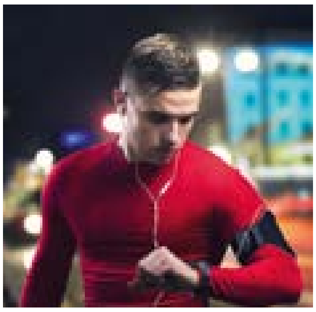
Powering the smart connected future

Contents

Results for Q4 and FY 2018

Press release – 6 March 2019

Dialog Semiconductor reports results for the fourth quarter and year ended 31 December 2018

Q4 2018 Revenue within guidance range at $431 million, increased operating margin and strong cash flow generation

London, UK, 6 March 2019 – Dialog Semiconductor Plc (XETRA: DLG), a provider of highly integrated power management, Configurable Mixed-signal IC, AC/DC, solid state lighting and Bluetooth® low energy wireless technology, today reports unaudited results for the quarter ended 31 December 2018.

Q4 and full year 2018 financial highlights

– Q4 revenue of US$431 million, within the October guidance range and 7% below Q4 2017. Full year revenue of US$1,442 million up 7% over 2017.

– Q4 revenue and full year revenue include the contribution of Silego Technology Inc. ("Silego").

– Q4 gross margin at 48.6% and underlying[1] gross margin at 48.7%. Full year gross margin at 47.9% and underlying gross margin at 48.3%, above 2017 and slightly ahead of the October guidance.

– Q4 operating profit of US$77.1 million and underlying[1] operating profit of US$103.4 million. Full year operating profit of US$199.7 million and underlying operating profit of US$281.6 million.

– All four operating business segments were profitable for the full year 2018.

– Q4 diluted EPS of US$0.74 and underlying[1] diluted EPS of US$1.06. Full year diluted EPS of US$1.80 and underlying diluted EPS of US$2.90.

– Q4 cash flow from operating activities of US$96.5 million (Q4 2017: US$130.2 million). US$82.4 million of free cash flow[1] generated in Q4 2018 (Q4 2017: US$111.0 million). US$678 million of cash and cash equivalents at 31 December 2018, US$199 million above 31 December 2017.

– On 11 October 2018, the Company reached an agreement with Apple Inc. to license certain of its power management technologies, transfer certain of its assets and over 300 employees to Apple to support chip research and development.

Q4 and full year 2018 operational highlights

– Design engagement momentum for custom mixed-signal and Power Management ICs (PMICs) at leading smartphone OEM.

– Leveraged our power management technology into new segments, introducing the first fully-integrated nanopower PMIC for low power consumer IoT applications.

– Shipped over four billion units of our Configurable Mixed-signal ICs since launch, leading a new product category enabling short design cycles and a lower component count.

– Maintained a commanding market share in the smartphone rapid charge segment.

– The extended range of LED backlighting products, combined with the acquisition of the ams AG portfolio in 2017, contributed to the expansion of our customer base.

– Fourth consecutive year of robust growth in Bluetooth® low energy, delivering 21% year-on-year revenue growth, with our SmartBond™ SoCs.

– New design engagements with leading customers to provide custom PMIC solutions in next generation game consoles, Digital Single-Lens Reflex ("DSLR") cameras and Solid State Drives ("SSD").

Commenting on the results, Dialog Chief Executive, Dr Jalal Bagherli, said:

"2018 was an important year for Dialog. Our agreement with Apple will enable us to generate immediate value for our shareholders while strengthening our long-term partnership. This has put us in a strong position to deliver on the next phase of revenue growth in our primary end-markets of consumer IoT and mobile. Our expertise and IP in mixed-signal ICs are aligned with our customers' growing requirements for energy-efficient products.

The investments we made in the organic and inorganic expansion of our business have helped us to deliver strong revenue growth during the year, despite specific customer headwinds. In 2018, revenue outside of Mobile Systems grew 33% year-on-year. We now have a healthy and diverse customer design-in pipeline, which coupled with a strong balance sheet and cash flow generation, gives me great confidence in the future of our business."

1 Underlying measures and free cash flow quoted in this Press Release are non-IFRS measures (see page 6).

Press release – 6 March 2019 continued

Outlook

Reflecting softer than typical seasonal trends, we anticipate revenue for Q1 2019 to be in the range of $270 million to $310 million and gross margin to be broadly in line with FY 2018.

We expect revenue for FY 2019 to decline from FY 2018 by single digit percentage points. As previously communicated, revenue from main PMIC for our largest customer will decline over the next few years.

For FY 2019, we anticipate the combined revenue of our remaining businesses to show strong year-on-year growth. As in previous years, revenue is expected to be second half weighted. Based on the expected revenue performance of the Group, we anticipate gross margin for FY 2019 to be broadly in line with FY 2018.

Financial overview

IFRS basis

US$ millions unless otherwise stated	**Q4 2018**	Q4 2017	Change	**FY 2018**	FY 2017	Change
Revenue	**430.7**	463.5	-7%	**1,442.1**	1,352.8	+7%
Gross margin[2]	**48.6%**	46.6%	+200bps	**47.9%**	47.7%	+20bps
R&D % of revenue[2]	**19.7%**	18.4%	+130bps	**22.6%**	22.4%	+20bps
SG&A % of revenue	**10.9%**	9.9%	+100bps	**11.7%**	10.7%	+100bps
Other operating income % of revenue	**-0.1%**	-2.1%	+200bps	**0.2%**	-2.1%	+230bps
Operating profit	**77.1**	75.4	+2%	**199.7**	187.0	+7%
Operating margin	**17.9%**	16.3%	+160bps	**13.8%**	13.8%	0bps
Net income	**57.9**	81.9	-29%	**139.8**	169.4	-17%
Basic EPS $	**0.78**	1.15	-32%	**1.89**	2.34	-19%
Diluted EPS $	**0.74**	1.09	-32%	**1.80**	2.21	-19%
Cash flow from operating activities	**96.5**	130.2	-26%	**288.6**	284.7	+1%

Underlying[1]

US$ millions unless otherwise stated	**Q4 2018**	Q4 2017	Change	**FY 2018**	FY 2017	Change
Revenue	**430.7**	463.5	-7%	**1,442.1**	1,352.8	+7%
Gross margin[2]	**48.7%**	47.1%	+160bps	**48.3%**	47.9%	+40bps
R&D % of revenue[2]	**17.5%**	16.4%	+110bps	**20.4%**	20.4%	0bps
SG&A % of revenue	**7.2%**	7.4%	-20bps	**8.5%**	8.4%	+10bps
EBITDA	**117.7**	123.1	-4%	**339.6**	315.8	+8%
EBITDA margin	**27.3%**	26.6%	+70bps	**23.5%**	23.3%	+20bps
Operating profit	**103.4**	108.1	-4%	**281.6**	259.5	+9%
Operating margin	**24.0%**	23.3%	+70bps	**19.5%**	19.2%	+30bps
Net income	**82.8**	103.4	-20%	**225.4**	228.0	-1%
Basic EPS $	**1.11**	1.40	-21%	**3.05**	3.08	-1%
Diluted EPS $	**1.06**	1.34	-21%	**2.90**	2.92	-1%

2 Certain product development costs have been reclassified from cost of sales to research and development expenses (see page 5)

Revenue in Q4 2018 was US$431 million, 7% below Q4 2017. The lower revenue was due to the decline in Mobile Systems and Automotive & Industrial, partially offset by strong growth in Advanced Mixed Signal and Connectivity. Excluding the contribution of the acquisition of Silego, revenue was 11% below Q4 2017. Mobile Systems revenue was 13% below Q4 2017. The year-on-year performance was driven by softness in consumer demand and the reduction of our share of volume from Apple announced on 31 May 2018, partially offset by content increase in other platforms. In Q4 2018 Advanced Mixed Signal revenue was up 42% year-on-year. Excluding revenue from Silego, Advanced Mixed Signal was 4% below Q4 2017 mainly as a result of lower volumes of LED Solid State Lighting ICs in the residential segment. Connectivity was up 6% year-on-year driven by the solid performance of Bluetooth® low energy and audio ICs. Automotive & Industrial was 15% below Q4 2017 due to lower volumes in the automotive segment.

Q4 2018 gross margin was 48.6%, 200bps above Q4 2017 and Q4 2018 underlying[1] gross margin was 160bps above Q4 2017 at 48.7%. The strong performance in gross margin was mostly due to product mix and lower manufacturing costs.

Operating expenses (OPEX) comprising SG&A and R&D expenses, in Q4 2018 were up 1% year-on-year to US$131.8 million, or 30.6% of revenue. Underlying[1] OPEX, in Q4 2018 was down 4% year-on-year to US$106.4 million, or 24.7% of revenue. The year-on-year decrease in underlying OPEX was mainly due to lower G&A expenses.

R&D expense in Q4 2018 was broadly in line with Q4 2017 at US$85.0 milllion, including the impact from the consolidation of Silego into the Group. As a percentage of revenue, R&D in Q4 2018 was up 130bps year-on-year to 19.7% (Q4 2017: 18.4%). On an underlying[1] basis, R&D expense decreased 1% from Q4 2017 to US$75.2 million. As a percentage of revenue, underlying R&D in Q4 2018 was 110bps above Q4 2017 at 17.5% (Q4 2017: 16.4%) due to the lower revenue in Q4 2018.

SG&A expense in Q4 2018 was up 2% from Q4 2017 to US$46.8 million. This increase was largely due to US$0.7 million of integration costs relating to the acquisition of Silego. As a percentage of revenue, SG&A in Q4 2018 was 100bps above Q4 2017 to 10.9%. Underlying[1] SG&A in Q4 2018 was down 9% year-on-year to US$31.2 million mainly due to lower performance-based bonus. As a percentage of revenue, underlying SG&A was 20bps below Q4 2017 at 7.2% (Q4 2017: 7.4%).

Operating profit in Q4 2018 was US$77.1 million, up 2% year-on-year due to lower other operating costs (Q4 2018: US$0.6 million; Q4 2017: US$9.6 million, mostly related to the deconsolidation of Dyna Image), partially offset by the impact of the lower Group revenue coupled with higher OPEX resulting from the consolidation of Silego. Operating profit margin in the quarter was 17.9%, 160bps above Q4 2017. Underlying[1] operating profit was US$103.4 million, 4% below Q4 2017 mainly driven by the lower year-on-year revenue partially offset by lower OPEX. Underlying operating margin in the quarter was 24.0%, 70 bps above Q4 2017. This increase was mainly due to the higher underlying gross margin partially offset by higher OPEX as a percentage of revenue.

The effective tax rate in 2018 was 28.2% (2017: 13.0%). Our income tax expense for 2018 includes a charge of US$2.8 million (2017: credit of US$1.5 million) resulting from the finalisation of prior year tax items with tax authorities. The low effective tax rate in 2017 reflected a non-cash deferred tax credit of US$6.7 million resulting from US tax reform and a credit of US$19.3 million due to the tax effects of unpredictable currency exchange rate movements. The underlying effective tax rate in 2018 was 21.8% compared with 14.5% in 2017. Excluding the charge of US$2.8 million in respect of the finalisation of prior year items (2017: credit of US$1.5 million), our underlying effective tax rate for 2018 was 20.8%, which compares with 15.0% for 2017. Our underlying effective tax rate for 2017 was unusually low, mainly because of the tax effects of unpredictable, and significant in the year, currency exchange rate movements.

In Q4 2018, net income was 29% below Q4 2017. This decrease was mainly due to the higher income tax expense, and a fair value loss of US$2.3 million on the Energous warrants. Underlying[1] net income was 20% below Q4 2017. The year-on-year decrease in underlying net income was mostly driven by the operating profit movement and higher income tax expense. Diluted EPS in Q4 2018 was 32% below Q4 2017. Underlying diluted EPS in Q4 2018 was 21% below Q4 2017.

At the end of Q4 2018, our total inventory level was US$150 million, 6% above Q3 2018 (or ~61 days), representing a 3-day decrease in our days of inventory from the previous quarter. During Q1 2019, we expect inventory value and days of inventory to increase from Q4 2018.

At the end of Q4 2018, we had a cash and cash equivalents balance of US$678 million. Cash flow from operating activities in Q4 2018 was US$96.5 million, 26% below Q4 2017 (Q4 2017: US$130.2 million) mainly as a result of the year-on-year decrease in net income.

On 11 October 2018, the Company reached an agreement with Apple Inc. to license certain of its power management technologies, transfer certain of its assets and over 300 employees to Apple to support chip research and development. Apple will pay $300 million in cash for the transaction and prepay $300 million for Dialog products to be delivered over the next three years. The transaction is expected to be completed in H1 2019.

Press release – 6 March 2019 continued

Operational overview

Innovation is at the core of our business model. Over the past five years, the Company has invested approximately US$1.4 billion in R&D, making it one of the leading investors in the European technology sector. Our focused R&D approach results in the development of deep expertise in the design of highly-integrated and power-efficient mixed-signal ICs primarily for consumer applications. We continue to invest in the development of innovative and differentiated technology in high-growth segments of our targeted end markets - IoT, mobile, automotive, and computing & storage. Our ability to recruit, develop and retain engineering talent is vital for our success. In 2018, the workforce grew by 1% to 2,100 employees, 76% of whom work in engineering functions (as at 31 December 2018) and we integrated Silego's R&D capabilities into our design centres in North America, Europe and Asia. In 2018, employee turnover was 10.7%, broadly in line with 2017 (2017: 10.3%). Our colleagues are based in 29 different locations across 16 countries and it is this global pool of talent which enables us to maintain strong relationships with our customers and partners and sustain our track record of innovation.

Our solid competitive positioning rests upon delivering technical excellence through short design cycles, enabling our customers a fast go-to-market. To meet the needs of our customers in very competitive markets, our products offer different levels of configurability and programmability which results in more integration and differentiation.

Our primary end markets are the Internet of Things (IoT) and mobile. The increasing number of smart connected devices has contributed to continuing adoption of standard radio technologies, such as Bluetooth® low energy. Energy efficiency is a key requirement in consumer markets and we continue to leverage our power management technologies into new applications beyond mobile devices. The adoption of new rapid charge technologies and the increasing use of backlighting, represent exciting opportunities for our business in mobile. An important element of our strategy is to continue to leverage our products and expertise into automotive and computing & storage. The expansion of high-performance processors into infotainment systems, more complex in-cabin electronics, and increasing requirements for more efficent power management, have created new opportunities for our business in these two end-markets.

In line with our strategic goals, during 2018 we expanded our product portfolio through a combination of organic and inorganic initiatives.

Mobile Systems

In Q4 2018, revenue from the Mobile Systems Segment was 13% below Q4 2017 mostly due to lower volumes and the reduced share of volume from Apple for the main PMIC for the 2018 smartphone platform announced on 31 May 2018, partially offset by higher content per device in other platforms. For the FY 2018, revenue was 1% below FY 2017 driven by the reduced share of volume from Apple for the main PMIC for the 2018 smartphone platform.

Consumer needs and requirements are evolving, requiring increasing battery life for an array of "always-on" IoT devices. To serve this need, Mobile Systems has expanded its product portfolio of Application Specific Standard Products (ASSP) with the launch of our first fully-integrated nanopower PMIC for low-power IoT applications and the Haptic IC. Our Haptic IC provides a more sophisticated haptics experience for mobile and gaming applicatons, as well as in touchscreens.

In Q4 2018, we reached an agreement with Apple Inc. to license certain of our main PMIC technologies, and transfer certain of our assets and over 300 employees. Additionally, we were awarded new custom mixed-signal designs for next generation models. These opportunities, and all other opportunities from our largest customer are made available to us on a product by product basis and depend on our ability to work to the highest technical standards, develop leading-edge technology and a commitment to provide high-quality products at appropriate prices and volumes. We will continue to support our largest customer as this relationship evolves and develops over time.

In parallel, we continued to leverage our power management technology into our target end-markets, with increasing design momentum in gaming, SSDs and DSLR cameras. In gaming, we have engaged on a second custom PMIC design for a leading game console brand. In SSD, we are working with a leading manufacturer in the design of a custom PMIC. Lastly, in DSLR cameras, we are winning new designs for power management and motor drivers. The latest product designed for a mobile chipset partner went into volume production in Q4 2018 for the latest Micromax smartphone, a leader in the Indian smartphone market. Our ongoing collaborations with Renesas and Xilinx strengthens Dialog's presence in the automotive segment.

Advanced Mixed Signal

During Q4 2018, revenue from the Advanced Mixed Signal Segment was up 42% year-on-year. Excluding revenue from Silego, Advanced Mixed Signal was 4% below Q4 2017 as a result of lower volumes of LED Solid State Lighting ICs in the residential segment. FY 2018 revenue was up 73% year-on-year, due to the contribution of Silego as well as the solid performance of our Rapid Charge™ products.

The acquisition of Silego in November 2017 contributed to the expansion of our product portfolio. With over four billion units shipped to date, the Configurable Mixed-signal IC (CMIC) enables customers to customise and integrate multiple analog, logic and discrete components into a single chip fast. During 2018, we launched the first CMIC with in-system programming, accelerating the development process and reducing time-to-market. This technology will contribute to the expansion of our customer base and strengthen our presence in all our targeted end-markets. When compared on a full year basis, revenue from CMIC products in 2018 was up 24%[4] year-on-year.

Market adoption of rapid charge technologies continued in the second half of 2018. During the year our USB Power Delivery (USB PD) chipset was adopted by Hosiden, a leading manufacturer of charger adapters for mobile devices. We expect USB PD Type C, to become more prevalent from the second half of 2019. Dialog has successfully maintained a commanding market share in the rapid charge market through a combination of differentiated technology, speed of execution and wide support of rapid charge protocols. At the end of 2018, our Rapid Charge™ products for power adapters had approximately 60% market share of the rapid charge adapter market for smartphones.

Our broad product portfolio in LED Solid-State Lighting (SSL) driver ICs and exclusive digital conversion technologies enable high quality solutions with a low cost. The extended range of LED backlighting products (combined with the acquisition of the ams AG portfolio in 2017) contributed to the expansion of our customer base and increased our share of the large panel display market.

4 Based on twelve months actual 2017 revenue of US$84.3 million.

Connectivity
In Q4 2018, revenue from the Connectivity Segment was up 6% year-on-year driven by the solid performance of Bluetooth® low energy and the new range of audio ICs. For the same reasons as in Q4 2018, revenue for FY 2018 was up 9% year-on-year.

During 2018, our Connectivity Segment reached a remarkable milestone, shipping over 200 million SmartBond™ System-on-Chip (SoC) units into the IoT market. For the full year 2018, revenue from SmartBond™, our Bluetooth® low energy SoC grew 21% year-on-year. This is a strong indication of the value we bring to customers and the continuing adoption of the technology across a wide range of applications. We continue to expand our product range and in addition to our targeted verticals, we see increasing medium-term opportunities in new segments such as connected health and automotive. In 2018 we expanded the SmartBond™ product portfolio supporting the Bluetooth® 5.0 standard and launched our Bluetooth® mesh Software Development Kit.

The Connectivity Segment is also targeting the consumer headset market with SmartBeat™ wireless Audio IC. This technology enables a new immersive headset experience and supports both wired USB 3.0 Type-C™ and Bluetooth® based consumer headsets. In 2018, Jabra selected our technology to enhance the audio quality of their new Engage Headset Series.

Automotive & Industrial
In Q4 2018, revenue from the Automotive & Industrial Segment was 15% below Q4 2017 due to lower volumes in the automotive segment. Automotive & industrial was broadly stable in FY 2018, despite lower volumes of our automotive products during the second half of the year.

Impact of reclassification of certain product development costs

With effect from 1 January 2018, we reclassified the amortisation of capitalised development costs, the amortisation of acquired technology-based intangible assets and royalties payable for the use of intellectual property in our product development activities from cost of sales to research and development (R&D) expenses.

As shown in the table below, we have represented comparative information for FY 2017 and Q4 2017 on a consistent basis.

FY 2017

	IFRS			Underlying[1]		
	As previously reported US$000	Effect of reclassification US$000	As reclassified US$000	As previously reported US$000	Effect of reclassification US$000	As reclassified US$000
Revenue	1,352,841	–	1,352,841	1,352,841	–	1,352,841
Cost of sales	(732,188)	24,217	(707,971)	(721,125)	16,679	(704,446)
Gross profit	620,653	24,217	644,870	631,716	16,679	648,395
R&D expenses	(278,796)	(24,217)	(303,013)	(259,106)	(16,679)	(275,785)
Operating profit	187,017	–	187,017	259,458	–	259,458
Gross margin %	45.9%		47.7%	46.7%		47.9%
R&D % of revenue	20.6%		22.4%	19.2%		20.4%

Q4 2017

	IFRS			Underlying[1]		
	As previously reported US$000	Effect of reclassification US$000	As reclassified US$000	As previously reported US$000	Effect of reclassification US$000	As reclassified US$000
Revenue	463,519	–	463,519	463,519	–	463,519
Cost of sales	(254,190)	6,677	(247,513)	(249,795)	4,455	(245,340)
Gross profit	209,329	6,677	216,006	213,724	4,455	218,179
R&D expenses	(78,462)	(6,677)	(85,139)	(71,467)	(4,455)	(75,922)
Operating profit	75,390	–	75,390	108,128	–	108,128
Gross margin %	45.2%		46.6%	46.1%		47.1%
R&D % of revenue	16.9%		18.4%	15.4%		16.4%

Press release – 6 March 2019 continued

Non-IFRS measures

Underlying measures of performance and free cash flow quoted in this press release are non-IFRS measures. Our use of underlying measures and reconciliations of the underlying measures to the nearest equivalent IFRS measures for FY 2018 and FY 2017 are presented in Section 3 of the full announcement of our results for Q4 and FY 2018. For ease of reference, we present below reconciliations for the non-IFRS measures for Q4 2018 and Q4 2017.

Income statement items

Q4 2018

US$000	**IFRS basis**	**Share-based compensation and related payroll taxes**	**Accounting for business combinations**	**Integration costs**	**Corporate transaction costs**	**Strategic investments**	**Underlying basis**
Revenue	430,745	–	–	–	–	–	430,745
Gross profit	209,469	359	–	–	–	–	209,828
SG&A expenses	(46,809)	4,507	3,731	662	6,693	–	(31,216)
R&D expenses	(84,951)	7,488	2,275	–	–	–	(75,188)
Other operating expense	(600)	–	600	–	–	–	–
Operating profit	77,109	12,354	6,606	662	6,693	–	103,424
Net finance income	223	–	590	–	–	1,814	2,627
Profit before income taxes	77,332	12,354	7,196	662	6,693	1,814	106,051
Income tax expense	(19,449)	(2,237)	(701)	(113)	(370)	(345)	(23,215)
Profit after income taxes	57,883	10,117	6,495	549	6,323	1,469	82,836
Share of loss of associate	3	–	–	–	–	–	3
Net income	57,886	10,117	6,495	549	6,323	1,469	82,839

Q4 2017

US$000	IFRS basis	Share-based compensation and related payroll taxes	Accounting for business combinations	Integration costs	Effective interest	Strategic investments	US tax reform	Underlying basis
Revenue	463,519	–	–	–	–	–	–	463,519
Gross profit	216,006	(133)	2,306	–	–	–	–	218,179
SG&A expenses	(45,849)	2,749	7,554	1,121	–	–	–	(34,425)
R&D expenses*	(85,139)	5,299	2,734	1,184	–	–	–	(75,922)
Other operating (expense)/income	(9,628)	–	–	–	–	9,924	–	296
Operating profit	75,390	7,915	12,594	2,305	–	9,924	–	108,128
Net finance income	5,925	–	436	–	49	(5,302)	–	1,108
Profit before income taxes	81,315	7,915	13,030	2,305	49	4,622	–	109,236
Income tax credit/(expense)	608	1,998	(3,557)	(701)	(10)	2,522	(6,658)	(5,798)
Net income	81,923	9,913	9,473	1,604	39	7,144	(6,658)	103,438

* 2017 Gross margin and R&D are presented on a consistent basis. Further information regarding the classification of certain product development costs is presented on page 5 and in note 1 to the interim financial statements.

Accounting for business combinations

US$000	**Q4 2018**	Q4 2017	**FY 2018**	FY 2017
Acquisition-related costs	**–**	3,207	**–**	4,539
Amortisation of acquired intangible assets	**5,657**	5,673	**22,629**	16,461
Consumption of the fair value uplift of acquired inventory	**–**	2,305	**3,129**	2,305
Consideration accounted for as compensation expense	**336**	1,409	**1,481**	1,409
Forfeiture of deferred consideration	**(27)**	–	**(204)**	–
Remeasurement of contingent consideration	**640**	–	**(878)**	–
Increase in operating profit	**6,606**	12,594	**26,157**	24,714
Unwinding of discount on contingent consideration	**590**	436	**2,220**	436
Increase in profit before income taxes	**7,196**	13,030	**28,377**	25,150
Income tax credit	**(701)**	(3,557)	**(3,448)**	(4,187)
Increase in net income	**6,495**	9,473	**24,929**	20,963

EBITDA

US$000	Q4 2018	Q4 2017	FY 2018	FY 2017
Net income	**57,886**	81,923	**139,799**	169,434
Net finance (income)/expense	**(223)**	(5,925)	**3,514**	(7,786)
Income tax expense/(credit)	**19,449**	(608)	**55,281**	25,369
Depreciation expense	**7,381**	8,004	**31,455**	30,807
Amortisation expense	**12,567**	12,622	**49,130**	41,969
EBITDA	**97,060**	96,016	**279,179**	259,793
Share-based compensation and related payroll taxes	**12,354**	7,915	**41,653**	35,498
Acquisition-related costs	**–**	3,207	**–**	4,539
Consumption of the fair value uplift of acquired inventory	**–**	2,305	**3,129**	2,305
Consideration accounted for as compensation expense	**336**	1,409	**1,481**	1,409
Forfeiture of deferred consideration	**(27)**	–	**(204)**	–
Remeasurement of contingent consideration	**640**	–	**(878)**	–
Corporate transaction costs	**6,693**	–	**11,346**	–
Integration costs	**662**	2,305	**2,765**	2,305
Impairment of intangible assets	**–**	2,790	**–**	2,790
Impairment of property, plant and equipment	**–**	1,537	**–**	1,537
Loss on deconsolidation of Dyna Image	**–**	5,597	**–**	5,597
Share of loss of associate	**(3)**	–	**1,113**	–
Underlying EBITDA	**117,715**	123,081	**339,584**	315,773

Free cash flow

US$000	Q4 2018	Q4 2017	FY 2018	FY 2017
Cash flow from operating activities	**96,466**	130,238	**288,649**	284,722
Purchase of property, plant and equipment	**(5,900)**	(9,907)	**(26,145)**	(47,938)
Purchase of intangible assets	**(2,306)**	(2,164)	**(6,197)**	(6,196)
Payments for capitalised development costs	**(5,821)**	(6,327)	**(24,771)**	(20,988)
Capital element of finance lease and hire purchase payments	**–**	(800)	**(1,651)**	(4,283)
Free cash flow	**82,439**	111,040	**229,885**	205,317

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Press release – 6 March 2019 continued

Dialog Semiconductor invites you today at 09.30 am (London) / 10.30 am (Frankfurt) to take part in a live conference call and to listen to management's discussion of the Company's Q4 2018 performance, as well as guidance for Q1 2019. Participants will need to register using the link below labelled 'Online Registration'. A full list of dial in numbers will also be available. To register for the webcast and receive dial in numbers, the conference PIN and a unique User ID please click on the link below:

https://www.incommglobalevents.com/registration/client/1558/dialog-semiconductor-q4-earnings-call/

In parallel to the call, the presentation will be available at:

http://webcast.openbriefing.com/DS06032019/

A replay will be posted on the Dialog website four hours after the conclusion of the presentation and will be available at:

https://www.dialog-semiconductor.com/investor-relations/results-center

The full release including the Company's condensed consolidated income statement, consolidated balance sheet, consolidated statements of cash flows and selected notes for the year ended 31 December 2018 is available under the investor relations section of the Company's website at:

http://www.dialog-semiconductor.com/investor-relations

For further information please contact:

Dialog Semiconductor

Jose Cano
Head of Investor Relations
T: +44 (0)1793 756 961
jose.cano@diasemi.com

FTI Consulting London

Matt Dixon
T: +44 (0)2037 271 137
matt.dixon@fticonsulting.com

FTI Consulting Frankfurt

Anja Meusel
T: +49 (0)69 9203 7120
anja.meusel@fticonsulting.com

Note to editors

Dialog Semiconductor provides highly integrated standard (ASSP) and custom (ASIC) mixed-signal integrated circuits (ICs), optimised for smartphone, tablet, IoT, LED Solid-State Lighting (SSL), and Smart Home applications. Dialog brings decades of experience to the rapid development of ICs while providing flexible and dynamic support, world-class innovation and the assurance of dealing with an established business partner. With world-class manufacturing partners, Dialog operates a fabless business model and is a socially responsible employer pursuing many programs to benefit the employees, community, other stakeholders and the environment we operate in.

Dialog's power saving technologies including DC-DC configurable system power management deliver high efficiency and enhance the consumer's user experience by extending battery lifetime and enabling faster charging of their portable devices. Its technology portfolio also includes audio, Bluetooth® Low Energy, Rapid Charge™ AC/DC power conversion and multi-touch.

Dialog Semiconductor plc is headquartered in London with a global sales, R&D and marketing organisation. In 2018, it had US$1.4 billion in revenue and approximately 2,100 employees worldwide. The company is listed on the Frankfurt (XETRA: DLG) stock exchange (Regulated Market, Prime Standard, ISIN GB0059822006) and is a member of the German TecDax index.

Forward Looking Statements

This press release contains "forward-looking statements" that reflect management's current views with respect to future events. The words "anticipate," "believe," "estimate", "expect," "intend," "may," "plan," "project" and "should" and similar expressions identify forward-looking statements. Such statements are subject to risks and uncertainties, including, but not limited to: an economic downturn in the semiconductor and telecommunications markets; changes in currency exchange rates and interest rates, the timing of customer orders and manufacturing lead times, insufficient, excess or obsolete inventory, the impact of competing products and their pricing, political risks in the countries in which we operate or sale and supply constraints. If any of these or other risks and uncertainties occur (some of which are described under the heading "Managing risk and uncertainty" in Dialog Semiconductor's most recent Annual Report) or if the assumptions underlying any of these statements prove incorrect, then actual results may be materially different from those expressed or implied by such statements. We do not intend or assume any obligation to update any forward-looking statement which speaks only as of the date on which it is made, however, any subsequent statement will supersede any previous statement.

Financial review FY 2018

Our disciplined approach to capital allocation aims to create shareholder value

In 2018, we delivered another year of revenue growth, increased underlying operating margin and free cash flow, while investing over US$325 million in the development of new products. We successfully integrated Silego and launched a new share buyback tranche for up to €150 million.

Basis of preparation of financial information

Accounting policies

The Group's financial statements for the year ended 31 December 2018 have been prepared in accordance with International Financial Reporting Standards ("IFRS") as adopted for use in the European Union and those parts of the Companies Act 2006 that are applicable to companies reporting under IFRS. The Group's financial statements also comply with IFRS as issued by the International Accounting Standards Board.

The Group's significant accounting policies are unchanged compared with the year ended 31 December 2017, except for the adoption of IFRS 15 *Revenue from Contracts with Customers* and IFRS 9 *Financial Instruments* with effect from 1 January 2018.

Revenue recognition

IFRS 15 *Revenue from Contracts with Customers* provides a single, principles-based five step model to be applied to all contracts with customers.

Adoption of IFRS 15 had no impact on the recognition and measurement of the majority of the Group's revenue. Under our previous revenue recognition policy, however, revenue on certain sales to distributors and the related cost of sales were not recognised until the onward sale of the products by the distributors to the end customers. Under IFRS 15, we are required to recognise revenue on all sales to distributors when the products are physically transferred to the distributors, net of allowances for estimated rebates and returns.

We applied IFRS 15 using the modified retrospective approach, whereby prior periods were not restated and we recognised a credit of US$1.5 million to the opening balance of retained earnings as at 1 January 2018 representing the cumulative effect of the adoption of IFRS 15.

Revenue recognised in 2018 was US$10.1 million higher than it would have been under our previous revenue recognition policy, of which US$9.4 million was recognised in our Advanced Mixed Signal operating segment and US$0.7 million in Connectivity.

Financial Instruments

IFRS 9 *Financial Instruments* introduced a new model for classification and measurement of financial assets and financial liabilities, a single, forward-looking "expected loss" model for measuring impairment of financial assets (including trade receivables) and a new approach to hedge accounting that is more closely aligned with an entity's risk management activities.

Adoption of IFRS 9 had no immediate impact on the Group's results or financial position.

Reclassification of certain product development costs

With effect from 1 January 2018, we changed the income statement classification of the amortisation of capitalised product development costs, the amortisation of acquired technology-based intangible assets and royalties payable for the use of intellectual property in our product development activities. Previously, we included these costs within cost of sales. We now include them within research and development expenses.

We made this change in order that our results are more comparable with our industry peers.

As shown in note 1 to the consolidated financial information, comparative amounts have been re-presented on a consistent basis with the effect that cost of sales was US$24.2 million lower and R&D expenses were US$24.2 million higher in 2017 than previously reported.

Non-IFRS measures

We assess the performance of the Group's businesses using a number of measures. Certain of them are non-IFRS measures because they exclude amounts that are included in, or include amounts that are excluded from, the most directly comparable measure calculated and presented in accordance with IFRS, or are calculated using financial measures that are not calculated in accordance with IFRS. All underlying measures of profitability and free cash flow are non-IFRS measures.

An explanation of the adjustments made to the equivalent IFRS measures in calculating the non-IFRS measures and reconciliations of the non-IFRS measures to the equivalent IFRS measures for the periods presented are set out in the section entitled "Financial performance measures" on pages 37 to 42.

We report non-IFRS measures because they provide useful additional information about the financial performance of the Group's businesses. We do not regard these non-IFRS measures as a substitute for, or superior to, the equivalent IFRS measures. Non-IFRS measures used by Dialog may not be directly comparable with similarly-titled measures used by other companies.

Agreements entered into with Apple

On 11 October 2018, we announced that we have entered into an agreement with Apple Inc. ("Apple") to license our power management technologies and to transfer to Apple certain assets and over 300 employees from our design centres in the UK, Germany and Italy.

Apple will pay US$300 million for the licence and asset transfers. The transaction is expected to complete in the first half of 2019, subject to applicable regulatory approvals and other customary closing conditions. We have accordingly classified the assets to be transferred to Apple and certain directly associated liabilities as held for sale.

Our revenue for 2018 was unaffected by this agreement and we will continue to supply Apple with PMICs for their current generation of products. Revenue associated with those products, which totalled approximately US$870 million in 2018, will begin to decline in the second half of 2019 and phase out by 2022. We expect to continue to provide PMICs to other customers across the globe.

When we announced this agreement with Apple, we also announced that we have been awarded a broad range of new contracts from Apple for the development and supply of power management, audio sub-system, charging and other mixed-signal integrated circuits.

Financial review continued

Revenue from the new contracts is expected to commence in 2019 and accelerate in 2020 and 2021.

On completion of the licence and asset transfer agreement, Apple will make a prepayment of US$300 million that is expected to be recouped against the sale of our products over the following three years.

During 2018, we incurred transaction costs of US$7.8 million in relation to the agreements with Apple (within general and administrative expenses).

Recent acquisitions

Silego Technology Inc.

We completed the acquisition of Silego Technology Inc. ("Silego") on 1 November 2017.

Silego is included in our Advanced Mixed Signal operating segment. Silego contributed US$104.2 million to the Group's revenue in 2018 compared with US$11.4 million in 2017. When compared on a full-year basis, Silego's revenue in 2018 was 24% higher than in 2017.

We incurred integration costs of US$2.8 million in relation to Silego during 2018, taking the total integration costs incurred to US$5.0 million.

Contingent consideration of up to US$30.4 million was payable for the acquisition of Silego dependent on Silego's revenue in 2017 and 2018. Based on Silego's revenue in 2017, the first instalment of US$10.0 million was paid in full and a further US$17.9 million was payable based on Silego's revenue for 2018.

During 2018, we recognised a credit of US$0.9 million arising from the finalisation of the contingent consideration and a credit of US$0.2 million due to the forfeiture by former employees of deferred consideration payable for Silego.

LED backlight business

We acquired ams AG's LED backlight technology and product portfolio on 15 November 2017.

We have included the business in our Advanced Mixed Signal operating segment where it contributed US$11.3 million to revenue in 2018 compared with US$0.8 million in 2017.

Dyna Image Corporation

Deconsolidation and subsequent accounting under the equity method

We hold a 48.5% shareholding in Dyna Image Corporation ("Dyna Image").

Dyna Image was accounted for as a subsidiary until it was deconsolidated at the end of 2017.

With effect from 1 January 2018, we have accounted for Dyna Image as an associate using the equity method with an initial carrying amount of US$1.1 million. During 2018, Dyna Image continued to make losses. We recognised our share of those losses in the consolidated income statement until the carrying amount of our investment was reduced to nil during the fourth quarter of 2018.

Under the equity method, the Group's revenue no longer includes any contribution from Dyna Image. During 2017, the Group's revenue included Dyna Image's revenue of US$5.5 million.

Agreement to dispose of our shareholding in Dyna Image

Following the termination of negotiations with a potential investor in December 2017, it had been the intention of the shareholders in Dyna Image to gradually wind down the company in a way that would safeguard the interests of its creditors. During early 2018, however, the shareholders were approached by a potential acquirer of the business.

On 7 December 2018, each of the shareholders in Dyna Image entered into an agreement to dispose of their respective interests in a transaction that is expected to complete in the first half of 2019, subject to applicable regulatory approvals.

We expect to receive consideration of between US$2.4 million and US$5.0 million in exchange for our shareholding in Dyna Image.

Synaptics Incorporated

During 2018, we held discussions with regard to the potential acquisition of Synaptics Incorporated. On 31 July 2018, we announced that these discussions had been terminated. We incurred related costs of US$3.6 million (within general and administrative expenses).

Results by operating segment

Year ended 31 December US$ millions	Revenue 2018	Revenue 2017	Change	Operating profit/(loss) 2018	Operating profit/(loss) 2017
Mobile Systems	**1,029.6**	1,042.9	-1%	**248.5**	271.7
Connectivity	**148.8**	136.4	+9%	**16.9**	14.3
Automotive & Industrial	**32.7**	33.0	-1%	**11.7**	12.5
Advanced Mixed Signal	**229.8**	132.7	+73%	**1.8**	(15.1)
Total segments	**1,440.9**	1,345.0	+7%	**278.9**	283.4
Corporate activities	**1.2**	7.8	-84%	**(79.2)**	(96.4)
Total Group	**1,442.1**	1,352.8	+7%	**199.7**	187.0

Results of operations

Analysis by operating segment

Mobile Systems segment revenue was US$1,029.6 million in 2018 compared with US$1,042.9 million in 2017, a decrease of 1%. Revenue declined principally due to the effect in the fourth quarter of 2018 of our reduced share of volume for the main PMIC on Apple's 2018 smartphone platform, though this was partially offset by higher demand for our custom PMICs on other platforms.

Mobile Systems' operating profit was $248.5 million in 2018 compared with $271.7 million in 2017. Operating profit benefited from favourable product mix but this was outweighed by the effect of the lower sales volume and higher R&D expenses. Operating margin declined to 24.1% (2017: 26.1%).

Mobile Systems' underlying operating profit was US$248.8 million in 2018 compared with US$271.8 million in 2017. Underlying operating margin was also lower at 24.2% (2017: 26.1%).

Mobile Systems' underlying operating profit excludes payroll taxes arising on share-based compensation of US$0.3 million (2017: US$0.1 million).

Connectivity segment revenue was US$148.8 million in 2018 compared with US$136.4 million in 2017, an increase of 9%. Connectivity's revenue increased principally due to strong growth in demand for Bluetooth® low energy products and our new range of audio ICs.

Connectivity's operating profit was higher at US$16.9 million in 2018 compared with US$14.3 million in 2017, with the effect of the higher sales volume and improved product margins being only partially offset by higher R&D expenses. Operating margin improved to 11.4% (2017: 10.5%).

Connectivity's underlying operating profit was broadly the same as its reported operating profit in both 2018 and 2017.

Automotive & Industrial segment revenue was US$32.7 million in 2018 compared with US$33.0 million in 2017, a decrease of 1%. Revenue declined over the year as a whole principally due to lower demand for automotive products in the fourth quarter of 2018.

Automotive & Industrial's operating profit was US$11.7 million in 2018 compared with US$12.5 million in 2017, a decrease of 7%. Operating profit was lower principally due to higher R&D expenses. Operating margin declined to 35.8% (2017: 38.1%).

Automotive & Industrial's underlying operating profit was broadly the same as its reported operating profit in both 2018 and 2017.

Advanced Mixed Signal segment revenue was US$229.8 million in 2018 compared with US$132.7 million in 2017, an increase of 73%. When adjusted to reflect the contribution of Silego for comparable periods and for the effect of IFRS 15, Advanced Mixed Signal's revenue in 2018 was broadly unchanged compared with 2017. Growth in sales of Rapid Charge™ smartphone power adaptors was offset by lower sales of residential solid state lighting driver ICs.

Advanced Mixed Signal made an operating profit of US$1.8 million in 2018 compared with an operating loss of US$15.1 million in 2017, the improvement being principally due to the contribution of Silego for the full year in 2018. Operating margin was 0.8% in 2018 compared with (11.4)% in 2017.

Advanced Mixed Signal's underlying operating profit was US$30.5 million in 2018 compared with US$5.9 million in 2017. Underlying operating margin was 13.3% in 2018 compared with 4.5% in 2017.

Advanced Mixed Signal's underlying operating result excludes the increase in cost of sales of US$3.1 million (2017: US$2.3 million) arising from consumption of the fair value uplift on acquired inventory, amortisation of US$22.6 million (2017: US$15.3 million) on the fair value uplift of acquired intangible assets, integration costs of US$1.4 million (2017: US$2.0 million) and deferred consideration payable for Silego treated as compensation expense of US$1.5 million (2017: US$1.4 million).

Corporate activities principally comprise the costs of operating central corporate functions, the Group's share-based compensation expense and certain other unallocated costs.

Corporate activities also comprise various development stage businesses and, until its deconsolidation at the end of 2017, included the results of Dyna Image.

Corporate activities showed an operating loss of US$79.2 million in 2018 compared with an operating loss of US$96.4 million in 2017.

Corporate's underlying operating loss was US$26.4 million in 2018 compared with US$45.2 million in 2017, with the improvement being principally due to lower R&D expenses in development stage businesses.

Corporate's underlying operating result excludes the Group's share-based compensation expense of US$41.2 million (2017: US$35.4 million), transaction costs of US$11.3 million (2017: US$4.5 million), integration costs of US$1.4 million (2017: US$0.3 million), credits totalling US$1.1 million in relation to the remeasurement and forfeiture of contingent and deferred consideration payable for Silego, and, in 2017, amortisation of US$1.1 million on the fair value uplift of acquired intangible assets and losses totalling US$9.9 million on the impairment of assets held by Dyna Image and its subsequent deconsolidation.

Analysis of the Group's results

Revenue was US$1,442.1 million in 2018 compared with US$1,352.8 million in 2017, an increase of 7%. When adjusted to reflect the contribution of Silego for comparable periods and for the effect of IFRS 15, revenue in 2018 was broadly unchanged compared with 2017. Revenue growth in Connectivity was offset by the net reduction in demand for our custom PMICs in Mobile Systems in the fourth quarter of 2018.

Dialog's revenue, particularly in its Mobile Systems segment, is dependent on the life cycle of its customers' products and the seasonal nature of the spending pattern in the consumer markets in which they operate. As a result, Dialog's business may fluctuate seasonally with lower revenue in the first half of the year, since many of its larger consumer-focused customers tend to have stronger sales later in the year as they prepare for the major holiday selling seasons.

Cost of sales was US$751.1 million in 2018 compared with US$708.0 million in 2017, an increase of 6% that was principally due to the acquisition of Silego.

Gross profit was US$691.1 million in 2018 compared with US$644.9 million in 2017, an increase of 7%.

Gross margin was 20 basis points higher at 47.9% in 2018 compared with 47.7% in 2017. Gross margin improved largely due to a favourable change in product unit costs.

Underlying gross profit was US$696.0 million in 2018 compared with US$648.4 million in 2017, an increase of 7%. Underlying gross margin was 40 basis points higher at 48.3% in 2018 compared with 47.9% in 2017.

Underlying gross profit excludes share-based compensation expenses and related payroll taxes of US$1.8 million (2017: US$1.2 million) and consumption of the fair value uplift on acquired inventory of US$3.1 million (2017: US$2.3 million).

Selling and marketing expenses were US$83.9 million in 2018 compared with US$70.4 million in 2017. We maintained tight control of selling and marketing costs but they increased due to the acquisition of Silego.

Underlying selling and marketing expenses increased to US$65.0 million in 2018 compared with US$56.6 million in 2017, and were higher as a percentage of the Group's revenue at 4.5% in 2018 compared with 4.2% in 2017.

Underlying selling and marketing expenses exclude share-based compensation expenses and related payroll taxes totalling US$4.4 million (2017: US$4.1 million), amortisation of US$14.0 million (2017: US$8.9 million) on the fair value uplift of acquired intangible assets, deferred consideration payable for Silego treated as compensation expense of US$0.5 million (2017: US$0.4 million) and, in 2017, integration costs of US$0.4 million.

General and administrative expenses were US$84.3 million in 2018 compared with US$74.9 million in 2017, with the increase being largely due to the acquisition of Silego and corporate transaction costs.

Underlying general and administrative expenses increased slightly to US$57.4 million in 2018 compared with US$56.9 million in 2017, but were lower as a percentage of the Group's revenue at 4.0% in 2018 compared with 4.2% in 2017.

Underlying general and administrative expenses exclude share-based compensation and related payroll taxes totalling US$12.8 million (2017: US$12.2 million), transaction costs of US$11.3 million (2017: US$4.5 million), deferred consideration payable for Silego treated as compensation expense of US$0.5 million (2017: US$0.5 million), integration costs of US$2.5 million (2017: US$0.7 million) and, in 2018, a credit of US$0.2 million on the forfeiture of deferred consideration payable for Silego.

R&D expenses were US$326.3 million in 2018 compared with US$303.0 million in 2017, an increase of 8%.

R&D costs totalled US$356.3 million in 2018 (2017: US$331.2 million), of which US$24.8 million (2017: US$21.0 million) were capitalised, and we recognised R&D expenditure credits of US$5.2 million (2017: US$7.2 million).

Dialog has an extensive R&D engineering team focused on mixed-signal semiconductor power saving technologies. Dialog believes that its R&D activities are critical to support its strategy of growth and product diversification.

Underlying R&D expenses were US$294.2 million in 2018 compared with US$275.8 million in 2017, an increase of 7%. When adjusted to reflect the contribution of Silego on a like-for-like basis, underlying R&D expenses were broadly unchanged in 2018 compared with 2017, because higher spending in Mobile Systems was largely offset by lower spending in development stage businesses. Underlying R&D expenses represented 20.4% of the Group's revenue in 2018, broadly unchanged compared with 2017.

Financial review continued

Underlying R&D expenses exclude share-based compensation expenses and related payroll taxes totalling US$22.7 million (2017: US$18.0 million), amortisation of US$8.6 million (2017: US$7.5 million) on the fair value uplift of acquired technology, integration costs of US$0.2 million (2017: US$1.2 million) and deferred consideration payable for Silego treated as compensation expense of US$0.6 million (2017: US$0.5 million).

Other operating income was US$3.2 million in 2018 compared with an expense of US$9.6 million in 2017.

In 2018, we recognised income from R&D contracts of US$2.3 million and a credit of US$0.9 million arising from the finalisation of the contingent consideration payable for Silego.

In 2017, we recognised income from R&D contracts of US$0.3 million and losses totalling US$9.9 million on the impairment of assets held by Dyna Image and its subsequent deconsolidation.

Operating profit was US$199.7 million in 2018 compared with $187.0 million in 2017.

Underlying operating profit was US$281.6 million in 2018 compared with US$259.5 million in 2017, an increase of 9%. Underlying operating profit improved because the effect of higher overall sales volumes outweighed the increase in underlying sales and marketing and R&D expenses.

Underlying operating margin was 30 basis points higher at 19.5% in 2018 compared with 19.2% in 2017.

Interest income was US$9.9 million in 2018 compared with US$6.0 million in 2017, with the increase reflecting higher US dollar interest rates.

Interest expense increased to US$3.1 million in 2018 compared with US$1.3 million in 2017, principally due to the additional interest expense recognised on the contingent consideration payable for Silego.

Other finance expense was US$10.3 million in 2018 compared with income of US$3.1 million in 2017.

Other finance income/(expense) comprises foreign currency translation gains and losses that arise on monetary assets and liabilities that are denominated in currencies other than the functional currencies of the entities by which they are held and fair value gains and losses recognised in relation to certain of our strategic investments.

We recognised a net currency translation loss of US$1.0 million in 2018 compared with a net gain of US$1.7 million in 2017.

During 2018, we recognised a fair value loss of US$10.9 million (2017: gain of US$0.9 million) on the warrants that we hold over shares in Energous and amortisation of the gain on initial recognition of the second tranche of warrants amounting to US$1.6 million (2017: US$0.8 million).

During 2017, we recognised losses totalling US$0.3 million on other strategic investments.

Share of loss of associate was US$1.1 million (2017: US$nil) in relation to Dyna Image.

Income tax

Our approach to tax is to support our business strategy and the creation of long-term value for our shareholders by conducting the Group's affairs in a tax efficient manner whilst remaining in compliance with applicable laws and regulations. Our "Approach to Tax" can be found at www.dialog-semiconductor.com.

Income tax expense was US$55.3 million (2017: US$25.4 million) on profit before tax of US$196.2 million (2017: US$194.8 million), an effective tax rate for the year of 28.2% (2017: 13.0%).

Our effective tax rate is sensitive to the geographic mix of the Group's profits, reflecting a combination of different tax rates in different countries, changes in tax legislation and tax rates, the impact of acquisitions, disposals and restructuring and to currency exchange rate movements, which give rise to tax effects where an entity's functional currency differs from the currency in which it is required to calculate and pay income taxes.

A large proportion of Dialog's R&D activities are undertaken in the UK and the Netherlands and we are therefore able to benefit from the UK and Netherlands tax regimes that provide incentives for innovation.

Our income tax expense for 2018 includes a charge of US$2.8 million (2017: credit of US$1.5 million) resulting from the finalisation of prior year tax items with tax authorities.

Our income tax expense for 2017 reflected a non-cash deferred tax credit of US$6.7 million resulting from US tax reform. We excluded this non-recurring credit in determining our underlying income tax expense for 2017.

Our underlying income tax expense was US$63.2 million (2017: US$38.6 million) on underlying profit before tax of US$289.7 million (2017: US$266.6 million). Our underlying effective tax rate for 2018 was therefore 21.8%, which compares with 14.5% for 2017.

Excluding the charge of US$2.8 million in respect of the agreement of prior year items (2017: credit of US$1.5 million), our underlying effective tax rate for 2018 was 20.8%, which compares with 15.0% for 2017.

Our underlying effective tax rate for 2017 was unusually low, principally because of the tax effects of unpredictable, and significant in the year, currency exchange rate movements.

Net income was US$139.8 million in 2018 compared with US$169.4 million in 2017. Net income in 2017 reflected a loss of US$4.5 million that was attributable to the non-controlling interest in Dyna Image. Underlying net income was US$225.4 million in 2018 compared with US$228.0 million in 2017, a decrease of 1%.

Basic earnings per share were US$1.89 (2017: US$2.34) based on the weighted average of 74.0 million shares (2017: 74.5 million shares) that were in issue during the year excluding 2.4 million shares (2017: 2.1 million shares) held by employee benefit trusts and, in 2017, the weighted average of 1.4 million of our own shares that were held in treasury. Underlying basic earnings per share were US$3.05 (2017: US$3.08).

Diluted earnings per share were US$1.80 (2017: US$2.21). Diluted earnings per share additionally reflect the weighted average of 3.7 million (2017: 4.1 million) dilutive employee share options. Underlying diluted earnings per share were US$2.90 (2017: US$2.92).

Cash flows

Cash flow from operating activities was US$288.7 million in 2018 compared with US$284.7 million in 2017, reflecting higher cash generated from operations that was partially offset by the timing of income tax cash flows.

Cash generated from operations before changes in working capital was US$322.3 million in 2018 compared with US$301.5 million in 2017.

Excluding the effect of acquisitions, net working capital increased by US$1.0 million compared with an increase of US$30.9 million in 2017.

Demand for our products is typically higher in the fourth quarter of the year and lower in the first and second quarters. Inventory levels therefore usually decline between the end of the third quarter and the end of the year. We anticipated higher than usual sales of new customer products in the first quarter of 2018 and therefore had unusually high levels of inventory at the end of 2017. Inventory levels were therefore lower at the end of 2018 compared with the end of 2017, releasing cash of US$13.6 million. At the end of 2018, inventories represented 61 days' cost of sales in the preceding quarter (end of 2017: 60 days' cost of sales).

Trade and other receivables were higher at the end of 2018 compared with the end of 2017, absorbing cash of US$36.3 million. At the end of 2018, trade and other receivables represented 24 days' sales in the preceding quarter (end of 2017: 15 days' sales) and reflected our reduced use of receivables financing facilities.

Trade and other payables were higher at the end of 2018 compared with the end of 2017 releasing cash of US$16.0 million, principally due to lower materials purchases in the fourth quarter of 2018 compared with 2017. At the end of 2018, trade and other payables represented 50 days' cost of sales in the preceding quarter (2017: 51 days' cost of sales).

Movements on other working capital items had the effect of releasing cash of US$6.0 million during 2018.

Interest paid was US$0.5 million in 2018 compared with US$0.4 million in 2017.

Interest received was US$8.7 million in 2018 compared with US$6.2 million in 2017.

During 2018, we made net income tax payments of US$41.1 million compared with net receipts of US$8.3 million in 2017. Income tax cash flows comprise payments on account in respect of current year taxable profits and adjusting payments or receipts in respect of earlier years. During 2017, we received repayments of income taxes overpaid in respect of earlier years totalling US$38.1 million.

Capital expenditure totalled US$58.8 million in 2018 compared with US$79.4 million in 2017, with the reduction principally reflecting the unusually high expenditure on testing equipment during 2017.

Free cash flow was US$229.9 million in 2018 compared with US$205.3 million in 2017. Our robust free cash flow provides a basis for financing strategic investments and for making distributions to shareholders.

Cash outflow in relation to acquired businesses was US$12.9 million in 2018 compared with US$267.9 million in 2017.

During 2018, we made a number of payments in relation to the purchase of Silego. We paid a purchase price adjustment of US$0.7 million following agreement with the vendors of Silego's cash, debt and working capital levels on completion. We also paid US$9.4 million in relation to the first tranche of the contingent consideration payable for Silego and US$2.8 million in settlement of deferred consideration.

During 2017, there was a net cash outflow of US$258.4 million on completion of the purchase of Silego and we paid US$9.5 million in cash for ams's LED backlight business.

Cash outflow on other investments was US$nil in 2018 compared with US$13.7 million in 2017.

During 2017, we paid US$15.0 million on subscription for shares in Energous and received US$1.3 million on the sale of our shareholding in Arctic Sand.

Summary cash flow statement

Year ended 31 December

US$ millions	2018	2017
Cash generated from operations	321.6	270.6
Interest received, net	8.2	5.8
Income taxes (paid)/received	(41.1)	8.3
Cash flow from operating activities	288.7	284.7
Purchase of property, plant and equipment	(26.1)	(47.9)
Purchase of intangible assets	(6.2)	(6.2)
Capitalised development expenditure	(24.8)	(21.0)
Capital element of finance lease payments	(1.7)	(4.3)
Free cash flow	229.9	205.3
Payment of contingent consideration	(9.4)	–
Purchase of businesses, net	(3.5)	(267.9)
Purchase of other investments, net	–	(13.7)
Purchase of own shares into treasury	–	(125.0)
Purchase of Dialog shares by EBTs, net	(18.2)	(17.1)
Other cash flows, net	0.1	0.4
Net cash inflow/(outflow) during the period	198.9	(218.0)
Currency translation differences	(0.3)	0.2
Increase/(decrease) in cash and cash equivalents	198.6	(217.8)

Net cash outflow on share purchases was US$18.2 million in 2018 compared with US$142.1 million in 2017.

Employee benefit trusts purchased the Company's ordinary shares in the market at a cost of US$21.8 million (2017: US$24.3 million) and received proceeds of US$3.6 million (2017: US$7.2 million) on the exercise of share options.

During 2017, we made settlements in relation to the Company's share buyback programme totalling US$125.0 million including transaction costs.

Liquidity and capital resources

Financial risk management

Dialog is exposed to financial risks including counterparty credit risk, liquidity risk and market risks, which include foreign exchange risk and interest rate risk.

Dialog has a centralised treasury function that is responsible for ensuring that adequate funding is available to meet the Group's requirements as they arise and for maintaining an efficient capital structure, together with managing the Group's counterparty credit risk, foreign currency and interest rate exposures. All treasury operations are conducted in accordance with strict policies and guidelines that are approved by the Board.

We use currency derivatives to manage currency risks and we hold certain equity options and warrants for strategic reasons. We do not hold derivative financial instruments for speculative purposes.

Cash and cash equivalents

Cash is managed in line with Treasury policy to ensure there is no significant concentration of credit risk in any one financial institution.

Credit risk is measured using counterparty credit ratings. As a minimum, a counterparty must have a long-term public rating of at least 'single A'.

Counterparty limits are based on a rating matrix and closely monitored. Credit risk is further limited by investing only in liquid instruments.

At the end of 2018, cash and cash equivalents amounted to US$677.8 million (end of 2017: US$479.3 million), which principally comprised investments in money market funds and bank deposits with a maturity of three months or less.

Revolving credit facility

In July 2017, the Company and certain of its subsidiaries, as guarantors, entered into a US$150 million three-year revolving credit facility provided by four financial institutions. The facility is committed and available for general corporate purposes. In June 2018, we exercised our option to extend the maturity date by a year but reduced the amount of the facility to US$112.5 million from July 2020 until it matures in July 2021. On the second anniversary of the facility, we have the option to extend the maturity date by a further year subject to the consent of the lenders. We also have the option to increase the amount of the facility by US$75 million subject to certain conditions.

The credit agreement contains various provisions, covenants and representations that are customary for such a facility.

Financial review continued

We have not yet made any drawings under the facility.

We consider that the revolving credit facility and our significant cash balances are sufficient to satisfy the Group's working capital requirements in the near- to medium-term.

Receivables financing facilities

We utilise non-recourse receivables financing facilities provided by two financial institutions in an aggregate amount of US$240 million. In March 2018, we extended the principal facility of US$220 million for a period of 18 months and it now matures on 31 October 2019.

Gross receivables sold under the facilities decreased by US$57.8 million to stand at US$113.5 million at the end of 2018 compared with US$171.3 million at the end of 2017.

At the end of 2018, cash and cash equivalents included US$96.1 million (end of 2017: US$145.1 million) in relation to receivables sold under these facilities.

Currency hedging activities

Dialog uses forward currency contracts and currency swaps to manage the Group's exposure to currency risk on highly probable forecast cash flows denominated in foreign currencies; principally employment costs, rents and other contractual payments. We also use derivatives to hedge the currency translation exposure on the Euro-denominated liabilities that arise in relation to successive tranches of the Company's share buyback programme.

Derivative financial instruments are measured at fair value that is determined based on market forward exchange rates at the balance sheet date. At the end of 2018, currency derivatives held by the Group were represented by a liability of US$6.2 million (end of 2017: asset of US$6.6 million).

All currency derivatives held to hedge forecast cash flows were designated as hedging instruments in cash flow hedge relationships. During 2018, a loss of US$10.1 million (2017: gain of US$16.4 million) was recognised in other comprehensive income representing the change during the year in the fair value of derivatives in effective hedging relationships and a cumulative fair value gain of US$2.3 million (2017: gain of US$0.4 million) was transferred from equity to profit or loss on the occurrence of the hedged cash flows.

After taking into account hedging, we recognised a net currency translation loss of US$0.9 million (2017: net loss of US$0.2 million) in profit or loss in relation to liabilities to purchase shares under the Company's share buyback programme.

Balance sheet

Summary balance sheet

As at 31 December US$ millions	2018	2017
Assets		
Cash and cash equivalents	**677.8**	479.3
Other current assets	**296.2**	281.2
Total current assets	**974.0**	760.5
Goodwill	**439.5**	439.5
Other intangible assets	**217.4**	235.6
Property, plant and equipment	**66.4**	83.9
Deferred tax assets	**6.0**	7.5
Other non-current assets	**13.8**	49.8
Total non-current assets	**743.1**	816.3
Total assets	**1,717.1**	1,576.8
Liabilities and equity		
Current liabilities	**393.9**	199.7
Deferred tax liabilities	**8.0**	4.0
Other non-current liabilities	**12.7**	30.7
Total liabilities	**414.6**	234.4
Total equity	**1,302.5**	1,342.4
Total liabilities and equity	**1,717.1**	1,576.8

Share buyback programme

We initiated our share buyback programme in May 2016. By the end of 2017, we had purchased a total of 4,483,816 shares at a cost of €168.7 million (US$184.7 million).

At the Company's 2018 AGM, the Directors were granted a new authority to purchase up to 7,638,214 of the Company's ordinary shares. Such authority shall (unless previously renewed, varied or revoked) expire on the day before the next AGM of the Company or on 30 June 2019, whichever is the earlier.

Purchases made under the share buyback programme are off-market and are effected by way of contingent forward purchase contracts entered into with brokers. Barclays, Goldman Sachs, HSBC or Merrill Lynch may be appointed as brokers for purchases under the 2018 AGM authority.

On 6 November 2018, the Company announced details of the first tranche of the share buyback programme pursuant to the 2018 AGM authority, under which it committed to purchase shares with a minimum cost of €100.0 million and a maximum cost of €150.0 million.

We have not yet been required by the appointed broker to make any intermediate settlements in relation to this tranche, under which the broker may continue to purchase shares until 21 May 2019.

We do not expect to announce another tranche of share purchases under the 2018 AGM authority but we will seek renewal of the share buyback authority at the Company's 2019 AGM. We will consider initiating further tranches of share purchases in the context of our regular assessment of the Group's future growth opportunities and its strategic objectives.

Capital management

The Group's capital is represented by its total equity.

We seek to maintain a capital structure that supports the ongoing activities of our business and its strategic objectives in order to deliver long-term returns to shareholders. We allocate capital to support organic and inorganic growth, investing to support research and development and our product pipeline.

We will fund our growth strategy using a mix of equity and debt after giving consideration to prevailing market conditions.

Goodwill

At the end of 2018 and 2017, the carrying amount of goodwill was US$439.5 million.

Goodwill impairment tests carried out during 2018 showed that the recoverable amount of each operating segment to which goodwill is allocated was comfortably in excess of its carrying amount and therefore no impairment was recognised.

Other intangible assets

At the end of 2018, the carrying amount of other intangible assets was US$217.4 million (end of 2017: US$235.6 million). During 2018, additions amounted to US$31.2 million, comprising capitalised product development costs of US$24.8 million and purchased software, licences and patents totalling US$6.4 million. During 2018, the amortisation expense was US$49.1 million (2017: US$42.0 million).

Property, plant and equipment

Since Dialog operates a fabless business model, it does not have any manufacturing facilities but it does occupy R&D facilities and administrative offices. At the end of 2018, Dialog operated in 29 locations worldwide covering a total of 57,800 square metres. Dialog's facilities are all held under operating leases. Management believes that Dialog's facilities are adequate for its current requirements.

Property, plant and equipment principally comprises test equipment, office equipment and leasehold improvements. At the end of 2018, the carrying amount of property, plant and equipment was US$66.4 million (end of 2017: US$83.9 million). Additions during the year amounted to US$26.1 million. During 2018, the depreciation expense was US$31.5 million (2017: US$30.8 million).

Other non-current assets

Other non-current assets decreased by US$37.5 million to US$19.8 million (end of 2017: US$57.3 million), primarily due to the recognition of losses totalling US$34.6 million on the remeasurement of our investments in Energous shares and warrants.

Current assets

Current assets totalled US$974.0 million at the end of 2018 compared with US$760.5 million at the end of 2017, an increase of US$213.5 million.

Cash and cash equivalents increased by US$198.5 million to US$677.8 million. Other current assets increased by US$15.0 million to US$296.2 million, principally reflecting an increase of US$36.3 million in trade and other receivables that was partially offset by a decrease of US$19.2 million in inventories.

Current liabilities

Current liabilities totalled US$393.9 million at the end of 2018 compared with US$199.7 million at the end of 2017. Excluding the share buyback obligation of US$171.8 million that was recognised at the end of 2018, current liabilities increased by US$22.0 million to US$221.7 million at the end of 2018, principally reflecting an increase of US$14.9 million in trade and other payables and the reclassification as current of the liability for the remaining contingent consideration payable for Silego.

Income tax assets and liabilities

At the end of 2018, the Group had net current tax payables of US$6.0 million (end of 2017: net payables of US$0.6 million).

At the end of 2018, the Group had net deferred tax liabilities of US$2.0 million (end of 2017: net assets of US$3.5 million), comprising deferred tax assets of US$6.0 million (end of 2017: US$7.5 million) and deferred tax liabilities of US$8.0 million (end of 2017: US$4.0 million).

Other non-current liabilities

Other non-current liabilities decreased by US$18.0 million to US$12.7 million (end of 2017: US$30.7 million), principally due to the reclassification as current of the liability for the remaining contingent consideration payable for Silego.

Total equity

Total equity was US$1,302.5 million at the end of 2018 (end of 2017: US$1,342.4 million). At the end of 2018, Dialog shares held by employee benefit trusts amounted to US$22.5 million (end of 2017: US$0.9 million).

Accounting standards to be adopted in 2019

Leases

IFRS 16 *Leases* provides a single lessee accounting model, requiring lessees to recognise a right-of-use asset and a lease liability for all leases, except those with a short lease term and/or involving an underlying asset of low value. In summary, for lessees, the distinction between an operating lease and a finance lease will disappear and most operating leases will be accounted for similarly to the way in which finance leases were accounted for under the predecessor accounting standard, IAS 17 *Leases*.

We will adopt IFRS 16 using a modified retrospective approach whereby prior periods will not be restated but we will recognise cumulative effect adjustments to the opening consolidated balance sheet on the transition date, 1 January 2019. We estimate that we will recognise lease liabilities totalling US$67.6 million on adoption of IFRS 16 and corresponding right-of-use assets totalling US$66.4 million (after deducting existing net accrued lease rentals of US$1.2 million).

Going forward, we expect that IFRS 16 will be beneficial to operating profit to the extent that depreciation of the right-of-use assets will be lower than the rental expense that would have been recognised under IAS 17. We expect, however, that operating profit will be only slightly higher in 2019 than it would have been under IAS 17. After taking into account the interest expense on the lease liabilities, we expect that net income will be slightly lower in 2019 than it would have been under IAS 17.

As we progress through 2019, we will show in the notes to our consolidated financial statements the effect of adopting IFRS 16 on our quarterly and year to date results.

We can confirm that the calculation of the financial covenants associated with our revolving credit facility will be unaffected by the adoption of IFRS 16.

Uncertain tax positions

IFRIC 23 *Uncertainty over Income Tax Treatments* clarifies the application of the recognition and measurement requirements of IAS 12 *Income Taxes* where there is uncertainty over income tax treatments.

We already account for income taxes on a basis consistent with IFRIC 23 and therefore do not expect it to affect the Group's results or financial position.

Consequences of Brexit

Considerable uncertainty exists as to the timing of the UK's exit from the EU, scheduled to take place on 29 March 2019, the terms of any withdrawal agreement between the UK and the EU and the effect of Brexit on the UK's future relationships with the EU, other multilateral organisations and individual countries outside the EU.

We continue to believe that Brexit will not have a significant impact on Dialog in the short term because only a small amount of our revenue is derived from customers in the UK. However, since approximately two-thirds of our workforce is based in the EU and our teams are typically comprised of several nationalities, we will monitor very closely any proposed changes to the current regulations in respect of the rights of EU and other nationals to work in the UK, and vice versa.

The longer-term effects of Brexit on our operating environment are difficult to predict and subject to wider global macroeconomic trends and events, but may impact ourselves, our customers and other counterparties.

While the withdrawal negotiations are ongoing and during any subsequent transition period, we will operate on a business as usual basis within applicable regulations and our continuing focus will be on growing our business.

Wissam Jabre
Chief Financial Officer,
Senior Vice President Finance

Consolidated statement of income

Year ended 31 December

	Note	2018 US$000	2017* US$000	2016* US$000
Revenue	3,4	**1,442,138**	1,352,841	1,197,611
Cost of sales		**(751,070)**	(707,971)	(630,963)
Gross profit		**691,068**	644,870	566,648
Selling and marketing expenses		**(83,877)**	(70,412)	(62,331)
General and administrative expenses		**(84,351)**	(74,850)	(70,940)
Research and development expenses		**(326,309)**	(303,013)	(261,278)
Other operating income/(expense)		**3,176**	(9,578)	137,708
Operating profit	4	**199,707**	187,017	309,807
Interest income	5	**9,883**	5,995	3,665
Interest expense	5	**(3,134)**	(1,302)	(3,447)
Other finance (expense)/income	5	**(10,263)**	3,093	(4,819)
Profit before income taxes		**196,193**	194,803	305,206
Income tax expense	6	**(55,281)**	(25,369)	(47,090)
Profit after income taxes		**140,912**	169,434	258,116
Share of loss of associate		**(1,113)**	–	–
Net income		**139,799**	169,434	258,116
Attributable to:				
– Shareholders in the Company		**139,799**	173,916	260,940
– Non-controlling interests		**–**	(4,482)	(2,824)
Net income		**139,799**	169,434	258,116

	Note	2018	2017*	2016*
Earnings per share (US$)	7			
Basic		**1.89**	2.34	3.43
Diluted		**1.80**	2.21	3.25
Weighted average number of shares (in thousands)	7			
Basic		**73,959**	74,472	76,047
Diluted		**77,655**	78,611	80,398

* Certain product development costs have been reclassified from cost of sales to research and development expenses (see note 1).

Consolidated statement of comprehensive income

Year ended 31 December

	2018 US$000	2017 US$000	2016 US$000
Net income	**139,799**	169,434	258,116
Other comprehensive income			
Items that may be reclassified to profit or loss in subsequent periods			
Currency translation differences on foreign operations:			
– (Loss)/gain recognised in the year	**(527)**	1,658	227
– Gain transferred to profit or loss on deconsolidation of Dyna Image	**–**	(1,144)	–
Income tax relating to currency translation differences on foreign operations	**(78)**	180	(47)
Fair value gain on available-for-sale investments	**–**	5,971	2,866
Income tax relating to available-for-sale investments	**–**	(1,015)	–
Cash flow hedges:			
– Fair value (loss)/gain recognised on effective hedges in the year	**(10,075)**	16,433	(13,264)
– Fair value (gain)/loss transferred to profit or loss	**(2,343)**	(441)	8,382
Income tax relating to cash flow hedges	**2,376**	(3,149)	765
	(10,647)	18,493	(1,071)
Items that will not be reclassified to profit or loss			
Fair value loss on equity investments	**(23,764)**	–	–
Income tax relating to equity investments	**1,015**	–	–
	(22,749)	–	–
Other comprehensive (loss)/income for the year	**(33,396)**	18,493	(1,071)
Total comprehensive income for the year	**106,403**	187,927	257,045
Attributable to:			
– Shareholders in the Company	**106,403**	192,416	259,769
– Non-controlling interests	**–**	(4,489)	(2,724)
Total comprehensive income for the year	**106,403**	187,927	257,045

Consolidated balance sheet

As at 31 December

	Note	2018 US$000	2017 US$000
Assets			
Cash and cash equivalents	8	**677,848**	479,295
Trade and other receivables		**114,514**	78,186
Other current financial assets		**202**	6,649
Inventories	9	**149,736**	168,947
Income tax receivables		**2,146**	12,739
Other current assets		**18,306**	14,656
		962,752	760,472
Assets classified as held for sale	14	**11,295**	–
Total current assets		**974,047**	760,472
Goodwill	10	**439,508**	439,508
Other intangible assets	11	**217,445**	235,637
Property, plant and equipment	12	**66,359**	83,870
Investment in associate	13	**–**	1,100
Other investments	13	**11,538**	46,155
Other non-current financial assets		**1,807**	2,090
Other non-current assets		**398**	503
Deferred tax assets		**6,034**	7,451
Total non-current assets		**743,089**	816,314
Total assets		**1,717,136**	1,576,786
Liabilities and equity			
Trade and other payables		**122,140**	107,195
Other current financial liabilities		**196,890**	16,041
Provisions		**5,253**	3,474
Income taxes payable		**8,193**	13,356
Other current liabilities		**58,237**	59,619
		390,713	199,685
Liabilities directly associated with assets held for sale	14	**3,167**	–
Total current liabilities		**393,880**	199,685
Non-current financial liabilities		**841**	17,378
Provisions		**3,078**	3,725
Deferred tax liabilities		**7,958**	4,017
Other non-current liabilities		**8,872**	9,560
Total non-current liabilities		**20,749**	34,680
Ordinary shares		**14,204**	14,204
Share premium account		**403,660**	403,660
Retained earnings		**930,576**	915,482
Other reserves	17	**(23,419)**	9,977
Dialog shares held by employee benefit trusts		**(22,514)**	(902)
Total equity		**1,302,507**	1,342,421
Total liabilities and equity		**1,717,136**	1,576,786

Consolidated statement of cash flows

Year ended 31 December

	Note	**2018 US$000**	2017 US$000	2016 US$000
Cash flows from operating activities				
Net income		**139,799**	169,434	258,116
Non-cash items within net income:				
– Depreciation of property, plant and equipment		**31,455**	30,807	27,219
– Amortisation of intangible assets		**49,130**	41,969	35,954
– Impairment of non-current assets		**–**	4,327	–
– Addition to inventory reserve, net		**5,643**	1,288	4,375
– Share-based compensation expense		**41,153**	35,320	28,167
– Loss on deconsolidation of Dyna Image		**–**	5,597	–
– Other non-cash items		**6,590**	(7,904)	2,118
Interest income, net	5	**(6,749)**	(4,693)	(218)
Income tax expense	6	**55,281**	25,369	47,090
Cash generated from operations before changes in working capital		**322,302**	301,514	402,821
Changes in working capital:				
– (Increase)/decrease in trade and other receivables		**(36,310)**	11,117	(8,105)
– Decrease/(increase) in inventories		**13,615**	(54,377)	21,609
– Decrease/(increase) in prepaid expenses		**56**	1,930	(301)
– Increase/(decrease) in trade and other payables		**15,968**	7,819	(44,206)
– Increase in provisions		**3,089**	2,136	260
– Change in other assets and liabilities		**2,852**	473	13,601
Cash generated from operations		**321,572**	270,612	385,679
Interest paid		**(530)**	(425)	(3,434)
Interest received		**8,714**	6,221	3,314
Income taxes (paid)/received		**(41,107)**	8,314	(136,799)
Cash flow from operating activities		**288,649**	284,722	248,760
Cash flows from investing activities				
Purchase of property, plant and equipment		**(26,145)**	(47,938)	(25,553)
Purchase of intangible assets		**(6,197)**	(6,196)	(8,177)
Purchase of businesses, net of acquired cash	2	**(3,480)**	(267,940)	(647)
Payment of contingent consideration	2	**(9,360)**	–	–
Cash held by Dyna Image on deconsolidation		**–**	(420)	–
Payments for capitalised development costs		**(24,771)**	(20,988)	(15,802)
Purchase of other investments, net		**–**	(13,738)	(10,000)
(Increase)/decrease in other long-term assets		**–**	(488)	227
Cash flow used for investing activities		**(69,953)**	(357,708)	(59,952)
Cash flows from financing activities				
Purchase of own shares into treasury		**–**	(125,035)	(61,472)
Currency hedges on share buyback obligation		**–**	1,227	(1,186)
Capital element of finance lease payments		**(1,651)**	(4,283)	(3,834)
Purchase of shares by employee benefit trusts		**(21,786)**	(24,301)	(3,127)
Sale of shares by employee benefit trusts		**3,617**	7,246	11,083
Issue of shares by a subsidiary to non-controlling interests		**–**	1,107	–
Facility arrangement costs		**–**	(988)	–
Share issue costs		**–**	(28)	–
Cash flow used for financing activities		**(19,820)**	(145,055)	(58,536)
Net cash inflow/(outflow) during the year		**198,876**	(218,041)	130,272
Cash and cash equivalents at beginning of year		**479,295**	697,167	566,809
Currency translation differences		**(323)**	169	86
Cash and cash equivalents at end of year		**677,848**	479,295	697,167

Consolidated statement of changes in equity

Year ended 31 December

	Ordinary shares US$000	Share premium account US$000	Retained earnings US$000	Other reserves (note 17) US$000	Dialog shares held by employee benefit trusts US$000	Equity attributable to shareholders in the Company US$000	Non-controlling interests US$000	Total US$000
As at 31 December 2015	14,402	403,687	631,548	(7,923)	(24,630)	1,017,084	7,801	1,024,885
Net income	–	–	260,940	–	–	260,940	(2,824)	258,116
Other comprehensive (loss)/income	–	–	–	(1,171)	–	(1,171)	100	(1,071)
Total comprehensive income/(loss)	–	–	260,940	(1,171)	–	259,769	(2,724)	257,045
Other changes in equity:								
– Purchase of own shares into treasury	–	–	(1,643)	(61,472)	–	(63,115)	–	(63,115)
– Share buyback obligation	–	–	(63,077)	–	–	(63,077)	–	(63,077)
– Purchase of shares by employee benefit trusts	–	–	–	–	(3,127)	(3,127)	–	(3,127)
– Sale of shares by employee benefit trusts	–	–	3,934	–	7,149	11,083	–	11,083
– Share-based compensation, net of tax	–	–	31,212	–	–	31,212	–	31,212
As at 31 December 2016	14,402	403,687	862,914	(70,566)	(20,608)	1,189,829	5,077	1,194,906
Net income	–	–	173,916	–	–	173,916	(4,482)	169,434
Other comprehensive income/(loss)	–	–	–	18,500	–	18,500	(7)	18,493
Total comprehensive income/(loss)	–	–	173,916	18,500	–	192,416	(4,489)	187,927
Other changes in equity:								
– Purchase of own shares into treasury	–	–	3,024	(125,050)	–	(122,026)	–	(122,026)
– Share buyback obligation	–	–	62,584	–	–	62,584	–	62,584
– Cancellation of treasury shares	(571)	–	(186,522)	187,093	–	–	–	–
– Shares issued by Dyna Image	–	–	361	–	–	361	746	1,107
– Deconsolidation of Dyna Image	–	–	–	–	–	–	(1,334)	(1,334)
– Shares issued to employee benefit trust	373	(27)	–	–	(373)	(27)	–	(27)
– Purchase of shares by employee benefit trusts	–	–	–	–	(24,301)	(24,301)	–	(24,301)
– Sale of shares by employee benefit trusts	–	–	(37,134)	–	44,380	7,246	–	7,246
– Share-based compensation, net of tax	–	–	36,339	–	–	36,339	–	36,339
As at 31 December 2017	**14,204**	**403,660**	**915,482**	**9,977**	**(902)**	**1,342,421**	**–**	**1,342,421**
Adjustment on initial application of IFRS 15 (note 18)	**–**	**–**	**1,541**	**–**	**–**	**1,541**	**–**	**1,541**
Adjusted balance as at 1 January 2018	**14,204**	**403,660**	**917,023**	**9,977**	**(902)**	**1,343,962**	**–**	**1,343,962**
Net income	**–**	**–**	**139,799**	**–**	**–**	**139,799**	**–**	**139,799**
Other comprehensive loss	**–**	**–**	**–**	**(33,396)**	**–**	**(33,396)**	**–**	**(33,396)**
Total comprehensive income/(loss)	**–**	**–**	**139,799**	**(33,396)**	**–**	**106,403**	**–**	**106,403**
Other changes in equity:								
– Share buyback obligation	**–**	**–**	**(171,187)**	**–**	**–**	**(171,187)**	**–**	**(171,187)**
– Purchase of shares by employee benefit trusts	**–**	**–**	**–**	**–**	**(21,786)**	**(21,786)**	**–**	**(21,786)**
– Sale of shares by employee benefit trusts	**–**	**–**	**3,443**	**–**	**174**	**3,617**	**–**	**3,617**
– Share-based compensation, net of tax	**–**	**–**	**41,498**	**–**	**–**	**41,498**	**–**	**41,498**
As at 31 December 2018	**14,204**	**403,660**	**930,576**	**(23,419)**	**(22,514)**	**1,302,507**	**–**	**1,302,507**

Notes to the consolidated financial information

For the year ended 31 December 2018

1. Background

Description of business

Dialog Semiconductor Plc ("the Company") is a public limited company that is incorporated in England and Wales and domiciled in the United Kingdom. The Company's ordinary shares are listed on the Frankfurt Stock Exchange.

Dialog creates and markets highly-integrated, mixed-signal integrated circuits, optimised for personal, portable, hand-held devices, low energy short-range wireless, LED solid state lighting and automotive applications. Dialog has four operating segments: Mobile Systems; Connectivity; Automotive & Industrial; and Advanced Mixed Signal. Segment information is presented in note 4.

Registered office

The Company's registered office is at Tower Bridge House, St Katharine's Way, London E1W 1AA, United Kingdom.

Basis of preparation of the financial information

The financial information on pages 16 to 36 is derived from the consolidated financial statements of the Company and its subsidiaries (together, the 'Group' or 'Dialog') for the year ended 31 December 2018.

The consolidated financial statements for the year ended 31 December 2018 have been prepared in accordance with International Financial Reporting Standards ('IFRS') as adopted for use in the European Union and those parts of the Companies Act 2006 that are applicable to companies reporting under IFRS and therefore comply with Article 4 of the IAS Regulation. The consolidated financial statements also comply with IFRS as issued by the International Accounting Standards Board.

The consolidated financial statements have been prepared on a going concern basis and in accordance with the historical cost convention, except that certain investments and derivative financial instruments are stated at their fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

The Group's significant accounting policies are unchanged compared with the year ended 31 December 2017 (see pages 105 to 111 of our Annual Report and Accounts 2017), except for the adoption of IFRS 15 *Revenue from Contracts with Customers* and IFRS 9 *Financial Instruments* with effect from 1 January 2018. Information about the adoption of IFRS 15 and IFRS 9 and their impact on the Group's results and financial position is set out in note 18.

The financial information does not constitute the Company's statutory accounts for the year ended 31 December 2018 for the purposes of section 435 of the Companies Act 2006 or contain sufficient information to comply with the disclosure requirements of IFRS.

Presentation currency

The consolidated financial statements are presented in US dollars ("US$"), which is the functional currency of the Company. All US dollar amounts are rounded to the nearest thousand ("US$000"), except where stated otherwise.

Approval of the consolidated financial statements

The consolidated financial statements for the year ended 31 December 2018 were authorised for issue by the Board of Directors on 6 March 2019.

The Company's auditors, Deloitte LLP, have given an unqualified report on the consolidated financial statements for the year ended 31 December 2018 in which they did not draw attention to any matters by way of emphasis without qualifying their report and did not make any statements under s498(2) or (3) Companies Act 2006.

The consolidated financial statments will be filed with the Registrar of Companies, subject to their approval by the Company's shareholders at the Company's Annual General Meeting on 2 May 2019.

Reclassification of certain product development costs

With effect from 1 January 2018, we reclassified within the consolidated statement of income the amortisation of capitalised development costs, the amortisation of acquired technology-based intangible assets and royalties payable for the use of intellectual property in our product development activities. Previously, we included these costs within cost of sales. We now include them within research and development expenses.

We have made this change in order that our results are more comparable with those of our industry peers.

Comparative amounts for 2017 and 2016 have been re-presented on a consistent basis as follows:

	2017			2016		
	As previously reported US$000	Effect of reclassification US$000	As reclassified US$000	As previously reported US$000	Effect of reclassification US$000	As reclassified US$000
Revenue	1,352,841	–	1,352,841	1,197,611	–	1,197,611
Cost of sales	(732,188)	24,217	(707,971)	(650,896)	19,933	(630,963)
Gross profit	620,653	24,217	644,870	546,715	19,933	566,648
Research and development expenses	(278,796)	(24,217)	(303,013)	(241,345)	(19,933)	(261,278)
Operating profit	187,017	–	187,017	309,807	–	309,807

Notes to the consolidated financial information continued

2. Consideration payable for Silego

Acquisition of Silego Technology Inc.
We completed the acquisition of Silego Technology Inc. ("Silego") on 1 November 2017.

We acquired Silego for US$276,000 on a cash and debt-free basis, subject to adjustments for cash,debt and working capital. Additional consideration of up to US$30,400 was payable in two instalments contingent on Silego's revenues for 2017 and 2018.

Purchase price adjustment
On completion, we paid initial consideration of US$290,508 in cash, including US$22,527 in respect of Silego's estimated cash, debt and working capital levels on completion. During 2018, we paid a purchase price adjustment of US$692 following the agreement with the vendors of Silego's actual cash, debt and working capital levels on completion.

Deferred consideration
On completion of the acquisition, unvested employee options were converted into deferred cash rights and the fair value of those rights was apportioned between a deferred consideration element and a future compensation element. During 2018, we paid US$2,788 in settlement of vested deferred consideration and recognised a credit of US$204 to profit or loss in respect of forfeitures. As at 31 December 2018, we recognised a liability of US$3,173 in relation to the remaining deferred consideration that is expected to be payable over the period to March 2021.

Contingent consideration
Silego's actual revenue for 2017 confirmed that the first instalment of contingent consideration of US$10,000 was payable in full. In February 2018, we paid US$9,360 in settlement of the amount attributable to the shares and vested options acquired and attributed the balance of the first instalment of US$640 to the deferred cash rights.

Silego's actual revenue for 2018 showed that US$17,874 was payable in settlement of the second instalment. Since Silego's actual revenue for 2018 was lower than our initial estimate, we recognised a credit of US$878 to profit or loss on remeasurement of the fair value of the contingent consideration. As at 31 December 2018, we recognised a liability of US$16,414 (net of discounting of US$316) for the second instalment of the contingent consideration attributable to the shares and vested options acquired and attributed the balance of the second instalment of US$1,144 to the deferred cash rights.

In February 2019, we paid US$16,730 in settlement of the amount of the second instalment attributable to the shares and vested options acquired.

3. Revenue

Revenue may be analysed as follows:

	2018 US$000	2017 US$000	2016 US$000
Sale of goods			
– Sales direct to end customers	**1,144,371**	1,156,451	1,023,465
– Sales to distributors	**296,598**	195,364	173,063
Royalties	**1,169**	1,026	1,083
Total	**1,442,138**	1,352,841	1,197,611

Revenue from research and development contracts of US$2,298 (2017: US$346; 2016: US$408) is included in other operating income.

4. Segment information

Segment information is presented in the financial statements on a basis consistent with the information presented to the Management Team (the "chief operating decision-maker") for the purposes of allocating resources within the Group and assessing the performance of the Group's businesses.

The Group's reportable segments are determined based on the nature of the products that they provide to our customers and are as follows: Mobile Systems; Automotive & Industrial; Connectivity; and Advanced Mixed Signal.

- → Mobile Systems provides power management and audio chips designed to meet the needs of the wireless systems markets and a range of advanced driver technologies for low power display applications – from PMOLEDs to electronic paper and MEMS displays.
- → Automotive & Industrial's products address the safety, management and control of electronic systems in cars and for industrial applications.
- → Connectivity's products include short-range wireless, digital cordless, Bluetooth® and VoIP technology.
- → Advanced Mixed Signal's products include CMICs, AC/DC converter solutions for smaller, fast charging power adaptors for portable devices as well as LED drivers for solid state lighting products.

No operating segments have been aggregated in determining our reportable segments. Each operating segment has a manager who is responsible for its performance and is accountable to the Chief Executive Officer.

The Management Team uses operating profit as the principal measure of the profitability of each of the Group's operating segments. Operating profit is, therefore, the measure of segment profit presented in the Group's segment disclosures. Whilst the Management Team also uses underlying operating profit to measure segment profitability, this is used as a supplement to operating profit. In addition to our reportable segments, we present information for Corporate activities. Corporate activities do not meet the definition of an operating segment. Corporate activities principally comprise the costs of operating central corporate functions, the Group's share-based compensation expense and certain other unallocated costs. In 2016, Corporate activities also included the termination fee of US$137,300 that was paid to us by Atmel.

Revenue and operating profit by segments are as follows:

	Revenue[1]			Operating profit/(loss)		
	2018 US$000	2017 US$000	2016 US$000	**2018 US$000**	2017 US$000	2016 US$000
Mobile Systems	**1,029,561**	1,042,908	922,946	**248,440**	271,716	239,859
Connectivity	**148,772**	136,443	118,334	**16,924**	14,276	5,342
Automotive & Industrial	**32,686**	32,975	30,014	**11,706**	12,575	10,126
Advanced Mixed Signal	**229,840**	132,714	116,808	**1,822**	(15,127)	(7,535)
Total segments	**1,440,859**	1,345,040	1,188,102	**278,892**	283,440	247,792
Corporate activities	**1,279**	7,801	9,509	**(79,185)**	(96,423)	62,015
Total Group	**1,442,138**	1,352,841	1,197,611	**199,707**	187,017	309,807
Interest income				**9,883**	5,995	3,665
Interest expense				**(3,134)**	(1,302)	(3,447)
Other finance (expense)/income				**(10,263)**	3,093	(4,819)
Profit before income taxes				**196,193**	194,803	305,206

1 Revenue is from sales to external customers (there were no inter-segment sales).

Notes to the consolidated financial information continued

5. Finance income/(expense)

a) Interest income

	2018 US$000	2017 US$000	2016 US$000
Interest on bank deposits	**5,619**	3,556	3,073
Interest on money market funds	**4,189**	2,423	584
Other interest income	**75**	16	8
Total	**9,883**	5,995	3,665

b) Interest expense

	2018 US$000	2017 US$000	2016 US$000
Interest on receivables financing facilities	**–**	–	(850)
Interest on finance leases and hire purchase contracts	**(50)**	(289)	(560)
Facility commitment fees	**(452)**	(194)	(1,913)
Amortisation of deferred facility arrangement costs	**(315)**	(151)	–
Unwinding of discount on contingent consideration	**(2,220)**	(436)	–
Unwinding of discount on provisions	**(70)**	(60)	(110)
Other interest expense	**(27)**	(172)	(14)
Total	**(3,134)**	(1,302)	(3,447)

During 2017, we incurred arrangement costs of US$988 in relation to the Group's US$150 million revolving credit facility and are amortising those costs over the initial three-year period to maturity of the facility in July 2020.

Facility commitment fees incurred during 2016 related to the borrowing facility that was arranged to finance the proposed merger with Atmel prior to the cancellation of the facility in January 2016.

c) Other finance (expense)/income

	2018 US$000	2017 US$000	2016 US$000
Currency translation (loss)/gain, net	**(994)**	1,695	(6,017)
Fair value (loss)/gain on Energous warrants (note 13)	**(10,853)**	941	1,929
Amortisation of gain on initial measurement of Energous warrants (note 13)	**1,584**	776	–
Loss on sale of Arctic Sand shares	**–**	(177)	–
Fair value loss on Dyna call option	**–**	(142)	(731)
Total	**(10,263)**	3,093	(4,819)

6. Income taxes

Income tax recognised in profit or loss

The components of the Group's income tax expense for the year were as follows:

	2018 US$000	2017 US$000	2016 US$000
Current tax			
United Kingdom	**(15,896)**	379	(10,171)
Foreign	**(33,633)**	(33,884)	(36,127)
Deferred tax			
United Kingdom	**(321)**	1,315	(549)
Foreign	**(5,431)**	6,821	(243)
Income tax expense	**(55,281)**	(25,369)	(47,090)

	2018 US$000	2017 US$000	2016 US$000
Current tax			
Current income tax charge	**(45,587)**	(38,643)	(46,993)
Adjustments in respect of prior years	**(3,942)**	5,138	695
Deferred tax			
Origination and reversal of temporary differences	**(4,663)**	(6,353)	(3,922)
Recognition of previously unrecognised deferred tax assets	**–**	9,655	–
Movement in deferred tax balances following intra-group reorganisation	**(1,920)**	1,977	808
Movement in deferred tax balances following US tax rate change	**–**	6,658	–
Adjustments in respect of prior years	**831**	(3,801)	2,322
Income tax expense	**(55,281)**	(25,369)	(47,090)

During 2014, we recognised a non-cash deferred tax credit of US$17,759 resulting from an intra-group reorganisation of certain Intellectual Property that was acquired with iWatt, Inc., which reduced the amount of the related deferred tax liabilities. We recognised further deferred tax credits of US$808 in 2016 and US$1,977 in 2017 and a deferred tax charge of US$1,920 in 2018 that related to the ongoing impact of the reorganisation on the deferred tax balances.

Factors affecting the income tax expense for the year

The Group's income tax expense differed from the amount that would have resulted from applying the statutory rate of corporation tax in the UK to the Group's profit before income taxes for the reasons shown in the following table:

	2018 US$000	2017 US$000	2016 US$000
Profit before income taxes	**196,193**	194,803	305,206
Income tax expense at UK corporation tax rate of 19.0% (2017: 19.25%; 2016: 20.0%)	**(37,277)**	(37,500)	(61,041)
Effect of different foreign tax rates	**(6,656)**	(12,569)	(15,434)
Non-taxable income:			
– Atmel termination fee	**–**	–	27,460
– Other non-taxable income	**39**	–	240
Non-deductible expenses:			
– Transaction costs	**(1,131)**	–	(697)
– Non-deductible portion of share-based compensation	**(9,336)**	(9,396)	(7,614)
– Other non-deductible expenses	**(3,232)**	(2,764)	(3,068)
Tax benefit from share-based compensation	**1,997**	3,658	4,871
Tax impact of deconsolidation of Dyna Image Corporation	**–**	(1,938)	–
Tax benefit from Intellectual Property and research and development incentives	**8,633**	6,576	8,728
Write-down of previously recognised deferred tax assets	**(1,015)**	(543)	–
Benefit from previously unrecognised deferred tax assets	**70**	9,655	–
Additional tax losses for which no deferred tax asset is recognised	**(117)**	(568)	(1,321)
Movement in deferred tax balances following intra-group reorganisation	**(1,920)**	1,977	808
Differences arising from different functional and tax currencies	**(2,065)**	9,576	(2,976)
Tax benefit from US tax rate change	**–**	6,658	–
Adjustments in respect of prior years	**(3,111)**	1,337	3,020
Other items	**(160)**	472	(66)
Income tax expense	**(55,281)**	(25,369)	(47,090)

Notes to the consolidated financial information continued

6. Income taxes continued

The Group's income tax expense for 2018 was US$55,281 (2017: US$25,369; 2016: US$47,090), an effective tax rate for the year of 28.2% (2017: 13.0%; 2016: 15.4%).

Our effective tax rate is sensitive to the geographic mix of the Group's profits and reflects a combination of different tax rates in different countries, in particular higher tax rates in Germany and, in prior years, in the US. Our effective tax rate can also be affected by changes in tax legislation and tax rates, the impact of acquisitions, disposals and restructuring and currency exchange rate movements, which give rise to tax effects where an entity's functional currency differs from the currency in which it is required to calculate and pay income taxes.

Our effective tax rate is reduced because a large proportion of Dialog's research and development activities are undertaken in the UK and the Netherlands and we are therefore able to benefit from the UK and Netherlands tax regimes that provide incentives for innovation.

Our income tax expense for 2018 includes a charge of US$2,820 (2017: credit of US$1,465) resulting from the finalisation of prior year tax items with tax authorities.

Our low effective tax rate for 2017 reflected a non-cash deferred tax credit of US$6,658 resulting from US tax reform and a credit of US$19,231 due to the tax effects of unpredictable currency exchange rate movements.

Our low effective tax rate for 2016 reflected the tax treatment of the Atmel termination fee of US$137,300. We obtained tax advice that the termination fee should not be taxable in the UK. We therefore concluded that no tax liability should arise and did not recognise a tax expense in relation to the termination fee.

Factors affecting the income tax expense in future years

Factors that may affect the Group's future tax expense include foreign exchange rate movements, changes in tax legislation and tax rates, the impact of acquisitions, disposals and restructuring and the resolution of open issues with tax authorities. From 2018, the application to Dialog of the UK tax regime that provides incentives for innovation has changed, resulting in a limit to the benefits available by reference to the location of Dialog's research and development activities. Given the global nature of Dialog's research and development activities, this may also affect the Group's future tax expense.

On 11 October 2018, we announced that we have entered into an agreement with Apple Inc, ("Apple") to license our power management technologies and transfer to Apple certain assets and over 300 employees from our design centres in the UK, Germany and Italy. The transaction is expected to complete in the first half of 2019, subject to applicable regulatory approvals and other customary closing conditions. Completion of the transaction may affect the geographic mix of the Group's profits and the location of its research and development activities, both of which may have an impact on the Group's future tax expense. We continue to review and assess the potential impact of this transaction.

The Group maintains provisions for potential tax liabilities where uncertainty exists concerning the amount of current or deferred tax recognised. Due to the complexity of tax laws and their interpretation, the amounts ultimately agreed with tax authorities in respect of these uncertainties may differ materially from the amounts provided and may therefore affect the Group's income tax expense in future periods.

International tax reform remains a key focus of attention, including the OECD's Base Erosion & Profit Shifting project, the EU's action plan for fair and efficient corporate taxation and US tax reform. We continually monitor developments and assess the potential impact for Dialog of such initiatives. We have concluded that current or announced future tax law changes as a result of such initiatives give rise to no changes to the principal risks for Dialog.

7. Earnings per share

Basic earnings per share amounts are calculated by dividing the profit for the year attributable to holders of ordinary shares in the Company by the weighted average number of ordinary shares outstanding during the year.

Diluted earnings per share amounts are calculated by dividing the profit attributable to holders of ordinary shares in the Company by the weighted average number of ordinary shares outstanding during the year plus the weighted average number of ordinary shares that would be issued if all the securities or other contracts to issue ordinary shares were exercised.

Profit attributable to shareholders in the Company and the weighted average number of ordinary shares for calculating basic and diluted earnings per share were calculated as follows:

		2018 US$000	2017 US$000	2016 US$000
Profit attributable to shareholders in the Company				
For calculating basic and diluted earnings per share	a	**139,799**	173,916	260,940
Weighted average number of ordinary shares				
Shares in issue at the beginning of the period		**76,382,139**	77,865,955	77,865,955
Effect on average number of shares during the period:				
– Shares issued to employee benefit trust		**–**	2,350,000	–
– Cancellation of treasury shares		**–**	(2,329,093)	–
Average number of shares in issue during the period		**76,382,139**	77,886,862	77,865,955
Deduct:				
– Average number of shares held by employee benefit trusts		**(2,422,787)**	(2,061,901)	(1,296,216)
– Average number of treasury shares		**–**	(1,352,891)	(523,135)
For calculating basic earnings per share	b	**73,959,352**	74,472,070	76,046,604
Add:				
– Average number of dilutive share options and awards		**3,695,214**	4,139,123	4,351,328
For calculating diluted earnings per share	c	**77,654,566**	78,611,193	80,397,932
Earnings per share (US$)				
Basic	a/b	**1.89**	2.34	3.43
Diluted	a/c	**1.80**	2.21	3.25

During 2018, the average number of anti-dilutive share options outstanding was 830,300 (2017: 375,041; 2016: 423,760).

8. Cash and cash equivalents

Cash and cash equivalents were as follows:

	As at 31 December 2018 US$000	As at 31 December 2017 US$000
Cash at bank	**3,920**	7,794
Cash held by employee benefit trusts	**2,829**	1,151
Cash available from receivables financing facilities	**96,099**	145,100
Bank deposits	**325,000**	100,000
Money market funds	**250,000**	225,250
Total	**677,848**	479,295

Short-term deposits are made for varying periods of up to three months.

As at 31 December 2018 and 2017, no amounts had been drawn from the cash available from receivables financing facilities.

9. Inventories

Inventories were as follows:

	As at 31 December 2018 US$000	As at 31 December 2017 US$000
Raw materials	**36,579**	12,301
Work in progress	**48,416**	59,704
Finished goods	**64,741**	96,942
Total	**149,736**	168,947

Notes to the consolidated financial information continued

10. Goodwill

Movements on goodwill during the years ended 31 December 2018 and 2017 were as follows:

	2018 US$000	2017 US$000
At the beginning of the year	439,508	251,208
Acquisition of Silego	–	190,765
Acquisition of ams's LED backlight business	–	3,866
Deconsolidation of Dyna Image	–	(6,907)
Effect of movements in foreign currency	–	576
At the end of the year	**439,508**	439,508

Goodwill is monitored by management at the level of the Group's operating segments and is therefore allocated at that level. As at 31 December 2018 and 2017, goodwill was allocated to operating segments as follows:

	US$000
Mobile Systems	107,163
Connectivity	88,198
Advanced Mixed Signal	244,147
Total	**439,508**

Impairment tests carried out during the year

Goodwill is tested for impairment annually and whenever there is an indication that it may be impaired. Goodwill is tested for impairment at the level of the operating segments to which it is allocated. Goodwill is impaired if the carrying amount of the operating segment to which it is allocated exceeds its recoverable amount. In conducting impairment tests of goodwill during 2018, we measured the recoverable amount of each operating segment to which goodwill is allocated on a value in use basis. Value in use represents the present value of the future cash flows that we estimate will be generated by the assets allocated to each operating segment in their current use and condition.

Expected future cash flows in the first three years were forecast based on the Group's Strategic Plan. Cash flows beyond the third year were estimated by applying a perpetuity growth factor to the forecast cash flow in the third year.

We consider that the key assumptions used in determining value in use are the expected compound annual growth of revenue during the forecast period, the perpetuity growth rate and the discount rate.

Expected future revenue of each operating segment is based on external forecasts of the future volume of the end-markets for the operating segment's products adjusted to reflect factors specific to the operating segment such as its customer base and available distribution channels, the possibility of new entrants to the market and future technological developments. Cash flows during the forecast period also reflect the cost of materials and other direct costs, research and development expenditure and selling, general and administrative expenses. We estimated the cost of materials and other direct and indirect costs based on current prices and market expectations of future price changes.

We applied a perpetuity growth rate of 2% per annum in estimating the future cash flows of each operating segment in both 2018 and 2017, which we consider to be the long-term growth rate in the demand for the products of each operating segment in its end-markets.

Discount rates applied to the cash flow projections were determined using a capital asset pricing model and reflected current market interest rates, relevant equity and size risk premiums and the risks specific to the operating segment concerned. Pre-tax discount rates used were as follows: Mobile Systems 12.7% (2017: 12.2%); Connectivity 14.2% (2017: 13.6%); and Advanced Mixed Signal 13.5% (2017: 11.0%).

We did not recognise any goodwill impairment during 2018 and the recoverable amount of each operating segment to which goodwill is allocated was comfortably in excess of its carrying amount.

11. Other intangible assets

Movements on other intangible assets for the years ended 31 December 2018 and 2017 were as follows:

	2018 US$000	2017 US$000
Net book value		
At the beginning of the year	235,637	125,619
Effect of movements in foreign currency	(5)	199
Acquisition of businesses	–	127,556
Additions	31,216	27,187
Amortisation charge for the period	(49,130)	(41,969)
Transfer to assets held for sale	(215)	–
Impairment of assets held by Dyna Image	–	(2,790)
Disposals	(58)	(165)
At the end of the year	217,445	235,637

12. Property, plant and equipment

Movements on property, plant and equipment for the years ended 31 December 2018 and 2017 were as follows:

	2018 US$000	2017 US$000
Net book value		
At the beginning of the year	83,870	69,668
Effect of movements in foreign currency	(293)	605
Acquisition of businesses	–	1,481
Additions	26,145	45,167
Depreciation charge for the period	(31,455)	(30,807)
Transfer to assets held for sale	(10,769)	–
Impairment of assets held by Dyna Image	–	(1,537)
Disposals	(1,139)	(707)
At the end of the year	66,359	83,870

13. Investments

Investments were as follows:

	As at 31 December 2018 US$000	As at 31 December 2017 US$000
Investment in associate	–	1,100
Other investments		
Equity investments:		
– Energous shares	10,073	33,837
Derivative financial instruments:		
– Energous warrants	1,465	12,318
Total other investments	11,538	46,155
Total investments	11,538	47,255

Investment in associate

As at 31 December 2018, the Group held a 48.5% ownership interest in Dyna Image Corporation ("Dyna Image"), which is an entity whose principal place of business and country of incorporation is Taiwan. Dyna Image was formerly accounted for as a subsidiary but the Company lost the power to direct its relevant activities in December 2017 and it was deconsolidated with effect from 31 December 2017.

On deconsolidation, the Group's investment in Dyna Image was measured at its fair value of US$1,100, which equated to the Group's share of the carrying amount of Dyna Image's net assets.

Dyna Image is now accounted for as an associate using the equity method.

During 2018, Dyna Image continued to make losses. We recognised our share of those losses in profit or loss until the carrying amount of our investment was reduced to nil during the fourth quarter of 2018.

During early 2018, the shareholders in Dyna Image were approached by a potential acquirer of the business. On 7 December 2018, each of the shareholders in Dyna Image entered into an agreement to dispose of their respective interests in a transaction that is expected to complete in the first half of 2019, subject to applicable regulatory approvals. Accordingly, we have reclassified the Group's investment in Dyna Image as an asset held for sale at its carrying amount of nil.

We expect to receive consideration of between US$2.4 million and US$5.0 million in exchange for our shareholding in Dyna Image.

Notes to the consolidated financial information continued

13. Investments continued

Other investments

Energous shares and warrants

Energous Corporation ("Energous") is the developer of WattUp®, a wire-free charging technology. In November 2016, we entered into a strategic alliance with Energous. At that time, we subscribed for 763,552 common shares in Energous and were granted warrants to purchase up to 763,552 common shares that are exercisable in full or in part on a cashless basis at any time between May 2017 and November 2019. We initially recognised the warrants at their grant date fair value of US$4,695 and an equivalent deferred credit within non-current liabilities. We will amortise the deferred credit to profit or loss in relation to the royalties that may be payable for the use of Energous' Intellectual Property over the initial seven-year term of the strategic alliance. Amortisation of the deferred credit has not yet commenced.

On 5 July 2017, we subscribed for a further 976,139 common shares in Energous at a cost of US$15,000 and were granted a second tranche of warrants to purchase up to 654,013 common shares that are exercisable in full or in part on a cashless basis at any time between January 2018 and July 2020. We initially recognised the second tranche of the warrants at their grant date fair value of US$4,753 and an equivalent deferred credit within non-current liabilities. We are amortising the deferred credit to profit or loss over the three-year period from the grant date to the expiry of the warrants.

During 2018, we recognised a fair value loss on the shares of US$23,764 (2017: gain of US$5,971) in other comprehensive income and recognised a fair value loss of US$10,853 (2017: gain of US$941) on the warrants in profit or loss (as other finance (expense)/income). Also during 2018, we recognised a credit of US$1,584 (2017: credit of US$776) in profit or loss on the amortisation of the fair value on initial recognition of the second tranche of the warrants (as other finance income).

14. Assets classified as held for sale

Transfer of design centre assets to Apple Inc.

On 11 October 2018, we entered into an agreement with Apple Inc. ("Apple") to license our power management technologies and transfer to Apple certain assets and over 300 employees from our design centres in the UK, Germany and Italy. Apple will pay US$300 million for the licence and asset transfers. The transaction is expected to complete in the first half of 2019, subject to applicable regulatory approvals and other customary closing conditions. Accordingly, we have reclassified as held for sale the design centre assets that will be transferred to Apple and the liabilities that are directly associated with them.

Design centre assets that will be transferred to Apple are included in the Mobile Systems operating segment. We expect that the carrying amount of the assets will be recovered in full by the transfer proceeds.

Assets held for sale and directly associated liabilities were as follows:

	As at 31 December 2018 US$000
Assets held for sale	
Other current assets	311
Other intangible assets	215
Property, plant and equipment	10,769
	11,295
Liabilities directly associated with assets held for sale	
Trade and other payables	100
Income taxes payable	63
Other current liabilities	1,721
Provisions	1,283
	3,167

Investment in associate

As explained in note 13, the Group's investment in Dyna Image Corporation was also classified as held for sale as at 31 December 2018 but had a carrying amount of nil.

15. Share-based compensation

The Company operates a number of share-based compensation plans under which it grants options and awards over its ordinary shares to certain of the Group's employees.

Movements in the total number of share options outstanding during the years ended 31 December 2018 and 2017 were as follows:

	2018		2017	
	Options	**Weighted average exercise price €**	Options	Weighted average exercise price €
Outstanding at the beginning of the year	**4,303,195**	**1.50**	4,469,977	2.90
Granted	**2,536,355**	**0.10**	1,345,455	0.10
Exercised	**(1,010,647)**	**3.05**	(1,240,297)	5.30
Forfeited	**(356,268)**	**0.19**	(271,940)	0.29
Outstanding at the end of the year	**5,472,635**	**0.65**	4,303,195	1.50
Options exercisable at the end of the year	**1,155,481**	**2.71**	1,302,600	4.71

When share options were exercised during 2018, the weighted average of the Company's share price was €22.71 (2017: €45.50).

The weighted average contractual life and exercise price of share options outstanding as at 31 December 2018 and 2017 were as follows:

	2018		**2017**	
Range of exercise prices	Number outstanding	Weighted average remaining contractual life (in years)	**Number outstanding**	**Weighted average remaining contractual life (in years)**
€0.0 – 1.00	5,270,419	4.73	**3,883,067**	**4.58**
€1.00 – 8.00	–	n/a	**–**	**n/a**
€8.00 – 16.85	202,216	0.97	**420,128**	**1.60**
€0.00 – 16.85	5,472,635	4.59	**4,303,195**	**4.29**

16. Share buyback programme

Share buyback authority

At the Company's 2016 AGM, the Directors were granted an authority to purchase up to 7,786,595 ordinary shares in the capital of the Company. During 2016 and 2017, 4,483,816 ordinary shares were purchased under the 2016 AGM authority at a total cost of US$186,522 (including transaction costs of US$1,866). The 2016 AGM authority expired on 3 May 2017.

At the Company's 2017 AGM, the Directors were granted a new authority to purchase up to 7,808,280 of our ordinary shares in further tranches. We did not announce any purchases under the 2017 AGM authority and it expired on 2 May 2018.

At the Company's 2018 AGM, the Directors were granted the authority to purchase up to 7,638,214 of our ordinary shares, representing approximately 10% of the issued ordinary share capital of the Company as at 21 March 2018. Such authority shall (unless previously renewed, varied or revoked) expire on the day before the next AGM of the Company or on 30 June 2019, whichever is the earlier.

Purchases made under the share buyback programme are off-market and are effected by way of contingent forward purchase contracts entered into with brokers. Barclays, Goldman Sachs, HSBC or Merrill Lynch may be appointed as brokers for purchases under the 2018 AGM authority.

First tranche pursuant to the 2018 AGM authority

On 6 November 2018, the Company announced details of a tranche of the share buyback programme pursuant to the 2018 AGM authority under which it committed to purchase shares with a minimum cost of €100.0 million and a maximum cost of €150.0 million. On initiation of this tranche, we recognised a liability and a corresponding debit to retained earnings of €150.0 million (US$171,173) in respect of the maximum obligation to purchase shares. We also debited transaction costs incurred of US$14 to retained earnings.

During the remainder of 2018, we recognised a currency translation loss of US$576 on the retranslation of the Euro-denominated liability into US dollars. As at 31 December 2018, the carrying amount of the liability was €150.0 million (US$171,763).

We have not yet been required by the appointed broker to make any intermediate settlements in relation to this tranche, under which the broker may continue to purchase shares until 21 May 2019.

Notes to the consolidated financial information continued

17. Other reserves

Movements on other reserves were as follows:

	Capital redemption reserve US$000	Currency translation reserve US$000	Fair value reserve US$000	Hedging reserve US$000	Treasury shares US$000	Total US$000
As at 31 December 2015	–	(4,480)	–	(3,443)	–	(7,923)
Other comprehensive income/(loss):						
– Currency translation differences on foreign operations	–	127	–	–	–	127
– Fair value loss on available-for-sale investments	–	–	2,866	–	–	2,866
– Cash flow hedges:						
Fair value loss recognised on effective hedges	–	–	–	(13,264)	–	(13,264)
Fair value loss transferred to profit or loss	–	–	–	8,382	–	8,382
– Income tax credit/(expense)	–	(47)	–	765	–	718
Other changes in equity:						
– Purchase of own shares into treasury	–	–	–	–	(61,472)	(61,472)
As at 31 December 2016	–	(4,400)	2,866	(7,560)	(61,472)	(70,566)
Other comprehensive income/(loss):						
– Currency translation differences on foreign operations	–	1,665	–	–	–	1,665
– Gain transferred to profit or loss on deconsolidation of Dyna Image	–	(1,144)	–	–	–	(1,144)
– Fair value loss on available-for-sale investments	–	–	5,971	–	–	5,971
– Cash flow hedges:						
Fair value gain recognised on effective hedges	–	–	–	16,433	–	16,433
Fair value loss transferred to profit or loss	–	–	–	(441)	–	(441)
– Income tax credit/(expense)	–	180	(1,015)	(3,149)	–	(3,984)
Other changes in equity:						
– Purchase of own shares into treasury	–	–	–	–	(125,050)	(125,050)
– Cancellation of treasury shares	571	–	–	–	186,522	187,093
As at 31 December 2017	571	(3,699)	7,822	5,283	–	9,977
Other comprehensive loss:						
– Currency translation differences on foreign operations	**–**	**(527)**	**–**	**–**	**–**	**(527)**
– Fair value loss on equity investments	**–**	**–**	**(23,764)**	**–**	**–**	**(23,764)**
– Cash flow hedges:						
Fair value loss recognised on effective hedges	**–**	**–**	**–**	**(10,075)**	**–**	**(10,075)**
Fair value gain transferred to profit or loss	**–**	**–**	**–**	**(2,343)**	**–**	**(2,343)**
– Income tax (expense)/credit	**–**	**(78)**	**1,015**	**2,376**	**–**	**3,313**
As at 31 December 2018	**571**	**(4,304)**	**(14,927)**	**(4,759)**	**–**	**(23,419)**

18. Adoption of IFRS 15 and IFRS 9

Introduction

We adopted IFRS 15 *Revenue from Contracts with Customers* and IFRS 9 *Financial Instruments* with effect from 1 January 2018. We explain below the changes that were made to the Group's significant accounting policies as a consequence of the adoption of these standards and their effect on the Group's results and financial position.

IFRS 15 Revenue from Contracts with Customers

Background
IFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognised. It replaced IAS 18 Revenue, IAS 11 Construction Contracts and related interpretations.

IFRS 15 provides a single, principles-based five-step model to be applied to all contracts with customers. The five steps in the model are as follows: identify the contract with the customer; identify the performance obligations in the contract; determine the transaction price; allocate the transaction price to the performance obligations in the contract; and recognise revenue when (or as) the performance obligations are satisfied.

Changes in revenue recognition policy
We generate revenue principally through the sale of our products. Relatively small amounts of revenue are generated from royalties for the use of intellectual property assets and from research and development contracts.

Sale of products
Prior to adopting IFRS 15, revenue from the sale of products was recognised when the significant risks and rewards of ownership had been transferred to the customer, the amount of revenue could be measured reliably and it was probable that payment would be received. We considered that these conditions were met when the products were transferred to the customer, except in the case of sales to distributors on "ship and debit" terms.

Where we sell to a distributor on ship and debit terms, the distributor may be entitled to a rebate if the distributor sells the product to end customers at a price lower than the price at which the distributor purchased the products from us. We therefore consider that we retain significant risks of ownership and therefore did not recognise revenue until the distributor had sold the products to end customers.

Under IFRS 15, revenue from the sale of products is recognised when the customer obtains control of the products. We consider that control passes when the products are transferred to the customer. Accordingly, where products are sold on "ex-works" incoterms, revenue is recognised when the products are released for collection by the customer. Otherwise, revenue is recognised when the products are delivered to the customer. Where products are supplied on a consignment basis, delivery takes place and revenue is recognised when the products are taken out of the consignment by the customer.

IFRS 15 had no effect on the recognition and measurement of revenue from the sale of products, except in relation to sales to distributors on ship and debit terms. Revenue on sales to distributors on ship and debit terms is now recognised when the products are transferred to the distributor rather than when the products are sold by the distributor to end customers. Revenue from sales to distributors on ship and debit terms is therefore now recognised earlier than it would have been prior to the adoption of IFRS 15.

Revenue recognised on the sale of products is measured at the fair value of the consideration received or receivable, excluding sales taxes and after making allowance for rebates and product returns.

Rebates are estimated using the expected value method based on actual rebates granted at the distributor and product level during the preceding quarter so as to reflect current pricing trends. As a consequence of our pricing policy, allowances for rebates on sales to distributors on ship and debit terms typically represent a significant proportion of the list price of the products.

Most of our distributor customers are entitled to limited rights of return, referred to as stock rotation rights. Typically, returns are allowed twice-yearly for a credit of up to a percentage of the value of products shipped by us to the distributor during the preceding six-month period. Revenue on sales to distributors is recognised after making allowance for stock rotation claims that is estimated based on stock rotation credits granted at the distributor level during the preceding six-month period. Historically, stock rotation claims have not been significant.

As permitted by IFRS 15, we do not capitalise the incremental costs of obtaining contracts (such as sales representatives' commissions) because the amortisation period of such costs would be one year or less.

Other revenue
IFRS 15 did not affect the recognition and measurement of royalty income and income from research and development contracts.

Revenue from royalties is recognised on an accruals basis in accordance with the terms of the relevant licensing agreements.

Revenue from research and development contracts is recognised by reference to the stage of completion of the contract, which is represented by the costs incurred for work performed to date as a percentage of the estimated total contract costs. If it is probable that a contract will be loss making, the expected loss is recognised immediately as an expense in profit or loss.

Notes to the consolidated financial information continued

18. Adoption of IFRS 15 and IFRS 9 continued

Financial effect of adopting IFRS 15

We adopted IFRS 15 with effect from 1 January 2018 using the modified retrospective approach, whereby information for prior periods has not been restated but a cumulative effect adjustment was made to the opening balance of retained earnings which represented the cumulative effect of the earlier recognition of revenue sales to distributors on ship and debit terms.

As at 1 January 2018, we recognised a credit to equity of US$1,541 on adoption of IFRS 15, which may be analysed as follows:

	US$000
Deferred revenue	8,578
Sales rebate allowance	(3,367)
Returns liability	(1,156)
Revenue recognised in equity	4,055
Deferred cost of sales	(2,738)
Returns asset	659
Royalty allowance	(24)
Cost of sales recognised in equity	(2,103)
Credit to equity before income taxes	1,952
Income tax expense	(411)
Credit to equity after income taxes	1,541

In the following tables, we summarise the effect of adopting IFRS 15 on the consolidated statement of income for the year ended 31 December 2018 and on the consolidated balance sheet as at 31 December 2018. The adoption of IFRS 15 had no effect on other comprehensive income or on the statement of cash flows.

Consolidated statement of income for the year ended 31 December 2018

	As reported under IFRS 15 US$000	Adjustment for effect of IFRS 15 US$000	Amounts under IAS 18 US$000
Revenue	**1,442,138**	(10,137)	1,432,001
Cost of sales	**(751,070)**	6,896	(744,174)
Gross profit	**691,068**	(3,241)	687,827
Operating profit	**199,707**	(3,241)	196,466
Profit before income taxes	**196,193**	(3,241)	192,952
Income tax expense	**(55,281)**	622	(54,659)
Profit after income taxes	**140,912**	(2,619)	138,293
Net income	**139,799**	(2,619)	137,180
Earnings per share (US$)			
Basic	**1.89**	(0.04)	1.85
Diluted	**1.80**	(0.03)	1.77

Consolidated balance sheet as at 31 December 2018

	As reported under IFRS 15 US$000	Adjustment for effect of IFRS 15 US$000	Amounts under IAS 18 US$000
Assets			
Other current assets	**18,306**	(637)	17,669
Total current assets	**974,047**	(637)	973,410
Total non-current assets	**743,089**	–	743,089
Total assets	**1,717,136**	(637)	1,716,499
Liabilities and equity			
Income taxes payable	**8,193**	(1,032)	7,161
Other current liabilities	**58,237**	4,555	62,792
Total current liabilities	**393,880**	3,523	397,403
Total non-current liabilities	**20,749**	–	20,749
Retained earnings	**930,576**	(4,160)	926,416
Total equity	**1,302,507**	(4,160)	1,298,347
Total liabilities and equity	**1,717,136**	(637)	1,716,499

18. Adoption of IFRS 15 and IFRS 9 continued

IFRS 9 Financial Instruments

Background
IFRS 9 sets out requirements for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. It replaced IAS 39 Financial Instruments: Recognition and Measurement.

IFRS 9 introduced a new model for classification and measurement of financial assets and financial liabilities, a single, forward-looking "expected loss" model for measuring impairment of financial assets (including trade receivables) and a new approach to hedge accounting that is more closely aligned with risk management activities.

Classification and measurement of financial assets and liabilities
IFRS 9 largely retained the requirements of IAS 39 for the classification of financial liabilities but changed the classification of financial assets.

Under IFRS 9, a financial asset must be classified on initial recognition as measured at amortised cost, fair value through other comprehensive income ("FVOCI") or fair value through profit or loss ("FVTPL"). IFRS 9 eliminated the IAS 39 categories for financial assets of held to maturity, loans and receivables and available-for-sale.

Classification of financial assets under IFRS 9 is generally based on the business model in which a financial asset is managed and its contractual cash flow characteristics. A financial asset is measured at amortised cost if it is held with the objective of collecting the contractual cash flows and its contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding. All other financial assets are measured at fair value.

We have an investment in the common shares of Energous Corporation that we intend to hold for the long term for strategic purposes. As permitted by IFRS 9, we have irrevocably elected to present changes in the fair value of this equity investment in other comprehensive income rather than in profit or loss. Consequently, fair value gains or losses arising subsequent to 1 January 2018 that may be realised on any future sale of all or part of this investment will not be reclassified to profit or loss.

We have not chosen to designate any financial assets or financial liabilities at FVTPL that would otherwise be classified as measured at amortised cost or FVOCI.

In the following table, we present the previous classification under IAS 39 of financial assets and financial liabilities held by the Group as at 1 January 2018 and their new classification under IFRS 9. It can be seen that there was no change in the basis of measurement of the financial assets or financial liabilities held by the Group as a result of their reclassification in accordance with IFRS 9.

	Classification under IAS 39	Classification under IFRS 9
Financial assets		
Cash and cash equivalents	Loans and receivables (amortised cost)	Amortised cost
Trade and other receivables	Loans and receivables (amortised cost)	Amortised cost
Investments:		
– Energous shares	Available-for-sale	FVOCI – equity instrument
– Energous warrants	FVTPL	FVTPL
Other financial assets:		
– Currency derivatives	Fair value – hedging instruments	Fair value – hedging instruments
– Rental and other deposits	Loans and receivables (amortised cost)	Amortised cost
Financial liabilities		
Trade and other payables	Amortised cost	Amortised cost
Other financial liabilities:		
– Hire purchase and finance lease obligations	Amortised cost	Amortised cost
– Currency derivatives	Fair value – hedging instruments	Fair value – hedging instruments
– Deferred consideration	Amortised cost	Amortised cost
– Contingent consideration	FVTPL	FVTPL

Impairment of financial assets
Where appropriate, financial assets that are measured at amortised cost are stated net of an allowance for credit losses. IFRS 9 replaced the "incurred loss" model in IAS 39 with an "expected credit loss" model.

Trade receivables
As permitted by IFRS 9, we recognise an allowance for credit losses in respect of trade receivables from initial recognition measured as the amount of the lifetime expected credit losses. We previously recognised a credit loss allowance only when there was objective evidence that we may not be able to collect the amount due.

Dialog is a business-to-business supplier with many established customers, several of which are large multi-national businesses, and has a record of insignificant credit losses. Before accepting a new customer, we assess the potential customer's credit quality and establish a credit limit. Credit quality is assessed using data maintained by reputable credit rating agencies, by checking references included in credit applications and, where they are available, by reviewing the customer's recent financial statements. Credit limits are subject to multiple levels of authorisation and are reviewed on a regular basis.

Against this background, we determined that there was no appreciable difference between the credit loss allowance that we recognised against trade receivables using the incurred loss model under IAS 39 and that recognised using the expected credit loss model on adoption of IFRS 9.

Notes to the consolidated financial information continued

18. Adoption of IFRS 15 and IFRS 9 continued

Cash and cash equivalents

Under IFRS 9, we normally recognise an allowance for credit losses in respect of cash and cash equivalents that is measured as the amount of expected credit losses over the next 12 months. If, however, the risk of default has increased significantly since initial recognition, we measure the allowance as the amount of lifetime credit losses. We previously recognised a credit loss allowance only when there was objective evidence of default.

Cash deposits and cash equivalent investments are placed only with reputable financial institutions that satisfy the criteria set out in our Board approved treasury policy, including a requirement that each has a median credit rating of not less than A- (Standard & Poor's), A3 (Moody's) or A- (Fitch). Credit risk is further limited by investing only in liquid instruments. Historically, we have not recognised any significant credit losses in respect of cash deposits and cash equivalent investments.

Hedge accounting

We use forward currency contracts principally to hedge our exposure to exchange rate movements on forecast operating expenses and tax cash flows denominated in foreign currencies, principally the Euro and the pound sterling. Where possible, these contracts are designated as hedging instruments in cash flow hedge relationships.

We have elected to adopt the new general hedge accounting model in IFRS 9, which requires us to ensure that hedge accounting relationships are aligned with our risk management objectives and strategy and to apply a more qualitative and forward-looking approach to assessing hedge effectiveness than was the case under IAS 39. Whilst hedges must still be expected to be highly effective on inception and in subsequent periods, the requirement of IAS 39 for the actual effectiveness of the hedge to be within a specified range in order for hedge accounting to continue has been removed under IFRS 9.

We applied the hedge accounting requirements of IFRS 9 prospectively with effect from 1 January 2018. All hedging relationships designated under IAS 39 as at 31 December 2017 met the criteria for hedge accounting under IFRS 9 as at 1 January 2018 and were therefore regarded as continuing hedging relationships.

Financial effect of adopting IFRS 9

We adopted the classification and measurement (including impairment) requirements of IFRS 9 with effect from 1 January 2018 using the modified retrospective approach, whereby information for prior periods has not been restated to reflect these requirements.

We recognised no changes in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 and, therefore, there was no cumulative effect adjustment to the opening balance of equity as at 1 January 2018.

Financial performance measures

Use of non-IFRS measures

We use a number of measures to assess our financial performance, to ensure our performance is aligned to strategy and continued alignment with shareholders' interests. We consider certain of these measures to be particularly important and identify them as "key performance indicators" (KPIs). We have identified the following financial measures as KPIs: revenue growth; gross margin, operating expenses as a percentage of revenue; operating profit margin; diluted EPS and free cash flow. We monitor the profit or loss measures that are KPIs on both an IFRS basis and an underlying basis.

Underlying measures of performance and free cash flow are non-IFRS measures because they exclude amounts that are included in, or include amounts that are excluded from, the most directly comparable measure calculated and presented in accordance with IFRS or are calculated using financial measures that are not calculated in accordance with IFRS. We do not regard non-IFRS measures as a substitute for, or superior to, the equivalent IFRS measures. Non-IFRS measures presented by Dialog may not be directly comparable with similarly-titled measures used by other companies.

Underlying measures of performance

We report underlying measures of performance because we believe they provide both management and investors with useful additional information about the financial performance of our businesses. Underlying measures of performance represent the equivalent IFRS measures adjusted for specific items that are considered by us to hinder comparison of the financial performance of our businesses either from one period to another or with other similar businesses.

Underlying measures of performance exclude items that can have a significant effect on the Group's profit or loss. We compensate for these limitations by monitoring separately the items that are excluded from the equivalent IFRS measures in calculating the underlying measures.

We outline below the specific items of income and expense that are recognised in profit or loss in accordance with IFRS but are excluded from our underlying results and their related tax effects.

Share-based compensation

We exclude the share-based compensation expense recognised in relation to options and awards granted under the Company's share-based compensation plans because the awards are equity-settled and therefore have no immediate effect on shareholders' returns. We additionally exclude the effect on profit or loss of changes in the accrual for payroll taxes payable on the exercise or vesting of such options and awards because the accrual fluctuates with the Company's share price and the effect on profit or loss is therefore not necessarily indicative of our trading performance.

Business combinations

We exclude those effects of applying the acquisition method of accounting under IFRS that we consider are not indicative of the Group's trading performance, including the accounting for transaction costs; the fair value adjustment to inventories of acquired businesses; the recognition of certain elements of the purchase price as compensation expense; and the recognition of remeasurements of contingent consideration in profit or loss.

In 2018 and 2017, we excluded from our underlying results the following in relation to the accounting for the acquisitions of Silego and ams AG's LED backlight business:

- acquisition-related costs;
- the recognition in cost of sales of the consumption of the fair value uplift to inventory held by the acquired businesses at the acquisition date;
- the element of deferred amounts payable for Silego that is recognised as compensation expense;
- the credit recognised on the forfeiture of deferred consideration payable for Silego; and
- the credit arising from the change in estimate of the liabilities for the contingent consideration payable for Silego and the interest expense recognised on the unwinding of the discount on the liabilities.

We also exclude from our underlying results the amortisation of identifiable intangible assets that are recognised in business combinations in order that the performance of those businesses that we have acquired may be compared fairly with those businesses that we have developed on an organic basis.

Integration costs

We exclude the costs of integrating acquired businesses that are considered by us to hinder the assessment of the financial performance of those businesses.

In 2018 and 2017, we excluded the costs that we incurred in relation to the integration of Silego.

Corporate transaction costs

We exclude significant transaction costs and other non-recurring items recognised in relation to corporate transactions other than business combinations.

In 2018, we excluded from our underlying results the costs that we incurred in relation to the acquisition discussions with Synaptics Incorporated and the licence and asset transfer agreements that we entered into with Apple Inc.

In 2016, we excluded the fee that we received from Atmel Corporation on their termination of the merger agreement that existed between us and residual transaction costs and facility commitment fees that we incurred prior to termination.

Financial performance measures continued

Underlying measures of performance continued

Effective interest on financial liabilities

We adjusted our interest expense to exclude the non-cash element of the interest expense recognised in relation to a patent licensing agreement that was accounted for as a hire purchase contract within other intangible assets. We considered that the cash interest payments are more indicative of the effect of this arrangement on shareholders' returns.

Strategic investments

We exclude the effect on profit or loss of the measurement at fair value of our strategic investments (comprising the shares and the warrants that we hold in Energous, the call option that we held over the shares that we do not own in Dyna Image prior to its expiry in June 2018 and, until they were sold in May 2017, the shares that we held in Arctic Sand). We hold these instruments for strategic reasons linked to our commercial partnerships with these companies. Since we do not hold these instruments for trading purposes, we exclude fluctuations in their fair values when assessing our trading performance.

In December 2017, we recognised impairment losses totalling US$4,327 in relation to the intangible assets and property, plant and equipment held by Dyna Image and ceased to account for it as a subsidiary, recognising a loss of US$5,597 on deconsolidation. Since these were discrete non-recurring losses, we excluded them from our underlying results.

Income tax effect of underlying adjustments

We calculate the income tax effect of underlying adjustments by considering the specific tax treatment of each item and by applying the relevant statutory tax rate to those items that are taxable or deductible for tax purposes.

US tax reform

In December 2017, the US President signed into law significant reforms of the US tax system, including a reduction of the Federal corporate income tax rate from 35% to 21%. Our income tax expense for 2017 reflected a non-cash deferred tax credit of US$6,658 resulting from the remeasurement of US deferred tax balances at the lower tax rate. Since this was a discrete non-recurring benefit, we excluded it from our underlying results.

Reconciliation of underlying measures to equivalent IFRS measures

Reconciliations of the underlying measures of performance to the equivalent IFRS measures for the years ended 31 December 2018, 2017 and 2016 are presented in the following tables:

Year ended 31 December 2018

US$000 unless stated otherwise	IFRS basis	Share-based compensation and related payroll taxes	Accounting for business combinations	Integration costs	Corporate transaction costs	Effective interest	Strategic investments	Underlying basis
Revenue	1,442,138	–	–	–	–	–	–	1,442,138
Cost of sales	(751,070)	1,791	3,129	13	–	–	–	(746,137)
Gross profit	691,068	1,791	3,129	13	–	–	–	696,001
Gross margin %	*47.9%*							*48.3%*
SG&A expenses	(168,228)	17,163	14,757	2,524	11,346	–	–	(122,438)
R&D expenses	(326,309)	22,699	9,148	228	–	–	–	(294,234)
Other operating income	3,176	–	(877)	–	–	–	–	2,299
Operating profit	199,707	41,653	26,157	2,765	11,346	–	–	281,628
Operating margin %	*13.8%*							*19.5%*
Net finance (expense)/income	(3,514)	–	2,220	–	–	50	9,269	8,025
Profit before income taxes	196,193	41,653	28,377	2,765	11,346	50	9,269	289,653
Income tax expense	(55,281)	(2,108)	(3,448)	(555)	(1,024)	(9)	(746)	(63,171)
Profit after income taxes	140,912	39,545	24,929	2,210	10,322	41	8,523	226,482
Share of loss of associate	(1,113)	–	–	–	–	–	–	(1,113)
Net income	139,799	39,545	24,929	2,210	10,322	41	8,523	225,369
EBITDA	n/a							339,584
EBITDA margin %	*n/a*							*23.5%*

Reconciliation of underlying measures to equivalent IFRS measures continued

Year ended 31 December 2017

US$000 unless stated otherwise	IFRS basis	Share-based compensation and related payroll taxes	Accounting for business combinations	Integration costs	Effective interest	Strategic investments	US tax reform	Underlying basis
Revenue	1,352,841	–	–	–	–	–	–	1,352,841
Cost of sales*	(707,971)	1,219	2,306	–	–	–	–	(704,446)
Gross profit	644,870	1,219	2,306	–	–	–	–	648,395
Gross margin %	*47.7%*							*47.9%*
SG&A expenses	(145,262)	16,285	14,358	1,121	–	–	–	(113,498)
R&D expenses*	(303,013)	17,994	8,050	1,184	–	–	–	(275,785)
Other operating (expense)/income	(9,578)	–	–	–	–	9,924	–	346
Operating profit	187,017	35,498	24,714	2,305	–	9,924	–	259,458
Operating margin %	*13.8%*							*19.2%*
Net finance income	7,786	–	436	–	289	(1,398)	–	7,113
Profit before income taxes	194,803	35,498	25,150	2,305	289	8,526	–	266,571
Income tax expense	(25,369)	(3,476)	(4,187)	(701)	(56)	1,889	(6,658)	(38,558)
Net income	169,434	32,022	20,963	1,604	233	10,415	(6,658)	228,013
EBITDA	n/a							315,773
EBITDA margin %	*n/a*							*23.3%*

Year ended 31 December 2016

US$000 unless stated otherwise	IFRS basis	Share-based compensation and related payroll taxes	Accounting for business combinations	Aborted merger with Atmel	Effective interest	Strategic investments	Underlying basis
Revenue	1,197,611	–	–	–	–	–	1,197,611
Cost of sales*	(630,963)	1,120	–	–	–	–	(629,843)
Gross profit	566,648	1,120	–	–	–	–	567,768
Gross margin %	*47.3%*						*47.4%*
SG&A expenses	(133,271)	15,826	7,473	3,485	–	–	(106,487)
R&D expenses*	(261,278)	13,570	7,029	–	–	–	(240,679)
Other operating income	137,708	–	–	(137,300)	–	–	408
Operating profit	309,807	30,516	14,502	(133,815)	–	–	221,010
Operating margin %	*25.9%*						*18.5%*
Net finance expense	(4,601)	–	–	1,913	526	(1,199)	(3,361)
Profit before income taxes	305,206	30,516	14,502	(131,902)	526	(1,199)	217,649
Income tax expense	(47,090)	(4,686)	(351)	(383)	(105)	386	(52,229)
Net income	258,116	25,830	14,151	(132,285)	421	(813)	165,420
EBITDA	n/a						269,681
EBITDA margin %	*n/a*						*22.5%*

* Certain product development costs have been reclassified from cost of sales to research and development expenses (see note 1 to the consolidated financial information).

Accounting for business combinations

We excluded from the underlying measures of performance the following specific items arising from business combinations accounting under IFRS:

US$000	**2018**	2017	2016
Acquisition-related costs	**–**	4,539	–
Amortisation of acquired intangible assets	**22,629**	16,461	14,502
Consumption of the fair value uplift of acquired inventory	**3,129**	2,305	–
Consideration accounted for as compensation expense	**1,481**	1,409	–
Forfeiture of deferred consideration	**(204)**	–	–
Remeasurement of contingent consideration	**(878)**	–	–
Increase in operating profit	**26,157**	24,714	14,502
Unwinding of discount on contingent consideration	**2,220**	436	–
Increase in profit before income taxes	**28,377**	25,150	14,502
Income tax credit	**(3,448)**	(4,187)	(351)
Increase in net income	**24,929**	20,963	14,151

Financial performance measures continued

Explanation of financial performance measures

Change in revenue

We monitor the change in revenue from one period to another and the trend in revenue over time because they are important measures of the growth in our business. During the periods presented, there were no differences between revenue determined in accordance with IFRS and on an underlying basis. During each period, the change in revenue was as follows:

US$000 unless stated otherwise	2018	2017	2016
IFRS and underlying measures			
Revenue in the period	**1,442,138**	1,352,841	1,197,611
Revenue in the comparative period	**1,352,841**	1,197,611	1,355,312
Increase/(decrease) in revenue	**6.6%**	13.0%	(11.6)%

Gross margin

Gross margin is gross profit expressed as a percentage of revenue. We monitor gross margin because we believe it provides a measure of the value that we add to our products. Gross margin determined in accordance with IFRS and on an underlying basis was as follows:

US$000 unless stated otherwise	2018	2017	2016
IFRS measures			
Revenue	**1,442,138**	1,352,841	1,197,611
Gross profit	**691,068**	644,870	566,648
Gross margin	**47.9%**	47.7%	47.3%
Underlying measures			
Revenue	**1,442,138**	1,352,841	1,197,611
Gross profit	**696,001**	648,395	567,768
Gross margin	**48.3%**	47.9%	47.4%

Operating expenses as a percentage of revenue

We monitor operating expenses as a percentage of revenue because we believe it provides a measure of our effort in innovation and the efficiency of our operating structure. Operating expenses comprise selling, general and administrative ("SG&A") expenses and research and development ("R&D") expenses. Operating expenses as a percentage of revenue determined in accordance with IFRS and on an underlying basis was as follows:

US$000 unless stated otherwise	2018	2017	2016
IFRS measures			
Revenue	**1,442,138**	1,352,841	1,197,611
Operating expenses	**(494,537)**	(448,275)	(394,549)
Operating expenses as a percentage of revenue	**34.3%**	33.1%	32.9%
Underlying measures			
Revenue	**1,442,138**	1,352,841	1,197,611
Operating expenses	**(416,672)**	(389,283)	(347,166)
Operating expenses as a percentage of revenue	**28.9%**	28.8%	29.0%

Change in operating profit

We monitor the change in operating profit from one period to another and the trend in operating profit over time because we believe they are important measures of the performance of our operations. Operating profit growth determined in accordance with IFRS and on an underlying basis was as follows:

US$000 unless stated otherwise	2018	2017	2016
IFRS measures			
Operating profit in the period	**199,707**	187,017	309,807
Operating profit in the comparative period	**187,017**	309,807	259,746
Increase/(decrease) in operating profit	**6.8%**	(39.6)%	19.3%
Underlying measures			
Operating profit in the period	**281,628**	259,458	221,010
Operating profit in the comparative period	**259,458**	221,010	317,656
Increase/(decrease) in operating profit	**8.5%**	17.4%	(30.4)%

Explanation of financial performance measures continued

Operating profit margin

Operating profit margin is operating profit expressed as a percentage of revenue. We monitor operating profit margin because we believe it provides a measure of the overall profitability of our operations. Operating profit margin determined in accordance with IFRS and on an underlying basis was as follows:

US$000 unless stated otherwise	2018	2017	2016
IFRS measures			
Revenue	**1,442,138**	1,352,841	1,197,611
Operating profit	**199,707**	187,017	309,807
Operating profit margin	**13.8%**	13.8%	25.9%
Underlying measures			
Revenue	**1,442,138**	1,352,841	1,197,611
Operating profit	**281,628**	259,458	221,010
Operating profit margin	**19.5%**	19.2%	18.5%

Underlying EBITDA and EBITDA margin

Underlying EBITDA is a non-IFRS measure that we define as underlying net income before net finance expense, income tax expense and depreciation and amortisation expenses. Underlying EBITDA margin is a non-IFRS measure that represents underlying EBITDA expressed as a percentage of revenue. We present underlying EBITDA and underlying EBITDA margin because we believe these measures are useful to investors and other users of our financial information in evaluating the sensitivity of our underlying trading performance to changes in variable operating expenses. Underlying EBITDA may be reconciled to net income determined in accordance with IFRS as follows:

US$000	2018	2017	2016
Net income	**139,799**	169,434	258,116
Net finance expense/(income)	**3,514**	(7,786)	4,601
Income tax expense	**55,281**	25,369	47,090
Depreciation expense	**31,455**	30,807	27,219
Amortisation expense	**49,130**	41,969	35,954
EBITDA	**279,179**	259,793	372,980
Share-based compensation and related payroll taxes	**41,653**	35,498	30,516
Acquisition-related costs	**–**	4,539	–
Consumption of the fair value uplift of acquired inventory	**3,129**	2,305	–
Consideration accounted for as compensation expense	**1,481**	1,409	–
Forfeiture of deferred consideration	**(204)**	–	–
Remeasurement of contingent consideration	**(878)**	–	–
Corporate transaction costs	**11,346**	–	3,485
Integration costs	**2,765**	2,305	–
Share of loss of associate	**1,113**	–	–
Impairment of intangible assets	**–**	2,790	–
Impairment of property, plant and equipment	**–**	1,537	–
Loss on deconsolidation of Dyna Image	**–**	5,597	–
Merger termination fee	**–**	–	(137,300)
Underlying EBITDA	**339,584**	315,773	269,681

Underlying EBITDA margin was as follows:

US$000 unless stated otherwise	2018	2017	2016
Underlying measures			
Revenue	**1,442,138**	1,352,841	1,197,611
EBITDA	**339,584**	315,773	269,681
EBITDA margin	**23.5%**	23.3%	22.5%

Financial performance measures continued

Explanation of financial performance measures continued

Earnings per share

We monitor basic and diluted earnings per share ("EPS") on an IFRS basis and on an underlying basis. We believe that underlying EPS measures are useful to investors in assessing our ability to generate earnings and provide a basis for assessing the value of the Company's shares (for example, by way of price earnings multiples). Earnings for calculating IFRS and underlying EPS measures were calculated as follows:

US$000	2018	2017	2016
IFRS measures			
Net income	**139,799**	169,434	258,116
Loss attributable to non-controlling interests	**–**	4,482	2,824
Earnings for calculating basic and diluted EPS	**139,799**	173,916	260,940
Underlying measures			
Net income*	**225,369**	228,013	165,420
Loss attributable to non-controlling interests	**–**	1,425	2,299
Earnings for calculating basic and diluted EPS	**225,369**	229,438	167,719

* Underlying net income is reconciled to net income determined in accordance with IFRS basis in the tables set out under the heading "Reconciliation of underlying measures to equivalent IFRS measures".

Underlying and diluted EPS measures are calculated using the weighted average number of shares that are used in calculating the equivalent measures under IFRS as presented in note 7 to the consolidated financial information.

Basic and diluted EPS on an IFRS basis and on an underlying basis were as follows:

US$	2018	2017	2016
IFRS earnings per share			
Basic	**1.89**	2.34	3.43
Diluted	**1.80**	2.21	3.25
Underlying earnings per share			
Basic	**3.05**	3.08	2.20
Diluted	**2.90**	2.92	2.09

Free cash flow

Free cash flow is a non-IFRS measure that represents cash flow from operating activities, less capital expenditure. We believe that free cash flow is useful to investors because it provides a measure of the cash generated by our business that is available for expansion, to make strategic investments in, or acquire, other businesses, to repay borrowings and to fund distributions to shareholders.

Free cash flow was calculated as follows:

US$000	2018	2017	2016
Cash flow from operating activities	**288,649**	284,722	248,760
Purchase of property, plant and equipment	**(26,145)**	(47,938)	(25,553)
Purchase of intangible assets	**(6,197)**	(6,196)	(8,177)
Payments for capitalised development costs	**(24,771)**	(20,988)	(15,802)
Capital element of finance lease payments	**(1,651)**	(4,283)	(3,834)
Free cash flow	**229,885**	205,317	195,394

Registered office

Dialog Semiconductor Plc
Tower Bridge House
St Katharine's Way
London E1W 1AA
UK
www.dialog-semiconductor.com

www.dialog-semiconductor.com