

INVACARE CORP  
Form 10-Q  
November 05, 2018

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q

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

For the quarterly period ended September 30, 2018  
OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission File Number 001-15103

INVACARE CORPORATION  
(Exact name of registrant as specified in its charter)

Ohio 95-2680965  
(State or other jurisdiction of (IRS Employer Identification No.)  
incorporation or organization)

One Invacare Way, Elyria, Ohio 44035  
(Address of principal executive offices) (Zip Code)  
(440) 329-6000  
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes  No

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

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

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

As of November 2, 2018, the registrant had 33,194,680 Common Shares and 6,357 Class B Common Shares outstanding.



## Table of Contents

	Item	Page
<b>PART I: FINANCIAL INFORMATION</b>		
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	2	<u>1</u>
<u>Financial Statements (Unaudited)</u>	1	
<u>Condensed Consolidated Statement of Comprehensive Income (Loss) - Three and Nine Months Ended September 30, 2018 and September 30, 2017</u>		<u>19</u>
<u>Condensed Consolidated Balance Sheets - September 30, 2018 and December 31, 2017</u>		<u>20</u>
<u>Condensed Consolidated Statement of Cash Flows - Nine Months Ended September 30, 2018 and September 30, 2017</u>		<u>21</u>
<u>Notes to Condensed Consolidated Financial Statements - September 30, 2018</u>		<u>22</u>
<u>Quantitative and Qualitative Disclosures About Market Risk</u>	3	<u>61</u>
<u>Controls and Procedures</u>	4	<u>61</u>
<b>PART II: OTHER INFORMATION</b>		
<u>Legal Proceedings</u>	1	<u>62</u>
<u>Risk Factors</u>	1A	<u>62</u>
<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	2	<u>63</u>
<u>Exhibits</u>	6	<u>64</u>
<u>Signatures</u>		<u>65</u>

## About Invacare Corporation

Invacare Corporation (NYSE: IVC) ("Invacare" or the "company") is a leading manufacturer and distributor in its markets for medical equipment used in non-acute care settings. At its core, the company designs, manufactures and distributes medical devices that help people to move, breathe, rest and perform essential hygiene. The company provides clinically complex medical device solutions for congenital (e.g., cerebral palsy, muscular dystrophy, spina bifida), acquired (e.g., stroke, spinal cord injury, traumatic brain injury, post-acute recovery, pressure ulcers) and degenerative (e.g., ALS, multiple sclerosis, chronic obstructive pulmonary disease (COPD), age related, bariatric) conditions. The company's products are important parts of care for people with a wide range of challenges, from those who are active and heading to work or school each day and may need additional mobility or respiratory support, to those who are cared for in residential care settings, at home and in rehabilitation centers. The company sells its products principally to home medical equipment providers with retail and e-commerce channels, residential care operators, dealers and government health services in North America, Europe and Asia/Pacific. For more information about the company and its products, visit the company's website at [www.invacare.com](http://www.invacare.com). The contents of the company's website are not part of this Quarterly Report on Form 10-Q and are not incorporated by reference herein.

MD&A Overview

Table of Contents

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The discussion and analysis presented below is concerned with material changes in financial condition and results of operations between the periods specified in the condensed consolidated balance sheets at September 30, 2018 and December 31, 2017, and in the condensed consolidated statement of comprehensive income (loss) for the three and nine months ended September 30, 2018 and September 30, 2017. All comparisons presented are with respect to the same period last year, unless otherwise stated. This discussion and analysis should be read in conjunction with the consolidated financial statements and accompanying notes that appear elsewhere in this Quarterly Report on Form 10-Q and the MD&A included in the company's Annual Report on Form 10-K for the year ended December 31, 2017 and for some matters, SEC filings from prior periods may be useful sources of information.

OVERVIEW

---

Invacare is a multi-national company with integrated capabilities to design, produce and distribute durable medical equipment. The company makes products that help people move, breathe, rest and perform essential hygiene, and with those products the company supports people with congenital, acquired and degenerative conditions. The company's products and solutions are important parts of care for people with a range of challenges, from those who are active and go to work or school each day and may need additional mobility or respiratory support, to those who are cared for in residential care settings, at home and in rehabilitation centers. The company operates in facilities in North America, Europe and Asia/Pacific, which are the result of dozens of acquisitions made over the company's nearly forty-year history. Some of these acquisitions have been combined into integrated operating units, while others remain relatively independent.

Strategy

The company had a strategy to be a leading provider of durable medical equipment to providers in global markets by providing the broadest portfolio available. This strategy had not kept pace with certain reimbursement changes, competitive dynamics and company-specific challenges in recent years. Since 2015, the company has made a major shift in its strategy. The company has since been aligning its resources to produce solutions that address clinically complex needs thereby increasing the value of the company's product offering. By focusing the company's efforts to provide the best possible assistance and outcomes to the people and caregivers who use its products, the company aims to improve its financial condition for sustainable profit and growth. To execute this transformation, the company is undertaking a substantial three-phase multi-year transformation plan.

Transformation

The company has been executing a multi-year transformation to shift to its new strategy, especially in North America. This is expected to yield better financial results from the application of the company's resources to products and solutions that provide greater healthcare value in clinically complex rehabilitation and post-acute care. The transformation is divided into the following three phases:

Phase One - Assess and Reorient

- Increase commercial effectiveness;
- Shift and narrow the product portfolio;
- Focus innovation on clinically complex solutions;
- Accelerate quality efforts on quality and excellence; and
- Develop and expand talent.

Phase Two - Build and Align

- Leverage commercial improvements;
- Optimize the business for cost and efficiency;
- Continue to improve quality systems;
- Launch new clinical product platforms; and
- Expand talent management and culture.

The company is currently in Phase Two of the transformation, focused primarily on North America, with gradual changes being undertaken in the Europe segment. By the end of this phase, the company expects growth in sales and gross profit, as well as an improvement in operating income and free cash flow. The company also is optimizing its infrastructure and improving efficiencies to streamline customer interactions and to reduce costs. The company expects Phase Two to extend through 2019 and to overlap with the beginning of Phase Three in certain areas.

Phase Three - Grow

- Lead in quality culture and operations excellence; and
- Grow above market.

By the end of phase three, the company expects continued improvements in net sales, operating margin, operating income and free cash flow.

MD&A Overview

Table of Contents

OUTLOOK

The company's pursuit of profitable sales growth and cost reductions is expected to lead to achieving its long-term operating income and EBITDA goals. While the company remains positive about the growth potential of its businesses, there is much more work to be done, especially in North America to accelerate the return to profitable growth and offset inflationary pressures driven by the effects of tariffs. The company will undertake additional actions to streamline operations, and resize and reshape the organization. For example, the company announced a reduction in force in North America on November 1, 2018 which is expected to yield annualized savings of \$5.0 million.

In North America, the company's focus will be on continued growth in the mobility and seating product category and implementing a multi-channel approach to ambulatory oxygen products, lifestyle products and the IPG segment. The company anticipates positive constant currency net sales growth in the mobility and seating segment. However, further consolidation of healthcare customers could result in additional pricing pressure. The company expects the reimbursement changes announced by Centers for Medicare and Medicaid Services (CMS) on November 1, 2018, which will be effective January 1, 2019, could have a negative impact on net sales beyond the first quarter of 2019 as providers are cautious to invest in inventory before the impacts of the national competitive bidding changes are fully known and assess the regional markets they will pursue.

While the company realized slight constant currency net sales growth in the Europe segment in 3Q18, the segment may continue to experience reduced sales in 4Q18 as it shifts its product mix toward more clinically valued, higher-margin products. The company expects sales growth in Europe during 2019 as it realizes the benefit of new product introductions.

As noted last quarter, the company anticipates in the near-term an unfavorable impact on its results due to tariffs, increased freight costs, as well as increased commodity and material costs directly related to those same factors, particularly in consideration of new tariffs introduced in September 2018. The specific impact is difficult to estimate as the U.S. federal government's policy on tariffs continues to be implemented, and the company may not be able to fully offset any increases with internal actions such as alternative supply chain arrangements, price increases to customers and other actions. These higher costs may make the company's products less price-competitive in its markets. The company implemented a price increase in October for lifestyle and respiratory products and continues to absorb significant cost increases in complex rehab products. Based on the level of tariffs implemented through September, the company estimates an annual

unfavorable impact, if unmitigated, of between \$5 to \$7 million.

Given these pressures on the business, the company expects to be diligent in managing investments and SG&A expenses for the remainder of the year. Working capital needs are expected to expand as the business grows, especially in support of expected increases in mobility and seating sales, which require substantial working capital and demonstration units to be effective. Previously, the company guided that free cash flow usage for 2018 would be similar to 2017, however, the company believes that cash flow usage may increase given the headwinds described above, including the impact of tariffs, national competitive bidding uncertainty and increased inventory related to net sales declines, specifically in respiratory products, and to product transfers in Europe. The company will continue to take actions to minimize cash flow usage for the remainder of the year. Based on current expectations, the company believes its cash balances and available borrowing capacity should be sufficient to fund its transformation. The company will continue to emphasize a culture of quality and operational excellence, profitable sales growth and the achievement of its long-term objectives.

## MD&amp;ANet Sales

Table of Contents

## RESULTS OF OPERATION - NET SALES

The company operates in four primary business segments: NA/HME, IPG, Europe and Asia/Pacific. Both the NA/HME and IPG segments operate in the Americas. The NA/HME segment sells each of the three primary product categories, which includes: lifestyle, mobility and seating, and respiratory therapy products. IPG sells long-term care medical equipment, health care furnishings and accessory products. Europe and Asia/Pacific sell product categories similar to those of NA/HME and IPG.

(\$ in thousands USD)	3Q18*	3Q17	Reported	Foreign	Constant
			%	Exchange	Currency
			Change	% Impact	% Change
Europe	144,339	143,281	0.7	0.3	0.4
NA/HME	73,696	79,516	(7.3)	(0.4)	(6.9)
IPG	15,148	13,975	8.4	(0.4)	8.8
Asia/Pacific	11,376	14,134	(19.5)	(6.5)	(13.0)
Consolidated	244,559	250,906	(2.5)	(0.3)	(2.2)

(\$ in thousands USD)	YTD	YTD	Reported	Foreign	Constant
			%	Exchange	Currency
	3Q18	3Q17	Change	% Impact	% Change
Europe	414,549	391,274	5.9	7.3	(1.4)
NA/HME	233,345	241,467	(3.4)	0.1	(3.5)
IPG	43,739	45,668	(4.2)	0.1	(4.3)
Asia/Pacific	36,138	37,737	(4.2)	(1.2)	(3.0)
Consolidated	727,771	716,146	1.6	4.0	(2.4)

\*Date format is quarter and year in each instance. "YTD" means the first nine months of the year.

The table above provides net sales change as reported and as adjusted to exclude the impact of foreign exchange translation (constant currency net sales). "Constant currency net sales" is a non-Generally Accepted Accounting Principles ("GAAP") financial measure, which is defined as net sales excluding the impact of foreign currency translation. The current year's functional currency net sales are translated using the prior year's foreign exchange rates. These amounts are then compared to the prior year's sales to calculate the constant currency net sales change. "Constant currency sequential net sales" is a non-GAAP financial measure in which a given quarter's net sales are compared to the most recent prior quarter's net sales with each quarter's net sales translated at the foreign exchange rates for the quarter ended March 31, 2018. Management believes that both financial measures provide meaningful information for evaluating the core operating performance of the company.

Constant currency net sales performance drivers by segment:

Europe - Constant currency net sales increased slightly in 3Q18 compared to 3Q17 driven by increases in mobility and seating sales partially offset by decreases in lifestyle and respiratory products. The company continues to apply its transformation strategy to this segment to focus more on clinically valued, higher-margin products. Constant currency

YTD 3Q18 net sales decreased compared to YTD 3Q17 as decreases in lifestyle and respiratory products were partially offset by mobility and seating increases.

North America/Home Medical Equipment (NA/HME) -

Constant currency net sales for 3Q18 decreased compared to 3Q17 driven by decreases in respiratory and lifestyle product sales which more than offset increases of 8.9% in mobility and seating products. Respiratory product sales decreased in all product categories compared to 3Q17. With the uncertainty regarding the impending reimbursement changes in the U.S. that will be effective January 1, 2019, the company believes providers were cautious to invest in inventory before the final determination on national competitive bidding is issued by the Centers for Medicare and Medicaid Services. The company believes such uncertainty and caution negatively impacted both respiratory and lifestyle product volumes in the NA/HME segment. The YTD 3Q18 decrease in constant currency net sales compared to the first nine months last year was driven by all product categories except for mobility and seating products.

Institutional Products Group (IPG) - Constant currency net sales 3Q18 increased compared to the same period last year primarily driven by increased sales of interior design projects and bed products. YTD 3Q18 net sales decreased compared to



## MD&amp;ANet Sales

Table of Contents

the same periods last year principally due to lower bed product sales which were negatively impacted by a 2Q18 supply disruption that was resolved by the end of 2Q18.

Asia/Pacific - Constant currency net sales decreased for 3Q18 and YTD 3Q18 compared to the same periods last year principally driven by decreased sales in institutional products, primarily beds in Australia, as well as decreases in mobility and seating and lifestyle products for the quarter only as mobility and seating sales increased on a year-to-date basis.

The following tables provide net sales at reported rates for the quarters ended September 30, June 30 and March 31, 2018, respectively, and net sales for the quarter ended September 30, and June 30, 2018, respectively, as translated at the foreign exchange rates for the quarter ended March 31, 2018 with each then compared to each other (constant currency sequential net sales). The company began this disclosure in 2017 to illustrate the effect of its transformation on its segments and continues to do so while the transformation continues, and this is useful.

	3Q18 at Reported Foreign Exchange Rates	Foreign Exchange Translation Impact	3Q18 at 1Q18 Foreign Exchange Rates	2Q18 at 1Q18 Foreign Exchange Rates	Sequential Growth \$	Sequential Growth %	
Europe	\$ 144,339	\$ 6,552	\$ 150,891	\$ 139,093	\$ 11,798	8.5	%
NA/HME	73,696	258	73,954	80,053	(6,099 )	(7.6 )	
IPG	15,148	39	15,187	13,719	1,468	10.7	
Asia Pacific	11,376	902	12,278	14,128	(1,850 )	(13.1 )	
Consolidated	\$ 244,559	\$ 7,751	\$ 252,310	\$ 246,993	\$ 5,317	2.2	%

	2Q18 at Reported Foreign Exchange Rates	Foreign Exchange Translation Impact	2Q18 at 1Q18 Foreign Exchange Rates	1Q18 at 1Q18 Foreign Exchange Rates	Sequential Growth \$	Sequential Growth %	
Europe	\$ 138,896	\$ 197	\$ 139,093	\$ 131,251	\$ 7,842	6.0	%
NA/HME	79,867	186	80,053	79,794	259	0.3	
IPG	13,704	15	13,719	14,887	(1,168 )	(7.8 )	
Asia Pacific	13,685	443	14,128	11,066	3,062	27.7	
Consolidated	\$ 246,152	\$ 841	\$ 246,993	\$ 236,998	\$ 9,995	4.2	%

MD&ANet Sales

Table of Contents

The net sales amounts in the preceding table are converted at Q1 2018 foreign exchange rates so that the sequential change in net sales can be shown, excluding the impact of changes in foreign currency exchange rates.

Compared to 2Q18, Europe constant currency sequential net sales improved 8.5%, which reflects historical trends as the third quarter of the year is typically this segment's strongest quarter related to net sales. The sequential improvement from 1Q18 to 2Q18 for NA/HME and Asia Pacific did not continue in 3Q18 while IPG sales, driven by interior design projects and bed sales, continued to improve in 3Q18 vs the prior quarters of 2018.

Compared to 2Q18, NA/HME constant currency sequential net sales decreased 7.6% primarily due to lower respiratory product sales and to a lesser extent lifestyle products and slower

growth in mobility and seating sequential improvement. With the uncertainty regarding the impending reimbursement changes in the U.S. that will be effective January 1, 2019, the company believes providers were cautious to invest in inventory before the final determination on national competitive bidding is issued by the Centers for Medicare and Medicaid Services. The company believes such uncertainty and caution negatively impacted both respiratory and lifestyle product volumes in the NA/HME segment.

The IPG sequential increase was driven by increased sales of interior design projects and bed products

The Asia Pacific sequential decrease was driven by decreases in all product categories.

MD&ANet Sales

Table of Contents

Net sales of mobility and seating products, which comprise most of the company's clinically complex product portfolio, increased to 43% from 40% for constant currency net sales by product for 3Q18 compared to 2Q18.

This increase reflects the company's continued transformation efforts, especially where the company has shifted the product portfolio and alignment of resources to focus on clinically complex solutions.

6

---

## MD&amp;A Gross Profit

Table of ContentsGROSS PROFIT

---

Gross profit dollars for 3Q18 decreased compared to 3Q17 principally due to reduced net sales, unfavorable material costs, increased freight and R&D expense. NA/HME experienced significantly higher costs from materials sourced both internationally and domestically due to the indirect impact of tariffs of approximately \$1,300,000 during the quarter. The tariff impact was significantly higher than the company's previous estimate. Gross profit as a percentage of net sales was lower by 140 basis points compared to 3Q17 primarily as a result of rising material costs associated with U.S. tariffs, higher freight costs incurred in NA/HME and Europe, and unfavorable operational variances in Europe.

Gross profit dollars for YTD 3Q18 decreased compared to YTD 3Q17 principally due to higher freight costs and unfavorable purchase price variances which partially offset by favorable product mix and reduced warranty expense. Gross profit as a percentage of net sales was lower by 70 basis points compared to the same period last year primarily due to increased freight costs.

Gross profit and gross margin drivers by segment:

Europe - Gross margin as a percentage of net sales for 3Q18 decreased 0.3 of a percentage point, while gross profit dollars decreased \$188,000, compared to 3Q17. The decrease in gross profit dollars was driven primarily by increased R&D expense and increased freight costs, primarily related to product

transfers associated with facility consolidation, partially offset by improved sales volumes and favorable product mix. Excluding the temporary impact of unfavorable manufacturing variances of approximately \$500,000 related to the product transfers, gross margin would have shown year over year improvement.

Gross margin as a percentage of net sales for YTD 3Q18 decreased 0.3 of a percentage point, while gross profit dollars increased \$5,838,000, compared to the same period last year. The increase in gross profit dollars was driven by favorable foreign currency partially offset by lower sales volume, unfavorable manufacturing variances, increased R&D and freight expense.

NA/HME - Gross margin as a percentage of net sales for 3Q18 decreased 4.7 percentage points, while gross profit dollars decreased \$5,028,000, compared to 3Q17. The decrease in gross profit dollars was primarily due to lower sales volumes, unfavorable material cost and increased freight costs, both impacted by tariffs. The negative impact of tariffs and material costs impacted by tariffs was approximately \$1,300,000 in 3Q18.

Gross margin as a percentage of net sales for YTD 3Q18 decreased 2.9 percentage points, while gross profit dollars decreased \$8,806,000, compared to YTD 3Q17. The decrease in gross profit dollars was primarily due to net sales volume declines, increased material costs and freight costs, both impacted by tariffs.

IPG - Gross margin as a percentage of net sales for 3Q18 increased 0.2 of a percentage point, and gross profit dollars increased \$299,000, compared to 3Q17. The increase in gross profit dollars was driven principally by an increase in sales and reduced warranty expense.

Gross margin as a percentage of net sales for YTD 3Q18 decreased 0.2 of a percentage point, and gross profit dollars decreased \$994,000, compared to YTD 3Q17. The decrease in gross profit dollars was driven by lower net sales partially offset by reduced warranty expense.

Asia/Pacific - Gross margin as a percentage of net sales for 3Q18 decreased 1.2 percentage points, while gross profit dollars decreased \$679,000, compared to 3Q17. The decrease in gross profit dollars was primarily due to a net sales decrease partially offset by reduced R&D expense.

Gross margin as a percentage of net sales for YTD 3Q18 increased 4.0 percentage points, while gross profit dollars increased \$2,571,000, compared to YTD 3Q17. The increase in gross profit dollars was primarily due to reduced research and development expenses and favorable manufacturing variances.



MD&A Gross Profit

Table of Contents

Sequential gross profit as a percentage of net sales and gross margin dollars decreased by 0.6 of a percentage point comparing 3Q18 to 2Q18 driven by material and freight costs as well as increased warranty expense. Sequential gross profit as a percentage of net sales increased for Europe and IPG but decreased for NA/HME and Asia/Pacific.

Sequential quarterly gross profit dollars decreased

\$1,757,000. The decrease in gross profit dollars was primarily attributable to the same items driving the gross margin percentage decrease, including the negative impact of direct tariffs and material costs impacted by tariffs indirectly of \$1,300,000 in 3Q18.

8

---

## MD&amp;ASG&amp;A

Table of Contents

## SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

(\$ in thousands USD)	3Q18	3Q17	Reported Change	Foreign Exchange Impact	Constant Currency Change
SG&A Expenses - \$	69,945	75,921	(5,976 )	605	(5,371 )
SG&A Expenses - % change			(7.9 )	(0.8 )	(7.1 )
% to net sales	28.6	30.3			

  

(\$ in thousands USD)	YTD 3Q18	YTD 3Q17	Reported Change	Foreign Exchange Impact	Constant Currency Change
SG&A Expenses - \$	214,972	224,155	(9,183 )	(6,053 )	(15,236 )
SG&A Expenses - % change			(4.1 )	2.7	(6.8 )
% to net sales	29.5	31.3			

SG&A expense excluding the impact of foreign currency translation, which is referred to as "constant currency SG&A", decreased for 3Q18 and YTD 3Q18 compared to the same periods last year primarily due to reduced employment costs.

## SG&amp;A expense drivers by segment:

Europe - SG&A expenses for 3Q18 were unchanged compared to 3Q17 with foreign currency translation decreasing SG&A expenses by approximately \$152,000, or 0.5%. Constant currency SG&A expenses increased \$164,000, or 0.5%. The increased expense was primarily attributable to unfavorable foreign currency transactions and higher sales and marketing costs principally offset by lower employment costs.

SG&A expenses for YTD 3Q18 increased by 7.0%, or \$6,449,000, compared to YTD 3Q17 with foreign currency translation increasing SG&A expenses by approximately \$6,040,000, or 6.6%. Constant currency SG&A expenses increased \$409,000, or 0.4%. The increased expense was primarily attributable to unfavorable foreign currency transactions and higher consulting and depreciation expense partially offset by lower employment costs.

NA/HME - SG&A expenses for 3Q18 decreased 14.5%, or \$4,631,000, compared to 3Q17 with foreign currency translation decreasing SG&A expenses by approximately \$154,000. Constant currency SG&A expenses decreased \$4,477,000, or 14.0% driven primarily by decreased employment costs and favorable foreign currency transactions.

SG&A expenses for YTD 3Q18 decreased 14.2%, or \$13,674,000, compared to YTD 3Q17 with foreign currency increasing SG&A expenses by approximately \$163,000. Constant currency SG&A expenses decreased \$13,837,000, or 14.4% driven primarily by decreased employment costs.

IPG - SG&A expenses for 3Q18 decreased 2.8%, or \$74,000, compared to 3Q17 with foreign currency translation having an immaterial impact. Constant currency SG&A expenses decreased \$70,000 or 2.7%. The decrease in expense was primarily related to lower employment costs.

SG&A expenses for YTD 3Q18 decreased 9.3%, or \$759,000, compared to YTD 3Q17 with foreign currency translation having an immaterial impact. Constant currency SG&A expenses decreased \$760,000 or 9.4%. The

decrease in expense was primarily related to lower employment costs.

Asia/Pacific - SG&A expenses for 3Q18 decreased 7.3%, or \$294,000, compared to 3Q17 with foreign currency translation decreasing SG&A expenses \$295,000, or 7.3%. Constant currency SG&A expenses were flat as lower employment costs were offset by unfavorable foreign currency transactions.

SG&A expenses for YTD 3Q18 decreased 1.2%, or \$133,000, compared to YTD 3Q17 with foreign currency translation decreasing SG&A expenses \$151,000, or 1.0%. Constant currency SG&A expenses increased \$18,000, or 0.2%. The slight increase in expense was primarily related to unfavorable foreign currency transactions principally offset by lower employment costs.

Other - SG&A expenses for 3Q18 decreased 16.8%, or \$989,000, compared to 3Q17. SG&A expenses for YTD 3Q18 decreased 6.4%, or \$1,066,000, compared to YTD 3Q17. Both the quarter and year-to-date decreases were driven primarily by decreased employment costs, including equity compensation expense.



## MD&amp;A Operating Income (Loss)

Table of Contents

## OPERATING INCOME (LOSS)

(\$ in thousands USD)	3Q18	3Q17	\$ Change	% Change	YTD 3Q18	YTD 3Q17	\$ Change	% Change
Europe	11,788	11,987	(199)	(1.7)	23,553	24,164	(611)	(2.5)
NA/HME	(12,836)	(12,446)	(390)	(3.1)	(29,394)	(34,267)	4,873	14.2
IPG	1,575	1,202	373	31.0	4,336	4,572	(236)	(5.2)
Asia/Pacific	2	387	(385)	(99.5)	2,544	(161)	2,705	1,680.1
All Other	(4,885)	(6,311)	1,426	22.6	(16,559)	(17,556)	997	5.7
Charges related to restructuring	(920)	(703)	(217)	(30.9)	(1,665)	(8,973)	7,308	81.4
Consolidated Operating Loss	(5,276)	(5,884)	608	10.3	(17,185)	(32,221)	15,036	46.7

For 3Q18 and YTD 3Q18, consolidated operating loss improved with 3Q18 improvement driven by lower employee costs offset by reduced gross profit while YTD 3Q18 improvement was driven by reduced restructuring charges and lower employee costs partially offset by reduced gross profit.

## Operating income (loss) by segment:

Europe - Operating income for 3Q18 decreased compared to 3Q17 principally due to unfavorable manufacturing variances, increased freight costs driven by product transfers associated with facility consolidation and higher R&D expense, partially offset by lower employment costs. Operating income for YTD 3Q18 decreased compared to YTD 3Q17 primarily driven by the same items noted for the quarter.

NA/HME - Operating loss for 3Q18 increased slightly compared to 3Q17 primarily related to lower sales and gross margin, partially offset by reduced SG&A expense, due largely to lower employment costs. 3Q18 operating loss includes the negative impact of tariffs and material costs impacted by tariffs of approximately \$1,300,000. Operating loss for YTD 3Q18 decreased compared to YTD 3Q17 primarily due to reduced employment costs, R&D and warranty expense, partially offset by the negative impact of product mix and increased freight costs.

IPG - Operating income for 3Q18 improved compared to the same period last year principally due to an increase in sales and reduced warranty expense. Operating income for YTD 3Q18 compared to YTD 3Q17 decreased compared to the same period last year principally due to a decrease in sales partially offset by reduced warranty expense and employment costs.

Asia/Pacific - Operating income for 3Q18 decreased compared to 3Q17 as a result of a net sales decrease and negative impact of product mix partially offset by reduced R&D expense. Operating income for YTD 3Q18 increased compared to YTD 3Q17 driven by reduced R&D expense, lower manufacturing and employment costs partially offset

by unfavorable foreign currency transactions.

All Other - Operating loss for 3Q18 improved compared to 3Q17 primarily due to reduced SG&A expense, driven by lower employment costs, and favorable intercompany profit in inventory eliminations. Operating loss for YTD 3Q18 improved compared to YTD 3Q17 primarily due to reduced SG&A expense, driven by lower equity compensation costs partially offset by higher consulting costs.

#### Charge Related to Restructuring Activities

Restructuring charges totaled \$1,665,000 for YTD 3Q18 principally related to severance costs. Restructuring charges were incurred in the Europe (\$1,170,000), Asia/Pacific (\$268,000) and NA/HME (\$227,000) segments.

Restructuring charges totaled \$8,973,000 for YTD 3Q17 which related principally to severance and contract termination costs incurred in the NA/HME segment (\$6,000,000) and severance in the Europe (\$1,890,000) and Asia/Pacific (\$1,083,000) segments. Significant charges were incurred YTD 3Q17 due to the company's decision to close one of its China locations. Most of the outstanding restructuring accruals at September 30, 2018 are expected to be paid out in the next twelve months.

## MD&amp;A Other Items

Table of Contents

## OTHER ITEMS

## Net Gain (Loss) on Convertible Debt Derivatives

(\$ in thousands USD)

Change in Fair Value - Gain (Loss)

	3Q18	3Q17	YTD 3Q18	YTD 3Q17
Convertible Note Hedge Assets	(55,443)	27,267	(39,690)	33,028
Convertible Debt Conversion Liabilities	59,523	(29,817)	43,894	(35,728)
Net Gain (Loss) on Convertible Debt Derivatives	4,080	(2,550)	4,204	(2,700)

The company recognized net gains of \$4,080,000 and \$4,204,000 in 3Q18 and YTD 3Q18, respectively, compared to net losses of \$2,550,000 and \$2,700,000 in 3Q17 and YTD 3Q17, respectively, related to the fair value of convertible debt derivatives. See "Long-Term Debt" in the notes to the Consolidated Financial Statements included elsewhere in this report for more detail.

## Interest

(\$ in thousands USD)	3Q18	3Q17	\$ Change	% Change
Interest Expense	7,115	6,844	271	4.0
Interest Income	(85)	(137)	52	(38.0)
(\$ in thousands USD)	YTD 3Q18	YTD 3Q17	\$ Change	% Change
Interest Expense	21,041	16,007	5,034	31.4
Interest Income	(470)	(274)	(196)	71.5

The increase in interest expense for 3Q18 and YTD 3Q18 compared to the same periods last year was primarily related to interest on the convertible notes issued in the second quarter of 2017.

## Income Taxes

The company had an effective tax rate of 46.2% and 27.2% on losses before tax from continuing operations for 3Q18 and YTD 3Q18, respectively, compared to an expected benefit of 21.0% on the continuing operations pre-tax loss for each period. The rate for 3Q18 was impacted by net gain on convertible debt derivatives with no tax expense due to valuation reserve in the U.S. The company had an effective tax rate of 22.8% and 16.2% on losses before tax from continuing operations for 3Q17 and YTD 3Q17, respectively, compared to an expected benefit at the U.S. statutory rate of 35.0% on the continuing operations pre-tax loss for each period. The company's effective tax rate 3Q17 and YTD 3Q17 was unfavorable as compared to the U.S. federal statutory rate expected benefit, principally due to the negative impact of the company not being able to record tax benefits related to the significant losses in countries which had tax valuation allowances. The effective tax rate was increased for 3Q18 and YTD 3Q18 and decreased for 3Q17 and YTD 3Q17 by certain taxes outside the United States, excluding countries with tax valuation allowances, that were at an effective rate higher than the U.S. statutory rate for 3Q18 and YTD 3Q18 and lower than the U.S. statutory rate for 3Q17 and YTD 3Q17. See "Income Taxes" in the notes to the Consolidated Financial Statements included elsewhere in this report for more detail.

## MD&amp;ALiquidity and Capital Resources

Table of Contents

## LIQUIDITY AND CAPITAL RESOURCES

The company continues to maintain an adequate liquidity position through its cash balances and unused bank lines of credit (see Long-Term Debt in the Notes to Condensed Consolidated Financial Statements included in this report).

Key balances on the company's balance sheet and related metrics:

(\$ in thousands USD)	September 30, December 31, \$		%	
	2018	2017	Change	Change
Cash and cash equivalents	118,268	176,528	(58,260)	(33.0 )
Working capital <sup>(1)</sup>	209,520	238,850	(29,330)	(12.3 )
Total debt <sup>(2)</sup>	299,806	301,415	(1,609 )	(0.5 )
Long-term debt <sup>(2)</sup>	298,225	299,375	(1,150 )	(0.4 )
Total shareholders' equity	369,932	423,294	(53,362)	(12.6 )
Credit agreement borrowing availability <sup>(3)</sup>	36,039	39,949	(3,910 )	(9.8 )

(1) Current assets less current liabilities.

(2) Long-term debt and Total debt include debt issuance costs recognized as a deduction from the carrying amount of debt liability and debt discounts classified as debt.

(3) Reflects the combined availability of the company's North American and European asset-based revolving credit facilities. The change in borrowing availability is due to changes in the calculated borrowing base.

The company's cash and cash equivalents balances were \$118,268,000 and \$176,528,000 at September 30, 2018 and December 31, 2017, respectively. The decrease in cash was the result of normal operations and continued investment in our transformation strategy. Debt repayments, acquisitions, divestitures, the timing of vendor payments, the timing of customer rebate payments, the granting of extended payment terms to significant national accounts and other activity can have a significant impact on the company's cash flow and borrowings outstanding such that the cash reported at the end of a given period may be materially different than cash levels during a given period. While the company has cash balances in various jurisdictions around the world, there are no material restrictions regarding the use of such cash for dividends within the company, loans or other purposes, except in China where the cash balance, as of September 30, 2018, was \$12,163,000. The company continues the process of eliminating its operations there, which until completed, restricts access to certain cash balances.

The company's total debt outstanding, inclusive of the debt discount related to debentures included in equity as well as the debt discount and fees associated with the company's Convertible Senior Notes due 2021 and 2022, decreased by \$1,609,000 to \$299,806,000 at September 30, 2018 from \$301,415,000 as of December 31, 2017. See "Long-Term Debt" in the Notes to Condensed Consolidated Financial Statements for more details regarding the company's convertible notes and credit facilities.

Based on the company's current expectations, the company believes that its cash balances and available borrowing capacity under its credit facilities should be sufficient to meet working capital needs, capital requirements, and commitments for at least

the next twelve months. Notwithstanding the company's expectations, if the company's operating results decrease as the result of pressures on the business due to, for example, currency fluctuations or regulatory issues or the company's failure to execute its business plans or if the company's transformation takes longer than expected, the company may

require additional financing, or may be unable to comply with its obligations under the credit facilities, and its lenders could demand repayment of any amounts outstanding under the company's credit facilities.

The company also has an agreement with De Lage Landen, Inc. ("DLL"), a third-party financing company, to provide lease financing to the company's U.S. customers. Either party could terminate this agreement with 180 days' notice or 90 days' notice by DLL upon the occurrence of certain events. Should this agreement be terminated, the company's borrowing needs under its credit facilities could increase.

While there is general concern about the potential for rising interest rates, the company expects that it will be able to absorb modest rate increases in the months ahead without any material impact on its liquidity or capital resources. The weighted average interest rate on revolving credit borrowings, excluding capital leases, was 4.78% for the for the three and nine months ended September 30, 2018 compared to 4.84% for the year ended December 31, 2017.

See "Long-Term Debt" in the Notes to the Consolidated Financial Statements for more details regarding the company's credit facilities.

MD&ALiquidity and Capital Resources

Table of Contents

CAPITAL EXPENDITURES

The company estimates that capital investments for 2018 could approximate between \$10,000,000 and \$15,000,000, compared to actual capital expenditures of \$14,569,000 in 2017. The anticipated expenditures relate primarily to the company's planned investments to transform the company. The terms of the company's credit facilities limit the company's annual capital expenditures to \$35,000,000. As of September 30, 2018, the company has material capital expenditure commitments outstanding, consisting primarily of computer systems contracts. See Item 7. Contractual Obligations of the company's Annual Report on Form 10-K for the year ended December 31, 2017.

DIVIDEND POLICY

On August 30, 2018, the company's Board of Directors declared a quarterly cash dividend of \$0.0125 per Common Share to shareholders of record as of October 12, 2018, which was paid on October 26, 2018. The Board of Directors has suspended the company's regular quarterly dividend on the Class B Common Shares. Fewer than 7,000 Class B Common Shares remain outstanding and suspending the regular Class B dividend allows the company to save on the administrative costs and compliance expenses associated with that dividend. Holders of Class B Common Shares are entitled to convert their shares into Common Shares at any time on a share-for-share basis and would be eligible for any Common Share dividends declared following any such conversion.



MD&A Cash Flows

Table of Contents

CASH FLOWS

---

The cash used by operating activities for the nine months ended September 30, 2018 was driven by a net loss, decreased accrued expenses and increased inventory partially offset by reduced receivables and increased accounts payable. The decrease in cash used by operating activities in the first nine months of 2018 compared to the same period last year was principally driven by a reduced net loss partially offset by net changes in other working capital items.

The decrease in cash flows used by investing activities for the first nine months of 2018 as compared to the same period last year was primarily related to an advance payment received related to the sale of the company's Isny, Germany property and partially offset by increased purchases of property and equipment.

Cash flows used by financing activities in the first nine months of 2018 are primarily attributable to dividends and payments on capital leases. Cash flows provided by financing activities in the first nine months of 2017 reflect net proceeds received due to the issuance of the company's Convertible Senior Notes due 2022, including the net proceeds used for the related convertible note hedge and warrant transactions and payment of financing costs. These proceeds were partially offset by the repayment of \$13,350,000 in aggregate principal amount of the company's convertible debentures due 2027 in the first quarter of 2017.

## MD&amp;A Cash Flows

Table of Contents

Free cash flow is a non-GAAP financial measure and is reconciled to the corresponding GAAP measure as follows:

(\$ in thousands USD)	3Q18	3Q17	YTD 3Q18	YTD 3Q17
Net cash used by operating activities	(2,444)	(2,899)	(49,542)	(53,367)
Plus:				
Sales of property and equipment	1	21	38	211
Advance payment from sale of property	3,524	—	3,524	—
Less: Purchases of property and equipment	(3,587)	(1,885)	(7,814 )	(7,389 )
Free Cash Flow	(2,506)	(4,763)	(53,794)	(60,545)

Free cash flow for the first nine months 2018 and 2017 was negatively impacted by the same items that affected cash flows used by operating activities. Free cash flow is a non-GAAP financial measure that is comprised of net cash used by operating activities plus purchases of property and equipment less proceeds from sales of property and equipment. Management believes that

this financial measure provides meaningful information for evaluating the overall financial performance of the company and its ability to repay debt or make future investments (including acquisitions, etc.).

Generally, the first half of the year is cash consumptive and impacted by significant disbursements related to annual customer rebate payments which normally occur in the first quarter of the year and, to lesser extent, into the second quarter of the year. In addition, the second quarter of the year represents the period annual employee bonuses are paid, if earned. Investment in inventory is historically heavy in the first half of the year with planning around the company's supply chain to fulfill shipments in the second half of the year and can be impacted by footprint rationalization projects. As a result, historically, the company realizes stronger cash flow in the second half of the year versus the first half of the year. On that basis and considering anticipated increased working capital investment, the company anticipates its cash flow usage and seasonality for 2018 will be similar to 2017.

The company's approximate cash conversion days at September 30, 2018, December 31, 2017 and September 30, 2017 are as follows:

The decrease in the most current days in receivables compared to prior periods was driven by lower receivables in the quarter ended September 30, 2018 compared to the prior periods shown. The days in inventory increased from the seasonal low at December 31, 2017. The days in inventory for the quarter ended September 30, 2018 were favorable to the quarter ended September 30, 2017 due to better inventory velocity over the prior year.

Days in receivables are equal to current quarter net current receivables divided by trailing four quarters of net sales multiplied by 365 days. Days in inventory and accounts payable are equal to current quarter net inventory and accounts payable, respectively,

divided by trailing four quarters of cost of sales multiplied by 365 days. Total cash conversion days are equal to days in receivables plus days in inventory less days in accounts payable.

The company provides a summary of days of cash conversion for the components of working capital so investors may see the rate at which cash is disbursed, collected and how quickly inventory is converted and sold.

MD&A Accounting Estimates and Pronouncements

Table of Contents

ACCOUNTING ESTIMATES AND PRONOUNCEMENTS

---

CRITICAL ACCOUNTING ESTIMATES

The Consolidated Financial Statements included in the report include accounts of the company and all majority-owned subsidiaries. The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions in certain circumstances that affect amounts reported in the accompanying Consolidated Financial Statements and related footnotes. In preparing the financial statements, management has made its best estimates and judgments of certain amounts included in the financial statements, giving due consideration to materiality. However, application of these accounting policies involves the exercise of judgment and use of assumptions as to future uncertainties and, thus, actual results could differ from these estimates. Please refer to the Critical Accounting Estimates section within MD&A of company's Annual Report on Form 10-K for the period ending December 31, 2017 as well as the revenue recognition and warranty disclosure below.

Revenue Recognition

The company recognizes revenues when control of the product or service is transferred to unaffiliated customers. Revenues from Contracts with Customers, ASC 606, provides guidance on the application of generally accepted accounting principles to revenue recognition issues. The company has concluded that its revenue recognition policy is appropriate and in accordance with GAAP under ASC 606.

All of the company's product-related contracts, and a portion related to services, have a single performance obligation, which is the promise to transfer an individual good or service, with revenue recognized at a point in time. Certain service-related contracts contain multiple performance obligations that require the company to allocate the transaction price to each performance obligation. For such contracts, the company allocates revenue to each performance obligation based on its relative standalone selling price at inception of the contract. The company determined the standalone selling price based on the expected cost-plus margin methodology. Revenue related to the service contracts with multiple performance obligations is recognized over time. To the extent performance obligations are satisfied over time, the company defers revenue recognition until the performance obligations are satisfied.

The determination of when and how much revenue to recognize can require the use of significant judgment. Revenue is recognized when obligations under the terms of a contract with the customer are satisfied; generally, this occurs with the transfer

of control of the company's products and services to the customer.

Revenue is measured as the amount of consideration expected to be received in exchange for transferring the product or providing services. The amount of consideration received and recognized as revenue by the company can vary as a result of variable consideration terms included in the contracts such as customer rebates, cash discounts and return policies. Customer rebates and cash discounts are estimated based on the most likely amount principle and these estimates are based on historical experience and anticipated performance. Customers have the right to return product within the company's normal terms policy, and as such, the company estimates the expected returns based on an analysis of historical experience. The company adjusts its estimate of revenue at the earlier of when the most likely amount of consideration the company expects to receive changes or when the consideration becomes fixed. The company generally does not expect that there will be significant changes to its estimates of variable consideration (see

Receivables in the Notes to the Consolidated Financial Statements include elsewhere in this report).

Depending on the terms of the contract, the company may defer recognizing a portion of the revenue at the end of a given period as the result of title transfer terms that are based upon delivery and or acceptance which align with transfer of control of the company's products to its customers.

Sales are made only to customers with whom the company believes collection is reasonably assured based upon a credit analysis, which may include obtaining a credit application, a signed security agreement, personal guarantee and/or a cross corporate guarantee depending on the credit history of the customer. Credit lines are established for new customers after an evaluation of their credit report and/or other relevant financial information. Existing credit lines are regularly reviewed and adjusted with consideration given to any outstanding past due amounts.

The company records distributed product sales gross as a principal since the company takes title to the products and has the risks of loss for collections, delivery and returns. The company's payment terms are for relatively short periods and thus do not contain any element of financing. Additionally, no contract costs are incurred that would require capitalization and amortization.

Sales, value-added, and other taxes the company collects concurrent with revenue producing activities are excluded from revenue. Incidental items that are immaterial in the context of

MD&A Accounting Estimates and Pronouncements

Table of Contents

the contract are recognized as expense. Shipping and handling costs are included in cost of products sold.

The majority of the company's warranties are considered assurance-type warranties and continue to be recognized as expense when the products are sold (see Current Liabilities in the Notes to the Consolidated Financial Statements include elsewhere in this report). These warranties cover against defects in material and workmanship for various periods depending on the product from the date of sale to the customer. Certain components carry a lifetime warranty. In addition, the company has sold extended warranties that, while immaterial, require the company to defer the revenue associated with those warranties until earned. A provision for estimated warranty cost is recorded at the time of sale based upon actual experience. The company continuously assesses the adequacy of its product warranty accruals and makes adjustments as needed. Historical analysis is primarily used to determine the company's warranty reserves. Claims history is reviewed and provisions are adjusted as needed. However, the company does consider other events, such as a product recall, which could require additional warranty reserve provisions. See Accrued Expenses in the Notes to the Consolidated Financial Statements for a reconciliation of the changes in the warranty accrual. In addition, the company has sold extended warranties that, while immaterial, require the company to defer the revenue associated with those warranties until earned. The company has established procedures to appropriately defer such revenue.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

For the company's disclosure regarding recently issued accounting pronouncements, see Accounting Policies - Recent Accounting Pronouncements in the Notes to the Consolidated Financial Statements contained in this Quarterly Report

on Form 10-Q.

17

---

## MD&amp;A Forward-Looking Statements

Table of Contents

## FORWARD-LOOKING STATEMENTS

This Form 10-Q contains forward-looking statements within the meaning of the “Safe Harbor” provisions of the Private Securities Litigation Reform Act of 1995. Terms such as “will,” “should,” “could,” “plan,” “intend,” “expect,” “continue,” “be” and “anticipate,” as well as similar comments, denote forward-looking statements that are subject to inherent uncertainties that are difficult to predict. Actual results and events may differ significantly from those expressed or anticipated as a result of risks and uncertainties, which include, but are not limited to, the following: adverse effects of the company’s consent decree of injunction with the U.S. Food and Drug Administration (FDA), including but not limited to, compliance costs, inability to rebuild negatively impacted customer relationships, unabsorbed capacity utilization, including fixed costs and overhead; any circumstances or developments that might adversely impact the third-party expert auditor’s required audits of the company’s quality systems at the facilities impacted by the consent decree, including any possible failure to comply with the consent decree or FDA regulations; adverse effects of regulatory proceedings or the company’s failure to comply with regulatory requirements or failure to receive regulatory clearance or approval for the company’s products in the United States or abroad; adverse effects of regulatory or governmental inspections of company facilities at any time and governmental investigations or enforcement actions, including the investigation of pricing practices of one of the company’s former rentals businesses; circumstances or developments that may make the company unable to implement or realize the anticipated benefits, or that may increase the costs, of its current business initiatives; possible adverse effects on the company’s liquidity that may result from delays in the implementation or realization of benefits of its current business initiatives, or from any requirement to settle conversions of its outstanding convertible notes in cash; product liability or warranty claims; product recalls, including more extensive warranty or recall experience than expected; possible adverse effects of being leveraged, including interest rate or event of default risks; exchange rate fluctuations, particularly in light of the relative importance of the company’s foreign operations to its overall financial performance and including the existing and potential impacts from the Brexit referendum; adverse impacts of new tariffs or increases in commodity prices or freight costs; potential impacts of the United States administration’s policies, and any legislation or regulations that may result from those policies, and of new United States tax laws, rules, regulations or policies; legal actions, including adverse judgments or settlements of litigation or claims in excess of available insurance limits; adverse changes in government and other third-party payor reimbursement levels and practices both in the U.S. and in other countries (such as, for example, more extensive pre-payment reviews and post-payment audits by payors, or the continuing impact of the U.S. Medicare National Competitive Bidding program); ineffective cost reduction and restructuring efforts or inability to realize anticipated cost savings or achieve desired efficiencies from such efforts; delays, disruptions or excessive costs

incurred in facility closures or consolidations; tax rate fluctuations; additional tax expense or additional tax exposures, which could affect the company’s future profitability and cash flow; inability to design, manufacture, distribute and achieve market acceptance of new products with greater functionality or new product platforms that deliver the anticipated benefits; consolidation of health care providers; lower cost imports; uncollectible accounts receivable; difficulties in implementing/upgrading Enterprise Resource Planning systems; risks of cybersecurity attack, data breach or data loss and/or delays in or inability to recover or restore data and IT systems; risks inherent in managing and operating businesses in many different foreign jurisdictions; decreased availability or increased costs of materials which could increase the company’s costs of producing or acquiring the company’s products, including increases in commodity costs or freight costs; heightened vulnerability to a hostile takeover attempt or other shareholder activism; provisions of Ohio law or in the company’s debt agreements, charter documents or other agreements that may prevent or delay a change in control, as well as the risks described from time to time in the company’s reports as filed with the Securities and Exchange Commission. Except to the extent required by law, the company does not undertake and specifically declines any obligation to review or update any forward-looking statements or to publicly announce the results of any revisions to any of such statements to reflect future events or developments or otherwise.





## Financial Statements

Table of Contents

## Part I. FINANCIAL INFORMATION

## Item 1. Financial Statements.

## INVACARE CORPORATION AND SUBSIDIARIES

## Condensed Consolidated Statement of Comprehensive Income (Loss) (unaudited)

(In thousands, except per share data)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2018	2017	2018	2017
Net sales	\$244,559	\$250,906	\$727,771	\$716,146
Cost of products sold	178,970	180,166	528,319	515,239
Gross Profit	65,589	70,740	199,452	200,907
Selling, general and administrative expenses	69,945	75,921	214,972	224,155
Charges related to restructuring activities	920	703	1,665	8,973
Operating Loss	(5,276 )	(5,884 )	(17,185 )	(32,221 )
Net (gain) loss on convertible debt derivatives	(4,080 )	2,550	(4,204 )	2,700
Interest expense	7,115	6,844	21,041	16,007
Interest income	(85 )	(137 )	(470 )	(274 )
Loss Before Income Taxes	(8,226 )	(15,141 )	(33,552 )	(50,654 )
Income tax provision	3,800	3,450	9,125	8,225
Net Loss	\$(12,026 )	\$(18,591 )	\$(42,677 )	\$(58,879 )
Dividends Declared per Common Share	\$0.0125	\$0.0125	\$0.0375	\$0.0375
Net Loss per Share—Basic	\$(0.36 )	\$(0.57 )	\$(1.29 )	\$(1.80 )
Weighted Average Shares Outstanding—Basic	33,232	32,867	33,104	32,725
Net Loss per Share—Assuming Dilution	\$(0.36 )	\$(0.57 )	\$(1.29 )	\$(1.80 )
Weighted Average Shares Outstanding—Assuming Dilution	33,766	33,372	33,849	33,086
Net Loss	\$(12,026 )	\$(18,591 )	\$(42,677 )	\$(58,879 )
Other comprehensive income (loss):				
Foreign currency translation adjustments	(4,294 )	27,439	(15,916 )	54,699
Defined Benefit Plans:				
Amortization of prior service costs and unrecognized gains (loss)	(98 )	(168 )	145	(889 )
Deferred tax adjustment resulting from defined benefit plan activity	(3 )	21	(52 )	33
Valuation reserve (reversal) associated with defined benefit plan activity	3	(21 )	52	(33 )
Current period unrealized gain (loss) on cash flow hedges	437	(191 )	2,156	(1,467 )
Deferred tax benefit (loss) related to unrealized gain (loss) on cash flow hedges	(20 )	8	(171 )	113
Other Comprehensive Income (Loss)	(3,975 )	27,088	(13,786 )	52,456
Comprehensive Income (Loss)	\$(16,001 )	\$8,497	\$(56,463 )	\$(6,423 )
(Elements as a % of Net Sales)				
Net Sales	100.0	% 100.0	% 100.0	% 100.0
Cost of products sold	73.2	71.8	72.6	71.9
Gross Profit	26.8	28.2	27.4	28.1
Selling, general and administrative expenses	28.6	30.3	29.5	31.3
Charges related to restructuring activities	0.4	0.3	0.2	1.3
Operating Loss	(2.2 )	(2.3 )	(2.4 )	(4.5 )

Edgar Filing: INVACARE CORP - Form 10-Q

Net gain (loss) on convertible debt derivatives	(1.7	)	1.0	(0.6	)	0.4		
Interest expense	2.9		2.7	2.9		2.2		
Interest income	—		(0.1	)	(0.1	)	—	
Loss Before Income Taxes	(3.4	)	(6.0	)	(4.6	)	(7.1	)
Income tax provision	1.6		1.4	1.3		1.1		
Net Loss	(4.9	)%	(7.4	)%	(5.9	)%	(8.2	)%

See notes to condensed consolidated financial statements.

## Financial Statements

Table of ContentsINVACARE CORPORATION AND SUBSIDIARIES  
Condensed Consolidated Balance Sheets (unaudited)

	September 30, 2018	December 31, 2017
	(In thousands)	
Assets		
Current Assets		
Cash and cash equivalents	\$ 118,268	\$ 176,528
Trade receivables, net	115,051	125,615
Installment receivables, net	1,736	1,334
Inventories, net	141,764	121,933
Other current assets	32,324	31,504
Total Current Assets	409,143	456,914
Other Assets	57,941	97,576
Intangibles	28,236	30,244
Property and Equipment, net	76,251	80,016
Goodwill	391,287	401,283
Total Assets	\$962,858	\$ 1,066,033
Liabilities and Shareholders' Equity		
Current Liabilities		
Accounts payable	\$97,068	\$ 90,566
Accrued expenses	98,473	118,697
Current taxes payable	2,501	6,761
Short-term debt and current maturities of long-term obligations	1,581	2,040
Total Current Liabilities	199,623	218,064
Long-Term Debt	250,414	241,405
Other Long-Term Obligations	142,889	183,270
Shareholders' Equity		
Preferred Shares (Authorized 300 shares; none outstanding)	—	—
Common Shares (Authorized 100,000 shares; 37,032 and 36,532 issued and outstanding at September 30, 2018 and December 31, 2017, respectively)—no par	9,418	9,304
Class B Common Shares (Authorized 12,000 shares; 6 shares issued and outstanding at September 30, 2018 and December 31, 2017, respectively)—no par	2	2
Additional paid-in-capital	296,736	290,125
Retained earnings	144,102	187,999
Accumulated other comprehensive income (loss)	23,084	36,870
Treasury shares (3,837 and 3,701 shares at September 30, 2018 and December 31, 2017, respectively)	(103,410 )	(101,006 )
Total Shareholders' Equity	369,932	423,294
Total Liabilities and Shareholders' Equity	\$962,858	\$ 1,066,033

See notes to condensed consolidated financial statements.

## Financial Statements

Table of Contents

## INVACARE CORPORATION AND SUBSIDIARIES

## Condensed Consolidated Statement of Cash Flows (unaudited)

	For the Nine Months Ended September 30,	
	2018	2017
Operating Activities	(In thousands)	
Net loss	\$ (42,677 )	\$ (58,879 )
Adjustments to reconcile net loss to net cash used by operating activities:		
Depreciation and amortization	11,979	10,958
Provision for losses on trade and installment receivables	1,607	1,187
Benefit for deferred income taxes	(212 )	(806 )
Provision for other deferred liabilities	47	537
Provision for equity compensation	4,099	6,629
Loss (gain) on disposals of property and equipment	22	(87 )
Amortization of convertible debt discount	8,588	6,094
Amortization of debt fees	1,869	1,597
(Gain) Loss on convertible debt derivatives	(4,204 )	2,700
Changes in operating assets and liabilities:		
Trade receivables	6,015	(3,153 )
Installment sales contracts, net	(815 )	(903 )
Inventories	(23,066 )	930
Other current assets	(1,050 )	2,351
Accounts payable	8,093	(12,491 )
Accrued expenses	(19,853 )	(7,775 )
Other long-term liabilities	16	(2,256 )
Net Cash Used by Operating Activities	(49,542 )	(53,367 )

Investing Activities			
Purchases of property and equipment	(7,814)	)	(7,389)
Proceeds from sale of property and equipment	38		211
Advance payment from sale of property	3,524		—
Change in other long-term assets	(588)	)	(239)
Other	11		(85)
Net Cash Used by Investing Activities	(4,829)	)	(7,502)
Financing Activities			
Proceeds from revolving lines of credit and long-term borrowings	—		95,220
Payments on revolving lines of credit and long-term borrowings	(1,081)	)	(15,914)
Proceeds from exercise of stock options	2,625		1,761
Payment of financing costs	—		(4,711)
Payment of dividends	(1,220)	)	(1,200)
Issuance of warrants	—		14,100
Purchase of treasury stock	(2,404)	)	(1,221)
Net Cash (Used) Provided by Financing Activities	(2,080)	)	88,035
Effect of exchange rate changes on cash	(1,809)	)	4,564
Increase (decrease) in cash and cash equivalents	(58,260)	)	31,730
Cash and cash equivalents at beginning of year	176,528		124,234
Cash and cash equivalents at end of period	\$ 118,268		\$ 155,964

See notes to condensed consolidated financial statements.

Notes to Financial Statements Accounting Policies

Table of Contents

Accounting Policies

---

**Principles of Consolidation:** The consolidated financial statements include the accounts of the company and its wholly owned subsidiaries and include all adjustments, which were of a normal recurring nature, necessary to present fairly the financial position of the company as of September 30, 2018 and the results of its operations and changes in its cash flow for the nine months ended September 30, 2018 and 2017, respectively. Certain foreign subsidiaries, represented by the European segment, are consolidated using an August 31 quarter end to meet filing deadlines. No material subsequent events have occurred related to the European segment, which would require disclosure or adjustment to the company's financial statements. All significant intercompany transactions are eliminated. The results of operations for the three and nine months ended September 30, 2018 are not necessarily indicative of the results to be expected for the full year.

**Use of Estimates:** The consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States, which require management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results may differ from these estimates.

**Accounts Receivable:** The company records accounts receivable when control of the product or service transfers to its unaffiliated customers, risk of loss is passed and title is transferred. The estimated allowance for uncollectible amounts is based primarily on management's evaluation of the financial condition of specific customers. The company records accounts receivable reserves for amounts that may become uncollectible in the future. The company writes off accounts receivable when it becomes apparent, based upon customer circumstances, that such amounts will not be collected and when legal remedies are exhausted.

Reserves for customer bonus and cash discounts are recorded as a reduction in revenue and netted against gross accounts receivable. Customer rebates in excess of a given customer's accounts receivable balance are classified in Accrued Expenses. Customer rebates and cash discounts are estimated based on the most likely amount principle as well as historical experience and anticipated performance. In addition, customers have the right to return product within the company's normal terms policy, and as such the company estimates the expected returns based on an analysis of historical experience and adjusts revenue accordingly.

**Recent Accounting Pronouncements (Already Adopted):**

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers," which replaces numerous requirements in U.S. GAAP and provides companies with a single revenue recognition model for recognizing revenue from contracts with customers. ASU 2014-09 requires a company to recognize revenue when promised goods or services are transferred to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods and services. The guidance requires five steps to be applied: 1) identify the contract(s) with customers, 2) identify the performance obligations in the contract, 3) determine the transaction price, 4) allocate the transaction price to the performance obligation in the contract and 5) recognize revenue when (or as) the entity satisfies a performance obligation. The guidance also requires both quantitative and qualitative disclosures,

which are more comprehensive than previous revenue standards. The disclosures are intended to enable financial statement users to understand the nature, timing and uncertainty of revenue and the related cash flow.

Effective January 1, 2018, the company adopted the new accounting standard, and all the related amendments, on a modified retrospective basis, with no cumulative effect adjustment to equity needed. Upon adoption, the standard did not have a material impact on the company's results of operations or cash flows nor does the company expect it to have a material impact on future periods. Pursuant to ASU 2014-09, revenues are recognized as control transfers to the customers, which is consistent with the prior revenue recognition model and the prior accounting for the vast majority of the company's contracts. While the company does have a minor amount of service business for which revenue is recognized over time as compared to a point in time, the company's process to estimate the amount of revenue to be recognized did not change as a result of the implementation of the new standard.

Notes to Financial Statements Accounting Policies

Table of Contents

Recent Accounting Pronouncements (Not Yet Adopted):

In February 2016, the FASB issued ASU 2016-02, "Leases." ASU 2016-02 requires lessees to put most leases on their balance sheet while recognizing expense in a manner similar to existing accounting. The new accounting guidance is effective for fiscal periods beginning after December 15, 2018 and early adoption is permitted. The company continues to assess the impact of the adoption of ASU 2016-02 on the company's financial statements. While the company has not finalized its assessment of the impact of ASU 2016-02, the company does expect the standard to have a significant impact on the company's consolidated balance sheets as the company will be required to record assets and liabilities related to its operating leases. The standard is not expected to have a material impact on the company's results of operations or cash flows.

In June 2016, the FASB issued ASU 2016-13, "Measurement of Credit Losses on Financial Statements." ASU 2016-13 requires a new credit loss standard for most financial assets and certain other instruments. For example, entities will be required to use an "expected loss" model that will generally require earlier recognition of allowances for losses for trade receivables. The standard also requires additional disclosures, including disclosures regarding how an entity tracks credit quality. The amendments in the pronouncement are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Entities may early adopt the amendments as of fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The company is currently reviewing the impact of the adoption of ASU 2016-13 on the company's financial statements.

In January 2017, the FASB issued ASU 2017-04, "Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment". The guidance in ASU 2017-04 eliminates the requirement to determine the fair value of individual assets and liabilities of a reporting unit to measure goodwill impairment. Under the amendments in the new ASU, goodwill impairment testing will be performed by comparing the fair value of the reporting unit with its



carrying amount and recognizing an impairment charge for the amount by which the carrying amount exceeds the reporting unit's fair value. The new standard is effective for annual and interim goodwill impairment tests in fiscal years beginning after December 15, 2019, and should be applied on a prospective basis. Early adoption is permitted for annual or interim goodwill impairment testing performed after January 1, 2017. The company is currently reviewing the impact of the adoption of ASU 2017-04 but does not expect the adoption to impact the company's financial statements.

Notes to Financial Statements Divested Businesses

Table of Contents

Divested Businesses

---

Operations Held for Sale

Prior to 2018, the company had recorded expenses related to the sale of all operations held for sale totaling \$2,892,000, of which \$2,366,000 has been paid out as of September 30, 2018.

Discontinued Operations

From 2012 through 2014, the company sold three businesses which were classified as discontinued operations. Prior to 2018, the company had recorded cumulative expenses related to the sale of discontinued operations totaling \$8,801,000, of which \$8,405,000 have been paid as of September 30, 2018.

## Notes to Financial Statements Current Assets

Table of Contents

## Current Assets

## Receivables

Receivables consist of the following (in thousands):

	September 30, 2018	December 31, 2017
Accounts receivable, gross	\$ 142,252	\$ 154,966
Customer rebate reserve	(17,033 )	(18,747 )
Allowance for doubtful accounts	(5,034 )	(5,113 )
Cash discount reserves	(3,925 )	(4,252 )
Other, principally returns and allowances reserves	(1,209 )	(1,239 )
Accounts receivable, net	\$ 115,051	\$ 125,615

Reserves for customer bonus and cash discounts are recorded as a reduction in revenue and netted against gross accounts receivable. Customer rebates in excess of a given customer's accounts receivable balance are classified in Accrued Expenses. Customer rebates and cash discounts are estimated based on the most likely amount principle as well as historical experience and anticipated performance. In addition, customers have the right to return product within the company's normal terms policy, and as such the company estimates the expected returns based on an analysis of historical experience and adjusts revenue accordingly. The decrease in customer rebates reserve from December 31, 2017 to September 30, 2018 was the result of rebate payments, the majority of which are paid in the first quarter of each year.

Accounts receivable are reduced by an allowance for amounts that may become uncollectible in the future. Substantially all the company's receivables are due from health care, medical equipment providers and long-term care facilities located throughout the United States, Australia, Canada, New Zealand, China and Europe. A significant portion of products sold to providers, both foreign and domestic, are ultimately funded through government reimbursement programs such as Medicare and Medicaid in the U.S. As a consequence, changes in these programs can have an adverse impact on dealer liquidity and profitability.

The estimated allowance for uncollectible amounts are based primarily on management's evaluation of the financial condition of specific customers. In addition, as a result of the company's financing arrangement with DLL, a third-party financing company which the company has worked with since 2000, management monitors the collection status of these contracts in accordance with the company's limited recourse obligations and provides amounts necessary for estimated losses in the allowance for doubtful accounts and establishes reserves for specific customers as needed. The company writes off

uncollectible trade accounts receivable after such receivables are moved to collection status and legal remedies are exhausted. See Concentration of Credit Risk in the Notes to the Consolidated Financial Statements for a description of the financing arrangement. Long-term installment receivables are included in "Other Assets" on the consolidated balance sheet.

The company's U.S. customers electing to finance their purchases can do so using DLL. In addition, the company often provides financing directly for its Canadian customers for which DLL is not an option, as DLL typically provides financing to Canadian customers only on a limited basis. The installment receivables recorded on the books of the company represent a single portfolio segment of finance receivables to the independent provider channel and

long-term care customers. The portfolio segment is comprised of two classes of receivables distinguished by geography and credit quality. The U.S. installment receivables are the first class and represent installment receivables re-purchased from DLL because the customers were in default. Default with DLL is defined as a customer being delinquent by three payments. The Canadian installment receivables represent the second class of installment receivables which were originally financed by the company because third party financing was not available to the HME providers. The Canadian installment receivables are typically financed for twelve months and historically have had a very low risk of default.

The estimated allowance for uncollectible amounts and evaluation for impairment for both classes of installment receivables is based on the company's quarterly review of the financial condition of each individual customer with the allowance for doubtful accounts adjusted accordingly. Installments are individually and not collectively reviewed for impairment. The company assesses the bad debt reserve levels based upon the status of the customer's adherence to a legally negotiated payment schedule and the company's ability to enforce judgments, liens, etc.

For purposes of granting or extending credit, the company utilizes a scoring model to generate a composite score that considers each customer's consumer credit score and or D&B credit rating, payment history, security collateral and time in business. Additional analysis is performed for most customers desiring credit greater than \$250,000, which generally includes a detailed review of the customer's financial statements as well as consideration of other factors such as exposure to changing reimbursement laws.

## Notes to Financial Statements Current Assets

Table of Contents

Interest income is recognized on installment receivables based on the terms of the installment agreements. Installment accounts are monitored and if a customer defaults on payments and is moved to collection, interest income is no longer recognized. Subsequent payments received once an account is put on non-accrual status are generally first applied to the principal balance and then to the interest. Accruing of interest on collection accounts would only be restarted if the account became current again.

All installment accounts are accounted for using the same methodology regardless of the duration of the installment agreements. When an account is placed in collection status, the company goes through a legal process for pursuing collection of outstanding amounts, the length of which typically approximates eighteen months. Any write-offs are made after the legal process has been completed. The company has not made any changes to either its accounting policies or methodology to estimate allowances for doubtful accounts in the last twelve months.

Installment receivables consist of the following (in thousands):

	September 30, 2018			December 31, 2017		
	Current	Long-Term	Total	Current	Long-Term	Total
Installment receivables	\$2,234	\$2,697	\$4,931	\$2,415	\$2,076	\$4,491
Less: Unearned interest	(29 )	—	(29 )	(38 )	—	(38 )
	2,205	2,697	4,902	2,377	2,076	4,453
Allowance for doubtful accounts	(469 )	(2,234 )	(2,703 )	(1,043 )	(1,601 )	(2,644 )
Installment receivables, net	\$1,736	\$463	\$2,199	\$1,334	\$475	\$1,809

Installment receivables purchased from DLL during the nine months ended September 30, 2018 increased the gross installment receivables balance by \$1,295,000. No sales of installment receivables were made by the company during the quarter.

The movement in the installment receivables allowance for doubtful accounts was as follows (in thousands):

	Nine Months Ended September 30, 2018	Year Ended December 31, 2017
Balance as of beginning of period	\$ 2,644	\$ 2,838
Current period provision (benefit)	399	1,001
Direct write-offs charged against the allowance	(340 )	(1,195 )
Balance as of end of period	\$ 2,703	\$ 2,644

Installment receivables by class as of September 30, 2018 consist of the following (in thousands):

	Total Installment Receivables	Unpaid Principal Balance	Related Allowance for Doubtful Accounts	Interest Income Recognized
U.S.				
Impaired installment receivables with a related allowance recorded	\$ 4,087	\$ 4,087	\$ 2,703	\$ —
Canada	844	815	—	99

Edgar Filing: INVACARE CORP - Form 10-Q

Non-Impaired installment receivables with no related allowance recorded				
Impaired installment receivables with a related allowance recorded	—	—	—	—
Total Canadian installment receivables	844	815	—	99
Total				
Non-Impaired installment receivables with no related allowance recorded	844	815	—	99
Impaired installment receivables with a related allowance recorded	4,087	4,087	2,703	—
Total installment receivables	\$ 4,931	\$ 4,902	\$ 2,703	\$ 99

26

---

## Notes to Financial Statements Current Assets

Table of Contents

Installment receivables by class as of December 31, 2017 consist of the following (in thousands):

	Total Installment Receivables	Unpaid Principal Balance	Related Allowance for Doubtful Accounts	Interest Income Recognized
U.S.				
Impaired installment receivables with a related allowance recorded	\$ 3,566	\$ 3,566	\$ 2,642	\$ —
Canada				
Non-Impaired installment receivables with no related allowance recorded	923	885	—	74
Impaired installment receivables with a related allowance recorded	2	2	2	—
Total Canadian installment receivables	925	887	2	74
Total				
Non-Impaired installment receivables with no related allowance recorded	923	885	—	74
Impaired installment receivables with a related allowance recorded	3,568	3,568	2,644	—
Total installment receivables	\$ 4,491	\$ 4,453	\$ 2,644	\$ 74

Installment receivables with a related allowance recorded as noted in the table above represent those installment receivables on a non-accrual basis in accordance with ASU 2010-20. As of September 30, 2018, the company had no U.S. installment receivables past due of 90 days or more for which the company is still accruing interest. Individually, all U.S. installment receivables are assigned a specific allowance for doubtful accounts based on management's review when the

company does not expect to receive both the contractual principal and interest payments as specified in the loan agreement. In Canada, the company had an immaterial amount of Canadian installment receivables which were past due of 90 days or more as of December 31, 2017 for which the company was still accruing interest.

The aging of the company's installment receivables was as follows (in thousands):

	September 30, 2018			December 31, 2017		
	Total	U.S.	Canada	Total	U.S.	Canada
Current	\$836	\$—	\$ 836	\$916	\$—	\$ 916
0-30 Days Past Due	8	—	8	6	—	6
31-60 Days Past Due	—	—	—	—	—	—
61-90 Days Past Due	—	—	—	—	—	—
90+ Days Past Due	4,087	4,087	—	3,569	3,566	3
	\$4,931	\$4,087	\$ 844	\$4,491	\$3,566	\$ 925

## Notes to Financial Statements Current Assets

Table of Contents

## Inventories

Inventories consist of the following (in thousands):

	September 30, 2018	December 31, 2017
Finished goods	\$ 63,899	\$ 52,773
Raw materials	67,228	59,497
Work in process	10,637	9,663
Inventories, net	\$ 141,764	\$ 121,933

## Other Current Assets

Other current assets consist of the following (in thousands):

	September 30, 2018	December 31, 2017
Value added tax receivables	\$ 15,665	\$ 16,174
Service contracts	3,145	2,812
Derivatives (foreign currency forward exchange contracts)	1,400	730
Prepaid inventory	602	711
Prepaid insurance	547	2,647
Prepaid debt fees	394	397
Recoverable income taxes	387	341
Prepaid and other current assets	10,184	7,692
Other Current Assets	\$ 32,324	\$ 31,504



## Notes to Financial Statements Long-Term Assets

Table of Contents

## Long-Term Assets

## Other Long-Term Assets

Other long-term assets consist of the following (in thousands):

	September 30, December 31,	
	2018	2017
Convertible 2022 note hedge asset	\$ 29,399	\$ 46,680
Convertible 2021 note hedge asset	24,506	46,915
Cash surrender value of life insurance policies	2,011	1,991
Deferred financing fees	499	787
Long-term installment receivables	463	475
Long-term deferred taxes	306	518
Investments	90	103
Other	667	107
Other Long-Term Assets	\$ 57,941	\$ 97,576

The year-to-date changes in the fair values of the note hedge assets during the year were significantly impacted by the change in the company's stock price.

## Property and Equipment

Property and equipment consist of the following (in thousands):

	September 30, December 31,	
	2018	2017
Machinery and equipment	\$ 301,791	\$ 307,244
Land, buildings and improvements	77,805	78,522
Leasehold improvements	9,069	9,947
Furniture and fixtures	10,067	10,264
Property and Equipment, gross	398,732	405,977
Less allowance for depreciation	(322,481 )	(325,961 )
Property and Equipment, net	\$ 76,251	\$ 80,016

In the third quarter of 2018, the company agreed to sell its Isny, Germany location with a net book value at the signing of the agreement of approximately \$2,900,000, which is included in Land, buildings and improvements in the table above. In accordance with the agreement, title will not transfer to the buyer until April 2020; however, the company received an advance payment of \$3,524,000 representing a majority of the proceeds to be received, which is reflected in the investing section of the Consolidated Statement of Cash Flows and classified in Other Long-Term Obligation in the Consolidated Balance Sheets. The company will continue to depreciate the building and expects to record a gain on the transaction when completed in 2020.

## Goodwill

The change in goodwill from December 31, 2017 to September 30, 2018 was due to foreign currency translation.



## Notes to Financial Statements Long-Term Assets

Table of Contents

## Intangibles

The company's intangibles consist of the following (in thousands):

	September 30, 2018		December 31, 2017	
	Historical Cost	Accumulated Amortization	Historical Cost	Accumulated Amortization
Customer lists	\$53,172	\$ 51,733	\$54,516	\$ 51,957
Trademarks	25,661	—	26,372	—
Developed technology	7,748	6,630	7,925	6,636
Patents	5,531	5,527	5,566	5,559
License agreements	773	773	1,187	1,187
Other	1,162	1,148	1,162	1,145
Intangibles	\$94,047	\$ 65,811	\$96,728	\$ 66,484

All the company's intangible assets have been assigned definite lives and continue to be amortized over their useful lives, except for trademarks shown above, which have indefinite lives. The changes in intangible balances reflected on the balance sheet from December 31, 2017 to September 30, 2018 were the result of foreign currency translation and amortization.

The company evaluates the carrying value of definite-lived assets whenever events or circumstances indicate possible impairment. Definite-lived assets are determined to be impaired if the future un-discounted cash flows expected to be generated by the asset are less than the carrying value. Actual impairment amounts for definite-lived assets are then calculated using a discounted cash flow calculation. The company reviews indefinite-lived assets for impairment annually in the fourth quarter of each year and whenever events or circumstances indicate possible impairment. Any impairment amounts for indefinite-lived assets are calculated as the difference between the future discounted cash flows expected to be generated by the asset less than the carrying value for the asset.

Amortization expense related to intangibles was \$1,238,000 in the first nine months of 2018 and is estimated to be \$1,640,000 in 2018, \$1,279,000 in 2019, \$190,000 in 2020, \$190,000 in 2021, \$190,000 in 2022 and \$190,000 in

2023. Amortized intangibles are being amortized on a straight-line basis over remaining lives of 1 to 10 years with most of the intangibles being amortized over an average remaining life of approximately 3 years.

## Notes to Financial Statements Current Liabilities

Table of Contents

## Current Liabilities

## Accrued Expenses

Accrued expenses consist of accruals for the following (in thousands):

	September 30, December 31,	
	2018	2017
Salaries and wages	\$ 27,974	\$ 33,390
Taxes other than income taxes, primarily Value Added Taxes	20,037	22,627
Warranty	18,179	22,468
Professional	6,392	5,203
Freight	4,169	4,002
Interest	3,383	3,919
Product liability, current portion	3,172	2,905
Deferred revenue	3,117	2,770
Severance	1,326	3,704
Insurance	911	645
Rent	636	808
Derivative liabilities (foreign currency forward exchange contracts)	487	2,120
Rebates	398	5,831
Supplemental Executive Retirement Program liability	391	391
Other items, principally trade accruals	7,901	7,914
Accrued Expenses	\$ 98,473	\$ 118,697

Depending on the terms of the contract, the company may defer the recognition of a portion of the revenue at the end of a reporting period to align with the transfer of control of the company's products to the customer. In addition, to the extent performance obligations are satisfied over time, the company defers revenue recognition until the performance obligations are satisfied.

Accrued rebates relate to several volume incentive programs the company offers its customers. The company accounts for these rebates as a reduction of revenue when the products are sold in accordance with the guidance in ASC 605-50, Customer Payments and Incentives. Rebates are netted against gross accounts receivables unless in excess of such receivables and then classified as accrued expenses. The reduction in accrued rebates from December 31, 2017 to September 30, 2018 primarily relates to payments principally made in the first quarter each year.

Generally, the company's products are covered by warranties against defects in material and workmanship for various periods depending on the product from the date of sale to the customer. Certain components carry a lifetime warranty. A provision for estimated warranty cost is recorded at the time of sale based upon actual experience. In addition, the company has sold extended warranties that, while immaterial, require the

company to defer the revenue associated with those warranties until earned. The company has established procedures to appropriate defer such revenue.

The company continuously assesses the adequacy of its product warranty accruals and makes adjustments as needed. Historical analysis is primarily used to determine the company's warranty reserves. Claims history is reviewed and

provisions are adjusted as needed. However, the company does consider other events, such as a product field action and recalls, which could require additional warranty reserve provision.

The following is a reconciliation of the changes in accrued warranty costs for the reporting period (in thousands):

Balance as of January 1, 2018	\$22,468
Warranties provided during the period	5,619
Settlements made during the period	(10,312 )
Changes in liability for pre-existing warranties during the period, including expirations	404
Balance as of September 30, 2018	\$18,179

Warranty reserves are subject to adjustment in future periods as new developments change the company's estimate of the total cost.

## Notes to Financial Statements Long-Term Liabilities

Table of Contents

## Long-Term Debt

Debt consists of the following (in thousands):

	September 30, 2018	December 31, 2017
Convertible senior notes at 5.00%, due in February 2021	\$ 128,208	\$ 122,355
Convertible senior notes at 4.50%, due in June 2022	93,981	89,675
Other notes and lease obligations	29,806	31,415
	251,995	243,445
Less current maturities of long-term debt	(1,581 )	(2,040 )
Long-Term Debt	\$ 250,414	\$ 241,405

The company had outstanding letters of credit of \$3,121,000 and \$2,945,000 as of September 30, 2018 and December 31, 2017, respectively. There were no borrowings denominated in foreign currencies, excluding a portion of the company's capital leases, as of September 30, 2018 and December 31, 2017. The weighted average interest rate on all borrowings, excluding capital leases, was 4.78% for the nine months ended September 30, 2018 compared to 4.84% for the year ended December 31, 2017.

On September 30, 2015, the company entered into an Amended and Restated Revolving Credit and Security Agreement, which was subsequently amended (the "Credit Agreement") and which matures on January 16, 2021. The Credit Agreement was entered into by and among the company, certain of the company's direct and indirect U.S. and Canadian subsidiaries and certain of the company's European subsidiaries (together with the company, the "Borrowers"), certain other of the company's direct and indirect U.S., Canadian and European subsidiaries (the "Guarantors"), and PNC Bank, National Association ("PNC"), JPMorgan Chase Bank, N.A., J.P. Morgan Europe Limited, KeyBank National Association, and Citizens Bank, National Association (the "Lenders"). PNC is the administrative agent (the "Administrative Agent") and J.P. Morgan Europe Limited is the European agent (the "European Agent") under the Credit Agreement.

In connection with entering into the company's Credit Agreement, the company incurred fees which were capitalized and are being amortized as interest expense. As of September 30, 2018, debt fees yet to be amortized through January 2021 totaled \$893,000.

## U.S. and Canadian Borrowers Credit Facility

For the company's U.S. and Canadian Borrowers, the Credit Agreement provides for an asset-based-lending senior secured revolving credit facility which is secured by substantially all the company's U.S. and Canadian assets, other than real estate. The Credit Agreement provides the company and the other Borrowers with a credit facility in an aggregate principal amount of

\$100,000,000, subject to availability based on a borrowing base formula, under a senior secured revolving credit, letter of credit and swing line loan facility (the "U.S. and Canadian Credit Facility"). Up to \$25,000,000 of the U.S. and Canadian Credit Facility will be available for issuance of letters of credit. The aggregate principal amount of the U.S. and Canadian Credit Facility may be increased by up to \$25,000,000 to the extent requested by the company and agreed to by any Lender or new financial institution approved by the Administrative Agent.

The aggregate borrowing availability under the U.S. and Canadian Credit Facility is determined based on a borrowing base formula. The aggregate usage under the U.S. and Canadian Credit Facility may not exceed an amount equal to the sum of (a) 85% of eligible U.S. accounts receivable plus (b) the lesser of (i) 70% of eligible U.S. inventory and eligible foreign in-transit inventory and (ii) 85% of the net orderly liquidation value of eligible U.S. inventory and eligible foreign in-transit inventory (not to exceed \$4,000,000), plus (c) the lesser of (i) 85% of the net orderly liquidation value of U.S. eligible machinery and equipment and (ii) \$877,200 as of September 30, 2018 (subject to reduction as provided in the Credit Agreement), plus (d) 85% of eligible Canadian accounts receivable, plus (e) the lesser of (i) 70% of eligible Canadian inventory and (ii) 85% of the net orderly liquidation value of eligible Canadian inventory, less (f) swing loans outstanding under the U.S. and Canadian Credit Facility, less (g) letters of credit issued and undrawn under the U.S. and Canadian Credit Facility, less (h) a \$5,000,000 minimum availability reserve, less (i) other reserves required by the Administrative Agent, and in each case subject to the definitions and limitations in the Credit Agreement. As of September 30, 2018, the company was in compliance with all covenant requirements and had borrowing capacity on the U.S. and Canadian Credit Facility under the Credit Agreement of \$21,831,000, considering the minimum availability reserve, then-outstanding letters of credit, other reserves and the \$11,250,000 dominion trigger amount described below. Borrowings under the U.S. and Canadian Credit Facility are secured by substantially all of the company's U.S. and Canadian assets, other than real estate.



Notes to Financial Statements Long-Term Liabilities

Table of Contents

Interest will accrue on outstanding indebtedness under the Credit Agreement at the LIBOR rate, plus a margin ranging from 2.25% to 2.75%, or at the alternate base rate, plus a margin ranging from 1.25% to 1.75%, as selected by the company. Borrowings under the U.S. and Canadian Credit Facility are subject to commitment fees of 0.25% or 0.375% per year, depending on utilization.

The Credit Agreement contains customary representations, warranties and covenants. Exceptions to the operating covenants in the Credit Agreement provide the company with flexibility to, among other things, enter into or undertake certain sale and leaseback transactions, dispositions of assets, additional credit facilities, sales of receivables, additional indebtedness and intercompany indebtedness, all subject to limitations set forth in the Credit Agreement, as amended. The Credit Agreement also contains a covenant requiring the company to maintain minimum availability under the U.S. and Canadian Credit Facility of not less than the greater of (i) 11.25% of the maximum amount that may be drawn under the U.S. and Canadian Credit Facility for five (5) consecutive business days, or (ii) \$5,000,000 on any business day. The company also is subject to dominion triggers under the U.S. and Canadian Credit Facility requiring the company to maintain borrowing capacity of not less than \$11,250,000 on any business day or \$12,500,000 for five consecutive days in order to avoid triggering full control by an agent for the lenders of the company's cash receipts for application to the company's obligations under the agreement.

The Credit Agreement contains customary default provisions, with certain grace periods and exceptions, which provide that events of default that include, among other things, failure to pay amounts due, breach of covenants, representations or warranties, bankruptcy, the occurrence of a material adverse effect, exclusion from any medical reimbursement program, and an interruption of any material manufacturing facilities for more than 10 consecutive days. There were no borrowings outstanding under the U.S. and Canadian Credit Facility at September 30, 2018.

European Credit Facility

The Credit Agreement also provides for a revolving credit, letter of credit and swing line loan facility which gives the company and the European Borrowers the ability to borrow up to an aggregate principal amount of \$30,000,000, with a \$5,000,000 sublimit for letters of credit and a \$2,000,000 sublimit for swing line loans (the "European Credit Facility"). Up to \$15,000,000 of the European Credit Facility will be available to each of Invacare Limited (the "UK Borrower") and Invacare Poirier SAS (the "French Borrower" and, together with the UK Borrower, the "European Borrowers"). The European Credit Facility matures in January 2021, together with the U.S. and Canadian Credit Facility.

The aggregate borrowing availability for each European Borrower under the European Credit Facility is determined based on a borrowing base formula. The aggregate borrowings of each of the European Borrowers under the European Credit Facility may not exceed an amount equal to (a) 85% of the European Borrower's eligible accounts receivable, less (b) the European Borrower's borrowings and swing line loans outstanding under the European Credit Facility, less (c) the European Borrower's letters of credit issued and undrawn under the European Credit Facility, less (d) a \$3,000,000 minimum availability reserve, less (e) other reserves required by the European Agent, and in each case subject to the definitions and limitations in the Credit Agreement. As of September 30, 2018, the aggregate borrowing availability to the European Borrowers under the European Credit Facility was approximately \$14,208,000, considering the \$3,000,000 minimum availability reserve and the \$3,375,000 dominion trigger amount described below.

The aggregate principal amount of the European Credit Facility may be increased by up to \$10,000,000 to the extent requested by the company and agreed to by any Lender or Lenders that wish to increase their lending participation or,

if not agreed to by any Lender, a new financial institution that agrees to join the European Credit Facility and that is approved by the Administrative Agent and the European Agent.

Interest will accrue on outstanding indebtedness under the European Credit Facility at the LIBOR rate, plus a margin ranging from 2.50% to 3.00%, or for swing line loans, at the overnight LIBOR rate, plus a margin ranging from 2.50% to 3.00%, as selected by the company. The margin that will be adjusted quarterly based on utilization. Borrowings under the European Credit Facility are subject to commitment fees of 0.25% or 0.375% per year, depending on utilization.

The European Credit Facility is secured by substantially all the personal property assets of the UK Borrower and its in-country subsidiaries, and all the receivables of the French Borrower and its in-country subsidiaries. The UK and French facilities (which comprise the European Credit Facility) are cross collateralized, and the US personal property assets previously pledged under the U.S. and Canadian Credit Facility also serve as collateral for the European Credit Facility.

The European Credit Facility is subject to customary representations, warranties and covenants generally consistent with those applicable to the U.S. and Canadian Credit Facility. Exceptions to the operating covenants in the Credit Agreement provide the company with flexibility to, among other things, enter into or undertake certain sale/leaseback transactions, dispositions of assets, additional credit facilities, sales of receivables, additional indebtedness and intercompany indebtedness, all subject to limitations set forth in the Credit Agreement. The Credit Agreement also contains a covenant requiring the European Borrowers to maintain undrawn

Notes to Financial Statements Long-Term Liabilities

Table of Contents

availability under the European Credit Facility of not less than the greater of (i) 11.25% of the maximum amount that may be drawn under the European Credit Facility for five (5) consecutive business days, or (ii) \$3,000,000 on any business day. The European Borrowers also are subject to cash dominion triggers under the European Credit Facility requiring the European Borrower to maintain borrowing capacity of not less than \$3,375,000 on any business day or 12.50% of the maximum amount that may be drawn under the European Credit Facility for five (5) consecutive business days in order to avoid triggering full control by an agent for the Lenders of the European Borrower's cash receipts for application to its obligations under the European Credit Facility.

The European Credit Facility is subject to customary default provisions, with certain grace periods and exceptions, consistent with those applicable to the U.S. and Canadian Credit Facility, which provide that events of default include, among other things, failure to pay amounts due, breach of covenants, representations or warranties, cross-default, bankruptcy, the occurrence of a material adverse effect, exclusion from any medical reimbursement program, and an interruption in the operations of any material manufacturing facility for more than 10 consecutive days.

The proceeds of the European Credit Facility will be used to finance the working capital and other business needs of the company. There were no borrowings outstanding under the European Credit Facility at September 30, 2018.

Convertible senior subordinated debentures due 2027

In 2007, the company issued \$135,000,000 principal amount of 4.125% Convertible Senior Subordinated Debentures due 2027 (the "debentures"), of which \$0 principal amount remains outstanding as of September 30, 2018. The holders of the debentures exercised their right to require the company to repurchase all the debentures on February 1, 2017 at a price equal to 100% of the principal amount, which totaled \$13,350,000. As a result of the repurchase, the company wrote-off unamortized debt fees of \$207,000 and recognized amortization expense of \$311,000 in the first quarter of 2017.

Convertible senior notes due 2021

In the first quarter of 2016, the company issued \$150,000,000 aggregate principal amount of 5.00% Convertible Senior Notes due 2021 (the "2021 notes") in a private offering to qualified institutional buyers pursuant to Rule 144A under the Securities Act. The 2021 notes bear interest at a rate of 5.00% per year payable semi-annually in arrears on February 15 and August 15 of each year, beginning August 15, 2016. The 2021 notes will mature on February 15, 2021, unless repurchased or converted in accordance with their terms prior to such date. Prior to August 15, 2020, the 2021 notes will be convertible only upon

satisfaction of certain conditions and during certain periods, and thereafter, at any time until the close of business on the second scheduled trading day immediately preceding the maturity date. Unless and until the company obtains shareholder approval under applicable New York Stock Exchange rules, the 2021 notes will be convertible, subject to certain conditions, into only cash. If the company obtains such shareholder approval, the 2021 notes may be settled in cash, the company's common shares or a combination of cash and the company's common shares, at the company's election. The company is considering whether to seek such shareholder approval at its 2019 annual meeting of shareholders.

Holders of the 2021 notes may convert their 2021 notes at their option at any time prior to the close of business on the business day immediately preceding August 15, 2020 only under the following circumstances: (1) during any fiscal quarter commencing after March 31, 2016 (and only during such fiscal quarter), if the last reported sale price of the company's Common Shares for at least 20 trading days (whether or not consecutive) during the period of 30

consecutive trading days ending on, and including, the last trading day of the immediately preceding fiscal quarter is greater than or equal to 130% of the applicable conversion price for the 2021 notes on each applicable trading day; (2) during the five business day period after any 10 consecutive trading day period (the “measurement period”) in which the “trading price” (as defined in the Indenture) per one thousand U.S. dollar principal amount of 2021 notes for each trading day of such measurement period was less than 98% of the product of the last reported sale price of the company’s Common Shares and the applicable conversion rate for the 2021 notes on each such trading day; or (3) upon the occurrence of specified corporate events described in the Indenture.

Holders of the 2021 notes will have the right to require the company to repurchase all or some of their 2021 notes at 100% of their principal, plus any accrued and unpaid interest, upon the occurrence of certain fundamental changes. The initial conversion rate is 60.0492 common shares per \$1,000 principal amount of 2021 notes (equivalent to an initial conversion price of approximately \$16.65 per common share). The company evaluated the terms of the conversion features under the applicable accounting literature, including Derivatives and Hedging, ASC 815, and determined that the features did require separate accounting as a derivative. This derivative was capitalized on the balance sheet as a long-term liability and will be adjusted to reflect fair value each quarter. The fair value of the convertible debt conversion liability at issuance was \$34,480,000. The fair value of the convertible debt conversion liability at September 30, 2018 was \$28,461,000 compared to \$53,154,000 as of December 31, 2017. The company recognized gains of \$32,675,000 and \$24,693,000 for the three and nine months ended September 30, 2018, respectively, compared to losses of \$15,330,000 and \$16,849,000 for the three and nine

## Notes to Financial Statements Long-Term Liabilities

Table of Contents

months ended September 30, 2017, respectively, related to the convertible debt conversion liability.

In connection with the offering of the 2021 notes, the company entered into privately negotiated convertible note hedge transactions with two financial institutions (the “option counterparties”). These transactions cover, subject to customary anti-dilution adjustments, the number of the company’s common shares that will initially underlie the 2021 notes, and are expected generally to reduce the potential equity dilution, and/or offset any cash payments in excess of the principal amount due, as the case may be, upon conversion of the 2021 notes. The company evaluated the note hedges under the applicable accounting literature, including Derivatives and Hedging, ASC 815, and determined that the note hedges should be accounted for as derivatives. These derivatives were capitalized on the balance sheet as long-term assets and will be adjusted to reflect fair value each quarter. The fair value of the convertible note hedge assets at issuance was \$27,975,000. The fair value of the convertible note hedge assets at September 30, 2018 was \$24,506,000 compared to \$46,915,000 as of December 31, 2017. The company recognized losses of \$30,352,000 and \$22,409,000 for the three and nine months ended September 30, 2018, respectively, compared gains of \$14,189,000 and \$16,148,000 for the three and nine months ended September 30, 2017, respectively, related to the convertible note hedge asset.

The company entered into separate, privately negotiated warrant transactions with the option counterparties at a higher strike price relating to the same number of the company’s common shares, subject to customary anti-dilution adjustments, pursuant to which the company sold warrants to the option counterparties. The warrants could have a dilutive effect on the company’s outstanding common shares and the company’s earnings per share to the extent that the price of the company’s common shares exceeds the strike price of those warrants. The initial strike price of the warrants is \$22.4175 per share and is subject to certain adjustments under the terms of the warrant transactions. The company evaluated the warrants under the applicable accounting literature, including Derivatives and Hedging, ASC 815, and determined that the warrants meet the definition of a derivative, are indexed to the company's own stock and should be classified in shareholder's equity. The amount paid for the warrants and capitalized in shareholder's equity was \$12,376,000.

The net proceeds from the offering of the 2021 notes were approximately \$144,034,000, after deducting fees and offering expenses of \$5,966,000, which were paid in 2016. These debt issuance costs were capitalized and are being amortized as interest expense through February 2021. In accordance with ASU 2015-03, Simplifying the Presentation of Debt Issuance Costs, these debt issuance costs are presented on the balance sheet as a direct deduction from the carrying amount of the related debt liability. Approximately \$5,000,000 of the net proceeds

from the offering were used to repurchase the company’s common shares from purchasers of 2021 notes in the offering in privately negotiated transactions. A portion of the net proceeds from the offering were used to pay the cost of the convertible note hedge transactions (after such cost is partially offset by the proceeds to the company from the warrant transactions), which net cost was \$15,600,000.

The liability components of the 2021 notes consist of the following (in thousands):

	September 30, 2018	December 31, 2017
Principal amount of liability component	\$ 150,000	\$ 150,000
Unamortized discount	(18,946 )	(23,900 )
Debt fees	(2,846 )	(3,745 )
Net carrying amount of liability component	\$ 128,208	\$ 122,355

The unamortized discount of \$18,946,000 is to be amortized through February 2021. The effective interest rate on the liability component was 11.1%. Non-cash interest expense of \$1,691,000 and \$4,954,000 was recognized for the three and nine months ended September 30, 2018, respectively, compared to \$1,518,000 and \$4,446,000 for the three and nine months ended September 30, 2017, respectively. Actual interest expense accrued was \$1,875,000 and \$5,625,000 for the three and nine months ended September 30, 2018, respectively, compared to \$1,875,000 and \$5,625,000 for the three and nine months ended September 30, 2017, respectively, based on the stated coupon rate of 5.0%. The 2021 notes were not convertible as of September 30, 2018 nor was the applicable conversion threshold met.

#### Convertible senior notes due 2022

In the second quarter of 2017, the company issued \$120,000,000 aggregate principal amount of 4.50% Convertible Senior Notes due 2022 (the “2022 notes”) in a private offering to qualified institutional buyers pursuant to Rule 144A under the Securities Act. The 2022 notes bear interest at a rate of 4.50% per year payable semi-annually in arrears on June 1 and December 1 of each year, beginning December 1, 2017. The 2022 notes will mature on June 1, 2022, unless repurchased or converted in accordance with their terms prior to such date. Prior to December 1, 2021, the 2022 notes will be convertible only upon satisfaction of certain conditions and during certain periods, and thereafter, at any time until the close of business on the second scheduled trading day immediately preceding the maturity date. Unless and until the company obtains shareholder approval of the issuance of the company's common shares upon conversion of the 2022 notes under applicable New York Stock Exchange rules, the 2022 notes will be convertible, subject to certain conditions, into only cash. If the company obtains such

## Notes to Financial Statements Long-Term Liabilities

Table of Contents

shareholder approval, the 2022 notes may be settled in cash, the company's common shares or a combination of cash and the company's common shares, at the company's election. The company is considering whether to seek such shareholder approval at its 2019 annual meeting of shareholders.

Holders of the 2022 notes may convert their 2022 notes at their option at any time prior to the close of business on the business day immediately preceding December 1, 2021 only under the following circumstances: (1) during any fiscal quarter commencing after September 30, 2017 (and only during such fiscal quarter), if the last reported sale price of the company's Common Shares for at least 20 trading days (whether or not consecutive) during the period of 30 consecutive trading days ending on, and including, the last trading day of the immediately preceding fiscal quarter is greater than or equal to 130% of the applicable conversion price for the 2022 notes on each applicable trading day; (2) during the five business day period after any 10 consecutive trading day period (the "measurement period") in which the "trading price" (as defined in the Indenture) per one thousand U.S. dollar principal amount of 2022 notes for each trading day of such measurement period was less than 98% of the product of the last reported sale price of the company's Common Shares and the applicable conversion rate for the 2022 notes on each such trading day; or (3) upon the occurrence of specified corporate events described in the Indenture.

Holders of the 2022 notes will have the right to require the company to repurchase all or some of their 2022 notes at 100% of their principal, plus any accrued and unpaid interest, upon the occurrence of certain fundamental changes. The initial conversion rate is 61.6095 common shares per \$1,000 principal amount of 2022 notes (equivalent to an initial conversion price of approximately \$16.23 per common share). The company evaluated the terms of the conversion features under the applicable accounting literature, including Derivatives and Hedging, ASC 815, and determined that the features did require separate accounting as a derivative. This derivative was capitalized on the balance sheet as a long-term liability and will be adjusted to reflect fair value each quarter. The fair value of the convertible debt conversion liability at issuance was \$28,859,000. The fair value of the convertible debt conversion liability at September 30, 2018 was \$34,213,000 compared to \$53,414,000 at December 31, 2017. The company recognized gains of \$26,848,000 and \$19,201,000 for the three and nine months ended September 30, 2018, respectively, compared to losses of \$14,487,000 and \$18,879,000 for the three and nine months ended September 30, 2017, respectively, related to the convertible debt conversion liability.

In connection with the offering of the 2022 notes, the company entered into privately negotiated convertible note hedge transactions with one financial institution (the "option counterparty"). These transactions cover, subject to customary anti-dilution adjustments, the number of the company's common

shares that will initially underlie the 2022 notes, and are expected generally to reduce the potential equity dilution, and/or offset any cash payments in excess of the principal amount due, as the case may be, upon conversion of the 2022 notes. The company evaluated the note hedges under the applicable accounting literature, including Derivatives and Hedging, ASC 815, and determined that the note hedges should be accounted for as derivatives. These derivatives were capitalized on the balance sheet as long-term assets and will be adjusted to reflect fair value each quarter. The fair value of the convertible note hedge assets at issuance was \$24,780,000. The fair value of the convertible note hedge assets at September 30, 2018 was \$29,399,000 compared to \$46,680,000 at December 31, 2017. The company recognized losses of \$25,091,000 and \$17,281,000 for the three and nine months ended September 30, 2018, respectively, compared to gains of \$13,078,000 and \$16,880,000 for the three and nine months ended September 30, 2017, respectively, related to the convertible note hedge asset.

The company entered into separate, privately negotiated warrant transactions with the option counterparty at a higher strike price relating to the same number of the company's common shares, subject to customary anti-dilution adjustments, pursuant to which the company sold warrants to the option counterparties. The warrants could have a

dilutive effect on the company's outstanding common shares and the company's earnings per share to the extent that the price of the company's common shares exceeds the strike price of those warrants. The initial strike price of the warrants is \$21.4375 per share and is subject to certain adjustments under the terms of the warrant transactions. The company evaluated the warrants under the applicable accounting literature, including Derivatives and Hedging, ASC 815, and determined that the warrants meet the definition of a derivative, are indexed to the company's own stock and should be classified in shareholder's equity. The amount paid for the warrants and capitalized in shareholder's equity was \$14,100,000.

The net proceeds from the offering of the 2022 notes were approximately \$115,289,000, after deducting fees and offering expenses of \$4,711,000, which were paid in 2017. These debt issuance costs were capitalized and are being amortized as interest expense through June 2022. As of September 30, 2018, all of the debt issuance costs were paid. In accordance with ASU 2015-03, Simplifying the Presentation of Debt Issuance Costs, these debt issuance costs are presented on the balance sheet as a direct deduction from the carrying amount of the related debt liability. A portion of the net proceeds from the offering were used to pay the cost of the convertible note hedge transactions (after such cost is partially offset by the proceeds to the company from the warrant transactions), which net cost was \$10,680,000.



## Notes to Financial Statements Long-Term Liabilities

Table of Contents

The liability components of the 2022 notes consist of the following (in thousands):

	September 30, December 31,	
	2018	2017
Principal amount of liability component	\$ 120,000	\$ 120,000
Unamortized discount	(22,744 )	(26,378 )
Debt fees	(3,275 )	(3,947 )
Net carrying amount of liability component	\$ 93,981	\$ 89,675

The unamortized discount of \$22,744,000 is to be amortized through June 2022. The effective interest rate on the liability component was 10.9%. Non-cash interest expense of \$1,247,000 and \$3,634,000 was recognized for the three and nine months ended September 30, 2018, respectively, compared to \$1,125,000 and \$1,337,000 for both the three and nine months ended September 30, 2017, respectively. Actual interest expense accrued was \$1,350,000 and \$4,050,000 for the three and nine months ended September 30, 2018, respectively, compared to \$1,350,000 and \$1,605,000 for both the three and nine months ended September 30, 2017, respectively, based on the stated coupon rate of 4.5%. The 2022 notes were not convertible as of September 30, 2018 nor was the applicable conversion threshold met.

## Notes to Financial Statements Long-Term Liabilities

Table of Contents

## Other Long-Term Obligations

Other long-term obligations consist of the following (in thousands):

	September 30, December 31,	
	2018	2017
Convertible 2022 debt conversion liability	\$ 34,213	\$ 53,414
Convertible 2021 debt conversion liability	28,461	53,154
Deferred income taxes	27,918	28,890
Product liability	14,735	13,575
Pension	10,505	10,340
Deferred gain on sale leaseback	6,199	6,419
Deferred compensation	5,773	5,592
Supplemental Executive Retirement Plan liability	5,516	5,636
Advance payment on sale of land & buildings	3,524	—
Uncertain tax obligation including interest	2,895	2,738
Other	3,150	3,512
Other Long-Term Obligations	\$ 142,889	\$ 183,270

The convertible debt conversion liabilities amounts included in the above table represent the fair values of the conversion liabilities as of September 30, 2018 and December 31, 2017. The year-to-date changes in the fair values of the debt conversion liabilities during the year were significantly impacted by the change in the company's stock price. See "Long-Term Debt" in the notes to the Consolidated Financial Statements included elsewhere in this report for more detail.

On April 23, 2015, the company entered into a real estate sale leaseback transaction which resulted in the company recording an initial deferred gain of \$7,414,000, the majority of which is included in Other Long-Term Obligations and will be recognized over the 20-year life of the leases. The gains realized were \$71,000 and \$212,000 for the three and nine months ended September 30, 2018, respectively, compared to \$69,000 and \$205,000 for the three and nine months ended September 30, 2017, respectively.

In the third quarter of 2018, the company agreed to sell its Isny, Germany location with a net book value at the signing of the agreement of approximately \$2,900,000. In accordance with the agreement, title will not transfer to the buyer until April 2020; however, the company received an advance payment for a portion of the proceeds, as disclosed above. The advance payment is reflected in the investing section of the Consolidated Statement of Cash Flows. The company will continue to depreciate the building and expects to record a gain on the transaction when completed in 2020.

## Notes to Financial Statements Revenue

Table of Contents

## Revenue

The company has two revenue streams: product and services. Services include repair, refurbishment, preventive maintenance and rental of product. Services for the NA/HME and IPG segments include maintenance and repair of product. Services for the Europe segment include repair, refurbishment and preventive maintenance services. Services for the Asia Pacific segment include rental and repair of product. The following tables disaggregate the company's revenues by major source and by reportable segment for the three and nine months ended September 30, 2018 and September 30, 2017 (in thousands):

	Three Months Ended September 30, 2018		
	Product	Service	Total
Europe	\$140,697	\$3,642	\$144,339
NA/HME	73,539	157	73,696
IPG	14,790	358	15,148
Asia/Pacific	10,212	1,164	11,376
Total	\$239,238	\$5,321	\$244,559
% Split	98%	2%	100%

	Nine Months Ended September 30, 2018		
	Product	Service	Total
Europe	\$404,107	\$10,442	\$414,549
NA/HME	232,777	568	233,345
IPG	42,565	1,174	43,739
Asia/Pacific	32,651	3,487	36,138
Total	\$712,100	\$15,671	\$727,771
% Split	98%	2%	100%

	Three Months Ended September 30, 2017		
	Product	Service	Total
Europe	\$139,558	\$3,723	\$143,281
NA/HME	79,109	407	79,516
IPG	13,784	191	13,975
Asia/Pacific	12,903	1,231	14,134
Total	\$245,354	\$5,552	\$250,906
% Split	98%	2%	100%

	Nine Months Ended September 30, 2017		
	Product	Service	Total
Europe	\$381,637	\$9,637	\$391,274
NA/HME	239,839	1,628	241,467
IPG	45,141	527	45,668
Asia/Pacific	34,270	3,467	37,737
Total	\$700,887	\$15,259	\$716,146
% Split	98%	2%	100%

The company's revenues are principally related to the sale of products, approximately 98%, with the remaining 2% related to services including repair, refurbishment, preventive maintenance and rental of product. While the company has a significant amount of contract types, the sales split by contract type is estimated as follows: general terms and conditions (35%), large national customers (25%), governments, principally pursuant to tender contracts (15%) and other customers including buying groups and independent customers (25%).

All product and substantially all service revenues are recognized at a point in time. The remaining service revenue, recognized over time, are reflected in the Europe segment and include multiple performance obligations. For such contracts, the company allocates revenue to each performance obligation based on its relative standalone selling price. The company generally determines the standalone selling price based on the expected cost-plus margin methodology.

Revenue is recognized when obligations under the terms of a contract with the customer are satisfied; generally, this occurs with the transfer of control of the company's products and services. Revenue is measured as the amount of consideration expected to be received in exchange for transferring product or providing services. The amount of consideration received and revenue recognized by the company can vary as a result of variable consideration terms included in the contracts related to customer rebates, cash discounts and return policies. Customer rebates and cash discounts are estimated based on the most likely amount principle and these estimates are based on historical experience and anticipated performance. In addition, customers have the right to return product within the company's normal terms policy, and as such the company estimates the expected returns based on an analysis of historical experience. The company adjusts its estimate of revenue at the earlier of when the most likely amount of consideration it expects to receive changes or when the consideration becomes fixed. The company generally does not expect that there will be significant changes to its estimates of variable consideration (see "Receivables" and "Accrued Expenses" in the Notes to the Consolidated Financial Statements include elsewhere in this report for more detail).

Depending on the terms of the contract, the company may defer the recognition of a portion of the revenue at the end of a reporting period to align with transfer of control of the company's products to the customer. In addition, to the extent performance obligations are satisfied over time, the company defers revenue recognition until the performance obligations are satisfied. As of September 30, 2018 and December 31, 2017, the company had deferred revenue of \$3,117,000 and \$2,770,000, respectively, related to outstanding performance obligations.

Notes to Financial Statements Equity Compensation

Table of Contents

Equity Compensation

---

The company's Common Shares have a \$.25 stated value. The Common Shares and the Class B Common Shares generally have identical rights, terms and conditions and vote together as a single class on most issues, except that the Class B Common Shares have ten votes per share, carry a 10% lower cash dividend rate and, in general, can only be transferred to family members or for estate planning purposes. Holders of Class B Common Shares are entitled to convert their shares into Common Shares at any time on a share-for-share basis. When Class B Common Shares are transferred out of a familial relationship, they automatically convert to Common Shares. The Board of Directors suspended further dividends on the Class B Common Shares.

As of September 30, 2018, 6,357 Class B Common Shares remained outstanding. Conversion of Class B Common Shares have substantially diminished the significance of the company's dual class voting structure. As of September 30, 2018, the holders of the Common Shares represented approximately 99.9% of the company's total outstanding voting power.

Equity Compensation Plan

On May 17, 2018, the shareholders of the company approved the Invacare Corporation 2018 Equity Compensation Plan (the "2018 Plan"), which was adopted on March 27, 2018 by the company's Board of Directors (the "Board"). The company's Board adopted the 2018 Plan in order to authorize additional Common Shares for grant as equity compensation, and to reflect changes to Section 162(m) of the Internal Revenue Code (the "Code") resulting from the U.S. Tax Cuts and Jobs Act of 2017.

Following shareholder approval of the 2018 Plan, all of the Common Shares then-remaining available for issuance under the Invacare Corporation 2013 Equity Compensation Plan (the "2013 Plan") and all of the Common Shares that were forfeited or remained unpurchased or undistributed upon termination or expiration of awards under the 2013 Plan and under the Invacare Corporation 2003 Performance Plan (the "2003 Plan"), become available for issuance under the 2018 Plan. Awards granted previously under the 2013 Plan and 2003 Plan will remain in effect under their original terms.

The 2018 Plan uses a fungible share-counting method, under which each Common Share underlying an award of stock options or stock appreciation rights ("SAR") will count against the number of total shares available under the 2018 Plan as one share; and each Common Share underlying any award other than a stock option or a SAR will count against the number of total shares available under the 2018 Plan as two shares. Shares underlying awards made under the 2003 Plan or 2013 Plan that are forfeited

or remain unpurchased or undistributed upon termination or expiration of the awards will become available under the 2018 Plan for use in future awards. Any Common Shares that are added back to the 2018 Plan as the result of forfeiture, termination or expiration of an award granted under the 2018 Plan or the 2013 Plan will be added back in the same manner such shares were originally counted against the total number of shares available under the 2018 Plan or 2013 Plan, as applicable. Each Common Share that is added back to the 2018 Plan due to a forfeiture, termination or expiration of an award granted under the 2003 Plan will be added back as one Common Share.

The Compensation and Management Development Committee of the Board (the "Compensation Committee"), in its discretion, may grant an award under the 2018 Plan to any director or employee of the company or an affiliate. As of September 30, 2018, 4,003,255 Common Shares were available for future issuance under the 2018 Plan in connection with the following types of awards with respect to the company's Common Shares: incentive stock options, nonqualified stock options, SARs, restricted stock, restricted stock units, unrestricted stock and performance shares. The Compensation Committee also may grant performance units that are payable in cash. The Compensation

Committee has the authority to determine which participants will receive awards, the amount of the awards and the other terms and conditions of the awards.

The 2018 Plan provides that shares granted come from the company's authorized but unissued Common Shares or treasury shares. In addition, the company's stock-based compensation plans allow employee participants to exchange shares for minimum withholding taxes, which results in the company acquiring treasury shares.

The amounts of equity-based compensation expense recognized as part of SG&A expenses were as follows (in thousands):

	For the Nine Months Ended September 30,	
	2018	2017
Restricted stock / units	\$3,648	\$4,244
Performance shares / units	344	1,620
Non-qualified and performance stock options	107	765
Total stock-based compensation expense	\$4,099	\$6,629

## Notes to Financial Statements Equity Compensation

Table of Contents

As of September 30, 2018, unrecognized compensation expense related to equity-based compensation arrangements granted under the company's 2018 Plan and previous plans, which is related to non-vested options and shares, was as follows (in thousands):

	September 30, 2018
Restricted stock and restricted stock units	\$ 8,772
Performance shares and performance share units	9,631
Non-qualified and performance stock options	2,153
Total unrecognized stock-based compensation expense	\$ 20,556

Total unrecognized compensation cost will be adjusted for future changes in actual and estimated forfeitures and for updated vesting assumptions for the performance share awards (see "Stock Options" and "Performance Shares and Performance Share Units" below). No tax benefits for share-based

compensation were realized during the three or six months ended September 30, 2018 and 2017 due to a valuation allowance against deferred tax assets.

## Stock Options

Generally, non-qualified stock option awards have a term of ten years and were granted with an exercise price per share equal to the fair market value of one of the company's Common Shares on the date of grant. Stock option awards granted in 2017 were performance-based awards which will only become exercisable if the performance goals established by the Compensation Committee are achieved over a 3-year period ending in 2019 and subject to the Compensation Committee's exercise of negative discretion to reduce the number of options vested based on the progress towards the company's transformation. The company expects the compensation expense to be recognized over a weighted-average period of approximately two years.

The following table summarizes information about stock option activity for the nine months ended September 30, 2018:

	September 30, 2018	Weighted Average Exercise Price
Options outstanding at January 1, 2018	2,631,569	\$ 19.44
Granted	—	—
Exercised	(183,849 )	14.28
Canceled	(538,675 )	23.84
Options outstanding at September 30, 2018	1,909,045	\$ 18.70
Options exercise price range at September 30, 2018	\$ 12.15	to \$ 33.36
Options exercisable at September 30, 2018	1,354,202	
Shares available for grant at September 30, 2018*	4,003,255	

Shares available for grant as of September 30, 2018 reduced by net restricted stock and restricted stock unit award \* and performance share and performance share unit award activity of 2,506,754 shares and 2,441,612 shares, respectively.

The following table summarizes information about stock options outstanding at September 30, 2018:



Edgar Filing: INVACARE CORP - Form 10-Q

Exercise Prices	Options Outstanding		Weighted Average Exercise Price	Options Exercisable	
	Number Outstanding at September 30, 2018	Weighted Average Remaining Contractual Life (Years)		Number Exercisable at September 30, 2018	Weighted Average Exercise Price
\$ 12.15 – \$20.00	833,275	8.0	\$ 12.82	278,432	\$ 14.14
\$ 20.01 – \$25.00	726,751	1.8	22.20	726,751	22.20
\$ 25.01 – \$30.00	344,523	1.8	25.33	344,523	25.33
\$ 30.01 – \$33.36	4,496	2.6	33.36	4,496	33.36
Total	1,909,045	4.1	\$ 18.70	1,354,202	\$ 21.38

The 2018 Plan provides for a one-year minimum vesting period for stock options and, generally, options must be exercised within ten years from the date granted. No stock options were issued in 2018 and those issued in 2017 were performance-based and may vest after the conclusion of the three-year performance

period ending December 31, 2019 based on achievement of performance goals established by the Compensation Committee and subject to the Compensation Committee's exercise of negative discretion to reduce the number of options vested based on the progress towards the company's transformation. All other

## Notes to Financial Statements Equity Compensation

Table of Contents

outstanding stock options were issued in 2014 or prior years and were not performance-based.

For the stock options issued in 2014 and prior, 25% of such options vested one year following the issuance and provided a four-year vesting period whereby options vest in 25% installments in each year. Options granted with graded vesting were accounted for as single options.

The fair value of options granted is estimated on the date of grant using a Black-Scholes option-pricing model. The calculated fair value of the 2017 performance option awards was \$5.38 per option based on the following assumptions:

Expected dividend yield	0.4 %
Expected stock price volatility	39.1 %
Risk-free interest rate	2.31 %
Expected life in years	7.8

Expected dividend yield was based on historical dividends. Expected stock price volatility percentage was calculated at the date of grant based on historical stock prices for a period commensurate with the expected life of the option. The assumed expected life was based on the company's historical analysis of option history.

## Restricted Stock and Restricted Stock Units

The following table summarizes information about restricted shares and restricted share units (primarily for non-U.S. recipients):

	September 30, 2018	Weighted Average Fair Value
Stock / Units unvested at January 1, 2018	776,520	\$ 13.75
Granted	372,799	17.52
Vested	(371,814 )	14.97
Canceled	(85,818 )	13.59
Stock / Units unvested at September 30, 2018	691,687	\$ 15.15

The restricted stock awards generally vest ratably over the three years after the award date. Unearned restricted stock compensation, determined as the market value of the shares at the date of grant, is being amortized on a straight-line basis over the vesting period.

## Performance Shares and Performance Share Units

The following table summarizes information about performance shares and performance share units (for non-U.S. recipients):

	September 30, 2018	Weighted Average Fair Value
Shares / Units unvested at January 1, 2018	457,879	\$ 12.33
Granted	205,164	17.48
Vested	—	—
Canceled	(44,876 )	13.78
Shares / Units unvested at September 30, 2018	618,167	\$ 13.93

During the nine months ended September 30, 2018, performance shares and performance share units (for non-U.S. recipients) were granted as performance awards with a three-year performance period with payouts based on achievement of certain performance goals. The awards are classified as equity awards as they will be settled in Common Shares upon vesting. The number of shares earned will be determined at the end of the three-year performance period based on achievement of performance criteria for January 1, 2018 through December 31, 2020 established by the Compensation Committee at the time of grant. Recipients will be entitled to receive a number of Common Shares equal to the number of performance shares that vest based upon the levels of achievement which may range between 0% and 150% of the target number of shares with the target being 100% of the initial grant.

The fair value of the performance awards is based on the stock price on the date of grant discounted for the estimated value of dividends foregone as the awards are not eligible for dividends except to the extent vested. The company assesses the probability that the performance targets will be met with expense recognized whenever it is probable that at least the minimum performance criteria will be achieved. Depending upon the company's assessment of the probability of achievement of the goals, the company may not recognize any expense associated with performance awards in a given period, may reverse prior expense recorded or record additional expense to make up for expense not recorded in a prior period. Performance award compensation expense is generally expected to be recognized over three years. Expense is being recognized for the 2016, 2017 and 2018 awards as it is considered probable that the performance goals for those awards will be met.

## Notes to Financial Statements Accumulated Other Comprehensive Income

Table of Contents

## Accumulated Other Comprehensive Income (Loss) by Component

Changes in accumulated other comprehensive income ("OCI") for the three and nine months ended September 30, 2018 and September 30, 2017, respectively, were as follows (in thousands):

	Foreign Currency	Long-Term Notes	Defined Benefit Plans	Derivatives	Total
June 30, 2018	\$ 33,678	\$ 464	\$(7,409)	\$ 326	\$27,059
OCI before reclassifications	2,530	(6,824)	(81)	859	(3,516)
Amount reclassified from accumulated OCI	—	—	(17)	(442)	(459)
Net current-period OCI	2,530	(6,824)	(98)	417	(3,975)
September 30, 2018	\$ 36,208	\$(6,360)	\$(7,507)	\$ 743	\$23,084
December 31, 2017	\$50,376	\$(4,612)	\$(7,652)	\$(1,242)	\$36,870
OCI before reclassifications	(14,168)	(1,748)	292	1,602	(14,022)
Amount reclassified from accumulated OCI	—	—	(147)	383	236
Net current-period OCI	(14,168)	(1,748)	145	1,985	(13,786)
September 30, 2018	\$36,208	\$(6,360)	\$(7,507)	\$743	\$23,084
June 30, 2017	\$8,811	\$9,622	\$(11,969)	\$(431)	\$6,033
OCI before reclassifications	33,795	(6,356)	(238)	(578)	26,623
Amount reclassified from accumulated OCI	—	—	70	395	465
Net current-period OCI	33,795	(6,356)	(168)	(183)	27,088
September 30, 2017	\$42,606	\$3,266	\$(12,137)	\$(614)	\$33,121
December 31, 2016	\$(26,199)	\$17,372	\$(11,248)	\$740	\$(19,335)
OCI before reclassifications	68,805	(14,106)	(1,223)	(1,149)	52,327
Amount reclassified from accumulated OCI	—	—	334	(205)	129
Net current-period OCI	68,805	(14,106)	(889)	(1,354)	52,456
September 30, 2017	\$42,606	\$3,266	\$(12,137)	\$(614)	\$33,121

## Notes to Financial Statements Accumulated Other Comprehensive Income

Table of Contents

Reclassifications out of accumulated OCI for the three and nine months ended September 30, 2018 and September 30, 2017 were as follows (in thousands):

	Amount reclassified from OCI		Affected line item in the Statement of Comprehensive (Income) Loss		
	For the Three Months Ended September 30, 2018	For the Nine Months Ended September 30, 2017	For the Three Months Ended September 30, 2018	For the Nine Months Ended September 30, 2017	
<b>Defined Benefit Plans</b>					
Service and interest costs	\$(17 )	\$70	\$(147)	\$334	Selling, General and Administrative Income Taxes
Tax	—	—	—	—	
Total after tax	\$(17 )	\$70	\$(147)	\$334	
<b>Derivatives</b>					
Foreign currency forward contracts hedging sales	\$520	\$(399)	\$754	\$(165)	Net Sales
Foreign currency forward contracts hedging purchases	(986 )	837	(306 )	(35 )	Cost of Products Sold
Total loss (income) before tax	(466 )	438	448	(200 )	
Tax	24	(43 )	(65 )	(5 )	Income Taxes
Total after tax	\$(442)	\$395	\$383	\$(205)	

## Notes to Financial Statements Charges Related to Restructuring Activities

Table of ContentsCharges Related to Restructuring Activities

The company's restructuring charges were originally necessitated primarily by continued declines in Medicare and Medicaid reimbursement by the U.S. government, as well as similar healthcare reimbursement pressures abroad, which negatively affect the company's customers (e.g. home health care providers) and continued pricing pressures faced by the company due to the outsourcing by competitors to lower cost locations. Restructuring decisions were also the result of reduced profitability in the NA/HME and Asia/Pacific segments. In addition, as a result of the company's transformation strategy, additional restructuring actions were implemented in 2017 and continued in 2018. The company expects any near-term cost savings from restructuring will be offset by other costs because of pressures on the business.

For the nine months ended September 30, 2018, charges totaled \$1,665,000 which were related to NA/HME (\$227,000), Europe (\$1,170,000) and Asia/Pacific (\$268,000). In NA/HME, costs were incurred related to severance (\$362,000) and contract termination cost reversals (\$135,000). The European and Asia/Pacific charges were for severance costs. Payments for the nine months ended September 30, 2018 were \$4,314,000 and the cash payments were funded with company's cash on hand. Most of the 2018 charges are expected to be paid out within twelve months.

For the nine months ended September 30, 2017, charges totaled \$8,973,000 which were related to NA/HME (\$6,000,000), Europe segment (\$1,890,000) and Asia/Pacific (\$1,083,000). In NA/HME, costs were incurred related to severance (\$5,441,000) and contract termination costs (\$559,000). The NA/HME charges include the impact of the company's closure of its Suzhou, China, manufacturing facility. The European and Asia/Pacific charges were for severance costs. Payments for the nine months ended September 30, 2017 were \$8,232,000 and the cash payments were funded with company's cash on hand. Most of the 2017 charges have been paid out.

There have been no material changes in accrued balances related to the charges, either as a result of revisions to the plans or changes in estimates. In addition, the savings anticipated as a result of the company's restructuring plans have been or are expected to be achieved, primarily resulting in reduced salary and benefit costs principally impacting Selling, General and Administrative expenses, and to a lesser extent, Costs of Products Sold. However, in general, these savings have been more than offset by the general business decline, higher regulatory and compliance costs related to quality system improvements, and more recently, higher interest expense. To date, the company's liquidity has not been materially impacted. Please refer to Charges Related to Restructuring Activities of company's Annual Report on Form 10-K for the period ending December 31, 2017 for disclosure of restructuring activity prior to 2018. A progression by reporting segment of the accruals recorded as a result of the restructuring for the nine months ended September 30, 2018 is as follows (in thousands):

	Severance	Contract Terminations	Total
December 31, 2017 Balances			
NA/HME	\$ 2,439	\$ 167	\$ 2,606
Europe	249	134	383
Other	1,016	—	1,016
Total	3,704	301	4,005
Charges			
NA/HME	97	—	97
Europe	293	—	293
Asia/Pacific	11	—	11

Edgar Filing: INVACARE CORP - Form 10-Q

Total	401	—	401
Payments			
NA/HME	(1,697 )	(57 )	(1,754 )
Europe	(338 )	(97 )	(435 )
Asia/Pacific	(11 )	—	(11 )
Other	(260 )	—	(260 )
Total	\$ (2,306 )	\$ (154 )	\$ (2,460)

## Notes to Financial Statements Charges Related to Restructuring Activities

Table of Contents

	Severance	Contract Terminations	Total
March 31, 2018 Balances			
NA/HME	\$ 839	\$ 110	\$949
Europe	204	37	241
Other	756	—	756
Total	1,799	147	1,946
Charges (Reversals)			
NA/HME	124	(135 )	(11 )
Europe	108	—	108
Asia/Pacific	247	—	247
Total	479	(135 )	344
Payments			
NA/HME	(601 )	66	(535 )
Europe	(195 )	(37 )	(232 )
Asia/Pacific	(247 )	—	(247 )
Total	(1,043 )	29	(1,014 )
June 30, 2018 Balances			
NA/HME	362	41	403
Europe	117	—	117
Other	756	—	756
Total	1,235	41	1,276
Charges			
NA/HME	141	—	141
Europe	769	—	769
Asia/Pacific	10	—	10
Total	920	—	920
Payments			
NA/HME	(158 )	(11 )	(169 )
Europe	(661 )	—	(661 )
Asia/Pacific	(10 )	—	(10 )
Total	(829 )	(11 )	(840 )
September 30, 2018 Balances			
NA/HME	345	30	375
Europe	225	—	225
Other	756	—	756
Total	\$ 1,326	\$ 30	\$1,356



Notes to Financial Statements Income Taxes

Table of Contents

Income Taxes

---

The company had an effective tax rate of 46.2% and 27.2% on losses before tax from continuing operations for the three and nine months ended September 30, 2018, respectively, compared to an expected benefit of 21.0% on the continuing operations pre-tax loss for each period. The rate for 3Q18 was impacted by net gain on convertible debt derivatives with no tax expense due to valuation reserve in the U.S. The company had an effective tax rate of 22.8% and 16.2% on losses before tax from continuing operations for the three and nine months ended September 30, 2017, respectively, compared to an expected benefit at the U.S. statutory rate of 35.0% on the continuing operations pre-tax loss for each period. The company's effective tax rate for each of the three and nine months ended September 30, 2018 and September 30, 2017 were unfavorable as compared to the U.S. federal statutory rate expected benefit, principally due to the negative impact of the company not being able to record tax benefits related to the significant losses in countries which had tax valuation allowances. The effective tax rate was increased for the three and nine months ended September 30, 2018 and decreased for the three and nine months ended September 30, 2017 by certain taxes outside the United States, excluding countries with tax valuation allowances, that were at an effective rate higher than the U.S. statutory rate for the three and nine months ended September 30, 2018 and lower than the U.S. statutory rate for the three and nine months ended September 30, 2017.

The US Tax Cuts and Jobs Act of 2017 ("Tax Act") was enacted on December 22, 2017. The Tax Act subjects a US shareholder to current tax on global intangible low-taxed income (GILTI) earned by certain foreign subsidiaries. The

FASB Staff Q&A, Topic 740 No. 5, Accounting for Global Intangible Low-Taxed Income, states that an entity can make an accounting policy election to either recognize deferred taxes for temporary differences expected to reverse as GILTI in future years or provide for the tax expense related to GILTI in the year the tax is incurred. The company has elected to recognize the tax on GILTI as a period expense in the period the tax is incurred.

In accordance with the SEC issued SAB 118, which provided guidance on accounting for the tax effects of the Tax Act, the company made certain provisional estimates at December 31, 2017. The company has finalized the underlying timing differences and cumulative foreign earnings and profits deficit through 2017 and there were no significant changes to our provisional estimates as of December 31, 2017. The company is still analyzing certain aspects of the Tax Act which could potentially affect the measurement of these balances or potentially give rise to new or additional deferred tax amounts. No adjustments were made to the company's provisional calculations during the quarter or nine months ended September 30, 2018.

## Notes to Financial Statements Net Loss Per Common Share

Table of Contents

## Net Loss Per Common Share

The following table sets forth the computation of basic and diluted net loss per common share for the periods indicated.

(In thousands except per share data)	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2018	2017	2018	2017
<b>Basic</b>				
Average common shares outstanding	33,232	32,867	33,104	32,725
Net loss	\$(12,026)	\$(18,591)	\$(42,677)	\$(58,879)
Net loss per common share	\$(0.36 )	\$(0.57 )	\$(1.29 )	\$(1.80 )
<b>Diluted</b>				
Average common shares outstanding	33,232	32,867	33,104	32,725
Stock options and awards	534	505	745	361
Average common shares assuming dilution	33,766	33,372	33,849	33,086
Net loss	\$(12,026)	\$(18,591)	\$(42,677)	\$(58,879)
Net loss per common share *	\$(0.36 )	\$(0.57 )	\$(1.29 )	\$(1.80 )

\* Net loss per common share assuming dilution calculated utilizing weighted average shares outstanding-basic for the periods in which there was a net loss.

At September 30, 2018, 333,899 shares associated with stock options were excluded from the average common shares assuming dilution for both the three and six months ended September 30, 2018 as they were anti-dilutive. At September 30, 2018, the majority of the anti-dilutive shares were granted at an exercise price of \$25.24, which was higher than the average fair market value price of \$16.57 and \$17.43 for the three and nine months ended September 30, 2018, respectively.

At September 30, 2017, 988,926 and 1,301,286 shares associated with stock options were excluded from the average common shares assuming dilution for the three and nine months ended September 30, 2017, respectively, as they were anti-dilutive. At September 30, 2017, the majority of the anti-dilutive shares were granted at an exercise price of \$25.79, which was higher than the average fair market value price of \$14.27 and \$13.14 for the three and nine months ended September 30, 2017, respectively.

For both the three and months ended September 30, 2018 and September 30, 2017, respectively, no shares were included in the common shares assuming dilution related to the company's issued warrants as the average market price of the company stock for these periods did not exceed the strike price of the warrants.

Notes to Financial Statements Concentration of Credit Risk

Table of Contents

Concentration of Credit Risk

---

The company manufactures and distributes durable medical equipment to the home health care, retail and extended care markets. The company performs credit evaluations of its customers' financial condition. The company utilizes De Lage Landen, Inc. ("DLL"), a third-party financing company, to provide lease financing to Invacare's U.S. customers. The DLL agreement provides for direct leasing between DLL and the Invacare customer. The company retains a recourse obligation of \$1,107,000 at September 30, 2018 to DLL for events of default under the contracts, which total \$13,506,000 at September 30, 2018. Guarantees, ASC 460, requires the company to record a guarantee liability as it relates to the limited recourse obligation. The company's recourse is re-evaluated by DLL biannually, considers activity between the biannual dates and excludes any receivables purchased by the company from DLL. The company monitors the collections status of these contracts and has provided amounts for estimated losses in its allowances for doubtful accounts in accordance with Receivables, ASC 310-10-05-4. Credit losses are provided for in the financial statements.

Substantially all the company's receivables are due from health care, medical equipment providers and long-term care facilities located throughout the United States, Australia, Canada, New Zealand and Europe. A significant portion of products sold to dealers, both foreign and domestic, is ultimately funded through government reimbursement programs such as Medicare and Medicaid. The company has also seen a significant shift in reimbursement to customers from managed care entities. As a consequence, changes in these programs can have an adverse impact on dealer liquidity and profitability. In addition, reimbursement guidelines in the home health care industry have a substantial impact on the nature and type of equipment an end user can obtain as well as the timing of reimbursement and, thus, affect the product mix, pricing and payment patterns of the company's customers.

Notes to Financial Statements Derivatives

Table of Contents

Derivatives

---

ASC 815 requires companies to recognize all derivative instruments in the consolidated balance sheet as either assets or liabilities at fair value. The accounting for changes in fair value of a derivative is dependent upon whether or not the derivative has been designated and qualifies for hedge accounting treatment and the type of hedging relationship. For derivatives designated and qualifying as hedging instruments, the company must designate the hedging instrument, based upon the exposure being hedged, as a fair value hedge, cash flow hedge, or a hedge of a net investment in a foreign operation.

Cash Flow Hedging Strategy

The company uses derivative instruments in an attempt to manage its exposure to transactional foreign currency exchange risk. Foreign forward exchange contracts are used to manage the price risk associated with forecasted sales denominated in foreign currencies and the price risk associated with forecasted purchases of inventory over the next twelve months.

The company recognizes its derivative instruments as assets or liabilities in the consolidated balance sheet measured at fair value. A majority of the company's derivative instruments are designated and qualify as cash flow hedges. Accordingly, the effective portion of the gain or loss on the derivative instrument is reported as a component of other comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. The remaining gain or loss on the derivative instrument in excess of the cumulative change in the fair value of the hedged item, if any, is recognized in current earnings during the period of change.

To protect against increases/decreases in forecasted foreign currency cash flows resulting from inventory purchases/sales over the next year, the company utilizes foreign currency forward contracts to hedge portions of its forecasted purchases/sales denominated in foreign currencies. The gains and losses are included in cost of products sold and selling, general and administrative expenses on the consolidated statement of comprehensive income (loss). If it is later determined that a hedged forecasted transaction is unlikely to occur, any prospective gains or losses on the forward contracts would be recognized in earnings. The company does not expect any material amount of hedge ineffectiveness related to forward contract cash flow hedges during the next twelve months.

The company has historically not recognized any material amount of ineffectiveness related to forward contract cash flow hedges because the company generally limits its hedges to between 50% and 90% of total forecasted transactions for a given entity's exposure to currency rate changes and the transactions hedged are recurring in nature. Furthermore, most of the hedged transactions are related to intercompany sales and purchases for which settlement occurs on a specific day each month. Forward contracts with a total notional amount in USD of \$52,376,000 and \$45,421,000 matured for the nine months ended September 30, 2018 and September 30, 2017, respectively.



## Notes to Financial Statements Derivatives

Table of Contents

Outstanding foreign currency forward exchange contracts qualifying and designated for hedge accounting treatment were as follows (in thousands USD):

	September 30, 2018		December 31, 2017	
	Notional Amount	Unrealized Net Gain (Loss)	Notional Amount	Unrealized Net Gain (Loss)
USD / AUD	\$ 990	\$ 82	\$ 3,960	\$ 44
USD / CAD	8,572	(18 )	33,344	115
USD / CNY	996	(24 )	4,027	61
USD / EUR	19,192	664	72,259	(558 )
USD / GBP	1,233	31	4,640	(124 )
USD / NZD	4,959	(71 )	9,300	11
USD / SEK	603	92	—	—
USD / MXP	4,231	223	6,461	(158 )
EUR / GBP	8,242	(100 )	32,248	(682 )
EUR / SEK	1,655	114	7,732	39
EUR / NOK	984	(11 )	4,521	68
EUR / NZD	696	(11 )	2,855	(8 )
DKK / SEK	1,542	(127 )	6,453	(120 )
	\$ 53,895	\$ 844	\$ 187,800	\$ (1,312 )

## Derivatives Not Qualifying or Designated for Hedge Accounting Treatment

The company utilizes foreign currency forward contracts that are not designated as hedges in accordance with ASC 815. These contracts are entered into to eliminate the risk associated with the settlement of short-term intercompany trading receivables and payables between Invacare Corporation and its foreign subsidiaries. The currency forward contracts are entered into at the same time as the intercompany receivables or payables are created so that upon settlement, the gain/loss on the settlement is offset by the gain/loss on the foreign currency forward contract. No material net gain or loss was realized by the company in 2018 or 2017 related to these contracts and the associated short-term intercompany trading receivables and payables.

Foreign currency forward exchange contracts not qualifying or designated for hedge accounting treatment, as well as ineffective hedges, entered into in 2018 and 2017, respectively, and outstanding were as follows (in thousands USD):

	September 30, 2018		December 31, 2017	
	Notional Amount	Gain (Loss)	Notional Amount	Gain (Loss)
AUD / USD	\$ 16,300	\$ 45	\$ 2,750	\$ (77 )
NZD / USD	4,000	24	3,300	(53 )
EUR / AUD	—	—	4,000	43
AUD / NZD	3,600	—	3,600	9
EUR / NOK	19	—	—	—
	\$ 23,919	\$ 69	\$ 13,650	\$ (78 )

## Notes to Financial Statements Derivatives

Table of Contents

The fair values of the company's derivative instruments were as follows (in thousands):

	September 30, 2018		December 31, 2017	
	Assets	Liabilities	Assets	Liabilities
Derivatives designated as hedging instruments under ASC 815				
Foreign currency forward exchange contracts	\$ 1,320	\$ 476	\$ 678	\$ 1,990
Derivatives not designated as hedging instruments under ASC 815				
Foreign currency forward exchange contracts	80	11	52	130
Total derivatives	\$ 1,400	\$ 487	\$ 730	\$ 2,120

The fair values of the company's foreign currency forward exchange contract assets and liabilities are included in Other Current Assets and Accrued Expenses, respectively in the Consolidated Balance Sheets.

The effect of derivative instruments on Accumulated Other Comprehensive Income (OCI) and the Statement of Comprehensive Income (Loss) and was as follows (in thousands):

	Amount of Gain (Loss) Recognized in Accumulated OCI on Derivatives (Effective Portion)	Amount of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain (Loss) Recognized in Income on Derivatives (Ineffective Portion and Amount Excluded from Effectiveness Testing)
Three months ended September 30, 2018			
Foreign currency forward exchange contracts	\$ 859	\$ 442	\$ 28
Nine months ended September 30, 2018			
Foreign currency forward exchange contracts	\$ 1,602	\$ (383)	\$ 27
Three months ended September 30, 2017			
Foreign currency forward exchange contracts	\$ (578)	\$ (395)	\$ —
Nine months ended September 30, 2017			
Foreign currency forward exchange contracts	\$ (1,149)	\$ 205	\$ —

Derivatives not designated as hedging instruments under ASC 815	Amount of Gain (Loss) Recognized in Income on Derivatives
Three months ended September 30, 2018	
Foreign currency forward exchange contracts	\$ (358)
Nine months ended September 30, 2018	
Foreign currency forward exchange contracts	\$ 69
Three months ended September 30, 2017	
Foreign currency forward exchange contracts	\$ (53)
Nine months ended September 30, 2017	
Foreign currency forward exchange contracts	\$ 64

The gains or losses recognized as the result of the settlement of cash flow hedge foreign currency forward contracts are recognized in net sales for hedges of inventory sales and in cost of product sold for hedges of inventory purchases. For the three and nine months ended September 30, 2018, net sales were decreased by \$520,000 and \$754,000 while cost of product sold was decreased by \$986,000 and \$306,000 for net pre-tax realized gains of \$466,000 and \$448,000, respectively. For the three and nine months ended September 30, 2017, net sales were increased by

\$399,000 and \$165,000 while cost of product sold was

increased by \$837,000 and \$35,000 for net realized pre-tax losses of \$438,000 and \$200,000, respectively.

A loss of \$358,000 and gain of \$69,000 were recognized in selling, general and administrative (SG&A) expenses for the three and nine months ended September 30, 2018, respectively, compared to losses of \$53,000 and \$64,000 for the three and nine months ended September 30, 2017, respectively, related to forward contracts not designated as hedging instruments. The forward contracts were entered into to offset gains/losses that

## Notes to Financial Statements Derivatives

Table of Contents

were also recorded in SG&A expenses on intercompany trade receivables or payables. The gains/losses on the non-designated hedging instruments were substantially offset by gains/losses on intercompany trade payables.

The company's derivative agreements provide the counterparties with a right of set off in the event of a default. The right of set off would enable the counterparty to offset any net payment due by the counterparty to the company under the applicable agreement by any amount due by the company to the counterparty under any other agreement. For example, the terms of the agreement would permit a counterparty to a derivative contract that is also a lender under the company's Credit Agreement to reduce any derivative settlement amounts owed to the company under the derivative contract by any amounts owed to the counterparty by the company under the Credit Agreement. In addition, the agreements contain cross-default provisions that could trigger a default by the company under the agreement in the event of a default by the company under another agreement with the same counterparty. The company does not present any derivatives on a net basis in its financial statements, other than the conversion and bond hedge derivatives which are presented net on the Condensed Consolidated Statement of Comprehensive Income (Loss), and all derivative balances presented are subject to provisions that are similar to master netting agreements.

During the first quarter of 2016, the company entered into privately negotiated convertible 2021 note hedges and 2021 warrants in connection with its sale of \$150,000,000 in aggregate principal amount of the company's 5.00% Convertible Senior Notes due 2021. The 2021 warrants, which increased paid in capital by \$12,376,000, are clearly and closely related to the convertible 2021 notes and thus classified as equity. The 2021 note hedge asset and 2021 convertible debt conversion liability were recorded, based on initial fair values, as an asset of \$27,975,000 and a liability of \$34,480,000, respectively, and these fair values are updated quarterly with the offset to the income statement.

During the second quarter of 2017, the company entered into privately negotiated convertible 2022 note hedges and warrants in connection with its sale of \$120,000,000 in aggregate principal amount of the company's 4.50% Convertible Senior Notes due 2022. The 2022 warrants, which increased paid in capital by \$14,100,000, are clearly and closely related to the convertible 2022 notes and thus classified as equity. The 2022 note hedge assets and 2022 convertible debt conversion liability were recorded, based on initial fair values, as an asset of \$24,780,000 and a liability of \$28,859,000, respectively, and these fair values are updated quarterly with the offset to the income statement. See "Long-Term Debt" in the notes to the Consolidated Financial Statements included elsewhere in this report for more detail.

The fair values of the outstanding convertible note derivatives as of September 30, 2018 and their effect on the Statement of Comprehensive Income (Loss) were as follows (in thousands):

	Fair Value	Gain (Loss)	Gain (Loss)	Gain (Loss)	Gain (Loss)
	September	Three Months Ended	September	Nine Months Ended	September
	30, 2018	September	September	September	September
		30, 2018	30, 2017	30, 2018	30, 2017
Convertible 2021 debt conversion long-term liability	\$(28,461)	\$32,675	\$(15,330)	\$24,693	\$(16,849)
Convertible 2022 debt conversion long-term liability	(34,213)	) 26,848	(14,487)	) 19,201	(18,879)
Convertible 2021 note hedge long-term asset	24,506	(30,352)	) 14,189	(22,409)	) 16,148
Convertible 2022 note hedge long-term asset	29,399	(25,091)	) 13,078	(17,281)	) 16,880
Net fair value and net gain (loss) on convertible debt derivatives	\$(8,769)	) \$4,080	\$(2,550)	) \$4,204	\$(2,700)

The 2021 and 2022 convertible debt conversion liability amounts and the 2021 and 2022 note hedge asset amounts are included in Other Long-Term Obligations and Other Long-Term Assets, respectively, in the company's Consolidated

Balance Sheets. The year-to-date changes in the fair values of the convertible debt conversion liabilities and note hedge derivatives were significantly impacted by the change in the company's stock price.

## Notes to Financial Statements Fair Values

Table of Contents

## Fair Values

Pursuant to ASC 820, the inputs used to derive the fair value of assets and liabilities are analyzed and assigned a level I, II or III priority, with level I being the highest and level III being the lowest in the hierarchy. Level I inputs are quoted prices in active markets for identical assets or liabilities. Level II inputs are quoted prices for similar assets or liabilities in active markets:

quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs are observable in active markets. Level III inputs are based on valuations derived from valuation techniques in which one or more significant inputs are unobservable.

The following table provides a summary of the company's assets and liabilities that are measured on a recurring basis (in thousands):

	Basis for Fair Value Measurements at Reporting Date		
	Quoted Prices in Active Markets for Identical Assets / (Liabilities)	Significant Other Observable Inputs	Significant Other Unobservable Inputs
	Level I	Level II	Level III
September 30, 2018			
Forward exchange contracts—net	—	\$ 913	—
Convertible 2021 debt conversion liability	—	(28,461 )	—
Convertible 2021 note hedge asset	—	24,506	—
Convertible 2022 debt conversion liability	—	(34,213 )	—
Convertible 2022 note hedge asset	—	29,399	—
December 31, 2017			
Forward exchange contracts—net	—	\$ (1,390 )	—
Convertible 2021 debt conversion liability	—	(53,154 )	—
Convertible 2021 note hedge asset	—	46,915	—
Convertible 2022 debt conversion liability	—	(53,414 )	—
Convertible 2022 note hedge asset	—	46,680	—

The carrying values and fair values of the company's financial instruments are as follows (in thousands):

	September 30, 2018		December 31, 2017	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Cash and cash equivalents	\$118,268	\$118,268	\$176,528	\$176,528
Other investments	90	90	103	103
Installment receivables, net of reserves	2,199	2,199	1,809	1,809
Long-term debt (including current maturities of long-term debt) *	(251,995 )	(277,457 )	(243,445 )	(294,173 )
Convertible 2021 debt conversion liability in Other Long-Term Obligations	(28,461 )	(28,461 )	(53,154 )	(53,154 )
Convertible 2021 note hedge in Other Long-Term Assets	24,506	24,506	46,915	46,915
Convertible 2022 debt conversion liability in Other Long-Term Obligations	(34,213 )	(34,213 )	(53,414 )	(53,414 )
Convertible 2022 note hedge in Other Long-Term Assets	29,399	29,399	46,680	46,680

Edgar Filing: INVACARE CORP - Form 10-Q

Forward contracts in Other Current Assets	1,400	1,400	730	730
Forward contracts in Accrued Expenses	(487	) (487	) (2,120	) (2,120 )

\* The company's long-term debt is shown net of discount and fees associated with the Convertible Senior Notes due 2021 and 2022 on the company's condensed consolidated balance sheet. Accordingly, the fair values of the Convertible Senior Notes due 2021 and 2022 are included in the long-term debt presented in this table is also shown net of the discount and fees.

Notes to Financial Statements Fair Values

Table of Contents

The company, in estimating its fair value disclosures for financial instruments, used the following methods and assumptions:

Cash, cash equivalents: The carrying value reported in the balance sheet for cash, cash equivalents equals its fair value.

Other investments: The company has made an investment in a limited partnership, which is accounted for using the cost method, adjusted for any estimated declines in value. The investment was acquired in private placement and there is no quoted market price or stated rate of return. The company does not have the ability to easily sell the investment. The company completes an evaluation of the residual value related to such investments in the fourth quarter each year.

Installment receivables: The carrying value reported in the balance sheet for installment receivables approximates its fair value. The interest rates associated with these receivables have not varied significantly since inception.

Management believes that after consideration of the credit risk, the net book value of the installment receivables approximates market value.

Long-term debt: Fair value for the company's convertible debt is based on quoted market-based estimates as of the end of the period, while the revolving credit facility fair value is based upon an estimate of the market for similar borrowing arrangements. The fair values are deemed to be categorized as Level 2 in the fair value hierarchy.

Convertible debt derivatives: The fair values for the convertible debt conversion liabilities and note hedge derivatives are based on valuation models in which all the significant inputs are observable in active markets. The year-to-date



changes in the fair values of the convertible debt conversion liabilities and note hedge derivatives were significantly impacted by the change in the company's stock price.

Forward contracts: The company operates internationally, and as a result, is exposed to foreign currency fluctuations. Specifically, the exposure includes intercompany loans and third-party sales or payments. In an attempt to reduce this exposure, foreign currency forward contracts are utilized and accounted for as hedging instruments. The forward contracts are used to hedge the following currencies: AUD, CAD, CHF, CNY, DKK, EUR, GBP, MXP, NOK, NZD, SEK and USD. The company does not use derivative financial instruments for speculative purposes. Fair values for the company's foreign exchange forward contracts are based on quoted market prices for contracts with similar maturities. The company's forward contracts are included in Other Current Assets or Accrued Expenses in the Consolidated Balance Sheets.

## Notes to Financial Statements Business Segments

Table of Contents

## Business Segments

The company operates in four primary business segments: NA/HME, IPG, Europe and Asia/Pacific. Both the NA/HME and IPG segments operate in the Americas. The NA/HME segment sells each of the three primary product categories, which includes: lifestyle, mobility and seating, and respiratory therapy products. IPG sells long-term care medical equipment, health care furnishings and accessory products. Europe and Asia/Pacific sell product categories similar to those of NA/HME and IPG. The accounting policies of each segment are the same as those described in the summary of significant accounting policies for the company's consolidated financial statements. Intersegment sales and transfers are based on the costs to manufacture plus a reasonable profit element.

Segment performance is measured and resources are allocated based on a number of factors, with the primary profit or loss measure being segment operating profit (loss). Segment operating profit

(loss) represents net sales less cost of products sold less selling general and administrative expenses. Segment operating profit (loss) excludes unallocated corporate general and administrative expenses not allocated to the segments and intersegment sales and profit eliminations, which are included in All Other. In addition, segment operating profit (loss) further excludes charges related to restructuring activities, asset impairments and gain on sale of business (as applicable).

Segment operating income (loss), is used by the CODM for purposes of making decisions about allocating resources to a segment and assessing its performance. In addition, this metric is reviewed by the company's Board of Directors regarding segment performance and is a key metric in the performance management assessment of the company's employees.

(in thousands)	For the Three Months		For the Nine Months	
	Ended September 30,		Ended September 30,	
	2018	2017	2018	2017
Revenues from external customers				
Europe	\$144,339	\$143,281	\$414,549	\$391,274
NA/HME	73,696	79,516	233,345	241,467
IPG	15,148	13,975	43,739	45,668
Asia/Pacific	11,376	14,134	36,138	37,737
Consolidated	\$244,559	\$250,906	\$727,771	\$716,146
Intersegment revenues				
Europe	\$3,928	\$4,013	\$12,662	\$11,426
NA/HME	22,880	19,334	70,187	62,479
IPG	176	314	494	2,057
Asia/Pacific	4,164	3,405	15,078	11,161
Consolidated	\$31,148	\$27,066	\$98,421	\$87,123
Restructuring charges before income taxes				
Europe	\$769	\$686	\$1,170	\$1,890
NA/HME	141	(170)	227	6,000
Asia/Pacific	10	187	268	1,083
Consolidated	\$920	\$703	\$1,665	\$8,973
Operating income (loss)				
Europe	\$11,788	\$11,987	\$23,553	\$24,164
NA/HME	(12,836)	(12,446)	(29,394)	(34,267)
IPG	1,575	1,202	4,336	4,572

Edgar Filing: INVACARE CORP - Form 10-Q

Asia/Pacific	2	387	2,544	(161 )
All Other	(4,885 )	(6,311 )	(16,559 )	(17,556 )
Charge expense related to restructuring activities	(920 )	(703 )	(1,665 )	(8,973 )
Consolidated operating loss	(5,276 )	(5,884 )	(17,185 )	(32,221 )
Net gain (loss) on convertible debt derivatives	4,080	(2,550 )	4,204	(2,700 )
Net Interest expense	(7,030 )	(6,707 )	(20,571 )	(15,733 )
Loss before income taxes	\$(8,226 )	\$(15,141 )	\$(33,552 )	\$(50,654 )

## Notes to Financial Statements Business Segments

Table of Contents

Net sales by product, are as follows (in thousands):

	For the Three Months Ended September 30, 2018		For the Nine Months Ended September 30, 2017	
Europe				
Lifestyle	\$66,873	\$68,257	\$204,485	\$194,189
Mobility and Seating	66,969	64,262	177,153	164,720
Respiratory Therapy	5,500	6,258	18,742	20,008
Other(1)	4,997	4,504	14,169	12,357
	\$144,339	\$143,281	\$414,549	\$391,274
NA/HME				
Lifestyle	\$30,129	\$32,814	\$92,336	\$96,108
Mobility and Seating	30,369	28,439	90,597	82,500
Respiratory Therapy	12,969	17,807	49,660	61,116
Other(1)	229	456	752	1,743
	\$73,696	\$79,516	\$233,345	\$241,467
Institutional Products Group				
Continuing Care	\$15,148	\$13,975	\$43,739	\$45,668
Asia/Pacific				
Mobility and Seating	\$7,352	\$8,161	\$22,691	\$21,877
Lifestyle	2,261	2,773	7,262	7,556
Continuing Care	150	1,123	884	2,969
Respiratory Therapy	369	375	1,015	1,024
Other(1)	1,244	1,702	4,286	4,311
	\$11,376	\$14,134	\$36,138	\$37,737
Total Consolidated	\$244,559	\$250,906	\$727,771	\$716,146

(1) Includes various services, including repair services, equipment rentals and external contracting.

## Notes to Financial Statements Contingencies

Table of ContentsContingencies

---

## General

In the ordinary course of its business, the company is a defendant in a number of lawsuits, primarily product liability actions in which various plaintiffs seek damages for injuries allegedly caused by defective products. All of the product liability lawsuits that the company currently faces in the United States have been referred to the company's captive insurance company and/or excess insurance carriers while all non-U.S. lawsuits have been referred to the company's commercial insurance carriers. All such lawsuits are generally contested vigorously. The coverage territory of the company's insurance is worldwide with the exception of those countries with respect to which, at the time the product is sold for use or at the time a claim is made, the U.S. government has suspended or prohibited diplomatic or trade relations. The amount recorded for identified contingent liabilities is based on estimates. Amounts recorded are reviewed periodically and adjusted to reflect additional technical and legal information that becomes available. Actual costs to be incurred in future periods may vary from the estimates, given the inherent uncertainties in evaluating certain exposures.

As a medical device manufacturer, the company is subject to extensive government regulation, including numerous laws directed at preventing fraud and abuse and laws regulating reimbursement under various government programs. The marketing, invoicing, documenting, developing, testing, manufacturing, labeling, promoting, distributing and other practices of health care suppliers and medical device manufacturers are all subject to government scrutiny. Most of the company's facilities are subject to inspection at any time by the FDA or similar medical device regulatory agencies in other jurisdictions. Violations of law or regulations can result in administrative, civil and criminal penalties and sanctions, which could have a material adverse effect on the company's business.

In August 2018, the company received a Civil Investigative Demand ("CID") from the U.S. Department of Justice ("DOJ") related to its investigation into the rentals pricing practices of one of the company's former rentals businesses, which the company divested in July 2015. The former rentals business and its acquirer also received similar CID's from the DOJ, and in September 2018, the acquirer made a request for indemnification from the company under the divestiture agreement. The CID seeks documents and other information from the company, and the company is cooperating fully with the DOJ investigation. An unfavorable outcome could include the company being required to pay monetary damages, and incur attorneys' fees, penalties and other adverse actions. The company is unable to predict the outcome and is unable to make a meaningful estimate of the amount or range of loss, if any, that could result from any unfavorable outcome.

## Medical Device Regulatory Matters

The FDA in the United States and comparable medical device regulatory authorities in other jurisdictions regulate virtually all aspects of the marketing, invoicing, documenting, development, testing, manufacturing, labeling, promotion, distribution and other practices regarding medical devices. The company and its products are subject to the laws and regulations of the FDA and other regulatory bodies in the various jurisdictions where the company's products are manufactured or sold. The company's failure to comply with the regulatory requirements of the FDA and other applicable medical device regulatory requirements can subject the company to administrative or judicially imposed sanctions or enforcement actions. These sanctions include injunctions, consent decrees, warning letters, civil penalties, criminal penalties, product seizure or detention, product recalls and total or partial suspension of production.

In December 2012, the company became subject to a consent decree of injunction filed by FDA with respect to the company's Corporate facility and its Taylor Street manufacturing facility in Elyria, Ohio. The consent decree initially limited the company's (i) manufacture and distribution of power and manual wheelchairs, wheelchair components and wheelchair sub-assemblies at or from its Taylor Street manufacturing facility, except in verified cases of medical necessity, (ii) design activities related to wheelchairs and power beds that took place at the impacted Elyria facilities and (iii) replacement, service and repair of products which were already in use from the Taylor Street manufacturing facility. Under the terms of the consent decree, in order to resume full operations, the company had to successfully

complete independent, third-party expert certification audits at the impacted Elyria facilities, comprised of three distinct certification reports separately submitted to, and accepted by, FDA; submit its own report to the FDA; and successfully complete a reinspection by FDA of the company's Corporate and Taylor Street facilities.

On July 24, 2017, following its June 2017 reinspection of the Corporate and Taylor Street facilities, FDA notified the company that it is in substantial compliance with the FDA Act, FDA regulations and the terms of the consent decree and that the company was permitted to resume full operations at those facilities including the resumption of unrestricted sales of products made in those facilities.

The consent decree will continue in effect for at least five years from July 2017, during which time the company's Corporate and Taylor Street facilities must complete two semi-annual audits in the first year and then four annual audits in the next four years performed by a company-retained expert firm. The expert audit firm will determine whether the facilities remain

## Notes to Financial Statements Contingencies

Table of Contents

in continuous compliance with the FDA Act, FDA regulations and the terms of the consent decree. The FDA has the authority to inspect these facilities and any other FDA registered facility, at any time. The FDA has continued to actively inspect the company's facilities, other than through the processes established under the consent decree. The company expects that the FDA will, from time to time, inspect substantially all the company's domestic and foreign FDA-registered facilities. Recent inspections for which follow-up remains ongoing are summarized in the following paragraphs.

In August 2018, the company completed its second semi-annual independent expert audit of the Corporate and Taylor Street facilities, as required under the consent decree, and the facilities were found to remain in compliance with the FDA Act, the FDA regulations and the consent decree. The audit report has been submitted to FDA.

In September 2017, Alber GmbH, a wholly owned subsidiary of the company, received a warning letter from the FDA. The warning letter required completion of corrective actions to address Form 483 observations issued following FDA's inspection of Alber's facility in Albstadt, Germany in May 2017. As a consequence of the warning letter, all Alber devices could not be imported into the United States until all findings were corrected to FDA's satisfaction. On January 3, 2018, FDA notified the company that Alber's responses to the warning letter were adequate, and that FDA had as of that date, removed the import suspension. FDA conducted its subsequent reinspection of Alber in April 2018, the result of which included no noted observations. On July 27, 2018, FDA notified the company that it addressed the violations contained in the warning letter and that the warning letter at the Albstadt facility was closed.

In November 2017, the FDA inspected the company's facility in Sanford, Florida and issued its observations on Form 483, and the company submitted its response to FDA in a timely manner. In July 2018, the FDA notified the company that its responses to the Form 483 observations were adequate. The Sanford facility was the subject of a warning letter from the FDA issued in December 2010 related to quality systems processes and procedures, and the company continues to work on addressing the FDA's citations. On August 21, 2018, FDA notified the company that it addressed the violations contained in the warning letter and that the warning letter at the Sanford facility was closed.

The results of regulatory claims, proceedings, investigations, or litigation are difficult to predict. An unfavorable resolution or outcome of any FDA warning letters or inspectional observations, or other FDA enforcement related to company facilities, could materially and adversely affect the

company's business, financial condition, and results of operations.

The limitations previously imposed by the FDA consent decree negatively affected net sales in the NA/HME segment and, to a certain extent, the Asia/Pacific segment beginning in 2012. The limitations led to delays in new product introductions. Further, uncertainty regarding how long the limitations would be in effect limited the company's ability to renegotiate and bid on certain customer contracts and otherwise led to a decline in customer orders.

Although the company has been permitted to resume full operations at the Corporate and Taylor Street facilities, the negative effect of the consent decree on customer orders and net sales in the NA/HME and Asia/Pacific segments has been considerable, and it is uncertain as to whether, or how quickly, the company will be able to rebuild net sales to more typical historical levels, irrespective of market conditions. Accordingly, when compared to the company's 2010 results, the previous limitations in the consent decree had, and likely may continue to have, a material adverse effect on the company's business, financial condition and results of operations.

Separately, net sales in the NA/HME segment have likely been impacted by uncertainty on the part of the company's customers as they coped with prepayment reviews and post-payment audits by the Centers for Medicare and Medicaid Services ("CMS") and the impact of the National Competitive Bidding ("NCB") process. In addition, net sales in the NA/HME segment have declined and may continue to decline as a result of the company's strategic focus away from lower margin, less differentiated products, as the company becomes more focused on its clinically complex products.

**Warranty Matters**

The company's warranty reserves are subject to adjustment in future periods based on historical analysis of warranty claims and as new developments occur that may change the company's estimates related to specific product recalls.

See Current Liabilities in the Notes to the Consolidated Financial Statements for the total provision amounts and a reconciliation of the changes in the warranty accrual.

Any of the above contingencies could have an adverse impact on the company's financial condition or results of operations.

For additional information regarding the consent decree, other regulatory matters, and risks and trends that may impact the company's financial condition or results of operations, please see the following sections of the company's Annual Report on Form 10-K for the year ended December 31, 2017: Item 1. Business - Government Regulation and Item 1A. Risk Factors; Item 3. Legal Proceedings; and Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Outlook and - Liquidity and Capital Resources.



Notes to Financial Statements Subsequent Event

Table of Contents

Subsequent Event

---

On November 1, 2018, Invacare Corporation (the “Company”) implemented a reduction in its workforce of approximately 50 associates in North America as the Company is realigning its North America infrastructure to drive improved cost effectiveness and leverage. The Company expects to incur total pre-tax cash restructuring charges, primarily relating to severance and transition assistance, of approximately \$1.2 million, that will be expensed in the fourth quarter of 2018 principally in the North America/Home Medical Equipment segment. The Company expects cash payments to be made in the fourth quarter of 2018 through the second quarter of 2019. Once this reduction in workforce is completed, the Company expects that it will generate approximately \$5.0 million in annualized pre-tax savings.

Notes to Financial Statements Market Risk and Controls

Table of Contents

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

During the quarter ended September 30, 2018, there were no material changes to market risk information provided in the company's Annual Report on Form 10-K for the year ended December 31, 2017. Please refer to Item 7A - Quantitative and Qualitative Disclosures About Market Risk of company's Annual Report on Form 10-K for the period ending December 31, 2017.

Item 4. Controls and Procedures.

(a) Evaluation of Disclosure Controls and Procedures

As of September 30, 2018, an evaluation was performed, under the supervision and with the participation of the company's management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)). Based on that evaluation, the company's management, including the Chief Executive Officer and Chief Financial Officer, concluded that the company's disclosure controls and procedures were effective as of September 30, 2018, in ensuring that information required to be disclosed by the company in the reports it files and submits under the Exchange Act is (1) recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms and (2) accumulated and communicated to the company's management, including the Chief Executive Officer and the Chief Financial Officer, as appropriate to allow for timely decisions regarding required disclosure.

(b) Changes in Internal Control Over Financial Reporting

There have been no changes in the company's internal control over financial reporting that occurred during the company's last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the company's internal control over financial reporting.

Part II Other Information

Table of Contents

Part II. OTHER INFORMATION

Item 1. Legal Proceedings.

In the ordinary course of its business, the company is a defendant in a number of lawsuits, primarily product liability actions in which various plaintiffs seek damages for injuries allegedly caused by defective products. All of the product liability lawsuits that the company currently faces in the United States have been referred to the company's captive insurance company and/or excess insurance carriers while all non-U.S. lawsuits have been referred to the company's commercial insurance carriers. All such lawsuits are generally contested vigorously. The coverage territory of the company's insurance is worldwide with the exception of those countries with respect to which, at the time the product is sold for use or at the time a claim is made, the U.S. government has suspended or prohibited diplomatic or trade relations. Management does not believe that the outcome of any of these actions will have a material adverse effect upon the company's business or financial condition.

In December 2012, the company became subject to a consent decree of injunction filed by FDA in the U.S. District Court for the Northern District of Ohio with respect to the company's Corporate facility and its Taylor Street manufacturing facility in Elyria, Ohio. On July 24, 2017, following its reinspection of the Corporate and Taylor Street facilities, FDA notified the company that it was in substantial compliance with the FDA Act, FDA regulations and the terms of the consent decree and that the company was permitted to resume full operations at those facilities, including the resumption of unrestricted sales of products made in those facilities.

The consent decree will continue in effect for at least five years from July 24, 2017, during which time the company's Corporate and Taylor Street facilities must complete to two semi-annual audits in the first year and then four annual audits in the next four years performed by a company-retained expert firm. The expert audit firm will determine whether the facilities remain in continuous compliance with the FDA Act, FDA regulations and the terms of the consent decree.

The FDA has the authority to inspect the Corporate and Taylor Street facilities, and any other FDA registered facility, at any time. The FDA also has the authority to order the company to take a wide variety of actions if the FDA finds that the company is not in compliance with the consent decree, FDA Act or FDA regulations, including requiring the company to cease all operations relating to Taylor Street products. The FDA also can order the company to undertake a partial cessation of operations or a recall, to issue a safety alert, public health advisory, or press release, or to take any other corrective action the FDA deems necessary with respect to Taylor Street products.

FDA also has authority under the consent decree to assess liquidated damages of \$15,000 per violation per day for any violations of the consent decree, FDA Act or FDA regulations. FDA also may assess liquidated damages for shipments of adulterated or misbranded devices in the amount of twice the sale price of any such adulterated or misbranded device. The liquidated damages are capped at \$7,000,000 for each calendar year. The liquidated damages are in addition to any other remedies otherwise available to FDA, including civil money penalties.

For additional information regarding the consent decree, please see the "Contingencies" note to the financial statements contained in Part I of this Quarterly Report on Form 10-Q, the risk factors referred to in Part I, Item 1A of this Quarterly Report on Form 10-Q, and the following sections of the company's Annual Report on Form 10-K for the period ending December 31, 2017: Item 1. Business - Government Regulation; Item 1A. Risk Factors; and Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Outlook and - Liquidity and Capital Resources.

In August 2018, the company received a Civil Investigative Demand (“CID”) from the U.S. Department of Justice (“DOJ”) related to its investigation into the rentals pricing practices of one of the company’s former rentals businesses, which the company divested in July 2015. The former rentals business and its acquirer also received similar CID’s from the DOJ, and in September 2018, the acquirer made a request for indemnification from the company under the divestiture agreement. The CID seeks documents and other information from the company, and the company is cooperating fully with the DOJ investigation. An unfavorable outcome could include the company being required to pay monetary damages, and incur attorneys’ fees, penalties and other adverse actions. The company is unable to predict the outcome and is unable to make a meaningful estimate of the amount or range of loss, if any, that could result from any unfavorable outcome.

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the risk factors disclosed in Item 1A of the company’s Annual Report on Form 10-K for the fiscal period ended December 31, 2017.

## Part II Other Information

Table of Contents

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table presents information with respect to repurchases of common shares made by the company during the three months ended September 30, 2018.

Period	Total Number of Shares Purchased (1)	Avg. Price Paid Per Share \$	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs (2)
7/1/2018 - 7/31/2018	—	\$ —	—	2,453,978
8/1/2018 - 8/31/2018	—	—	—	2,453,978
9/1/2018 - 9/30/2018	—	—	—	2,453,978
Total	—	\$ —	—	2,453,978

(1) No shares were repurchased between July 1, 2018 and September 30, 2018 or were surrendered to the company by employees for minimum tax withholding purposes in conjunction with the vesting of restricted shares awarded to the employees or the exercise of non-qualified options by employees under the company's equity compensation plans.

(2) In 2001, the Board of Directors authorized the company to purchase up to 2,000,000 Common Shares, excluding any shares acquired from employees or directors as a result of the exercise of options or vesting of restricted shares pursuant to the company's performance plans. The Board of Directors reaffirmed its authorization of this repurchase program on November 5, 2010, and on August 17, 2011 authorized an additional 2,046,500 shares for repurchase under the plan. To date, the company has purchased 1,592,522 shares under this program, with authorization remaining to purchase 2,453,978 shares. The company purchased no shares pursuant to this Board authorized program during the quarter ended September 30, 2018.

Under the terms of the company's Credit Agreement, repurchases of shares by the company generally are not permitted except in certain limited circumstances in connection with the vesting or exercise of employee equity compensation awards.

Part II Other Information

Table of Contents

Item 6. Exhibits

Exhibit

No.	
<u>31.1</u>	Chief Executive Officer Rule 13a-14(a)/15d-14(a) Certification (filed herewith).
<u>31.2</u>	Chief Financial Officer Rule 13a-14(a)/15d-14(a) Certification (filed herewith).
<u>32.1</u>	Certification of the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).
<u>32.2</u>	Certification of the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).
101.INS*	XBRL instance document
101.SCH*	XBRL taxonomy extension schema
101.CAL*	XBRL taxonomy extension calculation linkbase
101.DEF*	XBRL taxonomy extension definition linkbase
101.LAB*	XBRL taxonomy extension label linkbase
101.PRE*	XBRL taxonomy extension presentation linkbase

\* Pursuant to Rule 406T of Regulation S-T, the Interactive Data Files on Exhibit 101 hereto are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise are not subject to liability under those sections.

Signatures

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

INVACARE  
CORPORATION

Date: November 5, 2018 By: /s/ Kathleen P.  
Leneghan  
Name: Kathleen  
P. Leneghan  
Title: Chief  
Financial  
Officer  
(As Principal  
Financial and  
Accounting  
Officer and on  
behalf of the  
registrant)