

INVACARE CORP
Form 10-Q
May 07, 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 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 (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 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 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 (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

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

Table of Contents

	Item	Page
PART I: FINANCIAL INFORMATION		
<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 Months Ended March 31, 2018 and March 31, 2017</u>		<u>18</u>
<u>Condensed Consolidated Balance Sheets - March 31, 2018 and December 31, 2017</u>		<u>19</u>
<u>Condensed Consolidated Statement of Cash Flows - Three Months Ended March 31, 2018 and March 31, 2017</u>		<u>20</u>
<u>Notes to Condensed Consolidated Financial Statements - March 31, 2018</u>		<u>21</u>
<u>Quantitative and Qualitative Disclosures About Market Risk</u>	3	<u>59</u>
<u>Controls and Procedures</u>	4	<u>59</u>
PART II: OTHER INFORMATION		
<u>Legal Proceedings</u>	1	<u>60</u>
<u>Risk Factors</u>	1A	<u>60</u>
<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	2	<u>61</u>
<u>Exhibits</u>	6	<u>62</u>
<u>Signatures</u>		<u>63</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 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.

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 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.

MD&A Overview

Table of Contents

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.

MD&ANet Sales

Table of Contents

RESULTS OF OPERATION - NET SALES

(\$ in thousands USD)	1Q18	1Q17	Reported		% Impact	Constant Currency % Change
			% Change	Foreign Exchange		
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.

MD&ANet Sales

Table of Contents

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)	13,789
Asia Pacific	13,144	44	13,188
Consolidated	250,351	(13,271)	237,080

MD&ANet Sales

Table of Contents

The net sales amounts in the above table are converted at Q1 2017 foreign exchange rates so that the sequential change in net sales can be shown, excluding the impact of changes in foreign currency exchange rates.

Reduced sequential net sales for the company was largely expected as the company's net sales are historically stronger in the second half of the year, specifically with negative growth in the Europe and Asia Pacific segments, as shown in this analysis. However, results in the first quarter of 2018 reflected the

company's efforts to stabilize net sales sequentially in the NA/HME and IPG segments. Specifically, sequential growth in its NA/HME segment resulted from new product introduction and focus on clinically complex products, increased productivity from its salesforce and the ability to sell all products made in the Taylor Street facility without restrictions from the consent decree.

MD&ANet Sales

Table of Contents

The company realized a favorable impact from sales mix attributable to increased mobility and seating products, which comprise most of the company's clinically complex product portfolio. Sales mix increased to 37% from 35% for constant currency net sales by product for the first quarter of 2018 as compared to same period last year.

This favorable net sales mix shift is the result of 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.

MD&A Gross Profit

Table of Contents

GROSS PROFIT

Gross profit dollar increase was principally related to favorable foreign currency translation and transactions and reduced research and development expenses partially offset by increased freight expense. Gross profit as a percentage of net sales was flat compared to the same period last year. Gross profit percentage was favorably impacted by foreign currency translation and transactions and reduced research and development ("R&D") expenses offset by increased freight expense. Gross profit dollars and gross margin as a percentage of net sales increased for the Europe and Asia Pacific segments and declined in the NA/HME and IPG segments.

Gross profit and gross margin drivers by segment:

Europe - Gross margin as a percentage of net sales increased 0.4 of a percentage point, while gross profit dollars increased \$4,019,000, compared to the same period last year. The increase in gross profit dollars was driven by favorable foreign currency translation and transactions and favorable net sales mix partially offset by increased freight costs and net sales decline on a constant currency basis.

NA/HME - Gross margin as a percentage of net sales decreased 2.5 percentage points, while gross profit dollars decreased \$3,302,000, compared to the same period last year. The decrease in gross profit dollars was primarily due to unfavorable net sales mix, net sales volume declines and increased freight costs partially offset by lower R&D expenses.

IPG - Gross margin as a percentage of net sales decreased 0.7 of a percentage point, and gross profit dollars decreased \$712,000, compared to the same period last year. The decrease in gross profit dollars was driven by volume declines.

Asia/Pacific - Gross margin as a percentage of net sales increased 7.2 percentage points, while gross profit dollars increased \$1,468,000, compared to the same period last year. The increase in gross profit dollars was primarily due to favorable net sales mix and reduced research and development expenses.

Sequential quarterly gross profit as a percentage of net sales increased 0.8 of a percentage point. The increase in gross margin percentage was driven by favorable sales mix and favorable foreign currency partially offset by increased freight expense. Sequential gross profit as a percentage of net sales increased in the Asia Pacific and Europe segments with declines in the NA/HME and IPG segments.

Sequential quarterly gross profit dollars decreased \$1,826,000. The decline in gross profit dollars was primarily attributable to volume declines principally in the Europe segment. Sequential gross profit dollars decreased in the Europe and NA/HME segments partially offset by increases in Asia Pacific and IPG segments.

MD&ASG&A

Table of Contents

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

(\$ in thousands USD)	1Q18	1Q17	Reported Change	Foreign Exchange Impact	Constant Currency Change
SG&A Expenses - \$	71,264	72,513	(1,249)	3,554	(4,803)
SG&A Expenses - % change			(1.7)	4.9	(6.6)
% to net sales	30.1	31.3			

For the quarter, the decrease in SG&A expense excluding the impact of foreign exchange, which is referred to as "constant currency SG&A", was primarily driven by reduced employment costs.

SG&A expense drivers by segment:

Europe - SG&A expenses increased by 8.5%, or \$2,524,000, compared to the same period last year with foreign currency translation increasing SG&A expenses by approximately \$3,272,000, or 11.0%. Constant currency SG&A expenses decreased \$748,000, or 2.5%. The decrease was primarily attributable to favorable foreign currency transactions.

NA/HME - SG&A expenses decreased 14.3%, or \$4,590,000, compared to the same period last year with foreign currency translation having an immaterial impact. Constant currency SG&A expenses decreased \$4,751,000, or 14.8% driven primarily by decreased employment costs and unfavorable foreign currency transactions.

Edgar Filing: INVACARE CORP - Form 10-Q

IPG - SG&A expenses decreased 14.7%, or \$412,000, compared to the same period last year with foreign currency translation having an immaterial impact. Constant currency SG&A expenses decreased \$416,000 or 14.8%. The decline in expense was primarily related to employment costs.

Asia/Pacific - SG&A expenses increased 1.8%, or \$66,000, compared to the same period last year with foreign currency translation increasing SG&A expenses \$117,000, or 3.2%. Constant currency SG&A expenses decreased \$51,000, or 1.4%. The decline in expense was primarily related to employment costs partially offset by unfavorable foreign currency transactions.

Other - SG&A expenses increased 26.5%, or \$1,163,000, compared to the same period last year primarily driven by increased employment costs, including equity compensation expense.

MD&A Operating Income (Loss)

Table of Contents

OPERATING INCOME (LOSS)

(\$ in thousands USD)	1Q18	1Q17	\$	%
			Change	Change
Europe	6,594	5,100	1,494	29.3
NA/HME	(8,138)	(9,426)	1,288	13.7
IPG	1,598	1,898	(300)	(15.8)
Asia/Pacific	972	(430)	1,402	326.0
All Other	(5,773)	(4,510)	(1,263)	(28.0)
Charges related to restructuring	(401)	(3,283)	2,882	87.8
Consolidated Operating Loss	(5,148)	(10,651)	5,503	51.7

For the quarter, the decrease in consolidated operating loss was impacted by reduced restructuring charges and improved segment operating income (loss) in Europe, Asia Pacific and NA/HME segments. The decline in segment operating loss was impacted by favorable gross profit dollars and reduced SG&A expense.

Operating income (loss) by segment:

Europe - Operating income increased compared to the same period last year principally due to favorable foreign currency translation and transactions, favorable net sales mix partially offset by increased freight costs and net sales decline.

NA/HME - Operating loss decreased compared to the same period last year primarily related to reduced SG&A and research and development expense partially offset by net sales declines, unfavorable net sales mix and increased freight costs.

IPG - Operating income declined principally due to a net sales decline partially offset by reduced SG&A expense.

Asia/Pacific - Operating income increased as a result of favorable net sales mix and reduced R&D and manufacturing costs.

All Other - Operating loss increase was primarily impacted by increased SG&A expense, primarily related to increased equity compensation expense. The quarter was also negatively impacted by unfavorable intercompany profit in inventory eliminations as a result of higher inventory levels.

Charge Related to Restructuring Activities

Restructuring charges totaled \$401,000 in the first quarter 2018 related to severance costs in the Europe (\$293,000), NA/HME (\$97,000) and Asia/Pacific (\$11,000) segments.

In the first quarter of 2017, the company incurred restructuring charges of \$3,283,000 related principally to severance and contract termination costs incurred in the NA/HME segment (\$2,242,000) and severance in the Europe (\$690,000) and Asia/Pacific (\$351,000) segments. Most of the outstanding restructuring accruals at March 31, 2018 are expected to be paid out in the next twelve months.

MD&A Other Items

Table of Contents

OTHER ITEMS

Net Gain (Loss) on Convertible Debt Derivatives

(\$ in thousands USD)	Change in Fair	
	Value - Gain (Loss)	
	1Q18	1Q17
Convertible Note Hedge Assets	4,286	(5,830)
Convertible Debt Conversion Liabilities	(4,183)	6,731
Net gain on convertible debt derivatives	103	901

The company recognized net gain of \$103,000 for the three months ended March 31, 2018, compared to a net gain of \$901,000 for the three months ended March 31, 2017, 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)	1Q18	1Q17	\$ Change	% Change
Interest Expense	6,962	4,518	2,444	54.1
Interest Income	(249)	(88)	(161)	183.0

The increase in interest expense for the quarter compared to the same period last year was primarily due to the issuance of convertible notes in the second quarter of 2017.

Income Taxes

The company had an effective tax rate of 20.0% and 18.3% on losses before tax from continuing operations for the three months ended March 31, 2018 and March 31, 2017, respectively, compared to an expected benefit at the U.S. statutory rate of 21% on the continuing operations pre-tax losses for period ended March 31, 2018 and 35% for the period ended March 31, 2017. The company's effective tax rate for the three months ended March 31, 2018 and March 31, 2017 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 the three months ended March 31, 2018 and decreased for the three months ended March 31, 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 months ended March 31, 2018 and lower than the U.S. statutory rate for the three months ended March 31, 2017. See "Income Taxes" in the notes to the Consolidated Financial Statements included elsewhere in this report for more detail.

MD&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)	March 31, December 31, \$		%	
	2018	2017	Change	Change
Cash and cash equivalents	150,618	176,528	(25,910)	(14.7)
Working capital ⁽¹⁾	232,933	238,850	(5,917)	(2.5)
Total debt ⁽²⁾	300,803	301,415	(612)	(0.2)
Long-term debt ⁽²⁾	299,028	299,375	(347)	(0.1)
Total shareholders' equity	422,672	423,294	(622)	(0.1)
Credit agreement borrowing availability ⁽³⁾	35,409	39,949	(4,540)	(11.4)

⁽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 \$150,618,000 and \$176,528,000 at March 31, 2018 and December 31, 2017, respectively. The decrease in cash was the result of normal operations, which includes losses in certain areas and seasonal variations in operations. 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 March 31, 2018, was \$1,702,000.

The company's total debt outstanding, inclusive of the debt discount related to debentures included in equity in accordance with FSB APB 14-1 as well as the debt discount and fees associated with the company's Convertible Senior Notes due 2021 and 2022, decreased by \$612,000 to \$300,803,000 at March 31, 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 decline 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 quarter ended March 31, 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 \$20,000,000 and \$25,000,000, compared to actual capital expenditures of \$14,569,000 in 2017. The anticipated increase relates primarily to the company's 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 March 31, 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 February 22, 2018, the company's Board of Directors declared a quarterly cash dividend of \$0.0125 per Common Share and \$0.011364 per Class B Common Share to shareholders of record as of April 4, 2018, which was paid on April 18, 2018. At the current rate, the cash dividend will amount to \$0.05 per Common Share and \$0.045 per Class B Common Share on an annual basis, subject to Board of Directors approval of future dividend payments.

MD&A Cash Flows

Table of Contents

CASH FLOWS

The cash used by operating activities for the three months ended March 31, 2018 was driven by a net loss, decreased accrued expenses and increased inventory partially offset by increased accounts payable. The three months ended March 31, 2017 was negatively impacted by a net loss and increases in inventory and accounts receivable and reductions in accrued expenses. The decrease in cash used by operating activities in the first three months of 2018 compared to the same period last year was principally driven by a reduced net loss, decreased accounts receivable and reduced accrued expenses.

The decrease in cash flows used by investing activities for the first three months of 2018 as compared to the same period last year was primarily related to reduced purchase of property and equipment.

Cash flows used by financing activities in the first three months of 2018 are primarily attributable to payments on capital leases. Cash flows used by financing activities in the first three months of 2017 reflect the repayment of \$13,350,000 in aggregate principal amount of the company's convertible debentures due 2027.

MD&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)	Three Months	
	Ended	
	2018	2017
Net cash used by operating activities	(24,651)	(30,330)
Plus: Sales of property and equipment	10	10
Less: Purchases of property and equipment	(2,065)	(3,034)
Free Cash Flow	(26,706)	(33,354)

Free cash flow for the first three 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.).

With the anticipation of 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 the extended quote to cash process for power wheelchairs. 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. The company also expects to increase its capital expenditures in 2018 as compared to the investment level in 2017. As a result, historically, the company realizes stronger cash flow in the second half of the year versus the first half of the year and the company anticipates its cash flow usage and seasonality for 2018 will be similar to 2017.

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

The increase in the most current days in receivables compared to prior periods was driven by higher receivables in the quarter ended March 31, 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 March 31, 2018 were favorable to the quarter ended March 31, 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 and 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.

MD&A Accounting Estimates and Pronouncements

Table of Contents

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 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). 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.

Warranty

Generally, the company's products are covered by assurance-type 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. 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.

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.

MD&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 bid on or win certain contracts, 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; regulatory proceedings or the company’s failure to comply with regulatory requirements or receive regulatory clearance or approval for the company’s products or operations in the United States or abroad; adverse effects of regulatory or governmental inspections of company facilities at any time and governmental warning letters or enforcement actions; 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; 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 Medicare National Competitive U.S. 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; risk 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 possible 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		
	March 31,		
	2018	2017	
Net sales	\$237,060	\$231,723	
Cost of products sold	170,543	166,578	
Gross Profit	66,517	65,145	
Selling, general and administrative expenses	71,264	72,513	
Charges related to restructuring activities	401	3,283	
Operating Loss	(5,148)	(10,651)	
Net gain on convertible debt derivatives	(103)	(901)	
Interest expense	6,962	4,518	
Interest income	(249)	(88)	
Loss Before Income Taxes	(11,758)	(14,180)	
Income tax provision	2,350	2,600	
Net Loss	\$(14,108)	\$(16,780)	
Dividends Declared per Common Share	\$0.0125	\$0.0125	
Net Loss per Share—Basic	\$(0.43)	\$(0.52)	
Weighted Average Shares Outstanding—Basic	32,911	32,475	
Net Loss per Share—Assuming Dilution	\$(0.43)	\$(0.52)	
Weighted Average Shares Outstanding—Assuming Dilution	33,799	32,704	
Net Loss	\$(14,108)	\$(16,780)	
Other comprehensive income (loss):			
Foreign currency translation adjustments	11,816	949	
Defined Benefit Plans:			
Amortization of prior service costs and unrecognized gains	(47)	(295)	
Deferred tax adjustment resulting from defined benefit plan activity	(82)	(3)	
Valuation reserve associated with defined benefit plan activity	82	3	
Current period unrealized loss on cash flow hedges	(247)	631	
Deferred tax loss related to unrealized loss on cash flow hedges	110	(166)	
Other Comprehensive Income	11,632	1,119	
Comprehensive Loss	\$(2,476)	\$(15,661)	
(Elements as a % of Net Sales)			
Net Sales	100.0	% 100.0	%
Cost of products sold	71.9	71.9	
Gross Profit	28.1	28.1	
Selling, general and administrative expenses	30.1	31.3	
Charges related to restructuring activities	0.2	1.4	
Operating Loss	(2.2)	(4.6))
Net gain on convertible debt derivatives	—	(0.4))
Interest expense	2.9	1.9	
Interest income	(0.1)	—	
Loss Before Income Taxes	(5.0)	(6.1))

Edgar Filing: INVACARE CORP - Form 10-Q

Income tax provision	1.0	1.1
Net Loss	(6.0)%	(7.2)%

See notes to condensed consolidated financial statements.

18

Financial Statements

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

	March 31, 2018	December 31, 2017
	(In thousands)	
Assets		
Current Assets		
Cash and cash equivalents	\$150,618	\$176,528
Trade receivables, net	127,370	125,615
Installment receivables, net	1,281	1,334
Inventories, net	132,038	121,933
Other current assets	33,966	31,504
Total Current Assets	445,273	456,914
Other Assets	101,964	97,576
Intangibles	30,387	30,244
Property and Equipment, net	79,367	80,016
Goodwill	410,291	401,283
Total Assets	\$1,067,282	\$1,066,033
Liabilities and Shareholders' Equity		
Current Liabilities		
Accounts payable	\$94,284	\$90,566
Accrued expenses	111,650	118,697
Current taxes payable	4,631	6,761
Short-term debt and current maturities of long-term obligations	1,775	2,040
Total Current Liabilities	212,340	218,064
Long-Term Debt	244,366	241,405
Other Long-Term Obligations	187,904	183,270
Shareholders' Equity		
Preferred Shares (Authorized 300 shares; none outstanding)	—	—
Common Shares (Authorized 100,000 shares; 36,872 and 36,532 issued and outstanding in 2018 and 2017, respectively)—no par	9,395	9,304
Class B Common Shares (Authorized 12,000 shares; 6 shares issued and outstanding in both 2018 and 2017, respectively)—no par	2	2
Additional paid-in-capital	293,211	290,125
Retained earnings	173,488	187,999
Accumulated other comprehensive income	48,502	36,870
Treasury shares (3,751 and 3,701 shares in 2018 and 2017, respectively)	(101,926)	(101,006)
Total Shareholders' Equity	422,672	423,294
Total Liabilities and Shareholders' Equity	\$1,067,282	\$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 Three Months Ended March 31,	
	2018	2017
	(In thousands)	
Operating Activities		
Net loss	\$(14,108)	\$(16,780)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	4,111	3,593
Provision for losses on trade and installment receivables	201	176
Benefit for deferred income taxes	(3	) (728)
Provision for other deferred liabilities	(66	) 283
Provision for equity compensation	1,766	838
Loss on disposals of property and equipment	35	9
Amortization of convertible debt discount	2,786	1,749
Amortization of debt fees	620	521
Gain on convertible debt derivatives	(103	) (901)
Changes in operating assets and liabilities:		
Trade receivables	(930	) (6,386)
Installment sales contracts, net	141	(161)
Inventories	(8,713	) (8,603)
Other current assets	(1,653	) (1,714)
Accounts payable	2,759	4,028
Accrued expenses	(11,509	) (4,322)
Other long-term liabilities	15	(1,932)
Net Cash Used by Operating Activities	(24,651)	(30,330)
Investing Activities		
Purchases of property and equipment	(2,065	) (3,034)
Proceeds from sale of property and equipment	10	10
Change in other long-term assets	(227	) 19
Other	(1	) (3)
Net Cash Used by Investing Activities	(2,283	) (3,008)
Financing Activities		
Payments on revolving lines of credit and long-term borrowings	(393	) (14,027)
Proceeds from exercise of stock options	1,410	—
Payment of dividends	(403	) (397)
Purchase of treasury stock	(920) —
Net Cash Used by Financing Activities	(306	) (14,424)
Effect of exchange rate changes on cash	1,330	364
Increase in cash and cash equivalents	(25,910)	(47,398)
Cash and cash equivalents at beginning of year	176,528	124,234
Cash and cash equivalents at end of period	\$150,618	\$76,836

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 March 31, 2018 and the results of its operations and changes in its cash flow for the three months ended March 31, 2018 and 2017, respectively. Certain foreign subsidiaries, represented by the European segment, are consolidated using a February 28 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 months ended March 31, 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.

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 is currently reviewing the impact of the adoption of ASU 2016-02 on the company's financial statements.

Notes to Financial Statements Accounting Policies

Table of Contents

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 March 31, 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 March 31, 2018.

Notes to Financial Statements Current Assets

Table of Contents

Current Assets

Receivables

Receivables as of March 31, 2018 and December 31, 2017 consist of the following (in thousands):

	2018	2017
Accounts receivable, gross	\$142,763	\$154,966
Customer rebate reserve	(5,195)	(18,747)
Allowance for doubtful accounts	(5,219)	(5,113)
Cash discount reserves	(3,773)	(4,252)
Other, principally returns and allowances reserves	(1,206)	(1,239)
Accounts receivable, net	\$127,370	\$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 from December 31, 2017 to March 31, 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.

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

Notes to Financial Statements Current Assets

Table of Contents

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):

	March 31, 2018			December 31, 2017		
	Current	Long-Term	Total	Current	Long-Term	Total
Installment receivables	\$2,344	\$1,956	\$4,300	\$2,415	\$2,076	\$4,491
Less: Unearned interest	(33)	—	(33)	(38)	—	(38)
	2,311	1,956	4,267	2,377	2,076	4,453
Allowance for doubtful accounts	(1,030)	(1,539)	(2,569)	(1,043)	(1,601)	(2,644)
Installment receivables, net	\$1,281	\$417	\$1,698	\$1,334	\$475	\$1,809

Installment receivables purchased from DLL during the three months ended March 31, 2018 increased the gross installment receivables balance by \$1,073,000. 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):

	Three Months Ended	
	March 31, 2018	December 31, 2017
Balance as of beginning of period	\$2,644	\$ 2,838
Current period provision (benefit)	(53)	1,001
Direct write-offs charged against the allowance	(22)	(1,195)
Balance as of end of period	\$2,569	\$ 2,644

Installment receivables by class as of March 31, 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	\$ 3,411	\$ 3,411	\$ 2,569	\$ —

Edgar Filing: INVACARE CORP - Form 10-Q

Canada				
Non-Impaired installment receivables with no related allowance recorded	889	856	—	25
Impaired installment receivables with a related allowance recorded	—	—	—	—
Total Canadian installment receivables	889	856	—	25
Total				
Non-Impaired installment receivables with no related allowance recorded	889	856	—	25
Impaired installment receivables with a related allowance recorded	3,411	3,411	2,569	—
Total installment receivables	\$ 4,300	\$ 4,267	\$ 2,569	\$ 25

25

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 March 31, 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):

	March 31, 2018			December 31, 2017		
	Total	U.S.	Canada	Total	U.S.	Canada
Current	\$886	\$—	\$ 886	\$916	\$—	\$ 916
0-30 Days Past Due	3	—	3	6	—	6
31-60 Days Past Due	—	—	—	—	—	—
61-90 Days Past Due	—	—	—	—	—	—
90+ Days Past Due	3,411	3,411	—	3,569	3,566	3
	\$4,300	\$3,411	\$ 889	\$4,491	\$3,566	\$ 925

Notes to Financial Statements Current Assets

Table of Contents

Inventories

Inventories consist of the following (in thousands):

	March	December
	31, 2018	31, 2017
Finished goods	\$58,708	\$52,773
Raw materials	64,354	59,497
Work in process	8,976	9,663
Inventories, net	\$132,038	\$121,933

Other Current Assets

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

	March 31,	December 31,
	2018	2017
Value added tax receivables	\$ 17,237	\$ 16,174
Service contracts	2,848	2,812
Prepaid insurance	2,143	2,647
Derivatives (foreign currency forward exchange contracts)	1,323	730
Prepaid inventory	653	711
Prepaid debt fees	397	397
Recoverable income taxes	382	341
Prepaid and other current assets	8,983	7,692
Other Current Assets	\$ 33,966	\$ 31,504

Notes to Financial Statements Long-Term Assets

Table of Contents

Long-Term Assets

28

Table of Contents

INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - March 31, 2017

Other Long-Term Assets

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

	March 31, December 31,	
	2018	2017
Convertible 2022 note hedge asset	\$48,919	\$ 46,680
Convertible 2021 note hedge asset	48,962	46,915
Cash surrender value of life insurance policies	1,929	1,991
Deferred financing fees	692	787
Long-term installment receivables	417	475
Long-term deferred taxes	547	518
Investments	103	103
Other	395	107
Other Long-Term Assets	\$ 101,964	\$ 97,576

Property and Equipment

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

	March 31, December 31,	
	2018	2017
Machinery and equipment	\$307,531	\$ 307,244
Land, buildings and improvements	79,675	78,522
Leasehold improvements	9,158	9,947
Furniture and fixtures	10,165	10,264
Property and Equipment, gross	406,529	405,977
Less allowance for depreciation	(327,162)	(325,961)
Property and Equipment, net	\$79,367	\$ 80,016

Goodwill

The change in goodwill from December 31, 2017 to March 31, 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):

	March 31, 2018		December 31, 2017	
	Historical Cost	Accumulated Amortization	Historical Cost	Accumulated Amortization
Customer lists	\$55,504	\$ 53,250	\$54,516	\$ 51,957
Trademarks	26,837	—	26,372	—
Developed technology	8,069	6,796	7,925	6,636
Patents	5,549	5,542	5,566	5,559
License agreements	1,173	1,173	1,187	1,187
Other	1,162	1,146	1,162	1,145
Intangibles	\$98,294	\$ 67,907	\$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 March 31, 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 \$418,000 in the first three months of 2018 and is estimated to be \$1,677,000 in 2018, \$1,348,000 in 2019, \$198,000 in 2020, \$198,000 in 2021, \$198,000 in 2022 and \$198,000 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 4 years.

Notes to Financial Statements Current Liabilities

Table of Contents

Current Liabilities

Accrued Expenses

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

	March 31, December 31,	
	2018	2017
Salaries and wages	\$ 33,134	\$ 33,390
Warranty cost	22,159	22,468
Taxes other than income taxes, primarily Value Added Taxes	18,458	22,627
Professional	5,029	5,203
Deferred revenue	4,591	2,770
Freight	4,225	4,002
Rebates	3,650	5,831
Interest	3,406	3,919
Product liability, current portion	2,857	2,905
Derivative liabilities (foreign currency forward exchange contracts)	2,652	2,120
Severance	1,799	3,704
Rent	772	808
Insurance	698	645
Supplemental Executive Retirement Program liability	391	391
Other items, principally trade accruals	7,829	7,914
Accrued Expenses	\$ 111,650	\$ 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.

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	2,823
Settlements made during the period	(3,335)
Changes in liability for pre-existing warranties during the period, including expirations	203
Balance as of March 31, 2018	\$22,159

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):

	March 31, 2018	December 31, 2017
Convertible senior notes at 5.00%, due in February 2021	\$ 124,256	\$ 122,355
Convertible senior notes at 4.50%, due in June 2022	91,082	89,675
Other notes and lease obligations	30,803	31,415
	246,141	243,445
Less current maturities of long-term debt	(1,775)	(2,040)
Long-Term Debt	\$244,366	\$ 241,405

Notes to Financial Statements Long-Term Liabilities

Table of Contents

The company had outstanding letters of credit of \$3,169,000 and \$2,945,000 as of March 31, 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 March 31, 2018 and December 31, 2017. The weighted average interest rate on all borrowings, excluding capital leases, was 4.78% for the quarter ended March 31, 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 March 31, 2018, debt fees yet to be amortized through January 2021 totaled \$1,089,000.

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) \$1,170,000 as of March 31, 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 March 31, 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 \$24,012,000, 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 March 31, 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 March 31, 2018, the aggregate borrowing availability to the European Borrowers under the European Credit Facility was approximately \$11,397,000, 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 March 31, 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 March 31, 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.

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 March 31, 2018 was \$55,527,000 compared to \$53,154,000 as of December 31, 2017. The company recognized a loss of \$2,373,000 for the three months ended March 31, 2018 compared to a gain of \$6,731,000 for the three months ended March 31, 2017 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 March 31, 2018 was \$48,962,000 compared to \$46,915,000 as of December 31, 2017. The company recognized a gain of \$2,047,000 for the three months ended March 31, 2018 compared to a loss of \$5,830,000 for the three months ended March 31, 2017 related to the convertible note hedge asset.

Notes to Financial Statements Long-Term Liabilities

Table of Contents

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):

	March 31, 2018	December 31, 2017
Principal amount of liability component	\$ 150,000	\$ 150,000
Unamortized discount	(22,298)	(23,900)
Debt fees	(3,446)	(3,745)
Net carrying amount of liability component	\$ 124,256	\$ 122,355

The unamortized discount of \$22,298,000 is to be amortized through February 2021. The effective interest rate on the liability component was 11.1%. Non-cash interest expense of \$1,602,000 was recognized for the three months ended March 31, 2018 compared to \$1,438,000 for the three months ended March 31, 2017 in comparison to actual interest expense accrued of \$1,875,000 for the three months ended March 31, 2018

compared to \$1,875,000 for the three months ended March 31, 2017 based on the stated coupon rate of 5.0%. The 2021 notes were not convertible as of March 31, 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 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.

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 March 31, 2018 was \$55,224,000 and \$53,414,000 December 31, 2017. The company recognized a loss of \$1,810,000 for the three months ended March 31, 2018 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

Notes to Financial Statements Long-Term Liabilities

Table of Contents

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 March 31, 2018 was \$48,919,000 compared to \$46,680,000 at December 31, 2017. The company recognized a gain of \$2,239,000 for the three months ended March 31, 2018 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 March 31, 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.

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

	March 31, 2018	December 31, 2017
Principal amount of liability component	\$ 120,000	\$ 120,000
Unamortized discount	(25,194)	(26,378)
Debt fees	(3,724)	(3,947)
Net carrying amount of liability component	\$ 91,082	\$ 89,675

The unamortized discount of \$25,194,000 is to be amortized through June 2022. The effective interest rate on the liability component was 10.9%. Non-cash interest expense of \$1,184,000 was recognized for the three months ended March 31, 2018 in comparison to actual interest expense accrued of \$1,350,000 for the same period based on the

stated coupon rate of 4.5%. The 2022 notes were not convertible as of March 31, 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):

	March 31, December 31,	
	2018	2017
Convertible 2022 debt conversion liability	\$ 55,224	\$ 53,414
Convertible 2021 debt conversion liability	55,527	53,154
Deferred income taxes	29,419	28,890
Product liability	13,421	13,575
Pension	10,784	10,340
Deferred gain on sale leaseback	6,346	6,419
Deferred compensation	5,693	5,592
Supplemental Executive Retirement Plan liability	5,596	5,636
Uncertain tax obligation including interest	2,738	2,738
Other	3,156	3,512
Other Long-Term Obligations	\$ 187,904	\$ 183,270

The convertible debt conversion liabilities amounts included in the above table represent the fair values of the conversion liabilities as of March 31, 2018 and December 31, 2017. 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 \$70,000 and 68,000 for the three months ended March 31, 2018, and 2017, respectively.

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 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 table disaggregates the company's revenues by major source and by reportable segment for the three months ended March 31, 2018 and March 31, 2017 (in thousands):

	Three Months Ended March 31, 2018		
	Product	Service	Total
Europe	\$128,002	\$3,312	\$131,314
NA/HME	79,571	211	79,782
IPG	14,508	379	14,887
Asia/Pacific	9,945	1,132	11,077
Total	\$232,026	\$5,034	\$237,060
% Split	98%	2%	100%
	Three Months Ended March 31, 2017		
	Product	Service	Total
Europe	\$116,790	\$2,718	\$119,508
NA/HME	83,636	626	84,262
IPG	16,238	135	16,373
Asia/Pacific	10,492	1,088	11,580
Total	\$227,156	\$4,567	\$231,723
% 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 March 31, 2018 and December 31, 2017, the company had deferred revenue of \$4,591,000 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 Class Common Shares.

On May 31, 2017, the company received notice that holders of 703,912 Class B Common Shares had elected to convert all their Class B Common Shares into Common Shares. As of March 31, 2018, 6,357 Class B Common Shares remained outstanding. The conversion substantially diminished the significance of the company's dual class voting structure, as of March 31, 2018, the holders of the Common Shares represent approximately 99.9% of the company's total outstanding voting power.

Equity Compensation Plan

On May 16, 2013, the shareholders of the company approved the Invacare Corporation 2013 Equity Compensation Plan (the "2013 Plan"), which was adopted on March 27, 2013 by the company's Board of Directors (the "Board"). The Board adopted the 2013 Plan to replace the company's prior equity plan, the Invacare Corporation Amended and Restated 2003 Performance Plan (the "2003 Plan"), which expired on May 21, 2013. Due to its expiration, no new awards may be granted under the 2003 Plan; however, awards granted prior to its expiration will remain outstanding until they are exercised, vest, terminate or expire in accordance with their terms.

The 2013 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 2013 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 2013 Plan as two shares. Shares underlying awards made under the 2003 Plan that are canceled or forfeited may be added back to the 2013 Plan for use in future awards. Any Common Shares that are added back to the 2013 Plan as the result of the cancellation or forfeiture of an award granted under 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 2013 Plan. Each common share that is added back to the 2013 Plan due to a cancellation or forfeiture of an

award granted under the 2003 Plan will be added back as one Common Share.

At March 31, 2018, an aggregate of 1,223,176 Common Shares underlay awards outstanding under the 2003 Plan, which shares may become available under the 2013 Plan to the extent such awards are forfeited or expire unexercised. The Compensation and Management Development Committee of the Board (the "Compensation Committee"), in its discretion, may grant an award under the 2013 Plan to any director or employee of the company or an affiliate. As of March 31, 2018, 1,012,993 common shares were available for future issuance under the 2013 Plan in connection with the following types of awards with respect to shares of 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 2013 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 company has submitted a new plan referred to as the Invacare Corporation 2018 Equity Compensation Plan (the “2018 Plan”) to the company's shareholders for approval at the company's 2018 annual meeting scheduled for May 17, 2018. The 2018 Plan, if approved by shareholders, will allow the Committee to grant substantially the same types of awards as are issuable under the 2013 Plan. The company’s Board of Directors 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. The company may continue to grant awards under the 2013 Plan until approval of the 2018 Plan by shareholders, at which time the company will transfer any common shares remaining for issuance under the 2013 Plan into the 2018 Plan. Awards granted prior to the 2013 Plan’s expiration will remain in effect under their original terms. The maximum number of company common shares available for issuance under the 2018 Plan will not exceed the sum of the following: (1) 1,800,000 shares; plus (2) any shares remaining for issuance under the 2013 Plan at the time of approval of the 2018 Plan by shareholders; plus (3) any shares covered by an award under the 2018 Plan, the 2013 Plan or the

Notes to Financial Statements Equity Compensation

Table of Contents

2003 Plan that are forfeited or remain unpurchased or undistributed upon termination or expiration of the award. The amounts of equity-based compensation expense recognized as part of selling, general and administrative expenses were as follows (in thousands):

	For the Three Months Ended March 31,	
	2018	2017
Restricted stock / units	\$908	\$442
Performance shares / units	631	214
Non-qualified and performance stock options	227	182
Total stock-based compensation expense	\$1,766	\$838

As of March 31, 2018, unrecognized compensation expense related to equity-based compensation arrangements granted under the company's 2013 Plan and previous plans, which is related to non-vested options and shares, was as follows (in thousands):

	March 31, 2018
Restricted stock and restricted stock units	\$ 11,783
Performance shares and performance share units	10,272
Non-qualified and performance stock options	2,275
Total unrecognized stock-based compensation expense	\$ 24,330

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 benefit for share-based compensation was realized for the three months ended March 31, 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 three months ended March 31, 2018:

	March 31, 2018	Weighted Average Exercise Price
Options outstanding at January 1, 2018	2,631,569	\$ 19.44
Granted	—	—
Exercised	(101,099)	13.95
Canceled	(149,950)	23.49
Options outstanding at March 31, 2018	2,380,520	\$ 19.42

Edgar Filing: INVACARE CORP - Form 10-Q

Options exercise price range at March 31, 2018	\$ 12.15	to \$ 33.36
Options exercisable at March 31, 2018	1,780,744	
Shares available for grant at March 31, 2018*	1,012,993	

Shares available for grant as of March 31, 2018 reduced by net restricted stock and restricted stock unit award and *performance share and performance share unit award activity of 2,677,466 shares and 2,486,490 shares, respectively.

Notes to Financial Statements Equity Compensation

Table of Contents

The following table summarizes information about stock options outstanding at March 31, 2018:

Exercise Prices	Options Outstanding		Weighted Average Exercise Price	Options Exercisable	
	Number Outstanding at March 31, 2018	Weighted Average Remaining Contractual Life (Years)		Number Exercisable at March 31, 2018	Weighted Average Exercise Price
\$ 12.15 – \$20.00	970,685	7.7	\$ 12.98	370,909	\$ 14.33
\$ 20.01 – \$25.00	730,151	2.3	22.21	730,151	22.21
\$ 25.01 – \$30.00	675,188	1.4	25.56	675,188	25.56
\$ 30.01 – \$33.36	4,496	3.1	33.36	4,496	33.36
Total	2,380,520	4.0	\$ 19.42	1,780,744	\$ 21.86

Pursuant to the plans, the Compensation Committee has established that grants may not be exercised within one year from the date granted and 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 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 outstanding stock options were issued in 2014 and prior 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 based on the following assumptions:

	2017
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):

Edgar Filing: INVACARE CORP - Form 10-Q

	March 31, 2018	Weighted Average Fair Value
Stock / Units unvested at January 1, 2018	776,520	\$ 13.75
Granted	352,547	17.51
Vested	(2,839)	11.25
Canceled	(36,758)	13.31
Stock / Units unvested at March 31, 2018	1,089,470	\$ 14.99

The restricted stock awards generally vest ratably over the three years after the award date, except for those awards granted in 2014, which vest after a three-year period. 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):

	March 31, 2018	Weighted Average Fair Value
Shares / Units unvested at January 1, 2018	457,879	\$ 12.33
Granted	205,164	17.48
Vested	—	—
Canceled	—	—
Shares / Units unvested at March 31, 2018	663,043	\$ 13.93

Notes to Financial Statements Equity Compensation

Table of Contents

During the three months ended March 31, 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 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 months ended March 31, 2018 and March 31, 2017, respectively, were as follows (in thousands):

	Foreign Currency	Long-Term Notes	Defined Benefit Plans	Derivatives	Total
December 31, 2017	\$ 50,376	\$ (4,612)	\$ (7,652)	\$ (1,242)	\$ 36,870
OCI before reclassifications	8,709	3,107	82	(385)	11,513
Amount reclassified from accumulated OCI	—	—	(129)	248	119
Net current-period OCI	8,709	3,107	(47)	(137)	11,632
March 31, 2018	\$ 59,085	\$ (1,505)	\$ (7,699)	\$ (1,379)	\$ 48,502
December 31, 2016	\$ (26,199)	\$ 17,372	\$ (11,248)	\$ 740	\$ (19,335)
OCI before reclassifications	(2,153)	3,102	(505)	764	1,208
Amount reclassified from accumulated OCI	—	—	210	(299)	(89)
Net current-period OCI	(2,153)	3,102	(295)	465	1,119
March 31, 2017	\$ (28,352)	\$ 20,474	\$ (11,543)	\$ 1,205	\$ (18,216)

Reclassifications out of accumulated OCI for the three months ended March 31, 2018 and March 31, 2017 were as follows (in thousands):

	Amount reclassified from OCI For the Three Months Ended March 31, 2018	Amount reclassified from OCI For the Three Months Ended March 31, 2017	Affected line item in the Statement of Comprehensive (Income) Loss
Defined Benefit Plans			
Service and interest costs	\$ (129)	\$ 210	Selling, General and Administrative
Tax	—	—	Income Taxes
Total after tax	\$ (129)	\$ 210	
Derivatives			
Foreign currency forward contracts hedging sales	\$ 25	\$ 68	Net Sales
Foreign currency forward contracts hedging purchases	251	(391)	Cost of Products Sold
Total loss (income) before tax	276	(323)	
Tax	(28)	24	Income Taxes
Total after tax	\$ 248	\$ (299)	

Notes to Financial Statements Charges Related to Restructuring Activities

Table of Contents

Charges 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 incurred 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 three months ended March 31, 2018, charges totaled \$401,000 which were related to severance in NA/HME (\$97,000), Europe (\$293,000) and Asia/Pacific (\$11,000). Payments for the three months ended March 31, 2018 were \$2,460,000 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 three months ended March 31, 2017, charges totaled \$3,283,000 which were related to NA/HME (\$2,242,000),

Europe segment (\$690,000) and Asia/Pacific (\$351,000). In NA/HME, costs were incurred related to severance (\$2,095,000) and contract termination costs (\$147,000). The European and Asia/Pacific charges were for severance costs. Payments for the three months ended March 31, 2017 were \$2,251,000 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 period ended March 31, 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
Total	401	—	401
Payments			
NA/HME	(1,697)	(57)	(1,754)

Edgar Filing: INVACARE CORP - Form 10-Q

Europe	(338)	(97)	(435)
Asia/Pacific	(11)	—	(11)
Other	(260)	—	(260)
Total	(2,306)	(154)	(2,460)
March 31, 2018 Balances			
NA/HME	839	110	949
Europe	204	37	241
Other	756	—	756
Total	\$ 1,799	\$ 147	\$1,946

Notes to Financial Statements Income Taxes

Table of Contents

Income Taxes

The company had an effective tax rate of 20.0% and 18.3% on losses before tax from continuing operations for the three months ended March 31, 2018 and March 31, 2017, respectively, compared to an expected benefit at the U.S. statutory rate of 21% on the continuing operations pre-tax losses for the period ended March 31, 2018 and 35% for the period ended March 31, 2017. The company's effective tax rate for the three months ended March 31, 2018 and March 31, 2017 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 the three months ended March 31, 2018 and decreased for the three months ended March 31, 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 months ended March 31, 2018 and lower than the U.S. statutory rate for the three months ended March 31, 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 determined that the provisional calculations will be finalized after the underlying timing differences and foreign earnings and profits are finalized with our 2017 federal tax return filing. Furthermore, the company is still analyzing certain aspects of the the

Tax Act and refining its calculations 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 ended March 31, 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 March 31,	
	2018	2017
Basic		
Average common shares outstanding	32,911	32,475
Net loss	\$(14,108)	\$(16,780)
Net loss per common share	\$(0.43)	\$(0.52)
Diluted		
Average common shares outstanding	32,911	32,475
Stock options and awards	888	229
Average common shares assuming dilution	33,799	32,704
Net loss	\$(14,108)	\$(16,780)
Net loss per common share *	\$(0.43)	\$(0.52)

* 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 March 31, 2018, 329,315 shares associated with stock options were excluded from the average common shares assuming dilution for the three months ended March 31, 2018 as they were anti-dilutive. At March 31, 2018, 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 \$17.63 for the three months ended March 31, 2018.

At March 31, 2017, 2,194,307 shares associated with stock options were excluded from the average common shares assuming dilution for the three months ended March 31, 2017 as they were anti-dilutive. At March 31, 2017, 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 \$11.99 for the three months ended March 31, 2017.

For both the three months ended March 31, 2018 and March 31, 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 \$1,865,000 at March 31, 2018 to DLL for events of default under the contracts, which total \$18,208,000 at March 31, 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 \$44,619,000 and \$37,343,000 matured for the three months ended March 31, 2018 and March 31, 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):

	March 31, 2018		December 31, 2017	
	Notional Amount	Unrealized Net Gain (Loss)	Notional Amount	Unrealized Net Gain (Loss)
USD / AUD	\$3,870	\$ 102	\$3,960	\$ 44
USD / CAD	25,826	(36)	33,344	115
USD / CNY	3,000	189	4,027	61
USD / EUR	60,473	(1,703)	72,259	(558)
USD / GBP	3,609	(157)	4,640	(124)
USD / NZD	7,515	103	9,300	11
USD / SEK	1,753	93	—	—
USD / MXP	4,810	356	6,461	(158)
EUR / GBP	25,640	(419)	32,248	(682)
EUR / SEK	6,256	121	7,732	39
EUR / NOK	3,678	(55)	4,521	68
EUR / NZD	2,197	(5)	2,855	(8)
DKK / SEK	4,580	(148)	6,453	(120)
	\$153,207	\$ (1,559)	\$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):

	March 31, 2018		December 31, 2017	
	Notional Amount	Gain (Loss)	Notional Amount	Gain (Loss)
AUD / USD	\$2,818	\$21	\$2,750	\$(77)
NZD / USD	4,000	(13)	3,300	(53)
EUR / AUD	4,929	199	4,000	43
AUD / NZD	2,604	24	3,600	9
EUR / NOK	55	(1)	—	—
	\$14,406	\$230	\$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):

	March 31, 2018		December 31, 2017	
	Assets	Liabilities	Assets	Liabilities
Derivatives designated as hedging instruments under ASC 815				
Foreign currency forward exchange contracts	\$1,079	\$ 2,638	\$ 678	\$ 1,990
Derivatives not designated as hedging instruments under ASC 815				
Foreign currency forward exchange contracts	244	14	52	130
Total derivatives	\$1,323	\$ 2,652	\$ 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) Recognized in Income on Derivatives (Ineffective Portion and Amount Excluded from Effectiveness Testing)	
	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)	Amount of Gain (Loss) Recognized in Income on Derivatives
Derivatives in ASC 815 cash flow hedge relationships				
Three months ended March 31, 2018				
Foreign currency forward exchange contracts	\$ (385)	\$ (248)	\$ (1)	
Three months ended March 31, 2017				
Foreign currency forward exchange contracts	\$ 764	\$ 299	\$ —	

	Amount of Gain (Loss) Recognized in Income on Derivatives
Derivatives not designated as hedging instruments under ASC 815	
Three months ended March 31, 2018	
Foreign currency forward exchange contracts	\$ 230
Three months ended March 31, 2017	
Foreign currency forward exchange contracts	\$ 65

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 three months ended March 31, 2018, net sales were decreased by \$25,000 while cost of product sold was increased by \$251,000 for a net pre-tax realized loss of \$276,000. For the three and three months ended March 31, 2017, net sales were decreased by \$68,000 while cost of product sold was decreased by \$391,000 for a net realized pre-tax gain of \$323,000.

A gain of \$230,000 was recognized in selling, general and administrative (SG&A) expenses for the three months ended March 31, 2018, compared to a gain of \$65,000 for the three months ended March 31, 2017, related to forward contracts not designated as hedging instruments. The forward contracts were entered into to offset gains/losses that 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,

Notes to Financial Statements Derivatives

Table of Contents

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 March 31, 2018 and their effect on the Statement of Comprehensive Income (Loss) were as follows (in thousands):

	Fair Value	Gain (Loss) Three Months Ended	March 31, 2017
Convertible 2021 debt conversion long-term liability	\$(55,527)	\$(2,373)	\$6,731
Convertible 2022 debt conversion long-term liability	(55,224)	(1,810)	—
Convertible 2021 note hedge long-term asset	48,962	2,047	(5,830)
Convertible 2022 note hedge long-term asset	48,919	2,239	—
Net fair value and net gains on convertible debt derivatives	\$(12,870)	\$103	\$901

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.

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
March 31, 2018			
Forward exchange contracts—net	—	\$ (1,329)	—
Convertible 2021 debt conversion liability	—	(55,527)	—
Convertible 2021 note hedge asset	—	48,962	—
Convertible 2022 debt conversion liability	—	(55,224)	—
Convertible 2022 note hedge asset	—	48,919	—
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):

	March 31, 2018		December 31, 2017	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Cash and cash equivalents	\$150,618	\$150,618	\$176,528	\$176,528
Other investments	103	103	103	103
Installment receivables, net of reserves	1,698	1,698	1,809	1,809
Long-term debt (including current maturities of long-term debt) *	(246,141)	(302,867)	(243,445)	(294,173)
Convertible 2021 debt conversion liability in Other Long-Term Obligations	(55,527)	(55,527)	(53,154)	(53,154)
Convertible 2021 note hedge in Other Long-Term Assets	48,962	48,962	46,915	46,915
Convertible 2022 debt conversion liability in Other Long-Term Obligations	(55,224)	(55,224)	(53,414)	(53,414)
Convertible 2022 note hedge in Other Long-Term Assets	48,919	48,919	46,680	46,680

Edgar Filing: INVACARE CORP - Form 10-Q

Forward contracts in Other Current Assets	1,323	1,323	730	730
Forward contracts in Accrued Expenses	(2,652	) (2,652	) (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 liability and note hedge derivatives are based on valuation models in which all the significant inputs are observable in active markets.

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 lines, 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 lines 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	
	Ended March 31,	
	2018	2017
Revenues from external customers		
Europe	\$131,314	\$119,508
NA/HME	79,782	84,262
IPG	14,887	16,373
Asia/Pacific	11,077	11,580
Consolidated	\$237,060	\$231,723
Intersegment revenues		
Europe	\$3,857	\$3,675
NA/HME	23,503	22,095
IPG	89	768
Asia/Pacific	5,660	3,860
Consolidated	\$33,109	\$30,398
Restructuring charges before income taxes		
Europe	\$293	\$690
NA/HME	97	2,242
Asia/Pacific	11	351
Consolidated	\$401	\$3,283
Operating income (loss)		
Europe	\$6,594	\$5,100
NA/HME	(8,138)	(9,426)
IPG	1,598	1,898

Edgar Filing: INVACARE CORP - Form 10-Q

Asia/Pacific	972	(430)
All Other	(5,773)	(4,510)
Charge expense related to restructuring activities	(401)	(3,283)
Consolidated operating loss	(5,148)	(10,651)
Net gain on convertible debt derivatives	103	901
Net Interest expense	(6,713)	(4,430)
Loss before income taxes	\$(11,758)	\$(14,180)

56

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.

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 take place at the impacted Elyria facilities and (iii) replacement, service and repair of products 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 subject 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 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 to two semi-annual and then four annual audits 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 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 FDA has informed the company of further upcoming inspections to its facilities, and the company believes that additional inspections beyond those for which it has been notified will likely occur in the near future. 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 June 2017, FDA inspected the company's Corporate and Taylor Street facilities in connection with the consent decree, as described above, and issued an inspectional observation on Form 483. The company submitted its response to the agency in a timely manner. On July 24, 2017, the FDA notified the company

Notes to Financial Statements Contingencies

Table of Contents

that it was in substantial compliance with the QSR and that it was permitted to resume full operations at those facilities.

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 FDA Form 483 observations issued following an 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. The company expects the warning letter to be closed as a result of this inspection; however, the company cannot be assured of the timing or certainty of this outcome.

In October 2017, FDA inspected the Corporate and Taylor Street facilities to investigate an anonymous complaint concerning one of the Verification of Medical Necessity documents collected by the company while subject to the restrictions under the consent decree. There were no Form 483 observations issued by FDA at the conclusion of the inspection.

In November 2017, FDA inspected the company's facility in Pinellas Park, Florida and issued its observations on Form 483, one of which was annotated as corrected and verified at the conclusion of the inspection. The company has submitted its response to FDA in a timely manner.

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. The Sanford facility is 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.

In November 2017, the FDA inspected the company's facility in Porta Westfalica, Germany, and there were no inspectional observations issued at the end of the inspection.

In December 2017, California Department of Public Health, acting on behalf of FDA, inspected the company's facility in Simi Valley, California and there were no inspectional observations issued at the end of the inspection.

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 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 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 Market Risk and Controls

Table of Contents

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

During the quarter ended March 31, 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 March 31, 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 March 31, 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 reached agreement with FDA on the terms of a consent decree of injunction with respect to the company's Corporate facility and its Taylor Street manufacturing facility in Elyria, Ohio. A complaint and consent decree were filed in the U.S. District Court for the Northern District of Ohio, and on December 21, 2012, the Court approved the consent decree and it became effective. 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 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 to two semi-annual and then four annual audits performed by a company-retained expert firm. The expert audit firm will determine whether the facilities remain in continuous compliance with the FDA Act, 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.

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.

60

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 March 31, 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)
1/1/2018 - 1/31/2018	—	\$ —	—	2,453,978
2/1/2018 - 2/28/2018	50,411	18.25	—	2,453,978
3/1/2018 - 3/31/2018	—	—	—	2,453,978
Total	50,411	\$ 18.25	—	2,453,978

(1) All 50,411 shares repurchased between February 1, 2018 and February 28, 2018 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 March 31, 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: May 7, 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)

63

-left:1pt none #D9D9D9 ;border-bottom:1pt none #D9D9D9 ;border-right:1pt none #D9D9D9
;height:12.75pt;padding:0pt;">

-

-

12,379

Commercial real estate

312,172

8,257

5,941

-

326,370

Residential real estate

108,587

457

2,454

-

111,498

Consumer and other

1,527

138

-

-

1,665

\$

455,111

\$

8,861

\$

8,489

\$

-

\$

472,461

The following table reflects information about our impaired loans by class as of March 31, 2015 and December 31, 2014:

(Dollars in thousands)	March 31, 2015			December 31, 2014		
	Recorded Investment	Unpaid Principal Balance	Related Allowance	Recorded Investment	Unpaid Principal Balance	Related Allowance
With no related allowance recorded:						
Commercial and industrial	\$ 20	\$ 20	\$ -	\$ -	\$ -	\$ -
Commercial real estate	2,351	2,351	-	3,167	3,736	-
Residential real estate	1,433	1,432	-	1,829	1,835	-
With an allowance recorded:						
Commercial and industrial	1	1	1	94	94	51
Commercial real estate	3,593	4,162	334	1,938	1,938	136
Residential real estate	541	552	108	485	489	101
Consumer and other	138	138	73	-	-	-
Total:						
Commercial and industrial	21	21	1	94	94	51
Commercial real estate	5,944	6,513	334	5,105	5,674	136
Residential real estate	1,974	1,984	108	2,314	2,324	101
Consumer and other	138	138	73	-	-	-
	\$ 8,077	\$ 8,656	\$ 516	\$ 7,513	\$ 8,092	\$ 288

The following table presents the average recorded investment and income recognized for the three months ended March 31, 2015 and 2014:

	For the Three Months Ended March 31, 2015		For the Three Months Ended March 31, 2014	
	Average Recorded Investment	Interest Recognized	Average Recorded Investment	Interest Recognized
(Dollars in thousands)				
With no related allowance recorded:				
Commercial and industrial	\$ 10	\$ -	\$ -	\$ -
Commercial real estate	2,759	5	4,968	8
Residential real estate	1,631	1	1,845	20
Total impaired loans without a related allowance	4,400	6	6,813	28
With an allowance recorded:				
Commercial and industrial	47	-	-	-
Commercial real estate	2,766	8	5,319	1
Residential real estate	513	3	849	4
Consumer and other	69	-	1	-
Total impaired loans with an allowance	3,395	11	6,169	5
Total impaired loans	\$ 7,795	\$ 17	\$ 12,982	\$ 33

We recognize interest income on performing impaired loans as payments are received. On non-performing impaired loans we do not recognize interest income as all payments are recorded as a reduction of principal on such loans.

Impaired loans include loans modified in troubled debt restructurings where concessions have been granted to borrowers experiencing financial difficulties. These concessions could include a reduction in the interest rate on the loan, payment extensions, postponement or forgiveness of principal, forbearance or other actions intended to maximize collection. The concessions rarely result in the forgiveness of principal or accrued interest. In addition, we attempt to obtain additional collateral or guarantor support when modifying such loans. Non-accruing restructured loans may be returned to accrual status when there has been a sustained period of repayment performance (generally six consecutive months of payments) and both principal and interest are deemed collectible.

The following table presents the recorded investment in troubled debt restructured loans, based on payment performance status:

Edgar Filing: INVACARE CORP - Form 10-Q

(Dollars in thousands)	Commercial Real Estate	Residential Real Estate	Total
March 31, 2015			
Performing	\$ 1,162	\$ 418	\$ 1,580
Non-performing	2,725	223	2,948
Total	\$ 3,887	\$ 641	\$ 4,528
December 31, 2014			
Performing	\$ 1,169	\$ 421	\$ 1,590
Non-performing	2,730	224	2,954
Total	\$ 3,899	\$ 645	\$ 4,544

Troubled debt restructured loans are considered impaired and are included in the previous impaired loans disclosures in this footnote. As of March 31, 2015, we have not committed to lend additional amounts to customers with outstanding loans that are classified as troubled debt restructurings.

There were no troubled debt restructurings that occurred during the three months ended March 31, 2015 and 2014.

There were no troubled debt restructurings for which there was a payment default within twelve months following the date of the restructuring for the three months ended March 31, 2015 and 2014.

We may obtain physical possession of residential real estate collateralizing a consumer mortgage loan via foreclosure on an in-substance repossession. As of March 31, 2015, we held foreclosed residential real estate properties with a carrying value of \$281 thousand as a result of obtaining physical possession. In addition, as of March 31, 2015, we had consumer loans with a carrying value of \$1.3 million collateralized by residential real estate property for which formal foreclosure proceedings were in process.

NOTE 5 – EARNINGS PER SHARE

Basic earnings per share are calculated by dividing net income by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares (unvested restricted stock grants and stock options) had been issued, as well as any adjustment to income that would result from the assumed issuance of potential common shares that may be issued by us. Potential common shares related to stock options are determined using the treasury stock method.

(In thousands, except share and per share data)	Three Months Ended March 31, 2015		Three Months Ended March 31, 2014	
	Income (Numerator)	Shares (Denominator)	Income (Numerator)	Shares (Denominator)
Basic earnings per share:		Per Share Amount		Per Share Amount
Net earnings applicable to common stockholders	\$ 952	4,571,142	\$ 678	4,526,506
Effect of dilutive securities:				
Unvested stock awards	-	31,768	-	38,094
Diluted earnings per share:				
Net income applicable to common stockholders and assumed conversions	\$ 952	4,602,910	\$ 678	4,564,600

There were 21,224 and 7,734 shares of unvested restricted stock awards and options outstanding during the quarter ended March 31, 2015 and 2014, respectively, which were not included in the computation of diluted earnings per share because to do so would have been anti-dilutive.

NOTE 6 – OTHER COMPREHENSIVE INCOME

Accounting principles generally require that recognized revenue, expenses, gains and losses be included in net income. Although certain changes in assets and liabilities, such as unrealized gains and losses on available for sale securities, are reported as a separate component of the equity section of the balance sheet, such items, along with net income, are components of comprehensive income.

15

Edgar Filing: INVACARE CORP - Form 10-Q

The components of other comprehensive income, both before tax and net of tax, are as follows:

	Three Months Ended March 31, 2015			Three Months Ended March 31, 2014		
	Before Tax	Tax Effect	Net of Tax	Before Tax	Tax Effect	Net of Tax
(Dollars in thousands)						
Other comprehensive income:						
Unrealized gains on available for sale securities	\$ 316	\$ 127	\$ 189	\$ 1,717	\$ 687	\$ 1,030
Reclassification adjustment for net gains on securities transactions included in net income	(168)	(67)	(101)	-	-	-
Total other comprehensive income	\$ 148	\$ 60	\$ 88	\$ 1,717	\$ 687	\$ 1,030

Reclassification adjustments for gains on securities transactions of \$168 thousand for the three months ended March 31, 2015 are presented in the income statement on the line item for net gain on securities transactions. There were no reclassification adjustments for gains on securities transactions for the three months ended March 31, 2014.

NOTE 7 – SEGMENT INFORMATION

Our insurance agency operations are managed separately from the traditional banking and related financial services that we also offer. The insurance agency operation provides commercial, individual, and group benefit plans and personal coverage.

	Three Months Ended March 31, 2015			Three Months Ended March 31, 2014		
	Banking and Financial Services	Insurance Services	Total	Banking and Financial Services	Insurance Services	Total
(Dollars in thousands)						
Net interest income from external sources	\$ 4,802	\$ -	\$ 4,802	\$ 4,305	\$ 1	\$ 4,306
Other income from external sources	743	1,158	1,901	606	985	1,591
Depreciation and amortization	239	4	243	158	5	163
Income before income taxes	928	400	1,328	622	354	976

Edgar Filing: INVACARE CORP - Form 10-Q

Income tax expense (1)	216	160	376	156	142	298
Total assets	598,265	5,986	604,251	543,151	3,821	546,972

(1) Insurance Services calculated at statutory tax rate of 40%

NOTE 8 – STOCK-BASED COMPENSATION

We currently have stock-based compensation plans in place for our directors, officers, employees, consultants and advisors. Under the terms of these plans we may grant restricted shares and stock options for the purchase of our common stock. The stock-based compensation is granted under terms determined by our Compensation Committee. Our standard stock option grants have a maximum term of 10 years, generally vest over periods ranging between one and four years, and are granted with an exercise price equal to the fair market value of the common stock on the date of grant. Restricted stock is valued at the market value of the common stock on the date of grant and generally vests over periods of two to seven years. All dividends paid on restricted stock, whether vested or unvested, are paid to the shareholder.

Edgar Filing: INVACARE CORP - Form 10-Q

Information regarding our stock option plans for the three months ended March 31, 2015 is as follows:

	Number of Shares	Weighted Average Exercise Price per Share	Weighted Average Contractual Term	Aggregate Intrinsic Value
Options outstanding, beginning of year	46,525	\$ 10.63		
Options granted	15,985	10.25		
Options expired	(3,817)	13.39		
Options outstanding, end of quarter	58,693	\$ 10.35	8.6	\$ 62,065
Options exercisable, end of quarter	6,708	\$ 12.63	0.6	\$ -
Option price range at end of quarter	\$9.97 to \$12.63			
	\$			
Option price of exercisable shares	12.63			

The following table summarizes information about stock option assumptions:

	March 31, 2015
Expected dividend yield	1.56%
Expected volatility	34.32%
Risk-free interest rate	1.37%
Expected option life	10.0 Years

During the three months ended March 31, 2015, we expensed \$9 thousand in stock-based compensation under stock option awards. There was no stock-based compensation expensed under stock option awards during the three months ended March 31, 2014.

The weighted average grant date fair value of options granted during the quarter ended March 31, 2015 was \$3.56 per share. Expected future expense relating to the unvested options outstanding as of March 31, 2015 is \$179 thousand over a weighted average period of 4.7 years. Upon exercise of vested options, management expects to draw on treasury stock as the source of the shares.

The summary of changes in unvested restricted stock awards for the three months ended March 31, 2015, is as follows:

	Number of Shares	Weighted Average Grant Date Fair Value
Unvested restricted stock, beginning of year	112,545	\$ 6.06
Granted	26,441	10.34
Vested	(36,991)	5.80
Unvested restricted stock, end of period	101,995	\$ 7.27

During the three months ended March 31, 2015 and 2014, we expensed \$82 thousand and \$80 thousand, respectively, in stock-based compensation under restricted stock awards.

At March 31, 2015, unrecognized compensation expense for unvested restricted stock was \$630 thousand, which is expected to be recognized over an average period of 2.0 years.

NOTE 9 – GUARANTEES

We do not issue any guarantees that would require liability recognition or disclosure, other than standby letters of credit. Standby letters of credit are conditional commitments issued by us to guarantee the performance of a customer to a third party. Generally, all letters of credit, when issued, have expiration dates within one year. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. Generally, we hold collateral and/or personal guarantees supporting these commitments. As of March 31, 2015, we had \$910 thousand of outstanding letters of credit. Management believes that the proceeds obtained through a liquidation of

collateral and the enforcement of guarantees would be sufficient to cover the potential amount of future payments required under the corresponding guarantees. The amount of the liability as of March 31, 2015, for guarantees under standby letters of credit issued is not material.

NOTE 10 – FAIR VALUE OF FINANCIAL INSTRUMENTS

Management uses its best judgment in estimating the fair value of our financial instruments; however, there are inherent weaknesses in any estimation technique. Therefore, for substantially all financial instruments, the fair value estimates herein are not necessarily indicative of the amounts we could have realized in a sale transaction on the dates indicated. The fair value amounts have been measured as of their respective period ends, and have not been re-evaluated or updated for purposes of these financial statements subsequent to those respective dates. As such, the fair values of these financial instruments subsequent to the respective reporting dates may be different than the amounts reported at each period end.

In accordance with U.S. GAAP, we use a hierarchical disclosure framework associated with the level of pricing observability utilized in measuring assets and liabilities at fair value. The three broad levels defined by the hierarchy are as follows:

- Level I - Quoted prices are available in active markets for identical assets or liabilities as of the reported date.
- Level II - Pricing inputs are other than quoted prices in active markets, which are either directly or indirectly observable as of the reported date. The nature of these asset and liabilities include items for which quoted prices are available but traded less frequently, and items that are fair valued using other financial instruments, the parameters of which can be directly observed.
- Level III - Assets and liabilities that have little to no pricing observability as of reported date. These items do not have two-way markets and are measured using management's best estimate of fair value, where the inputs into the determination of fair value require significant management judgment or estimation.

The following table summarizes the fair value of our financial assets measured on a recurring basis by the above pricing observability levels as of March 31, 2015 and December 31, 2014:

Quoted
Prices in Significant

Edgar Filing: INVACARE CORP - Form 10-Q

(Dollars in thousands)	Fair Value Measurements	Active Markets for Identical Assets (Level I)	Other Observable Inputs (Level II)	Significant Unobservable Inputs (Level III)
March 31, 2015				
U.S. government agencies	\$ 11,406	\$ -	\$ 11,406	\$ -
State and political subdivisions	32,201	-	32,201	-
Mortgage-backed securities -				
U.S. government-sponsored enterprises	40,955	-	40,955	-
Equity securities-financial services industry and other	11	11	-	-
December 31, 2014				
U.S. government agencies	\$ 7,858	\$ -	\$ 7,858	\$ -
State and political subdivisions	26,384	-	26,384	-
Mortgage-backed securities -				
U.S. government-sponsored enterprises	43,724	-	43,724	-
Equity securities-financial services industry and other	10	10	-	-

Our available for sale and held to maturity securities portfolios contain investments, which were all rated within our investment policy guidelines at time of purchase and upon review of the entire portfolio all securities are marketable and have observable pricing inputs.

Edgar Filing: INVACARE CORP - Form 10-Q

For financial assets measured at fair value on a nonrecurring basis the fair value measurements by level within the fair value hierarchy used at March 31, 2015 and December 31, 2014 are as follows:

(Dollars in thousands)	Fair Value Measurements	Quoted Prices in Active Markets for Identical Assets (Level I)	Significant Other Observable Inputs (Level II)	Significant Unobservable Inputs (Level III)
March 31, 2015				
Impaired loans	\$ 1,784	\$ -	\$ -	\$ 1,784
December 31, 2014				
Impaired loans	\$ 1,087	\$ -	\$ -	\$ 1,087
Foreclosed real estate	761	-	-	761

The following table presents additional qualitative information about assets measured at fair value on a nonrecurring basis and for which Level 3 inputs were used to determine fair value:

(Dollars in thousands)	Qualitative Information about Level III Fair Value Measurements			
	Fair Value Estimate	Valuation Techniques	Unobservable Input	Range (Weighted Average)
March 31, 2015				
Impaired loans	\$ 1,784	Appraisal of collateral	Appraisal adjustments (1)	0% to -74.8% (-7.5%)
December 31, 2014				
Impaired loans	\$ 1,087	Appraisal of collateral	Appraisal adjustments (1)	0% to -67.9% (-7.8%)
Foreclosed real estate	761	Appraisal of collateral	Selling expenses (1)	-7.0% (-7.0%)

(1) Appraisals may be adjusted by management for qualitative factors such as economic conditions and estimated selling expenses. The range and weighted average of selling expenses and other appraisal adjustments are presented as a percentage of the appraisal.

The following information should not be interpreted as an estimate of the fair value of the entire company since a fair value calculation is only provided for a limited portion of our assets and liabilities. Due to a wide range of valuation techniques and the degree of subjectivity used in making the estimates, comparisons between our disclosures and those of other companies may not be meaningful. The following methods and assumptions were used to estimate the fair value of our financial instruments at March 31, 2015 and December 31, 2014:

Cash and Cash Equivalents (Carried at Cost): The carrying amounts reported in the balance sheet for cash and cash equivalents approximate those assets' fair value.

Deposits (Carried at Cost): Fair value for fixed-rate time certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered in the market on certificates to a schedule of aggregated expected monthly maturities on time deposits. We generally purchase amounts below the insured limit, limiting the amount of credit risk on these time deposits.

Securities: The fair value of securities, available for sale (carried at fair value) and securities held to maturity (carried at amortized cost) are determined by obtaining quoted market prices on nationally recognized securities exchanges (Level I), or matrix pricing (Level II), which is a mathematical technique used widely in the industry to value debt securities without relying exclusively on quoted market prices for the specific securities but rather by relying on the securities'

relationship to other benchmark quoted prices. For certain securities which are not traded in active markets or are subject to transfer restrictions, valuations are adjusted to reflect illiquidity and/or non-transferability, and such adjustments are generally based on available market evidence (Level III). In the absence of such evidence, management's best estimate is used. Management's best estimate consists of both internal and external support on certain Level III measurements. Internal cash flow models using a present value formula that includes assumptions market participants would use along with indicative exit pricing obtained from broker/dealers (where available) were used to support fair values of certain Level III investments.

Federal Home Loan Bank Stock (Carried at Cost): The carrying amount of restricted investment in bank stock approximates fair value and considers the limited marketability of such securities.

Loans Receivable (Carried at Cost): The fair values of non-impaired loans are estimated using discounted cash flow analyses, using the market rates at the balance sheet date that reflect the credit and interest rate-risk inherent in the loans. Projected future cash flows are calculated based upon contractual maturity or call dates, projected repayments and prepayments of principal. Generally, for variable rate loans that reprice frequently and with no significant change in credit risk, fair values are based on carrying values.

Impaired Loans (Carried at Lower of Cost or Fair Value): Fair value of impaired loans is generally determined based upon independent third-party appraisals of the properties, or discounted cash flows based upon the expected proceeds. These assets are included in Level III fair values, based upon the lowest level of input that is significant to the fair value measurements. The fair value of impaired loans totaled \$1.8 million and \$1.1 million at March 31, 2015 and December 31, 2014, respectively. These balances consist of loans that were written down or required additional reserves during the periods ended March 31, 2015 and December 31, 2014, respectively.

Deposit Liabilities (Carried at Cost): The fair values disclosed for demand, savings and money market accounts are, by definition, equal to the amount payable on demand at the reporting date (i.e., their carrying amounts). Fair values for fixed-rate certificates of deposit are estimated using a discounted cash flow calculation that applies interest rates currently being offered in the market on certificates to a schedule of aggregated expected monthly maturities on time deposits.

Borrowings (Carried at Cost): Fair values of Federal Home Loan Bank ("FHLB") advances are estimated using discounted cash flow analysis, based on quoted prices for new FHLB advances with similar credit risk characteristics, terms and remaining maturity. These prices obtained from this active market represent a market value that is deemed to represent the transfer price if the liability were assumed by a third party.

Junior Subordinated Debentures (Carried at Cost): Fair values of junior subordinated debt are estimated using discounted cash flow analysis, based on market rates currently offered on such debt with similar credit risk characteristics, terms and remaining maturity.

Accrued Interest Receivable and Accrued Interest Payable (Carried at Cost): The carrying amounts of accrued interest receivable and payable approximate its fair value.

Off-Balance Sheet Instruments (Disclosed at Cost): Fair values for our off-balance sheet financial instruments (lending commitments and letters of credit) are based on fees currently charged in the market to enter into similar agreements, taking into account, the remaining terms of the agreements and the counterparties' credit standing.

20

Edgar Filing: INVACARE CORP - Form 10-Q

The fair values of our financial instruments at March 31, 2015 and December 31, 2014, were as follows:

(Dollars in thousands)	March 31, 2015		Quoted Prices in Active Markets for Identical Assets (Level I)	Significant Other Observable Inputs (Level II)	Significant Unobservable Inputs (Level III)
	Carrying Amount	Fair Value			
Financial assets:					
Cash and cash equivalents	\$ 6,966	\$ 6,966	\$ 6,966	\$ -	\$ -
Time deposits with other banks	100	100	-	100	-
Securities available for sale	84,573	84,573	11	84,562	-
Securities held to maturity	6,491	6,704	-	6,704	-
Federal Home Loan Bank stock	3,539	3,539	-	3,539	-
Loans receivable, net of allowance	467,540	467,313	-	-	467,313
Accrued interest receivable	1,908	1,908	-	1,908	-
Financial liabilities:					
Non-maturity deposits	357,007	357,007	-	357,007	-
Time deposits	116,505	107,011	-	116,918	-
Short-term borrowings	5,200	5,200	5,200	-	-
Long-term borrowings	56,000	57,738	-	57,738	-
Junior subordinated debentures	12,887	9,970	-	9,970	-
Accrued interest payable	265	265	-	265	-

(Dollars in thousands)	December 31, 2014		Quoted Prices in Active Markets for Identical Assets (Level I)	Significant Other Observable Inputs (Level II)	Significant Unobservable Inputs (Level III)
	Carrying Amount	Fair Value			
Financial assets:					
Cash and cash equivalents	\$ 5,859	\$ 5,859	\$ 5,859	\$ -	\$ -

Edgar Filing: INVACARE CORP - Form 10-Q

Time deposits with other banks	100	100	-	100	-
Securities available for sale	77,976	77,976	-	-	-
Securities held to maturity	6,006	6,190	-	6,190	-
Federal Home Loan Bank stock	3,908	3,908	-	3,908	-
Loans receivable, net of allowance	466,332	462,984	-	-	462,984
Accrued interest receivable	1,796	1,796	-	1,796	-
Financial liabilities:					
Non-maturity deposits	351,653	351,653	-	351,653	-
Time deposits	106,617	107,011	-	107,011	-
Short-term borrowings	23,500	23,500	23,500	-	-
Long-term borrowings	46,000	47,766	-	47,766	-
Junior subordinated debentures	12,887	9,361	-	9,361	-
Accrued interest payable	243	243	-	243	-

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

MANAGEMENT STRATEGY

We are a community-oriented financial institution serving northern New Jersey, northeastern Pennsylvania, New York City, New York and Orange County, New York. While offering traditional community bank loan and deposit products and services, we obtain non-interest income through our insurance brokerage operations and the sale of non-deposit products.

We continue to focus on strengthening our core operating performance by improving our net interest income and margin by closely monitoring our yield on earning assets and adjusting the rates offered on deposit products. The economic downturn continues to impact our level of non-performing assets ("NPAs"). We have been focused on building for the future and strengthening our core operating results within our risk management framework.

CRITICAL ACCOUNTING POLICIES

Our consolidated financial statements are prepared in accordance with U.S. GAAP and practices within the banking industry. Application of these principles requires management to make estimates, assumptions, and judgments that affect the amounts reported in our consolidated financial statements and accompanying notes. These estimates, assumptions, and judgments are based on information available as of the date of the financial statements; accordingly, as this information changes, the financial statements could reflect different estimates, assumptions, and judgments. Actual results could differ from those estimates.

Critical accounting estimates are necessary in the application of certain accounting policies and procedures, and are particularly susceptible to significant change. Critical accounting policies are defined as those that are reflective of significant judgments and uncertainties, and could potentially result in materially different results under different assumptions and conditions. There have been no material changes to our critical accounting policies during the three months ended March 31, 2015. For additional information on our critical accounting policies, please refer to Note 1 of the consolidated financial statements included in our 2014 Annual Report on Form 10-K.

COMPARISON OF OPERATING RESULTS FOR THREE MONTHS ENDED MARCH 31, 2015 AND 2014

Overview - For the quarter ended March 31, 2015, we reported net income of \$952 thousand, or \$0.21 per basic and diluted share, as compared to net income of \$678 thousand, or \$0.15 per basic and diluted share, for the same period last year. The increase in net income for the quarter ended March 31, 2015 was primarily due to increases in net interest income of \$496 thousand, other income of \$310 thousand and a decline in the provision for loan losses of \$148 thousand. The aforementioned were partially offset by an increase in non-interest expenses of \$602 thousand.

Comparative Average Balances and Average Interest Rates - The following table presents, on a fully tax equivalent basis, a summary of our interest-earning assets and their average yields, and interest-bearing liabilities and their average costs for the three month periods ended March 31, 2015 and 2014:

(Dollars in thousands)	Three Months Ended March 31,			2014		
	2015			2014		
	Average Balance	Interest	Average Rate (2)	Average Balance	Interest	Average Rate (2)
Earning Assets:						
Securities:						
Tax exempt (3)	\$ 31,339	\$ 312	4.04%	\$ 30,767	\$ 383	5.05%
Taxable	54,267	267	2.00%	70,451	217	1.25%
Total securities	85,606	579	2.74%	101,218	600	2.40%
Total loans receivable (1) (4)	470,870	5,172	4.45%	402,757	4,623	4.66%
Other interest-earning assets	7,118	4	0.23%	5,420	3	0.22%
Total earning assets	563,594	\$ 5,755	4.14%	\$ 509,395	\$ 5,226	4.16%
Non-interest earning assets	41,353			35,608		
Allowance for loan losses	(5,742)			(5,650)		
Total Assets	\$ 599,205			539,353		
Sources of Funds:						
Interest bearing deposits:						
NOW	\$ 128,160	\$ 50	0.16%	\$ 115,661	\$ 39	0.14%
Money market	14,511	5	0.14%	12,573	4	0.13%
Savings	140,497	71	0.20%	146,082	75	0.21%
Time	112,067	290	1.05%	98,931	272	1.12%
Total interest bearing deposits	395,235	416	0.43%	373,247	390	0.42%
Borrowed funds	63,715	380	2.42%	46,222	348	3.05%
Junior subordinated debentures	12,887	53	1.67%	12,887	53	1.67%
Total interest bearing liabilities	471,837	\$ 849	0.73%	\$ 432,356	\$ 791	0.74%
Non-interest bearing liabilities:						
Demand deposits	71,695			57,541		
Other liabilities	3,595			2,194		
Total non-interest bearing liabilities	75,290			59,735		

Edgar Filing: INVACARE CORP - Form 10-Q

Stockholders' equity	52,078	47,262
Total Liabilities and Stockholders' Equity	\$ 599,205	\$ 539,353

Net Interest Income and Margin (5)	4,906	3.53%	4,435	3.53%
Tax-equivalent basis adjustment	(104)		(129)	
Net Interest Income	\$ 4,802		\$ 4,306	

(1) Includes loan fee income

(2) Average rates on securities are calculated on amortized costs

(3) Full tax equivalent basis, using a 39% effective tax rate and adjusted for TEFRA (Tax and Equity Fiscal Responsibility Act) interest expense disallowance

(4) Loans outstanding include non-accrual loans

(5) Represents the difference between interest earned and interest paid, divided by average total interest-earning assets

Net Interest Income – Net interest income is the difference between interest and fees on loans and other interest-earning assets and interest paid on interest-bearing liabilities. Net interest income is directly affected by changes in volume and mix of interest-earning assets and interest-bearing liabilities that support those assets, as well as changing interest rates when differences exist in repricing dates of assets and liabilities.

Net interest income on a fully tax equivalent basis increased \$471 thousand, or 10.6%, to \$4.9 million for the first quarter of 2015, as compared to \$4.4 million for the same period in 2014. The increase in net interest income was largely due to a \$54.2 million, or 10.6%, increase in average interest earning assets, principally loans receivable, which

increased \$68.1 million, or 16.9%, and was partially offset by a decrease in the average balance on the securities portfolio of \$15.6 million, or 15.4%.

Interest Income – Our total interest income, on a fully tax equivalent basis, increased \$529 thousand, or 10.1%, to \$5.8 million for the quarter ended March 31, 2015, as compared to the same period last year. The increase was due to higher average earning assets, which increased \$54.2 million for the quarter ended March 31, 2015, as compared to the same period in 2014.

Our total interest income earned on loans receivable increased \$549 thousand, or 11.9%, to \$5.2 million for the first quarter of 2015, as compared to the same period in 2014. The increase was driven by an increase in average balance of loans receivable of \$68.1 million, or 16.9%, for the three months ended March 31, 2015, as compared to the same period last year. The increase in interest income earned on loans receivable was partially offset by a 21 basis point decline in average yields to 4.45% for the quarter ended March 31, 2015, as compared to the same period in 2014.

Our total interest income earned on securities, on a fully tax equivalent basis, decreased \$21 thousand, to \$579 thousand for the quarter ended March 31, 2015 from \$600 thousand for the same period in 2014. This decrease was largely due to a decrease in the average balances on securities, which decreased \$15.6 million to \$85.6 million for the quarter ended March 31, 2015, as compared to the same period last year.

Other interest-earning assets include federal funds sold and interest bearing deposits in other banks. Our interest earned on total other interest-earning assets increased \$1 thousand for the first quarter of 2015, as compared to the same period in 2014, due to an increase in average balances. The average balances in other interest-earning assets increased \$1.7 million to \$7.1 million in the first quarter of 2015 from \$5.4 million during the first quarter a year earlier.

Interest Expense – Our interest expense for the three months ended March 31, 2015 increased \$58 thousand, or 7.3%, to \$849 thousand from \$791 thousand for the same period in 2014. The increase was principally due to higher average balances in interest-bearing liabilities, which increased \$39.5 million, or 9.1%, to \$471.8 million for the first quarter of 2015 from \$432.4 million for the same period in 2014.

Our interest expense on deposits increased \$26 thousand, or 6.7%, for the quarter ended March 31, 2015, as compared to the same period last year. The increase was largely attributed to the increase in the average balance of total interest bearing deposits, which increased \$22.0 million during the first quarter of 2015, as compared to the same period in 2014.

Provision for Loan Losses – Provision for loan losses decreased \$148 thousand, or 32.7%, to \$305 thousand for the first quarter of 2015, as compared to \$453 thousand for the same period in 2014. The decrease in the provision for loan

losses for the quarter ended March 31, 2015 was largely attributed to the resolution of problem loans. The provision for loan losses reflects management's judgment concerning the risks inherent in our existing loan portfolio and the size of the allowance necessary to absorb the risks, as well as the activity in the allowance during the periods. Management reviews the adequacy of its allowance on an ongoing basis and will provide additional provisions, as management may deem necessary.

Non-Interest Income – We reported an increase in non-interest income of \$310 thousand, or 19.5%, to \$1.9 million for the first quarter of 2015, as compared to the same period last year. For the first quarter of 2015, insurance commissions and fees and gains on securities transactions increased \$182 thousand and \$168 thousand, respectively, as compared to the same period in 2014. The increases were partially offset by a decline in service fees on deposit accounts of \$51 thousand for the first quarter of 2015, as compared to the same period in 2014.

Non-Interest Expense – Our non-interest expenses increased \$602 thousand, or 13.5%, to \$5.1 million for the first quarter of 2015, as compared to the same period last year. The increase for the first quarter of 2015, as compared to the same period in 2014, was largely due to increases in salaries and employee benefits expenses of \$362 thousand, other expenses of \$139 thousand, expenses and write-downs related to foreclosed real estate of \$64 thousand and furniture and equipment expenses of \$46 thousand, which were partially offset by a decrease in FDIC fees of \$52 thousand. The increase in salaries and employee benefits expense was partially due to an increase in personnel to support our growth initiative in new markets, including the opening of our Astoria branch in the first quarter of 2015 and the addition of commercial lending staff.

Income Taxes – Our income tax expense, which includes both federal and state tax expenses, was \$376 thousand for the three months ended March 31, 2015, compared to \$298 thousand for the three months ended March 31, 2014.

COMPARISION OF FINANCIAL CONDITION AT MARCH 31, 2015 TO DECEMBER 31, 2014

Total Assets – At March 31, 2015, our total assets were \$604.3 million, an increase of \$8.3 million, or 1.4%, as compared to total assets of \$595.9 million at December 31, 2014. The increase in total assets was largely driven by growth in the securities portfolio of \$7.1 million, or 8.4%, which was partially offset by a decline in foreclosed real estate of \$1.6 million, or 35.9%.

Cash and Cash Equivalents – Our cash and cash equivalents increased by \$1.1 million to \$7.0 million at March 31, 2015, or 1.2% of total assets, from \$5.9 million, or 1.0% of total assets, at December 31, 2014.

Securities Portfolio – At March 31, 2015, the securities portfolio, which includes available for sale and held to maturity securities, was \$91.1 million, compared to \$84.0 million at December 31, 2014. Available for sale securities were \$84.6 million at March 31, 2015, compared to \$78.0 million at December 31, 2014. The available for sale securities are held primarily for liquidity, interest rate risk management and profitability. Accordingly, our investment policy is to invest in securities with low credit risk, such as U.S. government agency obligations, state and political obligations and mortgage-backed securities. Held to maturity securities were \$6.4 million at March 31, 2015 and \$6.0 million at December 31, 2014.

Net unrealized gains in the available for sale securities portfolio were \$429 thousand and \$281 thousand at March 31, 2015 and December 31, 2014, respectively.

We conduct a regular assessment of our investment securities to determine whether any securities are OTTI. Further detail of the composition of the securities portfolio and discussion of the results of the most recent OTTI assessment are in Note 2 – Securities to our unaudited consolidated financial statements.

The unrealized losses in our securities portfolio are mostly driven by changes in spreads and market interest rates. All of our debt and equity securities in an unrealized loss position have been evaluated for other-than-temporary impairment as of March 31, 2015 and we do not consider any security OTTI. We evaluated the prospects of the issuers in relation to the severity and the duration of the unrealized losses. In addition, we do not intend to sell, and it is more likely than not that we will not have to sell, any of our securities before recovery of their cost basis.

Other investments totaled \$3.5 million at March 31, 2015, as compared to \$3.9 million at December 31, 2014, which consisted primarily of FHLB stock. We also held \$100 thousand in time deposits with other financial institutions at March 31, 2015 and December 31, 2014.

Loans – The loan portfolio comprises our largest class of earning assets. Total loans receivable, net of unearned income, increased \$1.3 million, or 0.3%, to \$473.3 million at March 31, 2015, as compared to \$472.0 million at December 31, 2014. The increase in loans was primarily in the residential real estate portfolio, which increased \$3.2 million, or 2.8%, to \$114.7 million at March 31, 2015, as compared to \$111.5 million at December 31, 2014. The aforementioned increase was partially offset by a decrease in the commercial and industrial portfolio of \$1.7 million, or 8.4%, to \$18.8 million at March 31, 2015, as compared to \$20.5 million at December 31, 2014. In addition, during the first quarter of 2015, we had \$6.2 million in prepayments within the commercial loan portfolio.

The following table summarizes the composition of our gross loan portfolio by type:

(Dollars in thousands)	March 31, 2015	December 31, 2014
Commercial and industrial loans	\$ 18,822	\$ 20,549
Construction	13,239	12,379
Commercial real estate	325,742	326,370
Residential real estate	114,663	111,498
Consumer and other	1,324	1,665
Total gross loans	\$ 473,790	\$ 472,461

Loan and Asset Quality – Our overall credit quality continued to improve through March 31, 2015, as our total problem assets, which is composed of foreclosed real estate, criticized assets and classified assets, were down 9.8% from December 31, 2014, and the ratio of NPAs to total assets improved to 1.83% at March 31, 2015 from 2.02% at December 31, 2014.

NPAs, which include non-accrual loans, loans 90 days past due and still accruing, troubled debt restructured loans currently performing in accordance with renegotiated terms and foreclosed real estate, decreased \$983 thousand, or 8.2%, to \$11.1 million at March 31, 2015, as compared to \$12.0 million at December 31, 2014. Non-accrual loans increased \$708 thousand, or 12.0%, to \$6.6 million at March 31, 2015, as compared to \$5.9 million at December 31, 2014. The top five non-accrual loan relationships total \$3.8 million, which equates to 56.6% of total non-accrual loans

and 33.9% of total NPAs at March 31, 2015. The remaining non-accrual loans at March 31, 2015 have an average loan balance of \$93 thousand. Loans past due 30 to 89 days decreased \$1.5 million, or 25.9%, to \$4.2 million at March 31, 2015, as compared to \$5.6 million at December 31, 2014.

We continue to actively market our foreclosed real estate properties, which decreased \$1.6 million to \$2.9 million at March 31, 2015, as compared to \$4.4 million at December 31, 2014. The decrease was primarily due to the sale of \$1.5 million in foreclosed real estate properties and write-downs of \$97 thousand during 2015, which were partially offset by \$39 thousand in new foreclosed real estate properties. At March 31, 2015, our foreclosed real estate properties had an average carrying value of approximately \$259 thousand per property.

The allowance for loan losses increased \$122 thousand, or 2.2%, to \$5.8 million, or 1.22% of total loans, at March 31, 2015, compared to \$5.6 million, or 1.20% of total loans, at December 31, 2014. We recorded \$305 thousand in provision for loan losses, which was partially offset by \$183 thousand in net charge-offs for the quarter ended March 31, 2015. The allowance for loan losses as a percentage of non-accrual loans decreased to 86.9% at March 31, 2015 from 95.2% at December 31, 2014.

Management continues to monitor our asset quality and believes that the NPAs are adequately collateralized and anticipated material losses have been adequately reserved for in the allowance for loan losses. However, given the uncertainty of the current real estate market, additional provisions for losses may be deemed necessary in future periods. The following table provides information regarding risk elements in the loan portfolio at each of the periods presented:

(Dollars in thousands)	March 31, 2015	December 31, 2014
Non-accrual loans	\$ 6,632	\$ 5,924
Non-accrual loans to total loans	1.40%	1.26%
Non-performing assets	\$ 11,065	\$ 12,048
Non-performing assets to total assets	1.83%	2.02%
Allowance for loan losses as a % of non-accrual loans	86.90%	95.22%
Allowance for loan losses to total loans	1.22%	1.20%

A loan is considered impaired, in accordance with the impairment accounting guidance, when based on current information and events, it is probable that we will be unable to collect all amounts due from the borrower in accordance with the contractual terms of the loan. Total impaired loans at March 31, 2015 were \$8.1 million and at December 31, 2014 were \$7.5 million. Impaired loans measured at fair value on a non-recurring basis increased to \$1.8 million on March 31, 2015 from \$1.1 million at December 31, 2014. These balances consist of loans that were written down or required additional reserves during the periods ended March 31, 2015 and December 31, 2014,

respectively. Impaired loans include loans modified in troubled debt restructurings where concessions have been granted to borrowers experiencing financial difficulties. These concessions could include a reduction in the interest rate on the loan, payment extensions, forgiveness of principal, forbearance or other actions intended to maximize collection. Not all impaired loans and restructured loans are on non-accrual, and therefore not all are considered non-performing loans. Restructured loans still accruing totaled \$1.6 million at March 31, 2015 and December 31, 2014.

We also continue to monitor our portfolio for potential problem loans. Potential problem loans are defined as loans which cause management to have serious concerns as to the ability of such borrowers to comply with the present loan repayment terms and which may cause the loan to be placed on non-accrual status. As of March 31, 2015, we had five loan relationships totaling \$1.4 million that we deemed potential problem loans. Management is actively monitoring these loans.

Further detail of the credit quality of the loan portfolio is included in Note 4 – Allowance for Loan Losses and Credit Quality of Financing Receivables to our unaudited consolidated financial statements.

Allowance for Loan Losses – The allowance for loan losses consists of general, allocated and unallocated components. The allocated component relates to loans that are classified as impaired. For those loans that are classified as impaired, an allowance is established when the discounted cash flows, collateral value or observable market price of the impaired loan is lower than the carrying value of that loan. The general component covers non-impaired loans and is based on historical charge-off experience and expected losses derived from our internal risk rating process. The unallocated component covers the potential for other adjustments that may be made to the allowance for pools of loans after an assessment of internal or external influences on credit quality that are not fully reflected in the historical loss or risk rating data.

Management regularly assesses the appropriateness and adequacy of the loan loss reserve in relation to credit exposure associated with individual borrowers, overall trends in the loan portfolio and other relevant factors, and believes the reserve is reasonable and adequate for each of the periods presented.

At March 31, 2015, the total allowance for loan losses increased \$122 thousand, or 2.2%, to \$5.8 million, as compared to \$5.6 million at December 31, 2014. The components of this increase were a provision for loan losses of \$305 thousand and net charge-offs totaling \$183 thousand in the quarter ended March 31, 2015. The provision also reflects the continued weakness in current real estate values in our market area and reduced cash flows to support the repayment of loans. The allowance for loan losses as a percentage of total loans was 1.22% and 1.20% at March 31, 2015 and December 31, 2014, respectively.

The table below presents information regarding our provision and allowance for loan losses for the three months ended March 31, 2015 and 2014:

(Dollars in thousands)	March 31, 2015	March 31, 2014
Balance, beginning of period	\$ 5,641	\$ 5,421
Provision	305	453
Charge-offs	(214)	(457)
Recoveries	31	20
Balance, end of period	\$ 5,763	\$ 5,437

The table below presents details concerning the allocation of the allowance for loan losses to the various categories for each of the periods presented. The allocation is made for analytical purposes and it is not necessarily indicative of the categories in which future credit losses may occur. The total allowance is available to absorb losses from any category of loans.

(Dollars in thousands)	March 31, 2015		December 31, 2014	
	Amount	Percentage of Loans In Each Category To Gross Loans	Amount	Percentage of Loans In Each Category To Gross Loans
Commercial and industrial	\$ 138	4.0%	\$ 231	4.3%
Construction	388	2.8%	383	2.6%
Commercial real estate	3,787	68.7%	3,491	69.1%
Residential real estate	841	24.2%	903	23.6%
Consumer and other loans	88	0.3%	19	0.4%
Unallocated	521	-	614	-
Total	\$ 5,763	100.0%	\$ 5,641	100.0%

Bank-Owned Life Insurance (“BOLI”) – Our BOLI carrying value amounted to \$12.3 million at March 31, 2015 and \$12.2 million at December 31, 2014.

Goodwill and Other Intangibles – Goodwill represents the excess of the purchase price over the fair market value of net assets acquired. At March 31, 2015 and December 31, 2014, we had recorded goodwill totaling \$2.8 million, primarily as a result of the acquisition of Tri-State in 2001. In accordance with U.S. GAAP, goodwill is not amortized, but evaluated at least annually for impairment. Any impairment of goodwill results in a charge to income. We periodically assess whether events and changes in circumstances indicate that the carrying amounts of goodwill and intangible assets may be impaired. The estimated fair value of the reporting segment exceeded its book value; therefore, no write-down of goodwill was required. The goodwill related to the insurance agency is not deductible for tax purposes.

Deposits – Our total deposits increased \$15.2 million, or 3.3%, to \$473.5 million at March 31, 2015, from \$458.3 million at December 31, 2014. The increase in deposits was due to increases in both non-interest bearing deposits of \$6.3 million, or 8.9%, and interest bearing deposits of \$9.0 million, or 2.3%, for March 31, 2015, as compared to December 31, 2014. Our funding mix continues to improve as low cost deposits grow. Included in the aforementioned increase is approximately \$5.0 million in new deposits attributed to the opening of our Astoria branch.

Borrowings – Borrowings consist of short-term and long-term advances from the FHLB. The advances are secured under terms of a blanket collateral agreement by a pledge of qualifying mortgage loans. We had \$61.2 million and \$69.5 million in borrowings, at a weighted average interest rate of 2.49% at March 31, 2015 and 2.13% at December 31, 2014. The long-term borrowings at March 31, 2015 consisted of \$45.0 million of fixed rate advances and \$11.0 million of advances with quarterly convertible options that allow the FHLB to change the note rate to a then current market rate.

Junior Subordinated Debentures – On June 28, 2007, Sussex Capital Trust II (the “Trust”), a Delaware statutory business trust and our non-consolidated wholly owned subsidiary, issued \$12.5 million of variable rate capital trust pass-through securities to investors. The Trust purchased \$12.9 million of variable rate junior subordinated deferrable interest debentures from us. The debentures are the sole asset of the Trust. The terms of the junior subordinated debentures are the same as the terms of the capital securities. We have also fully and unconditionally guaranteed the obligations of the Trust under the capital securities. The interest rate is based on the three-month LIBOR plus 144 basis points and adjusts quarterly. The rate at March 31, 2015, was 1.71%. The capital securities are currently redeemable by us at par in whole or in part. The capital securities must be redeemed upon final maturity of the subordinated debentures on September 15, 2037. The proceeds of these trust preferred securities, which have been contributed to the Bank, are included in the Bank’s capital ratio calculations and treated as Tier I capital.

In accordance with FASB ASC 810, Consolidations, our wholly owned subsidiary, the Trust, is not included in our consolidated financial statements.

Equity – Stockholders’ equity, inclusive of accumulated other comprehensive income, net of income taxes, was \$52.0 million at March 31, 2015, an increase of \$740 thousand when compared to December 31, 2014. The increase was largely due to net income for the quarter ended March 31, 2015.

LIQUIDITY AND CAPITAL RESOURCES

A fundamental component of our business strategy is to manage liquidity to ensure the availability of sufficient resources to meet all financial obligations and to finance prospective business opportunities. Liquidity management is critical to our stability. Our liquidity position over any given period of time is a product of our operating, financing and investing activities. The extent of such activities is often shaped by such external factors as competition for deposits and loan demand.

Traditionally, financing for our loans and investments is derived primarily from deposits, along with interest and principal payments on loans and investments. At March 31, 2015, total deposits amounted to \$473.5 million, an increase of \$15.2 million, or 3.3%, from December 31, 2014. At March 31, 2015 and December 31, 2014, advances from FHLB and subordinated debentures totaled \$74.1 million and \$82.4 million, respectively, and represented 12.3% and 13.8% of total assets, respectively.

Loan production continued to be our principal investing activity. Total loans receivable, net of unearned income, at March 31, 2015, amounted to \$473.3 million, an increase of \$1.3 million, or 0.3%, compared to December 31, 2014.

Our most liquid assets are cash and due from banks and federal funds sold. At March 31, 2015, the total of such assets amounted to \$7.0 million, or 1.2%, of total assets, compared to \$5.9 million, or 1.0%, of total assets at

December 31, 2014. Another significant liquidity source is our available for sale securities portfolio. At March 31, 2015, available for sale securities amounted to \$84.6 million, compared to \$78.0 million at December 31, 2014.

In addition to the aforementioned sources of liquidity, we have available various other sources of liquidity, including federal funds purchased from other banks and the FRB discount window. The Bank also has the capacity to borrow an additional \$56.8 million through its membership in the FHLB and \$10.0 million at Atlantic Community Bankers Bank at March 31, 2015. Management believes that our sources of funds are sufficient to meet our present funding requirements.

The Bank's regulators have implemented risk based guidelines that require banks to maintain Tier I capital as a percentage of risk-adjusted assets of 4.0% and Tier II capital as a percentage of risk-adjusted assets of 8.0% at a minimum. At March 31, 2015, the Bank's Tier I, Tier II and Common Equity Tier I capital ratios were 12.67%, 13.90% and 12.67%, respectively. In addition to the risk-based guidelines, the Bank's regulators require that banks which meet the regulators' highest performance and operational standards maintain a minimum leverage ratio (Tier I capital as a percentage of tangible assets) of 4.0%. As of March 31, 2015, the Bank had a leverage ratio of 9.97%. The Bank's risk based and leverage ratios are in excess of those required to be considered "well-capitalized" under FDIC regulations.

The FRB also imposes similar capital requirements on bank holding companies with consolidated assets of \$500 million or more. Under FRB reporting requirements, a bank holding company that reaches \$500 million or more in total consolidated assets as of June 30 of the preceding year must begin reporting its consolidated capital beginning in March of the following year. The Bank began reporting its consolidated capital in March 2013.

We have no investment or financial relationship with any unconsolidated entities that are reasonably likely to have a material effect on liquidity or the availability of capital resources, except for the trust preferred securities of the Trust. We are not aware of any known trends or any known demands, commitments, events or uncertainties, which would

result in any material increase or decrease in liquidity. Management believes that any amounts actually drawn upon can be funded in the normal course of operations.

Off-Balance Sheet Arrangements – Our consolidated financial statements do not reflect off-balance sheet arrangements that are made in the normal course of business. These off-balance sheet arrangements consist of unfunded loans and letters of credit made under the same standards as on-balance sheet instruments. These unused commitments, at March 31, 2015, totaled \$86.2 million and consisted of \$40.7 million in commitments to grant commercial real estate, construction and land development loans, \$20.9 million in home equity lines of credit, \$23.7 million in other unused commitments and \$910 thousand in letters of credit. These instruments have fixed maturity dates, and because many of them will expire without being drawn upon, they do not generally present any significant liquidity risk to us. Management believes that any amounts actually drawn upon can be funded in the normal course of operations.

Item 3 - Quantitative and Qualitative Disclosures about Market Risk

Not applicable.

Item 4 - Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Management, including our Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) as of the end of the period covered by this report. Based upon the evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective to ensure that information required to be disclosed in the reports we file and submit under the Exchange Act is (i) recorded, processed, summarized and reported as and when required and (ii) accumulated and communicated to our management, including the Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely discussion regarding required disclosure.

Changes in Internal Control over Financial Reporting

There have been no changes in our internal control over financial reporting identified in connection with the evaluation that occurred during our last fiscal quarter that have materially affected, or that are reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

Item 1 - Legal Proceedings

We are not involved in any legal proceedings other than routine legal proceedings occurring in the ordinary course of business. Management believes that such proceedings are, in the aggregate, immaterial to our financial condition and results of operations.

Item 1A - Risk Factors

For a summary of risk factors relevant to our operations, see Part 1, Item 1A, “Risk Factors” in our 2014 Annual Report on Form 10-K. There are no material changes in the risk factors relevant to our operations.

Item 2 - Unregistered Sales of Equity Securities and Use of Proceeds

The following table provides information with respect to any purchase of shares of our common stock made by or on behalf of us or any “affiliated purchaser,” as defined in Rule 10b-18(a)(3) under the Exchange Act, during the three months ended March 31, 2015:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Program	Maximum Number of Shares that May Yet Be Purchased Under the Program(1)
January 1, 2015 through January 31, 2015	-	\$ -	-	-
February 1, 2015 through February 28, 2015	17,900	10.46	17,900	215,100
March 1, 2015 through March 31, 2015	1,550	10.54	1,550	213,550
Total	19,450	\$ 10.47	19,450	

(1) On February 25, 2015, the Board of Directors authorized a stock repurchase program, under which we may repurchase up to 233,000 shares. The stock repurchase program expires on February 26, 2016, unless completed sooner or otherwise extended.

There were no sales by us of unregistered securities during the three months ended March 31, 2015.

Item 3 - Defaults Upon Senior Securities

Not applicable.

Item 4 - Mine Safety Disclosures

Not applicable.

Item 5 - Other Information

Not applicable.

Item 6 - Exhibits

The exhibits required to be filed as part of this Quarterly Report on Form 10-Q are listed in the Exhibit Index attached hereto and are incorporated herein by reference.

SIGNATURES

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

Date: May 13, 2015 SUSSEX BANCORP

By: /s/ Steven M. Fusco
Steven M. Fusco
Chief Financial Officer and Senior Executive Vice President
(Principal Financial and Accounting Officer)

31

EXHIBIT INDEX

Exhibit

Number Description

Number	Description
*	
3.1	Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 to the Quarterly Report on 10-Q filed with the SEC on August 15, 2011).
3.2	Amended and Restated By-laws (incorporated by reference to Exhibit 3.1 to the Current Report on Form 8-K filed with the SEC on June 3, 2014).
4.1	Specimen common stock certificate (incorporated by reference to Exhibit 4.1 to Amendment No. 1 to the Registration Statement on Form S-1 filed with the SEC on June 3, 2013).
31.1*	Rule 13a-14(a)/15d-14(a) Certification of the Chief Executive Officer.
31.2*	Rule 13a-14(a)/15d-14(a) Certification of the Chief Financial Officer.
32.1*	Section 1350 Certifications of the Chief Executive Officer and Chief Financial Officer.
101	Financial statements from the Quarterly Report on Form 10-Q of Sussex Bancorp for the quarter ended March 31, 2015, formatted in XBRL (eXtensible Business Reporting Language): (i) the Consolidated Balance Sheets; (ii) the Consolidated Statements of Income and Comprehensive Income; (iii) the Consolidated Statements of Stockholders' Equity; (iv) the Consolidated Statements of Cash Flows and (v) Notes to Unaudited Consolidated Financial Statements.

* Furnished herewith and not deemed to be "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and shall not be deemed to be incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Exchange Act.