485
Income taxes	33,144	22,360
Net income	$ 105,737	$ 86,125
Basic earnings per share (note 11)	$ 0.74	$ 0.61
Diluted earnings per share (note 11)	$ 0.73	$ 0.60
Dividend declared per share	$ 0.37	$ 0.35
Basic shares outstanding (000's)	142,668	142,247
Diluted shares outstanding (000's)	144,030	143,480

See the accompanying notes to the unaudited condensed consolidated financial statements.

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RESMED INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Comprehensive Income (Unaudited)

(In US$ thousands)

	Three Months Ended September 30,	
	2018	2017
Net income	$ 105,737	$ 86,125
Other comprehensive income (loss):		
Foreign currency translation (loss) gain adjustments	(12,872)	36,389
Comprehensive income (loss)	$ 92,865	$ 122,514

See the accompanying notes to the unaudited condensed consolidated financial statements.

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RESMED INC. AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows (Unaudited)

(In US$ thousands)

	Three Months Ended September 30,			
	2018		2017	
Cash flows from operating activities:				
Net income	$	105,737	$	86,125
Adjustment to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization		30,424		29,571
Stock-based compensation costs		12,477		11,948
Impairment of equity investments		1,711		962
Changes in fair value of business combination contingent consideration (note 12)		(183)		-
Changes in operating assets and liabilities, net of effect of acquisitions:				
Accounts receivable		20,342		23,317
Inventories		(15,661)		(26,942)
Prepaid expenses, net deferred income taxes and other current assets		(7,703)		(15,408)
Accounts payable, accrued expenses and other		(99,025)		(15,590)
Net cash provided by operating activities		48,119		93,983
Cash flows from investing activities:				

Purchases of property, plant and equipment		(12,994)		(16,030)
Patent registration costs		(2,611)		(2,242)
Business acquisitions, net of cash acquired		(126,439)		-
Investment in equity investments		(2,467)		(3,225)
Proceeds (payments) on maturity of foreign currency contracts		(3,678)		6,073
Net cash used in investing activities		(148,189)		(15,424)
Cash flows from financing activities:				
Proceeds from issuance of common stock, net		389		3,615
Purchases of treasury stock		(19,399)		-
Payments of business combination contingent consideration (note 12)		(240)		-
Proceeds from borrowings, net of borrowing costs		303,000		50,000
Repayment of borrowings		(86,133)		(110,000)
Dividend paid		(52,793)		(49,698)
Net cash provided by (used in) financing activities		144,824		(106,083)
Effect of exchange rate changes on cash		(3,267)		16,691
Net increase (decrease) in cash and cash equivalents		41,487		(10,833)
Cash and cash equivalents at beginning of period		188,701		821,935
Cash and cash equivalents at end of period	$	230,188	$	811,102
Supplemental disclosure of cash flow information:				
Income taxes paid, net of refunds	$	125,005	$	30,157
Interest paid	$	3,708	$	7,785
Fair value of assets acquired, excluding cash	$	42,807	$	-

Liabilities assumed		(41,905)		-
Goodwill on acquisition		125,037		-
Deferred payments		500		-
Cash paid for acquisition	$	126,439	$	-

See the accompanying notes to the unaudited condensed consolidated financial statements.

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Notes to the Condensed Consolidated Financial Statements

(Unaudited)

(1) Summary of Significant Accounting Policies

Organization and Basis of Presentation

ResMed Inc. (referred to herein as "we", "us", "our" or the "Company") is a Delaware corporation formed in March 1994 as a holding company for the ResMed Group. Through our subsidiaries, we design, manufacture and market equipment for the diagnosis and treatment of sleep-disordered breathing and other respiratory disorders, including obstructive sleep apnea. Our manufacturing operations are located in Australia, Singapore, Malaysia, France, China and the United States. Major distribution and sales sites are located in the United States, Germany, France, the United Kingdom, Switzerland, Australia, Japan, China, Norway and Sweden.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ("U.S. GAAP") for interim financial information and with the instructions to Form 10-Q and the rules of the U.S. Securities and Exchange Commission ("SEC"). Accordingly, they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. In the opinion of management, all necessary adjustments, which consisted only of normal recurring items, have been included in the accompanying financial statements to present fairly the results of the interim periods. The results of operations for the interim periods presented are not necessarily indicative of the results that may be expected for the year ending June 30, 2019.

The condensed consolidated financial statements for the three months ended September 30, 2018 and September 30, 2017 are unaudited and should be read in conjunction with the consolidated financial statements and notes thereto included in our Form 10-K for the year ended June 30, 2018.

Revenue Recognition

We adopted Accounting Standard Codification ("ASC") Topic 606, "Revenue from Contracts with Customers" on July 1, 2018. We account for a contract with a customer when there is a legally enforceable contract, the rights of the parties are identified, the contract has commercial substance, and collectability of the contract consideration is probable. Our revenue relates primarily to the sale of our products that are therapy-based equipment. Some contracts include additional performance obligations such as the provision of extended warranties and data for patient monitoring. Our software as a service ("SaaS") business offers software access with ongoing support and maintenance services as well as professional services such as training and consulting.

Disaggregation of revenue

We have determined that we predominantly operate in a single operating segment, which is the sleep and respiratory disorders sector of the medical device industry. Due to the acquisition of Brightree LLC ("Brightree") in April 2016, our operations now include the supply of SaaS to medical equipment and home health providers. However, these SaaS operations, both in terms of revenue and profit, are not material to our global operations and have not been separately reported. The following table summarizes our net revenue disaggregated by product and region for the three months ended September 30, 2018 compared to September 30, 2017 (in millions):

	Three Months Ended September 30,	
	2018	2017
U.S., Canada and Latin America		
Devices	$ 172.4	$ 157.9
Masks	154.0	138.7
Total devices and masks	$ 326.4	$ 296.6
Software as a Service	47.5	38.1
Total	$ 373.9	$ 334.7
Combined Europe, Asia and other markets		
Devices	$ 151.7	$ 128.3
Masks	62.7	60.7
Total	$ 214.4	$ 189.0
Global revenue		
Devices	$ 324.1	$ 286.2
Masks	216.7	199.4
Total devices and masks	$ 540.8	$ 485.6
Software as a Service	47.5	38.1
Total	$ 588.3	$ 523.7

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Performance obligations and contract balances

Revenue is recognized when performance obligations under the terms of a contract with a customer are satisfied; generally this occurs with the transfer of risk and/or control of our products are provided at a point in time. For most products, we transfer control and recognize a sale when products are shipped from our manufacturing facility or warehouse to the customer. For contracts with customers that contain destination shipping terms, revenue is not recognized until risk has transferred and the goods are delivered to the agreed upon destination. Depending on the terms of the arrangement, we will defer the recognition of a portion of the consideration received when performance obligations are not yet satisfied. Consideration received from customers in advance of revenue recognition is classified as deferred revenue. Performance obligations resulting in deferred revenue relate primarily to the provision of software access with maintenance and support, extended warranties on our devices and provision of data for patient monitoring. Generally, deferred revenue will be recognized over a period of one to five years. The following table summarizes our contract balances at September 30, 2018 and June 30, 2018 (in thousands):

	September 30, 2018	June 30, 2018	Balance sheet caption
Contract assets			
Accounts receivable, net	$ 463,743	$ 483,681	Accounts receivable, net
Unbilled revenue, current	12,861	13,342	Prepaid expenses and other current assets
Unbilled revenue, non-current	3,718	2,973	Prepaid taxes and other non-current assets
Contract liabilities			
Deferred revenue, current	(64,822)	(60,828)	Deferred revenue (current liabilities)
Deferred revenue, non-current	(73,810)	(71,596)	Deferred revenue (non-current liabilities)

Transaction price determination

Revenue is measured as the amount of consideration we expect to receive in exchange for transferring goods or providing services. The amount of consideration received and revenue recognized varies with changes in marketing incentives (e.g., rebates, discounts, free goods) and returns offered to customers and their customers. When we give customers the right to return eligible products and receive credit, returns are estimated based on an analysis of historical experience. However, returns of products, excluding warranty related returns, are infrequent and insignificant. We adjust the estimate of revenue at the earlier of when the most likely amount of consideration can be estimated, the amount expected to be received changes, or when the consideration becomes fixed.

We offer our customers cash or product rebates based on volume or sales targets measured over quarterly or annual periods. We estimate rebates based on each customer's expected achievement of its targets. In accounting for these rebate programs, we reduce revenue ratably as sales occur over the rebate period by the expected value of the rebates to be returned to the customer. Rebates measured over a quarterly period are updated based on actual sales results and, therefore, no estimation is required to determine the reduction to revenue. For rebates measured over annual periods, we update our estimates on a quarterly basis based on actual sales results and updated forecasts for the remaining rebate periods. We also offer discounts to customers as part of normal business practice and these are deducted from revenue when the sale occurs.

Many of our contracts have a single performance obligation which is the shipment of our therapy-based equipment. However, when the contract has multiple performance obligations, we generally use an observable price to determine the stand-alone selling price by reference to pricing and discounting practices for the specific product or service when sold separately to similar customers. Revenue is then allocated proportionately, based on the determined stand-alone selling price, to the performance obligation.

Accounting and practical expedient elections

We have elected to account for shipping and handling activities as a fulfillment cost within cost of sales, and record shipping and handling costs collected from customers in net revenue. We have also elected for all taxes assessed by government authorities that are imposed on and concurrent with revenue-producing transactions, such as sales and value added taxes, to be excluded from revenue. We have adopted two practical expedients including the "right to invoice" practical expedient, which allows us to recognize revenue in the amount of the invoice when it corresponds directly with the value of performance completed to date and which is relevant for some of our SaaS contracts. The second practical expedient adopted permits relief from considering a significant financing component when the payment for the good or service is expected to be one year or less.

Provision for Warranty

We provide for the estimated cost of product warranties at the time the related revenue is recognized. We determine the amount of this provision by using a financial model, which takes into consideration actual historical expenses and potential risks associated with our different products. We use this financial model to calculate the future probable expenses related to warranty and the required level of the warranty provision. Although we engage in product improvement programs and processes, our warranty obligation is affected by product failure rates and costs incurred to correct those product failures. Should actual product failure rates or estimated costs to repair those product failures differ from our estimates, we would be required to revise our estimated warranty provision.

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New Accounting Pronouncements

(a) Recently issued accounting standards not yet adopted

ASU No. 2016-02, "Leases"

In February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-02, "Leases" (Topic 842). Under the new guidance, lessees are required to recognize a right-of-use asset and a lease liability on the balance sheet for all leases, other than those that meet the definition of a short-term lease. This update will establish a lease asset and lease liability by lessees for those leases classified as operating under current GAAP. Leases will be classified as either operating or finance under the new guidance. Operating leases will result in straight-line expense in the income statement, similar to current operating leases, and finance leases will result in more expense being recognized in the earlier years of the lease term, similar to current capital leases. For lessors, the update will more closely align lease accounting to comparable guidance in the new revenue standards described.

The new standard is effective for us beginning in the first quarter of the year ending June 30, 2020 and early application is permitted. ASU 2016-02 will be adopted on a modified retrospective transition basis. There is a practical expedient available that would permit any leases that existed at the date of adoption to continue to be accounted for in accordance with the previous GAAP, ASC 840. We are still evaluating whether we will adopt this practical expedient.

We formed an implementation team during the year ended June 30, 2018 to oversee adoption of the new standard. The implementation team has established a project plan as well as initiated collecting global data on our lease agreements. There are a number of steps in the team's project plan that remain to be completed including: executing global education program, designing the system solution for data collation and balance calculations, evaluating the impact, and working through required changes to systems, business processes and controls to support the adoption of the new leases standard. While the formal impact assessment is ongoing, we expect this amendment will affect the way we account for operating leases where we are the lessee (as described above), require reassessment of how we account for revenue where we are the lessor and will result in increased disclosures for all lease arrangements. We are still evaluating the impact the standard will have on our financial statements.

(b) Recently adopted accounting pronouncements

ASU No. 2014-09, “Revenue from Contracts with Customers”

In May 2014, the FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers” (Topic 606), which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. Since its initial release, the FASB has issued several amendments to the standard, which include clarification of accounting guidance related to identification of performance obligations, intellectual property licenses, and principal vs. agent considerations. ASU 2014-09 and all subsequent amendments (collectively, the “new revenue recognition standards”) replaced most existing revenue recognition guidance in U.S. GAAP during the current quarter when it became effective. The guidance also requires improved disclosures on the nature, amount, timing, and uncertainty of revenue that is recognized.

Effective July 1, 2018, we adopted the new revenue recognition standards and applied its provisions to all contracts using the modified retrospective method. Application of the new provisions did not have a material impact on our financial statements and no cumulative-effect adjustment was calculated or recognized. The comparative information has not been restated; however, if it were there would be no change in the accounting treatment. Refer to the “Revenue Recognition” section above for further details about our revenue recognition following adoption of the new revenue recognition standards.

ASU No. 2016-01, "Financial Instruments - Overall"

In January 2016, the FASB issued ASU No. 2016-01, "Financial Instruments - Overall" (Topic 825-10). The amendments address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments, and require equity investments, other than equity-method investments, to be measured at fair value with changes in fair value recognized through net income. The amendments also simplify the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment for impairment quarterly at each reporting period. We adopted ASU 2016-01 during the quarter ended September 30, 2018 and elected to apply the practical expedient for measuring equity investments that do not have readily determinable fair market. Based on our elections, our strategic equity investments that do not have readily determinable fair values are measured at cost, less any impairments, plus or minus changes resulting from observable price changes in orderly transactions for identifiable or similar investments of the same issuer. The measurement alternative was applied prospectively and the adoption of ASU 2016-01 did not result in an adjustment to retained earnings.

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ASU No. 2016-16, "Income Taxes: Intra-Entity Transfers of Assets Other Than Inventory"

In October 2016, the FASB issued Accounting Standard Update ASU No. 2016-16, "Income Taxes: Intra-Entity Transfers of Assets Other Than Inventory" (Topic 740). Under the new guidance, an entity is required to recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs and eliminates the exception for an intra-entity transfer of an asset other than inventory. ASU 2016-16 became effective during the three months ended September 30, 2018 and is required to be adopted on a modified retrospective basis, with a cumulative-effect adjustment recorded directly to retained earnings for intra-entity transfers that occur before the adoption date. Accordingly, we recognized the following reclassifications upon adoption (in thousands):

Balance Sheet Caption	As reported balance June 30, 2018	Adoption of ASU 2016-16 Increase/(Decrease)	Revised balance July 1, 2018
Assets			
Prepaid expenses and other current assets	$ 124,634	$ (28,947)	$ 95,687
Prepaid taxes and other non-current assets	273,710	(156,406)	117,304
Deferred income taxes	53,818	(3,445)	50,373
Equity			
Retained Earnings	2,432,328	(188,798)	2,243,530

(2) Inventories

Inventories were comprised of the following at September 30, 2018 and June 30, 2018 (in thousands):

	September 30, 2018	June 30, 2018
Raw materials	$ 74,219	$ 75,415
Work in progress	2,280	2,453
Finished goods	206,056	190,833
Total inventories	$ 282,555	$ 268,701

(3) Property, Plant and Equipment

Property, plant and equipment were comprised of the following as of September 30, 2018 and June 30, 2018 (in thousands):

	September 30, 2018	June 30, 2018
Machinery and equipment	$ 242,079	$ 239,671
Computer equipment	160,396	155,069
Furniture and fixtures	50,647	51,045
Vehicles	7,532	7,399
Clinical, demonstration and rental equipment	88,826	92,229
Leasehold improvements	32,437	32,169
Land	53,286	54,089
Buildings	226,602	229,193
	861,805	860,864
Accumulated depreciation and amortization	(479,983)	(474,314)
Property, plant and equipment, net	$ 381,822	$ 386,550

(4) Goodwill

Changes in the carrying amount of goodwill for three months ended September 30, 2018, and September 30, 2017, were as follows (in thousands):

	Three Months Ended September 30,	
	2018	2017
Balance at the beginning of the period	$ 1,068,944	$ 1,064,874

Business acquisition	125,037	-
Foreign currency translation adjustments	(1,951)	7,424
Balance at the end of the period	$ 1,192,030	$ 1,072,298

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(5) Other Intangible Assets

Other intangible assets were comprised of the following as of September 30, 2018 and June 30, 2018 (in thousands):

	September 30, 2018	June 30, 2018
Developed/core product technology	$ 229,533	$ 205,149
Accumulated amortization	(122,505)	(115,237)
Developed/core product technology, net	107,028	89,912
Trade names	53,797	48,832
Accumulated amortization	(18,447)	(16,868)
Trade names, net	35,350	31,964
Non-compete agreements	3,255	3,288
Accumulated amortization	(2,366)	(2,283)
Non-compete agreements, net	889	1,005
Customer relationships	127,634	118,084
Accumulated amortization	(51,077)	(48,157)
Customer relationships, net	76,557	69,927
Patents	92,246	91,708
Accumulated amortization	(69,877)	(69,332)
Patents, net	22,369	22,376
Total other intangibles, net	$ 242,193	$ 215,184

Intangible assets consist of developed/core product technology, trade names, non-compete agreements, customer relationships, and patents, which we amortize over the estimated useful life of the assets, generally between two and fifteen years. There are no expected residual values related to these intangible assets. In-process research and development is amortized over the estimated useful life of the assets, once the research and development efforts are completed.

(6) Equity Investments

The aggregate carrying amount of our equity investments at September 30, 2018 and June 30, 2018, was $42.0 million and $41.2 million, respectively, and is included in the non-current balance of other assets on the condensed consolidated balance sheets.

The carrying amounts of our equity investments without readily determinable fair values are initially measured at cost and are assessed for impairment and observable price changes in orderly transactions for identifiable or similar investments of the same issuer. We estimate the fair value of our equity investments to assess whether impairment losses shall be recorded using Level 3 inputs. These investments include our holdings in privately held service and research companies that are not exchange traded and therefore not supported with observable market prices. However, these investments are valued by reference to their net asset values that can be market supported and unobservable inputs including future cash flows. During the three months ended September 30, 2018 and 2017, we recognized $1.7 million and $1.0 million, respectively, of impairment losses related to our equity investments. We have determined, after the impairment charge, that the fair value of our remaining investments exceed their carrying values.

The following table shows a reconciliation of the changes in our equity investments during the three months ended September 30, 2018 and September 30, 2017 (in thousands):

	Three Months Ended September 30,	
	2018	2017
Balance at the beginning of the period	$ 41,226	$ 38,324
Investments	2,467	3,225
Impairment of equity investments	(1,711)	(962)
Balance at the end of the period	$ 41,982	$ 40,587

(7) Income Taxes

In accordance with ASC 740 Income Taxes, each interim reporting period is considered integral to the annual period, and tax expense is measured using an estimated annual effective tax rate. An entity is required to record income tax expense each quarter based on its annual effective tax rate estimated for the full fiscal year and use that rate to provide for income taxes on a current year-to-date basis, adjusted for discrete taxable events that occur during the interim period.

Our income tax returns are based on calculations and assumptions subject to audit by various tax authorities. In addition, the calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax laws. We regularly assess the potential outcomes of examinations by tax authorities in determining the adequacy of our provision for income taxes. Any final assessment resulting from tax audits may result in material changes to our past or future taxable income, tax payable or deferred tax assets, and may require us to pay penalties and interest that could materially adversely affect our financial results.

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(Unaudited)

In connection with the audit by the Australian Taxation Office ("ATO") for the tax years 2009 to 2013, we received Notices of Amended Assessments in March 2018. Based on these assessments, the ATO asserted that we owe $151.7 million in additional income tax and $38.4 million in accrued interest, of which $75.9 million was paid in April 2018 under a payment arrangement with the ATO. In June 2018, we received a notice from the ATO claiming penalties of 50% of the additional income tax that was assessed or $75.9 million. We do not agree with the ATO's assessments and continue to believe we are more likely than not to be successful in defending our position. At September 30, 2018, we have recorded a receivable in prepaid taxes and other non-current assets for the amount paid as we ultimately expect this will be refunded by the ATO. The ATO are performing a risk review and auditing tax years 2014 to 2017.

On December 22, 2017, the SEC issued guidance under Staff Accounting Bulletin No. 118, Income Tax Accounting Implications of the Tax Cuts and Jobs Act ("SAB 118") directing taxpayers to consider the impact of the U.S. legislation as "provisional" when it does not have the necessary information available, prepared or analyzed (including computations) in reasonable detail to complete its accounting for the change in tax law. In accordance with SAB 118, we recognized additional estimated income tax expense of $138.0 million during the year ended June 30, 2018 based on our best estimate and interpretation of the U.S. legislation. We are still accumulating data to finalize the underlying calculations, or in certain cases, the U.S. Treasury is expected to issue further guidance on the application of certain provisions of the U.S. legislation and recorded a further $0.5 million in income tax expense during three months ended September 30, 2018. In accordance with SAB 118, the estimated income tax expense is considered provisional and will be finalized before December 22, 2018.

(8) Product Warranties

Changes in the liability for warranty costs, which is included in accrued expenses in our condensed consolidated balance sheets, for the three months ended September 30, 2018 and September 30, 2017, are as follows (in thousands):

	Three Months Ended September 30,	
	2018	2017
Balance at the beginning of the period	$ 19,227	$ 19,558
Warranty accruals for the period	3,948	3,802
Warranty costs incurred for the period	(3,589)	(3,677)
Foreign currency translation adjustments	(261)	273
Balance at the end of the period	$ 19,325	$ 19,956

(9) Debt

Debt at September 30, 2018 and June 30, 2018 consisted of the following (in thousands):

	September 30, 2018	June 30, 2018
Short-term debt	$ 12,000	$ 12,000
Deferred borrowing costs	(25)	(534)
Short-term debt, net	11,975	11,466
	-	
Long-term debt	$ 520,000	$ 272,000
Deferred borrowing costs	(2,363)	(2,012)
Long-term debt, net	$ 517,637	$ 269,988
Total debt	$ 529,612	$ 281,454

Credit Facility

On October 31, 2013, we entered into a revolving credit agreement, as borrower, with lenders, including Union Bank, N.A., as administrative agent, joint lead arranger, swing line lender and letters of credit issuer, and HSBC Bank USA, National Association, as syndication agent and joint lead arranger, providing for a revolving credit facility of $700.0 million, with an uncommitted option to increase the revolving credit facility by an additional $300.0 million. On April 4, 2016, in connection with our acquisition of Brightree, we entered into a first amendment to the revolving credit agreement to increase the size of the revolving credit facility from $700.0 million to $1.0 billion, with an uncommitted option to increase the revolving credit facility by an additional $300.0 million, and to make other modifications to provide for the acquisition of Brightree. On January 9, 2017, we entered into a second amendment to our agreement with our existing lenders, including MUFG Union Bank, N.A. as successor in interest to Union Bank, N.A., as Administrative Agent, Joint Lead Arranger, Swing Line Lender and L/C Issuer; and HSBC Bank USA, National Association, as Syndication Agent and Joint Lead Arranger. The second amendment, among other things, increased the size of our senior unsecured revolving credit facility from $1.0 billion to $1.3 billion, with an uncommitted option to increase the revolving credit facility by an additional $300.0 million. The credit facility was due to terminate on October 31, 2018, when all unpaid principal and interest under the loans were to be repaid.

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On April 17, 2018, we entered into an Amended and Restated Credit Agreement (the "Revolving Credit Agreement"), as borrower, with lenders MUFG Union Bank, N.A., as administrative agent, joint lead arranger, joint book runner, swing line lender and letter of credit issuer, and Westpac Banking Corporation, as syndication agent, joint lead arranger and joint book runner. The Revolving Credit Agreement, among other things, provides a senior unsecured revolving credit facility of $800.0 million, with an uncommitted option to increase the revolving credit facility by an additional $300.0 million.

Additionally, on April 17, 2018, ResMed Limited entered into a Syndicated Facility Agreement (the "Term Credit Agreement"), as borrower, with lenders MUFG Union Bank, N.A., as administrative agent, joint lead arranger and joint book runner, and Westpac Banking Corporation, as syndication agent, joint lead arranger and joint book runner. The Term Credit Agreement, among other things, provides ResMed Limited a senior unsecured term credit facility of $200.0 million.

The Revolving Credit Agreement and Term Credit Agreement each terminate on April 17, 2023, when all unpaid principal and interest under the loans must be repaid. The term credit facility will also amortize on a semi-annual basis, with a $6.0 million principal payment required on each such semi-annual amortization date. The outstanding principal amounts will bear interest at a rate equal to LIBOR plus 0.75% to 1.50% (depending on the then-applicable leverage ratio) or the Base Rate (as defined in the Revolving Credit Agreement and the Term Credit Agreement, as applicable) plus 0.0% to 0.50% (depending on the then-applicable leverage ratio).

Our obligations under the Revolving Credit Agreement and Term Credit Agreement are guaranteed by us and certain of our direct and indirect U.S. subsidiaries, including, in each case, ResMed Corp., ResMed Motor Technologies Inc., Birdie Inc., Inova Labs, Inc., Brightree LLC, Brightree Services LLC, Brightree Home Health & Hospice LLC, and Brightree Patient Collections LLC. The Revolving Credit Agreement and Term Credit Agreement contain customary covenants, including, in each case, a financial covenant that requires that we maintain a maximum leverage ratio of funded debt to EBITDA (as defined in the Revolving Credit Agreement and Term Credit Agreement, as applicable). The entire principal amounts of the revolving credit facility and term credit facility, and, in each case, any accrued but unpaid interest may be declared immediately due and payable if an event of default occurs, as defined in the Revolving Credit Agreement and the Term Credit Agreement, as applicable. Events of default under the Revolving

Credit Agreement and the Term Credit Agreement include, in each case, failure to make payments when due, the occurrence of a default in the performance of any covenants in the respective agreements or related documents, or certain changes of control of ResMed, the respective guarantors of the revolving credit facility and the term credit facility, ResMed Holdings Ltd and/or ResMed EAP Holdings LLC.

At September 30, 2018, the interest rate that was being charged on the outstanding principal amounts was 3.0%. An applicable commitment fee of 0.100% to 0.175% (depending on the then-applicable leverage ratio) applies on the unused portion of the revolving credit facility. At September 30, 2018, we were in compliance with our debt covenants and there was $529.6 million outstanding under the revolving credit facility and term credit facility.

(10) Stockholders’ Equity

Common Stock. During the three months ended September 30, 2018, we repurchased 200,000 shares at an aggregate purchase price of $22.8 million under our share repurchase program. Since the inception of our share repurchase programs and through September 30, 2018, we have repurchased a total of 41.8 million shares for an aggregate of $1.6 billion. Shares that are repurchased are classified as treasury stock pending future use and reduce the number of shares outstanding used in calculating earnings per share. There is no expiration date for this program, and the program may be accelerated, suspended, delayed or discontinued at any time at the discretion of our board of directors. At September 30, 2018, 12.9 million additional shares can be repurchased under the approved share repurchase program.

Preferred Stock. In April 1997, the board of directors designated 2.0 million shares of our $0.01 par value preferred stock as Series A Junior Participating Preferred Stock. No shares were issued or outstanding at September 30, 2018 and June 30, 2018.

Stock Options and Restricted Stock Units. We have granted stock options and restricted stock units to personnel, including officers and directors, in accordance with the amended and restated ResMed Inc. 2009 Incentive Award Plan (as amended and restated, the “2009 Plan”). The options have expiration dates of seven years from the date of grant and the options and restricted stock units vest over one to four years.

At September 30, 2018, the maximum number of shares of our common stock authorized for issuance under the 2009 Plan was 51.1 million shares. The number of securities remaining available for future issuance under the 2009 Plan at September 30, 2018 was 17.8 million.

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The following table summarizes option activity during the three months ended September 30, 2018:

	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term in Years
Outstanding at beginning of period	1,205,826	$ 60.48	4.4
Granted	-	-	
Exercised	(11,973)	42.84	
Forfeited	(183)	52.02	
Outstanding at end of period	1,193,670	$ 60.65	4.1
Exercise price of granted options	$ -		
Options exercisable at end of period	671,647	$ 52.43	

The following table summarizes the activity of restricted stock units during the three months ended September 30, 2018:

	Restricted Stock Units	Weighted Average Grant-Date Fair Value	Weighted Average Remaining Contractual Term in Years
Outstanding at beginning of period	1,644,754	$ 62.89	1.6
Granted	7,093	104.57	
Vested	(2,911)	64.90	
Expired / cancelled	(10,206)	63.80	
Forfeited	(2,314)	63.80	
Outstanding at end of period	1,636,416	$ 63.08	1.4

Employee Stock Purchase Plan (the "ESPP"). Under the ESPP, we offer participants the right to purchase shares of our common stock at a discount during successive offering periods. At September 30, 2018, the number of shares remaining available for future issuance under the ESPP is 0.5 million shares.

(11) Earnings Per Share

Basic earnings per share is computed by dividing the net income available to common stockholders by the weighted average number of shares of common stock outstanding. For purposes of calculating diluted earnings per share, the denominator includes both the weighted average number of shares of common stock outstanding and the number of dilutive common stock equivalents such as stock options and restricted stock units.

For the three months ended September 30, 2018 and September 30, 2017, stock options and restricted stock units covering an aggregate of 10,006 and 6,982 shares of common stock, respectively, were not included in the computation of diluted earnings per share as the effect would have been anti-dilutive.

Basic and diluted earnings per share for the three months ended September 30, 2018 and September 30, 2017 are calculated as follows (in thousands except per share data):

	Three Months Ended September 30,	
	2018	2017
Numerator:		
Net income	$ 105,737	$ 86,125
Denominator:		
Basic weighted-average common shares outstanding	142,668	142,247
Effect of dilutive securities:		
Stock options and restricted stock units	1,362	1,233
Diluted weighted average shares	144,030	143,480
Basic earnings per share	$ 0.74	$ 0.61
Diluted earnings per share	$ 0.73	$ 0.60

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(12) Fair Value Measurements

In determining the fair value measurements of our financial assets and liabilities, we consider the principal and most advantageous market in which we transact and consider assumptions that market participants would use when pricing the financial asset or liability. We maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

The hierarchies of inputs are as follows:

Level 1:	Input prices quoted in an active market for identical financial assets or liabilities;
Level 2:	Inputs other than prices quoted in Level 1, such as prices quoted for similar financial assets and liabilities in active markets, prices for identical assets and liabilities in markets that are not active or other inputs that are observable or can be corroborated by observable market data; and
Level 3	Input prices quoted that are significant to the fair value of the financial assets or liabilities which are not observable nor supported by an active market.

The following table summarizes our financial assets and liabilities at September 30, 2018 and June 30, 2018, using the valuation input hierarchy (in thousands):

	Level 1	Level 2	Level 3	Total
Balances at September 30, 2018				
Foreign currency hedging instruments, net	$ -	$ (587)	$ -	$ (587)
Business acquisition contingent consideration	$ -	$ -	$ (1,082)	$ (1,082)

Balances at June 30, 2018				
Foreign currency hedging instruments, net	$ -	$ (2,699)	$ -	$ (2,699)
Business acquisition contingent consideration	$ -	$ -	$ (1,505)	$ (1,505)

We determine the fair value of our financial assets and liabilities as follows:

Foreign currency hedging instruments – These financial instruments are valued using third-party valuation models based on market observable inputs, including interest rate curves, on-market spot currency prices, volatilities and credit risk.

Contingent consideration – These liabilities include the fair value estimates of additional future payments that may be required for some of our previous business acquisitions based on the achievement of certain performance milestones. Each potential future payment is valued using the estimated probability of achieving each milestone, which is then discounted to present value.

The following is a reconciliation of changes in the fair value of contingent consideration for the three months ended September 30, 2018 and September 30, 2017 (in thousands):

	Three Months Ended September 30,	
	2018	2017
Balance at the beginning of the period	$ (1,505)	$ (1,580)
Changes in fair value included in operating income	183	-
Payments	240	-
Balance at the end of the period	$ (1,082)	$ (1,580)

We did not have any significant non-financial assets or liabilities measured at fair value on September 30, 2018 or June 30, 2018.

(13) Legal Actions and Contingencies

Litigation

In the normal course of business, we are subject to routine litigation incidental to our business. While the results of this litigation cannot be predicted with certainty, we believe that their final outcome will not, individually or in aggregate, have a material adverse effect on our consolidated financial statements taken as a whole.

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Taxation Matters

As described in note 7 – Income Taxes, we received Notices of Amended Assessments from the ATO for the tax years 2009 to 2013. Based on these assessments, the ATO asserted that we owe $151.7 million in additional income tax and $38.4 million in accrued interest, of which $75.9 million was paid in April 2018 under a payment arrangement with the ATO. In June 2018, we received a notice from the ATO claiming penalties of 50% of the additional income tax that was assessed, or $75.9 million. We do not agree with the ATO's assessments and we continue to believe we are more likely than not to be successful in defending our position. However, if we are not successful, we will not receive a refund of the $75.9 million paid in April 2018 and we would be required to pay the remaining $75.9 million in additional income tax, $38.4 million in accrued interest and $75.9 million in penalties, which would be recorded as income tax expense. The ATO are performing a risk review and auditing tax years 2014 to 2017.

In connection with the recent U.S. Tax Act and the analysis of historical tax filings, we identified an administrative oversight in our prior year tax filing relating to a gain on an internal legal entity reorganization. We have applied for relief from the U.S. Internal Revenue Service ("IRS") to amend the related tax returns required to correct the administrative oversight, which would indefinitely defer the recognition of this gain. We believe it is more likely than not that we will be granted this relief and therefore, have not recorded a reserve in relation to this matter during the three months ended September 30, 2018. As of September 30, 2018, we were awaiting additional communication from the IRS regarding the amended tax returns.

Contingent Obligations Under Recourse Provisions

We use independent financing institutions to offer some of our customers financing for the purchase of some of our products. Under these arrangements, if the customer qualifies under the financing institutions' credit criteria and finances the transaction, the customers repay the financing institution on a fixed payment plan. For some of these arrangements, the customer's receivable balance is with recourse, either limited or full, whereby we are responsible for repaying the financing company should the customer default. We record a contingent provision, which is estimated based on historical default rates. This is applied to receivables sold with recourse and is recorded in accrued expenses.

The following table summarizes the amount of receivables sold with recourse during the three months ended September 30, 2018 and September 30, 2017(in thousands):

	Three Months Ended September 30,	
	2018	2017
Total receivables sold:		
Full recourse	$ 10,082	$ 4,200
Limited recourse	18,824	17,434
Total	$ 28,906	$ 21,634

The following table summarizes the maximum exposure on outstanding receivables sold with recourse and provision for doubtful accounts at September 30, 2018 and June 30, 2018 (in thousands):

	September 30, 2018	June 30, 2018
Maximum exposure on outstanding receivables:		
Full recourse	$ 22,308	$ 20,139
Limited recourse	10,190	9,239
Total	$ 32,498	$ 29,378
Contingent provision for receivables with recourse	$ (1,252)	$ (2,277)

(14) Derivative Instruments and Hedging Activities

We transact business in various foreign currencies, including a number of major European currencies as well as the Australian and Singapore dollars. We have significant foreign currency exposure through both our Australian and Singapore manufacturing activities, and international sales operations. We have established a foreign currency hedging program using purchased currency options and forward contracts to hedge foreign-currency-denominated financial assets, liabilities and manufacturing cash flows. The terms of such foreign currency hedging contracts generally do not exceed three years. The goal of this hedging program is to economically manage the financial impact of foreign currency exposures denominated mainly in Euros, and Australian and Singapore dollars. Under this program, increases or decreases in our foreign currency denominated financial assets, liabilities, and firm commitments are partially offset by gains and losses on the hedging instruments.

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We do not designate these foreign currency contracts as hedges. We have determined our hedge program to be a non-effective hedge as defined under the FASB-issued authoritative guidance. All movements in the fair value of the foreign currency instruments are recorded within other income, net in our condensed consolidated statements of income. We do not enter into financial instruments for trading or speculative purposes.

We held foreign currency instruments with notional amounts totaling $530.2 million and $462.1 million at September 30, 2018 and June 30, 2018, respectively, to hedge foreign currency fluctuations. These contracts mature at various dates prior to December 31, 2019.

The following table summarizes the amount and location of our derivative financial instruments as of September 30, 2018 and June 30, 2018 (in thousands):

	September 30, 2018	June 30, 2018	Balance Sheet Caption
Foreign currency hedging instruments	$ 1,299	$ 281	Other assets - current
Foreign currency hedging instruments	(1,352)	(2,373)	Accrued expenses