INVACARE CORP
Form 10-Q
May 07, 2018

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

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

For the quarterly period ended March 31, 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 incorporation or organization)	(IRS Employer Identification No.)
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 x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x 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 x Non-accelerated filer ¨ (Do not check if a smaller reporting company) 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 x

As of May 4, 2018, the registrant had 33,157,645 Common Shares and 6,357 Class B Common Shares outstanding.

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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 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), elderly, bariatric) ailments. 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 Invacare's website at 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.

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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 sheet at March 31, 2018 and December 31, 2017, and in the condensed consolidated statement of comprehensive income (loss) for the three months ended March 31, 2018 and March 31, 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 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 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 the most clinically complex needs thereby increasing the value of the company's 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 & 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 lesser emphasis on, gradual changes 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.

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.

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STATUS OF THE CONSENT DECREE

On July 24, 2017, following its reinspection of the Corporate and Taylor Street facilities, the Food and Drug Administration ("FDA") notified the company that it was in substantial compliance with the FDA Quality System Regulation ("QSR") and, at that time, 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 a minimum of five years from July 24, 2017, during which time the company's Corporate and Taylor Street facilities must complete two semi-annual and then four annual audits performed by a company-retained expert audit firm. The expert audit firm will determine whether the facilities remain in continuous compliance with the Federal Food, Drug and Cosmetic Act (FDA Act), 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. As of the date of the filing of this Form 10-Q, the first expert audit of the Corporate and Taylor Street facilities was completed in 2018 and the result submitted to FDA. The expert's inspection led to a summary report, which included a finding that the company operates the subject facilities in compliance with FDA regulations and with the requirements of the consent decree. There were no significant deviations requiring further actions noted from the inspection.

For a complete description of the consent decree, see the "Contingencies" note to the financial statements contained in Item 1 of this Quarterly Report on Form 10-Q and "Forward-Looking Statements" contained below in this Item.

OUTLOOK

The company will continue to make significant investments in its transformation, reduce sales in certain areas, refocus resources away from less accretive activities, and look at its global infrastructure for opportunities to drive efficiency. Phase One investments are providing returns. The company expects to see improved results in 2018 with Phase Two actions continuing as the company continues to streamline operations, resize and reshape the organization, especially in North America, around its new business mix and size. By executing this strategy and making these operational improvements, the company expects long-term benefits for the company's constituents.

As a result of anticipated commercial effectiveness and resulting sales growth, the company expects increased working capital which, if realized, would support investments for growth, especially growth of NA/HME mobility and seating products. This would include investments in demonstration units and SG&A expense, and support of an extended quote-to-cash process for power wheelchairs. Also, the company expects to make additional restructuring and capital investments as it continues to reshape the business over the course of 2018. The company expects spending on capital expenditures to increase from recent low levels to approximately $20,000,000 to $25,000,000 in 2018. As a result, the company anticipates its cash flow usage for 2018 will be similar to the cash used in 2017, including consideration of seasonality of cash flow during the year.

The company is gradually applying the transformation to the Europe segment, which may slightly reduce the segment's net sales as it begins to shift its product mix toward more clinically valued, higher-margin products. Regarding the IPG segment, the company expects its new strategic selling approach in the capital selling environment to continue to take time to yield growth. In its pursuit of sustained increased shareholder value, the company continues to emphasize building a culture of quality excellence and achieving its long-term earnings potential.

RESULTS OF OPERATION - NET SALES

($ in thousands USD)	1Q18	1Q17	Reported % Change	Foreign Exchange % Impact	Constant Currency % Change
Europe	131,314	119,508	9.9	12.5	(2.6)
NA/HME	79,782	84,262	(5.3)	0.4	(5.7)
IPG	14,887	16,373	(9.1)	0.2	(9.3)
Asia/Pacific	11,077	11,580	(4.3)	3.2	(7.5)
Consolidated	237,060	231,723	2.3	6.7	(4.4)

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-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, 2017. Management believes that both of these financial measures provide meaningful information for evaluating the core operating performance of the company. For the quarter, constant currency net sales decreased in each segment.

Constant currency net sales performance drivers by segment:

Europe - The decline in constant currency net sales compared to the first quarter last year was driven by lower sales of lifestyle and respiratory products and, to a lesser extent, mobility and seating products.

North America/Home Medical Equipment (NA/HME) - Constant currency net sales decreased, driven largely by respiratory and lifestyle products partially offset by increases in mobility and seating products compared to the first quarter last year. The decline was also impacted by reduced net sales in China as result of the closure of one of the company's Suzhou, China facilities in 2017 which previously were accounted for in the NA/HME segment.

Institutional Products Group (IPG) - Constant currency net sales decreased compared to the first quarter last year principally due to lower net sales related to case goods, bed products and interior design projects. As previously disclosed, the company is transforming its go-to-market strategy in the post-acute care (PAC) channel. The company expects this new sales approach will take time to yield growth.

Asia/Pacific - Constant currency net sales decreased in institutional beds and respiratory products.

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MD&A Net Sales

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The following tables provide net sales at reported rates for the quarters ended March 31, 2018 and December 31, 2017 and net sales for the quarters ended March 31, 2018 and December 31, 2017, respectively, as translated at the foreign exchange rates for the quarter ended March 31, 2017 with each then compared

to the net sales for the most recent prior period (constant currency sequential net sales). The company began this disclosure in 1Q17 to illustrate the effect of its transformation on its segments and continues to do so while the transformation continues and this is useful.

($ in thousands USD)	1Q18 at Reported Foreign Exchange Rates	Foreign Exchange Translation Impact	1Q18 at 1Q17 Foreign Exchange Rates	4Q17 at 1Q17 Foreign Exchange Rates	Sequential Growth $	Sequential Growth %
Europe	131,314	(14,870)	116,444	131,053	(14,609)	(11.1)%
NA/HME	79,782	(326)	79,456	79,050	406	0.5
IPG	14,887	(47)	14,840	13,789	1,051	7.6
Asia Pacific	11,077	(359)	10,718	13,188	(2,470)	(18.7)
Consolidated	237,060	(15,602)	221,458	237,080	(15,622)	(6.6)%

	4Q17 at Reported Foreign Exchange Rates	Foreign Exchange Translation Impact	4Q17 at 1Q17 Foreign Exchange Rates
Europe	144,052	(12,999)	131,053
NA/HME	79,351	(301)	79,050
IPG	13,804	(15	