

INVACARE CORP  
Form 10-Q  
November 04, 2016

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2016

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, P.O. Box 4028, Elyria, Ohio 44036  
(Address of principal executive offices) (Zip Code)  
(440) 329-6000  
(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No "

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "small reporting company" in Rule 12b-2 of the Exchange Act. (Check One): Large accelerated filer " Accelerated filer x Non-accelerated filer " (Do not check if a smaller reporting company) Smaller reporting company "

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

As of November 2, 2016, the registrant had 31,725,515 Common Shares and 729,309 Class B Common Shares outstanding.



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## Part I. FINANCIAL INFORMATION

## Item 1. Financial Statements.

## INVACARE CORPORATION AND SUBSIDIARIES

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

(In thousands, except per share data)	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2016	2015	2016	2015
Net sales	\$268,145	\$283,776	\$800,734	\$859,073
Cost of products sold	194,703	206,137	585,837	627,052
Gross Profit	73,442	77,639	214,897	232,021
Selling, general and administrative expenses	77,705	77,463	229,261	240,388
Gain on sale of business	(7,386 )	(24 )	(7,386 )	(24 )
Charges related to restructuring activities	508	11	1,299	940
Operating Income (Loss)	2,615	189	(8,277 )	(9,283 )
Net gain on convertible debt derivatives	(1,192 )	—	(2,282 )	—
Interest expense	4,481	1,021	11,228	3,160
Interest income	(79 )	(42 )	(207 )	(122 )
Loss from Continuing Operations Before Income Taxes	(595 )	(790 )	(17,016 )	(12,321 )
Income tax provision	4,425	7,000	8,200	11,200
Net loss from Continuing Operations	\$(5,020 )	\$(7,790 )	\$(25,216 )	\$(23,521 )
Gain on Sale of Discontinued Operations (net of tax of \$140 for 2015)	—	—	—	260
Total Net Earnings from Discontinued Operations	—	—	—	260
Net Loss	\$(5,020 )	\$(7,790 )	\$(25,216 )	\$(23,261 )
Dividends Declared per Common Share	\$0.0125	\$0.0125	\$0.0375	\$0.0375
Net Earnings (Loss) per Share—Basic				
Net Loss from Continuing Operations	\$(0.15 )	\$(0.24 )	\$(0.78 )	\$(0.73 )
Net Earnings from Discontinued Operations	\$—	\$—	\$—	\$0.01
Net Loss per Share—Basic	\$(0.15 )	\$(0.24 )	\$(0.78 )	\$(0.72 )
Weighted Average Shares Outstanding—Basic	32,465	32,175	32,484	32,144
Net Earnings (Loss) per Share—Assuming Dilution				
Net Loss from Continuing Operations	\$(0.15 )	\$(0.24 )	\$(0.78 )	\$(0.73 )
Net Earnings from Discontinued Operations	\$—	\$—	\$—	\$0.01
Net Loss per Share—Assuming Dilution	\$(0.15 )	\$(0.24 )	\$(0.78 )	\$(0.72 )
Weighted Average Shares Outstanding—Assuming Dilution	32,610	32,715	32,589	32,655
Net Loss	\$(5,020 )	\$(7,790 )	\$(25,216 )	\$(23,261 )
Other comprehensive income (loss):				
Foreign currency translation adjustments	(3,408 )	4,518	17,668	(55,542 )
Defined Benefit Plans:				
Amortization of prior service costs and unrecognized gains	(333 )	(66 )	(529 )	747
Amounts arising, primarily due to the addition of new participants	—	—	—	(784 )
Deferred tax adjustment resulting from defined benefit plan activity	87	24	60	13
Valuation reserve associated with defined benefit plan activity	(87 )	(24 )	(60 )	(13 )
Current period unrealized gain (loss) on cash flow hedges	159	(630 )	(1,235 )	404
Deferred tax benefit (loss) related to unrealized gain (loss) on cash flow hedges	(29 )	78	60	(7 )

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Other Comprehensive Income (Loss)	(3,611 )	3,900	15,964	(55,182 )
Comprehensive Loss	\$(8,631 )	\$(3,890 )	\$(9,252 )	\$(78,443 )

See notes to condensed consolidated financial statements.

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Condensed Consolidated Balance Sheets (unaudited)

	September 30, 2016	December 31, 2015
	(In thousands)	
Assets		
Current Assets		
Cash and cash equivalents	\$ 138,427	\$ 60,055
Trade receivables, net	125,424	128,615
Installment receivables, net	1,456	1,145
Inventories, net	146,707	126,403
Other current assets	31,597	34,432
Assets held for sale	—	11,649
Total Current Assets	443,611	362,299
Other Assets	20,813	4,659
Intangibles	30,822	31,000
Property and Equipment, net	77,046	78,505
Goodwill	378,331	361,680
Total Assets	\$ 950,623	\$ 838,143
Liabilities and Shareholders' Equity		
Current Liabilities		
Accounts payable	\$ 96,204	\$ 103,571
Accrued expenses	118,684	118,956
Current taxes payable	7,688	17,154
Short-term debt and current maturities of long-term obligations	2,020	2,028
Liabilities held for sale	—	5,935
Total Current Liabilities	224,596	247,644
Long-Term Debt	158,074	45,092
Other Long-Term Obligations	102,947	82,589
Shareholders' Equity		
Preferred Shares (Authorized 300 shares; none outstanding)	—	—
Common Shares (Authorized 100,000 shares; 35,316 and 35,024 issued in 2016 and 2015, respectively)—no par	8,968	8,815
Class B Common Shares (Authorized 12,000 shares; 729 and 734 issued and outstanding in 2016 and 2015, respectively)—no par	183	184
Additional paid-in-capital	264,796	247,022
Retained earnings	284,179	310,583
Accumulated other comprehensive income	6,577	(9,387 )
Treasury shares (3,613 and 3,194 shares in 2016 and 2015, respectively)	(99,697 )	(94,399 )
Total Shareholders' Equity	465,006	462,818
Total Liabilities and Shareholders' Equity	\$ 950,623	\$ 838,143

See notes to condensed consolidated financial statements.

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## INVACARE CORPORATION AND SUBSIDIARIES

## Condensed Consolidated Statement of Cash Flows (unaudited)

	For the Nine Months Ended September 30,	
	2016	2015
	(In thousands)	
Operating Activities		
Net loss	\$(25,216 )	\$(23,261 )
Adjustments to reconcile net loss to net cash provided by operating activities:		
Gain on sale of business	(7,386 )	(24 )
Gain on sale of discontinued operation	—	(400 )
Depreciation and amortization	10,911	13,580
Provision for losses on trade and installment receivables	348	843
Provision (benefit) for deferred income taxes	(301 )	3,222
Provision for other deferred liabilities	557	238
Provision for stock-based compensation	5,534	3,297
Loss on disposals of property and equipment	51	965
Loss on debt extinguishment including debt finance charges and associated fees	—	668
Amortization of convertible debt discount	3,809	588
Amortization of debt fees	1,435	997
Gain on convertible debt derivatives	(2,282 )	—
Changes in operating assets and liabilities:		
Trade receivables	5,169	2,235
Installment sales contracts, net	(1,214 )	315
Inventories	(16,986 )	316
Other current assets	772	6,002
Accounts payable	(8,017 )	(14,439 )
Accrued expenses	(12,165 )	(17,940 )
Other long-term liabilities	(4,404 )	(12,751 )
Net Cash Used by Operating Activities	(49,385 )	(35,549 )
Investing Activities		
Purchases of property and equipment	(6,797 )	(5,896 )
Proceeds from sale of property and equipment	29	23,093
Proceeds from sale of business	13,829	13,700
Change in other long-term assets	(172 )	13,349
Other	78	107
Net Cash Provided by Investing Activities	6,967	44,353
Financing Activities		
Proceeds from revolving lines of credit and long-term borrowings	121,976	194,610
Payments on revolving lines of credit and long-term borrowings	(2,555 )	(205,333 )
Proceeds from exercise of stock options	17	1,914
Payment of financing costs	(5,966 )	(1,954 )
Payment of dividends	(1,188 )	(1,192 )
Issuance of warrants	12,376	—
Purchase of treasury stock	(5,298 )	—
Net Cash Provided (Used) by Financing Activities	119,362	(11,955 )
Effect of exchange rate changes on cash	1,428	(2,308 )
Increase (Decrease) in cash and cash equivalents	78,372	(5,459 )

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Cash and cash equivalents at beginning of year	60,055	38,931
Cash and cash equivalents at end of period	\$138,427	\$33,472
See notes to condensed consolidated financial statements.		

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INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2016

Accounting Policies

**Nature of Operations:** Invacare Corporation is a leading manufacturer and distributor of medical equipment used in the home based upon the company's distribution channels, breadth of product line and net sales. The company designs, manufactures and distributes an extensive line of health care products for the non-acute care environment, including the home health care, retail and extended care markets.

**Principles of Consolidation:** The consolidated financial statements include the accounts of the company and its wholly owned subsidiaries and include all adjustments, which were of a normal recurring nature, necessary to present fairly the financial position of the company as of September 30, 2016 and the results of its operations and changes in its cash flow for the nine months ended September 30, 2016 and 2015, respectively. Certain foreign subsidiaries, represented by the European segment, are consolidated using an August 31 quarter end in order to meet filing deadlines. No material subsequent events have occurred related to the European segment, which would require disclosure or adjustment to the company's financial statements. All significant intercompany transactions are eliminated. The results of operations for the three and nine months ended September 30, 2016 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.

**Recent Accounting Pronouncements:** In April 2014, the FASB issued ASU 2014-08 changing the presentation of discontinued operations on the statements of income and other requirements for reporting discontinued operations. Under the new standard, a disposal of a component or a group of components of an entity is required to be reported in discontinued operations if the disposal represents a strategic shift that has (or will have) a major effect on an entity's operations and financial results when the component meets the criteria to be classified as held for sale or is disposed. The amendments in this update also require additional disclosures about discontinued operations and disposal of an individually significant component of an entity that does not qualify for discontinued operations. This standard was required to be prospectively applied to all reporting periods presented in financial reports issued after the effective date. This standard can impact the presentation of the company's financial statements but does not affect the calculation of net income, comprehensive income or earnings per share. The company adopted ASU 2014-08 effective January 1, 2015 which impacted the company's Condensed Consolidated Statement of Comprehensive Income (Loss), Balance Sheets and Statement of Cash Flows. Specifically, the disposal by the company of its United States Rentals businesses, in the third quarter of 2015 and the GCM disposal in the third quarter of 2016, were not deemed to be discontinued operations.

In May 2014, the FASB issued ASU 2014-09, "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 existing 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. An entity can apply the new revenue standard retrospectively to each prior reporting period presented or retrospective with the cumulative effect of initially applying the standard

recognized at the date of initial application in retained earnings. The new accounting guidance is effective for annual periods beginning after December 15, 2017, due to an approved one-year deferral, and early adoption is permitted. The company is currently reviewing the impact of the adoption of ASU 2014-09 on the company's financial statements.

In April 2015, the FASB issued ASU 2015-03, "Simplifying the Presentation of Debt Issuance Costs." ASU 2015-03 requires debt issuance costs to be presented on the balance sheet as a direct deduction from the carrying amount of the related debt liability, which is similar to the presentation of debt discounts or premiums. ASU 2015-03 does not change the recognition and measurement guidance for debt issuance costs and requires retrospective application to all periods presented upon adoption. Amortization of debt fees are reflected as interest expense on the Condensed Consolidated Statement of Income (Loss). The company adopted ASU 2015-03 effective January 1, 2016 which did not have a material impact on the company's financial statements. See "Reclassifications" disclosure below for the amounts reclassified from Selling, General and Administrative expenses to Interest Expense.

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INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2016

In August 2014, the FASB issued ASU 2014-15, "Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern," which requires management to assess the company's ability to continue as a going concern and, in certain circumstances, provide footnote disclosure. This update is effective for annual reporting periods ending after December 15, 2016, and all annual and interim periods thereafter. The company is currently reviewing the impact of the adoption of ASU 2014-15.

In July 2015, the FASB issued ASU 2015-11, "Inventory (Topic 330): Simplifying the Measurement of Inventory," to simplify the subsequent measurement of inventory. After effectiveness of this update, entities will be required to subsequently measure inventory at the lower of cost or net realizable value rather than at the lower of cost or market. This update is effective for annual reporting periods beginning after December 15, 2016, including interim periods within those annual periods, and early adoption is permitted. The company is currently reviewing the impact of the adoption of ASU 2015-11 on the company's financial statements but does not currently believe it will a material impact on the company's financial statements.

In November 2015, the FASB issued ASU 2015-17, "Balance Sheet Classification of Deferred Taxes." ASU 2015-17 requires deferred tax assets and liabilities to be classified as noncurrent amounts on the balance sheet. The new accounting guidance is effective for fiscal periods beginning after December 15, 2016 and early adoption is permitted. The company adopted ASU 2015-17, on a prospective basis, effective October 1, 2015 and thus the company's deferred tax assets and liabilities have been classified as long-term in its Balance Sheet for all periods presented.

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.

In March 2016, the FASB issued ASU 2016-09, "Compensation – Stock Compensation: Topic 718: Improvements to Employee Share-Based Payment Accounting." ASU 2016-09 is intended to simplify several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. This pronouncement is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted. The company does not believe the impact of the adoption of ASU 2016-09 will have a material impact on the company's financial statements.

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 2016-09 on the company's financial statements.

Reclassifications: The company has historically classified the amortization of debt issuance costs as a component of Selling, General and Administrative (SG&A) Expenses. During the second quarter of 2016, the company determined that it is more appropriate to classify this amortization as a component of Interest Expense. Therefore, Interest Expense for the three and nine months ended September 30, 2015 has been increased by \$137,000 and \$997,000, respectively, with a corresponding decrease to SG&A expenses. The amortization of debt issuance costs of \$379,000 for the first three months of 2016 was previously included in SG&A expenses but has now been included in Interest

Expense. Total debt amortization fees for the for the nine months ended September 30, 2016 were \$1,435,000. There was no change to Loss from Continuing Operations Before Income Taxes for any period presented.

Operations Held For Sale

On July 2, 2015, Invacare Continuing Care, Inc., a Missouri Corporation and wholly-owned subsidiary of the company ("ICC") completed the sale (the "Transaction") of all the issued and outstanding membership interests in Dynamic Medical Systems, LLC, a Nevada limited liability company, and Invacare Outcomes Management, LLC, a Delaware limited liability company, each a wholly-owned subsidiary of ICC ("collectively, the rentals businesses"), pursuant to a Membership Interest Purchase Agreement (the "Purchase Agreement") among the company, ICC and Joerns Healthcare Parent, LLC, a Delaware limited liability company. The price paid to ICC for the rentals businesses was approximately \$15,500,000 in cash, which was subject to certain post-closing

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2016

adjustments required by the Purchase Agreement. Net proceeds from the Transaction were approximately \$13,700,000, net of taxes and expenses. The company recorded a pre-tax gain of approximately \$24,000 in the third quarter of 2015, which represented the excess of the net sales price over the book value of the assets and liabilities of the rentals businesses, as of the date of completion of the disposition. The company recorded expenses related to the sale of the rentals businesses totaling \$1,792,000, of which \$1,264,000 have been paid as of September 30, 2016. The sale of the rentals businesses was not dilutive to the company's results. The company utilized the net proceeds from the sale to reduce debt outstanding under its credit agreement. The company determined that the sale of the rentals businesses did not meet the criteria for classification as a discontinued operation in accordance with ASU 2014-08 but the "held for sale" criteria of ASC 360-10-45-9 were met and thus the rentals businesses were treated as held for sale as of June 30, 2015 until sold on July 2, 2015.

On September 30, 2016, the company, completed the sale of its subsidiary, Garden City Medical Inc, a Delaware corporation and wholly-owned subsidiary ("GCM"), dba PMI and Pinnacle Medsource, to Compass Health Brands Corp., a Delaware corporation (the "Purchaser"), pursuant to a Share Purchase Agreement. GCM sourced and distributed primarily products under the brand ProBasics<sup>TM</sup> by PMI. The price paid to the company for GCM was \$13,829,000 in cash and net proceeds from the transaction were \$12,729,000, net of expenses. The company recorded a pre-tax gain of \$7,386,000 in the third quarter of 2016, which represented the excess of the net sales price over the book value of the assets and liabilities of GCM. The company recorded expenses related to the sale of GCM totaling \$1,100,000, none of which was paid out as of September 30, 2016. The sale of GCM will be dilutive to the company's results. The company will utilize the net proceeds to fund operations. The company determined that the sale of GCM did not meet the criteria for classification as a discontinued operation in accordance with ASU 2014-08 but the "held for sale" criteria of ASC 360-10-45-9 were met and thus GCM was treated as held for sale for purposes of the Condensed Consolidated Balance Sheets as of December 31, 2015.

The assets and liabilities of GCM that were sold on September 30, 2016 and shown as held for sale as of December 31, 2015 in the company's Consolidated Balance Sheets were comprised of the following (in thousands):

	September 30, 2016	December 31, 2015
Trade receivables, net	\$ 4,526	\$ 5,040
Inventories, net	5,335	6,404
Other current assets	74	27
Property and equipment, net	149	178
Assets sold	\$ 10,084	\$ 11,649
Accounts payable	\$ 2,990	\$ 2,037
Accrued expenses and other short-term obligations	1,751	3,464
Current taxes payable	—	434
Liabilities sold	\$ 4,741	\$ 5,935

With the sale of GCM, the company entered into an agreement with the Purchaser for the Purchaser to buy, at cost, all ProBasics<sup>TM</sup> inventory capitalized on the balance sheets of certain Invacare subsidiaries which was not sold as part of the GCM sale on September 30, 2016. The value of this inventory as of September 30, 2016 was approximately \$2,400,000 and the company anticipates all of this inventory will be transferred to the Purchaser in the fourth quarter of 2016. Under the agreement, depending on certain conditions, the Purchaser may have until September 30, 2017 to pay for the inventory.

Discontinued Operations

From 2012 through 2014, the company sold three businesses which were classified as discontinued operations. The company recorded cumulative expenses related to the sale of discontinued operations totaling \$8,801,000, of which \$8,405,000 have been paid as of September 30, 2016. The company recorded an incremental intra-period tax allocation expense to discontinued operations for the nine months ended September 30, 2015 which represented the cumulative intra-period allocation expense to discontinued operations based on the company's prior year estimate of the projected domestic taxable loss related to continuing operations for 2015.

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INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2016

Receivables

Accounts receivable are reduced by an allowance for amounts that may become uncollectible in the future. Substantially all of 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 (\$7,346,000 at September 30, 2016 and \$9,726,000 at December 31, 2015) is 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 De Lage Landen, Inc. ("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 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 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.

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2016

Installment receivables consist of the following (in thousands):

	September 30, 2016			December 31, 2015		
	Current	Long-Term	Total	Current	Long-Term	Total
Installment receivables	\$2,134	\$3,166	\$5,300	\$2,309	\$2,318	\$4,627
Less: Unearned interest	(49 )	—	(49 )	(42 )	—	(42 )
	2,085	3,166	5,251	2,267	2,318	4,585
Allowance for doubtful accounts	(629 )	(2,812 )	(3,441 )	(1,122 )	(1,670 )	(2,792 )
Installment receivables, net	\$1,456	\$354	\$1,810	\$1,145	\$648	\$1,793

Installment receivables purchased from DLL during the nine months ended September 30, 2016 increased the gross installment receivables balance by \$1,578,000. No sales of installment receivables were made by the company during the quarter.

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

	Nine Months Ended September 30, 2016	Year Ended December 31, 2015
Balance as of beginning of period	\$ 2,792	\$ 5,852
Current period provision (benefit)	1,243	(332 )
Direct write-offs charged against the allowance	(594 )	(2,728 )
Balance as of end of period	\$ 3,441	\$ 2,792

Installment receivables by class as of September 30, 2016 consist of the following (in thousands):

	Total Installment Receivables	Unpaid Principal Balance	Related Allowance for Doubtful Accounts	Interest Income Recognized
U.S.				
Impaired installment receivables with a related allowance recorded	\$ 4,178	\$ 4,178	\$ 3,371	\$ —
Canada				
Non-Impaired installment receivables with no related allowance recorded	1,052	1,003	—	46
Impaired installment receivables with a related allowance recorded	70	70	70	—
Total Canadian installment receivables	1,122	1,073	70	46
Total				
Non-Impaired installment receivables with no related allowance recorded	1,052	1,003	—	46
Impaired installment receivables with a related allowance recorded	4,248	4,248	3,441	—
Total installment receivables	\$ 5,300	\$ 5,251	\$ 3,441	\$ 46

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2016

Installment receivables by class as of December 31, 2015 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	\$ 3,618	\$ 3,618	\$ 2,729	\$ —
Canada				
Non-Impaired installment receivables with no related allowance recorded	946	904	—	52
Impaired installment receivables with a related allowance recorded	63	63	63	—
Total Canadian installment receivables	1,009	967	63	52
Total				
Non-Impaired installment receivables with no related allowance recorded	946	904	—	52
Impaired installment receivables with a related allowance recorded	3,681	3,681	2,792	—
Total installment receivables	\$ 4,627	\$ 4,585	\$ 2,792	\$ 52

Installment receivables with a related allowance recorded as noted in the table above represent those installment receivables on a non-accrual basis in accordance with ASU 2010-20. As of September 30, 2016, 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 September 30, 2016 and December 31, 2015 for which the company is still accruing interest.

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

	September 30, 2016			December 31, 2015		
	Total	U.S.	Canada	Total	U.S.	Canada
Current	\$1,030	\$—	\$1,030	\$908	\$—	\$908
0-30 Days Past Due	8	—	8	16	—	16
31-60 Days Past Due	3	—	3	12	—	12
61-90 Days Past Due	—	—	—	1	—	1
90+ Days Past Due	4,259	4,178	81	3,690	3,618	72
	\$5,300	\$4,178	\$1,122	\$4,627	\$3,618	\$1,009

## Inventories

Inventories consist of the following (in thousands):

	September 30, 2016	December 31, 2015
Finished goods	\$73,021	\$60,803
Raw materials	62,828	54,005
Work in process	10,858	11,595
Inventories, net	\$146,707	\$126,403

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2016

## Other Current Assets

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

	September 30, December 31,	
	2016	2015
Value added tax receivables	\$ 15,360	\$ 18,031
Service contracts	2,155	2,013
Derivatives (foreign currency forward contracts)	1,979	4,143
Prepaid inventory	1,099	158
Prepaid debt fees	901	869
Recoverable income taxes	704	367
Prepaid insurance	444	2,538
Prepaid and other current assets	8,955	6,313
Other Current Assets	\$ 31,597	\$ 34,432

## Other Long-Term Assets

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

	September 30, December 31,	
	2016	2015
Convertible note hedge asset	\$ 16,678	\$ —
Cash surrender value of life insurance policies	1,752	1,674
Deferred taxes	1,272	908
Deferred financing fees	447	1,088
Installment receivables	354	648
Investments	125	160
Other	185	181
Other Long-Term Assets	\$ 20,813	\$ 4,659

During the quarter ended March 31, 2016, the company issued \$150,000,000 principal amount of Convertible Senior Notes due 2021. As part of the transaction, the company entered into related convertible note hedge derivatives which are included in Other Long-Term Assets, the value of which will be adjusted quarterly to reflect fair value. See "Long-Term Debt" in the notes to the Consolidated Financial Statements included elsewhere in this report for more detail.

## Property and Equipment

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

	September 30, December 31,	
	2016	2015
Machinery and equipment	\$ 305,471	\$ 299,205
Land, buildings and improvements	75,715	73,830
Leasehold improvements	12,192	11,947
Furniture and fixtures	10,246	10,023
Property and Equipment, gross	403,624	395,005
Less allowance for depreciation	(326,578)	(316,500)
Property and Equipment, net	\$ 77,046	\$ 78,505

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2016

## Goodwill

The change in goodwill from December 31, 2015 to September 30, 2016 was due to foreign currency translation.

## Intangibles

All of the company's intangible assets have been assigned definite lives and continue to be amortized over their useful lives, except for \$25,233,000 related to trademarks, which have indefinite lives. The changes in intangible balances reflected on the balance sheet from December 31, 2015 to September 30, 2016 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.

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

	September 30, 2016		December 31, 2015	
	Historical Cost	Accumulated Amortization	Historical Cost	Accumulated Amortization
Customer lists	\$51,602	\$ 47,510	\$49,858	\$ 45,019
Trademarks	25,233	—	24,524	—
Developed technology	7,577	6,145	7,405	5,921
Patents	5,540	5,500	5,959	5,843
License agreements	1,163	1,163	1,098	1,098
Other	1,161	1,136	1,161	1,124
Intangibles	\$92,276	\$ 61,454	\$90,005	\$ 59,005

Amortization expense related to intangibles was \$1,235,000 in the first nine months of 2016 and is estimated to be \$1,637,000 in 2016, \$1,563,000 in 2017, \$1,542,000 in 2018, \$1,222,000 in 2019, \$182,000 in 2020 and \$182,000 in 2021. Amortized intangibles are being amortized on a straight-line basis over remaining lives of 1 to 10 years with the majority of the intangibles being amortized over an average remaining life of approximately 5 years.

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2016

## Accrued Expenses

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

	September 30, 2016	December 31, 2015
Salaries and wages	\$ 35,483	\$ 41,216
Warranty cost	24,744	22,820
Taxes other than income taxes, primarily value added taxes	19,903	21,424
Professional	6,880	5,774
Freight	6,772	5,978
Product liability, current portion	3,564	3,127
Severance	1,698	2,477
Interest	1,694	872
Deferred revenue	1,525	400
Supplemental Executive Retirement Program liability	1,279	1,279
Derivative liabilities	1,137	2,014
Rent	932	402
Insurance	909	695
Rebates	560	1,791
Other items, principally trade accruals	11,604	8,687
Accrued Expenses	\$ 118,684	\$ 118,956

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.

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 sales 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. The company continuously assesses the adequacy of its product warranty accrual 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 product field actions and recalls, which could warrant additional warranty reserve provision.

In 2016, the company recorded additional warranty expense of \$1,220,000 for a product recall which was related to a component on a lifestyles product, recorded in the North America/HME segment, and an additional warranty expense of \$1,670,000 for a component of a lifestyles product which was recorded in the European segment. The company's warranty reserves are subject to adjustment in future periods to the extent that new developments change the company's estimate of the total cost of these matters.

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

Balance as of January 1, 2016	\$22,820
Warranties provided during the period	9,714
Settlements made during the period	(11,585 )
Changes in liability for pre-existing warranties during the period, including expirations	3,795
Balance as of September 30, 2016	\$24,744

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2016

## Long-Term Debt

Debt consists of the following (in thousands):

	September 30, 2016	December 31, 2015
Convertible senior notes at 5.00%, due in February 2021	\$ 113,450	\$ —
Convertible senior subordinated debentures at 4.125%, due in February 2027	12,806	12,147
Senior secured revolving credit facility, due in January 2018	—	—
Other notes and lease obligations	33,838	34,973
	160,094	47,120
Less current maturities of long-term debt	(2,020 )	(2,028 )
Long-Term Debt	\$ 158,074	\$ 45,092

The company had outstanding letters of credit of \$3,414,000 and \$3,230,000 as of September 30, 2016 and December 31, 2015, respectively. As of September 30, 2016, the weighted average floating interest rate on all borrowings, excluding capital leases, was 4.93% compared to 3.83% as of December 31, 2015. There were no borrowings denominated in foreign currencies, excluding a portion of the company's capital leases, as of September 30, 2016 or December 31, 2015.

On September 30, 2015 the company entered into an Amended and Restated Revolving Credit and Security Agreement (the "Credit Agreement"), amending and restating the company's existing Revolving Credit and Security Agreement which was originally entered into on January 16, 2015 and amended on April 22, 2015 (the "Original Credit Agreement") and which matures in January 2018. 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 Original Credit Agreement and the Credit Agreement, the company incurred \$1,954,000 in fees which were capitalized and are being amortized as interest expense through January 2018. In addition, as a result of terminating the previous credit agreement, which was scheduled to mature in October 2015, the company wrote off \$668,000 in previously capitalized fees in the first quarter of 2015, which is reflected in interest expense.

On February 16, 2016, in connection with the commencement of the company's offering of 5.00% convertible senior notes due 2021 described below, the company entered into a First Amendment to Amended and Restated Revolving Credit and Security Agreement (the "Credit Agreement Amendment"), which amended the Credit Agreement. The Credit Agreement Amendment provided for, among other things:

- the amendment of the negative covenant regarding indebtedness to permit the issuance of the convertible senior notes due 2021;
- the amendment of various negative covenants to permit the convertible note hedge and warrant transactions entered into by the company in connection with the issuance of the convertible senior notes;
- the amendment of the mandatory prepayment provision to eliminate the prepayment requirement that would have otherwise been required upon the receipt of proceeds from the issuance of the convertible senior notes and the sale of

the warrants and the negative covenant regarding dividends to permit the issuance of certain equity interests, payment of interest on the notes and certain payments to be made upon conversion of the convertible notes, as well as upon the exercise, settlement or termination of the convertible note hedge and warrant transactions, so long as the company is not, and would not after giving pro-forma effect to any such transaction be, in default under the Credit Agreement and has had undrawn availability equal to at least 20% of the maximum revolving advance amount under its North American-based credit facility (which maximum amount was \$100,000,000 at September 30, 2016) for the 30 consecutive days ending as of the most recent North American borrowing base certificate delivered by the company under the Credit Agreement;

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INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2016

- the amendment of the negative covenant to permit the repurchase by the company of up to \$5,000,000 of its common shares (which were subsequently repurchased in connection with the issuance of the convertible notes) so long as the company is not, and would not after giving pro-forma effect to any such repurchase be, in default under the Credit Agreement and has had undrawn availability equal to at least 20% of the maximum revolving advance amount under its North American-based credit facility (which maximum amount was \$100,000,000 at September 30, 2016) for the 30 consecutive days ending as of the date of the most recent North American borrowing base certificate delivered by the company under the Credit Agreement;
- the amendment of the negative covenant regarding capital expenditures to increase the aggregate amount of permitted expenditures from \$20,000,000 to \$35,000,000;
- the amendment of the negative covenant regarding investments to permit certain qualifying acquisitions for total aggregate consideration of up to \$30,000,000;
- the amendment of the negative covenant regarding sales of assets to increase the aggregate amount of permitted dispositions from \$20,000,000 to \$25,000,000 (calculated as of the date of the Credit Agreement Amendment), so long as the company is not, and would not after giving pro-forma effect to any such disposition be, in default under the Credit Agreement and has had undrawn availability equal to at least 20% of the maximum revolving advance amount under its North American-based credit facility (which maximum amount was \$100,000,000 at September 30, 2016) for the 30 consecutive days ending as of the date of the most recent North American borrowing base certificate delivered by the company under the Credit Agreement; and
- the amendment of the availability block (which affects the company's borrowing base) by reducing the block from \$10,000,000 to \$5,000,000, the effect of which is to increase borrowing capacity.

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 of 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 set forth in the Credit Agreement and summarized below.

Under the Credit Agreement, 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) \$2,631,000 (subject to reduction as provided in the Credit Agreement), plus (d) 85% of eligible Canadian accounts receivable, plus (e) the lesser of (i) 70% of eligible Canadian inventory and (ii) 85% of the net orderly liquidation value of eligible Canadian inventory, less (f) swing loans outstanding under the U.S. and Canadian Credit Facility, less (g) letters of credit issued and undrawn under the U.S. and Canadian Credit Facility, less (h) a \$5,000,000 minimum availability reserve, less (i) other reserves required by the Administrative Agent, and in each case subject to the definitions and limitations in the Credit Agreement. As of September 30, 2016, 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 \$38,687,000, taking into account the \$5,000,000 minimum availability reserve, then-outstanding letters of credit, other reserves and the

\$11,250,000 dominion trigger amount described below.

Interest will accrue on outstanding indebtedness under the U.S. and Canadian Credit Facility at the LIBOR rate, plus a margin ranging from 2.25% to 2.75%, or for swing line loans, at the alternate base rate, plus a margin ranging from 1.25% to 1.75%, as selected by the company. The margin will be adjusted quarterly based on utilization. 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.

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INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2016

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. 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. The initial borrowings under the U.S. and Canadian Credit Facility were used to repay and terminate the company's previous credit agreement, which was scheduled to mature in October 2015.

European Credit Facility

The Credit Agreement also provides for a revolving credit, letter of credit and swing line loan facility which gives 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 2018, 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 set forth in the Credit Agreement and summarized below. Under the Credit Agreement, the aggregate borrowings of each of the European Borrowers under the European Credit Facility may not exceed an amount equal to (a) 85% of the European Borrower's eligible accounts receivable, less (b) the European Borrower's borrowings and swing line loans outstanding under the European Credit Facility, less (c) the European Borrower's letters of credit issued and undrawn under the European Credit Facility, less (d) a \$3,000,000 minimum availability reserve, less (e) other reserves required by the European Agent, and in each case subject to the definitions and limitations in the Credit Agreement. As of September 30, 2016, the aggregate borrowing availability to the European Borrowers under the European Credit Facility was approximately \$16,256,000, taking into account 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 of the personal property assets of the UK Borrower and its in-country subsidiaries, and all of 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

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2016

limitations set forth in the Credit Agreement. The Credit Agreement also contains a covenant requiring the European Borrowers to maintain undrawn 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.

## 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 \$13,350,000 principal amount remains outstanding. The debentures are unsecured senior subordinated obligations of the company, pay interest at 4.125% per annum on each February 1 and August 1, and are convertible upon satisfaction of certain conditions into cash, common shares of the company, or a combination of cash and common shares of the company, subject to certain conditions. The debentures allow the company to satisfy any such conversion using any combination of cash or stock, and at the company's discretion. In the event of such a conversion, the company intends to satisfy the accreted value of the debentures using cash. Assuming adequate cash on hand at the time of conversion, the company also intends to satisfy the conversion spread using cash, as opposed to stock.

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

	September 30, 2016	December 31, 2015
Principal amount of liability component	\$ 13,350	\$ 13,350
Unamortized discount	(544	) (1,203
Net carrying amount of liability component	\$ 12,806	\$ 12,147

In the first quarter of 2016, the company executed a release, acknowledged by Wells Fargo Bank, N.A., as trustee, effecting the release as guarantors of all of the company's subsidiaries that were guarantors of the debentures, issued pursuant to the terms of the indenture, dated as of February 12, 2007, between the company and the trustee.

## 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 "notes") in a private offering to qualified institutional buyers pursuant to Rule 144A under the Securities Act. The 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 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 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 notes will be convertible, subject to certain conditions, into cash. If the company obtains such shareholder approval, the 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 notes will have the right to require the company to repurchase all or some of their 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 notes (equivalent to an initial conversion price of approximately \$16.65

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2016

per common share). The company evaluated the terms of the conversion features under the applicable accounting literature, including Derivatives and Hedging, ASC 815, and determined that the features did require separate accounting as a derivative. This derivative was capitalized on the balance sheet as a long-term liability and will be adjusted to reflect fair value each quarter. The fair value of the convertible debt conversion liability at issuance was \$34,480,000. The fair value of the convertible debt conversion liability at September 30, 2016 was \$20,901,000. The company recognized gains of \$7,732,000 and \$13,579,000 for the three and nine months ended September 30, 2016, respectively.

In connection with the offering of the 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 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 notes. The company evaluated the note hedges under the applicable accounting literature, including Derivatives and Hedging, ASC 815, and determined that the note hedges should be accounted for as derivatives. These derivatives were capitalized on the balance sheet as long-term assets and will be adjusted to reflect fair value each quarter. The fair value of the convertible note hedge assets at issuance was \$27,975,000. The fair value of the convertible note hedge assets at September 30, 2016 was \$16,678,000. The company recognized losses of \$6,540,000 and \$11,297,000 for the three and nine months ended September 30, 2016, respectively.

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 notes were approximately \$144,034,000, after deducting fees and offering expenses of \$5,966,000. These debt issuance costs were capitalized and are being amortized as interest expense through February 2021. As of September 30, 2016, all \$5,966,000 of these 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. Approximately \$5,000,000 of the net proceeds from the offering were used to repurchase the company's common shares from purchasers of 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 notes consist of the following (in thousands):

	September 30, 2016
Principal amount of liability component	\$ 150,000
Unamortized discount	(31,330 )
Debt fees	(5,220 )

Net carrying amount of liability component \$ 113,450

The unamortized discount of \$31,330,000 is to be amortized through February 2021. The effective interest rate on the liability component was 11.1%. Non-cash interest expense of \$1,362,000 and \$3,150,000 was recognized for the three and nine months ended September 30, 2016, respectively, in comparison to actual interest expense accrued of \$1,875,000 and \$4,503,000, for the same periods respectively, based on the stated coupon rate of 5.0%. The notes were not convertible as of September 30, 2016 nor was the applicable conversion threshold met.

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2016

## Other Long-Term Obligations

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

	September 30, December 31,	
	2016	2015
Deferred income taxes	\$ 31,583	\$ 32,115
Convertible debt conversion liability	20,901	—
Product liability	16,030	14,582
Pension	10,390	9,868
Deferred gain on sale leaseback	6,773	6,978
Supplemental Executive Retirement Plan liability	4,826	4,930
Deferred compensation	4,130	4,167
Uncertain tax obligation including interest	3,383	4,467
Other	4,931	5,482
Other Long-Term Obligations	\$ 102,947	\$ 82,589

During the quarter ended March 31, 2016, the company issued \$150,000,000 principal amount of its 5.00% Convertible Senior Notes due 2021. As a result of the issuance, a long-term liability representing the convertible debt conversion liability was recorded which will be adjusted to reflect fair value quarterly. The amount included in the above table represents the fair value of the conversion liability as of September 30, 2016. 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 gain realized for the three months and nine months ended September 30, 2016 was \$67,000 and \$198,000, respectively. The gain realized for the three and nine months ended September 30, 2015 was \$67,000 and \$109,000, respectively.

## Equity Compensation

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. 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.

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. The 2013 Plan initially allows the Compensation Committee to grant up to 4,460,337 common shares 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 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.

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2016

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 amounts of equity-based compensation expense recognized as part of selling, general and administrative expenses were as follows (in thousands):

	For the Nine Months Ended September 30, 2016 2015	
Restricted stock and restricted stock units	\$4,085	\$1,895
Performance shares and performance share units	774	294
Non-Qualified stock options	675	1,108
Total stock-based compensation expense	\$5,534	\$3,297

As of September 30, 2016, 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):

	September 30, 2016
Restricted stock and restricted stock units	\$ 9,618
Performance shares and performance share units	3,470
Non-Qualified stock options	255
Total unrecognized stock-based compensation expense	\$ 13,343

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 "Performance Shares and Performance Share Units" below). No tax benefit for share-based compensation was realized for the three and nine months ended September 30, 2016 and 2015 as a result of a valuation allowance against deferred tax assets. In accordance with ASC 718, any tax benefits resulting from tax deductions in excess of the compensation expense recognized is classified as a component of financing cash flows.

**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. The company expects the compensation expense to be recognized over a weighted-average period of approximately two years. The following table summarizes information about stock option activity for the nine months ended September 30, 2016:

	September 30, 2016	Weighted Average Exercise Price
Options outstanding at January 1, 2016	2,942,783	\$ 21.22
Granted	—	—
Exercised	(1,250 )	13.82
Canceled	(334,713 )	22.02
Options outstanding at September 30, 2016	2,606,820	\$ 21.13
Options exercise price range at September 30, 2016	\$ 13.37	to \$ 33.36

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Options exercisable at September 30, 2016	2,530,477
Shares available for grant at September 30, 2016*	1,378,107

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Shares available for grant as of September 30, 2016 reduced by net restricted stock and restricted stock unit award \*and performance share and performance share unit award activity of 2,084,996 shares and 1,410,063 shares, respectively.

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2016

The following table summarizes information about stock options outstanding at September 30, 2016:

Exercise Prices	Options Outstanding		Weighted Average Exercise Price	Options Exercisable	
	Number Outstanding At 9/30/16	Weighted Average Remaining Contractual Life (Years)		Number Exercisable At 9/30/16	Weighted Average Exercise Price
\$ 13.37 – \$20.00	720,008	5.7	\$ 14.12	643,665	\$ 14.06
\$ 20.01 – \$25.00	1,118,478	3.0	22.58	1,118,478	22.58
\$ 25.01 – \$30.00	763,838	2.9	25.55	763,838	25.55
\$ 30.01 – \$33.36	4,496	0.4	33.36	4,496	33.36
Total	2,606,820	3.7	\$ 21.13	2,530,477	\$ 21.33

Pursuant to the plans, the 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. The company has not issued stock options since 2014. However, for 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 each option grant was estimated on the date of grant using the Black-Scholes option-pricing model with assumptions for expected dividend yield, expected stock price volatility, risk-free interest rate and expected life. The assumed expected life was based on the company's historical analysis of option history. The expected stock price volatility was also based on actual historical volatility, and expected dividend yield was based on historical dividends as the company had no current intention of changing its dividend policy.

## Restricted Stock and Restricted Stock Units

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

	September 30, 2016	Weighted Average Fair Value
Stock / Units unvested at January 1, 2016	641,505	\$ 18.89
Granted	440,872	12.93
Vested	(121,163 )	18.48
Canceled	(86,999 )	16.91
Stock / Units unvested at September 30, 2016	874,215	\$ 16.14

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.

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2016

## Performance Shares and Performance Share Units

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

	September 30, 2016	Weighted Average Fair Value
Shares / Units unvested at January 1, 2016	198,401	\$ 19.50
Granted	234,402	12.82
Vested	—	—
Canceled	(45,391 )	17.57
Shares / Units unvested at September 30, 2016	387,412	\$ 15.68

During the nine months ended September 30, 2016, 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, 2016 through December 31, 2018 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. No performance award expense has been recognized for the 2015 and 2014 awards as it is not considered probable that the performance goals for those awards will be met.

## Accumulated Other Comprehensive Income (Loss) by Component

Changes in accumulated other comprehensive income ("OCI") for the three and nine months ended September 30, 2016, respectively, were as follows (in thousands):

	Foreign Currency	Long-Term Notes	Defined Benefit Plans	Derivatives	Total
June 30, 2016	\$ 16,456	\$ 2,987	\$(9,953 )	\$ 698	\$ 10,188
OCI before reclassifications	(14,398 )	10,990	(563 )	828	(3,143 )
Amount reclassified from accumulated OCI	—	—	230	(698 )	(468 )
Net current-period OCI	(14,398 )	10,990	(333 )	130	(3,611 )
September 30, 2016	\$ 2,058	\$ 13,977	\$(10,286)	\$ 828	\$ 6,577
December 31, 2015	\$(5,744)	\$ 4,111	\$(9,757 )	\$ 2,003	\$(9,387)



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OCI before reclassifications	7,802	9,866	(835	) (103	) 16,730
Amount reclassified from accumulated OCI	—	—	306	(1,072	) (766
Net current-period OCI	7,802	9,866	(529	) (1,175	) 15,964
September 30, 2016	\$2,058	\$13,977	\$(10,286)	\$828	\$6,577

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2016

Changes in accumulated other comprehensive income ("OCI") for the three and nine months ended September 30, 2015, respectively, were as follows (in thousands):

	Foreign Currency	Long-Term Notes	Defined Benefit Plans	Derivatives	Total
June 30, 2015	\$ 18,465	\$ 1,246	\$(7,572)	\$ 398	\$ 12,537
OCI before reclassifications	15,386	(10,868 )	(69 )	(833 )	3,616
Amount reclassified from accumulated OCI	—	—	3	281	284
Net current-period OCI	15,386	(10,868 )	(66 )	(552 )	3,900
September 30, 2015	\$ 33,851	\$(9,622 )	\$(7,638)	\$ (154 )	\$ 16,437
December 31, 2014	\$ 86,236	\$(6,465)	\$(7,601)	\$(551)	\$ 71,619
OCI before reclassifications	(52,385 )	(3,157 )	(84 )	854	(54,772 )
Amount reclassified from accumulated OCI	—	—	47	(457 )	(410 )
Net current-period OCI	(52,385 )	(3,157 )	(37 )	397	(55,182 )
September 30, 2015	\$ 33,851	\$(9,622)	\$(7,638)	\$(154)	\$ 16,437

Reclassifications out of accumulated OCI for the three and nine months ended September 30, 2016 and September 30, 2015 were as follows (in thousands):

	Amount reclassified from OCI				Affected line item in the Statement of Comprehensive (Income) Loss
	For the Three Months Ended September 30, 2016		For the Nine Months Ended September 30, 2015		
<b>Defined Benefit Plans</b>					
Service and interest costs	\$ 230	\$ 3	\$ 306	\$ 47	Selling, General and Administrative Income Taxes
Tax	—	—	—	—	
Total after tax	\$ 230	\$ 3	\$ 306	\$ 47	
<b>Derivatives</b>					
Foreign currency forward contracts hedging sales	\$(1,417)	\$ 1,087	\$(2,826)	\$ 1,865	Net Sales
Foreign currency forward contracts hedging purchases	619	(971 )	1,576	(2,935 )	Cost of Products Sold
Total before tax	(798 )	116	(1,250 )	(1,070 )	
Tax	100	165	178	613	Income Taxes
Total after tax	\$(698 )	\$ 281	\$(1,072)	\$(457 )	

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INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2016

Charges Related to Restructuring Activities

The company's restructuring charges recorded since 2011 were 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 as a result of outsourcing by competitors to lower cost locations. In addition, restructuring decisions were also the result of reduced profitability in the North America/HME and Asia/Pacific segments. The company expects any near-term cost savings from restructuring will be offset by other costs as a result of pressures on the business.

The company's restructuring commenced in the second quarter of 2011 with the company's decision to close the Hong, Denmark assembly facility as part of the company's ongoing globalization initiative to reduce complexity in the company's supply chain, which is intended to reduce expenses to help offset pricing pressures. In the third quarter of 2011, the company continued to execute on the closure of the Hong, Denmark assembly facility and initiated the closure of a smaller facility in the U.S. Charges for the quarter ended December 31, 2011 were primarily incurred at the company's corporate headquarters for severance, with additional costs incurred as a result of the closure of the Hong, Denmark facility. The facility closures were completed in 2012 in addition to the elimination of various positions principally in the North America/HME and Asia/Pacific segments.

Charges for the year ended December 31, 2011 totaled \$10,534,000 including charges for severance (\$8,352,000), contract exit costs primarily related to the closure of the Hong, Denmark assembly facility (\$1,788,000) and inventory write-offs (\$277,000) recorded in cost of products sold and other miscellaneous costs (\$117,000). The majority of the 2011 North America/HME charges were incurred for severance, primarily at the corporate headquarters as the result of the elimination of various positions principally in sales and administration in Elyria, Ohio. These eliminations were permanent reductions in workforce that primarily resulted in reduced selling, general and administrative expenses. In Europe, the charges were the result of the closure of the company's Hong, Denmark facility. The assembly activities were transferred to other company facilities or outsourced to third parties. This closure enabled the company to reduce fixed operating costs related to the facility and reduce headcount with the transfer of a portion of the production to other company facilities. The 2011 charges have been paid out.

Charges for the year ended December 31, 2012 totaled \$11,395,000 including charges for severance (\$6,775,000), lease termination costs (\$1,725,000), building and asset write-downs, primarily related to the closure of the Hong, Denmark assembly facility, and other miscellaneous charges in Europe and Asia/Pacific (\$2,404,000) and inventory write-offs (\$491,000) in Asia/Pacific recorded in cost of products sold. Severance charges were primarily incurred in the North America/HME segment (\$4,242,000), Asia/Pacific segment (\$1,681,000) and Europe segment (\$817,000). A portion of the North America/HME segment severance was related to positions eliminated, principally in sales and marketing as well as manufacturing, at the company's Taylor Street facility as a result of the FDA consent decree. The savings from these charges were reflected primarily in reduced selling, general and administrative expenses and manufacturing expenses for the company. In Europe, positions were eliminated as a result of finalizing the exit from the manufacturing facility in Denmark and an elimination of a senior management position in Switzerland. In Asia/Pacific, at the end of October 2012, the company's management approved a plan to restructure the company's operations in this segment. In Australia, the company consolidated offices / warehouses, decreased staffing and exited various activities while returning to a focus on distribution. At the company's subsidiary, which produces microprocessor controllers, the company decided to cease the contract manufacturing business for companies outside of the healthcare industry. Payments for the year ended December 31, 2012 were \$9,381,000 and were funded with operating cash flows. The 2012 charges have been paid out.

Charges for the year ended December 31, 2013 totaled \$9,336,000 including charges for severance (\$8,282,000), lease termination costs (\$698,000) and other miscellaneous charges principally in North America/HME (\$356,000). Severance charges were primarily incurred in the North America/HME segment (\$5,405,000), Europe segment (\$1,640,000) and Asia/Pacific segment (\$970,000). The charges were incurred as a result of the elimination of various positions as part of the company's globalization initiatives. North America/HME segment severance was principally related to positions eliminated due to lost sales volumes resulting from the impact of the FDA consent decree. The savings from these charges were reflected primarily in reduced selling, general and administrative expenses and manufacturing expenses for the company. In Europe, severance was incurred for the elimination of certain sales and supply chain positions. In Asia/Pacific, severance was principally incurred at the company's subsidiary, which produces microprocessor controllers, as a result of the company's decision in 2012 to cease the contract manufacturing business for companies outside of the healthcare industry. The lease termination costs were principally related to Australia as a result of the restructuring announced in 2012. Payments for the year ended December 31, 2013 were \$11,844,000 and were funded with operating cash flows and cash on hand. The 2013 charges have been paid out.

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## INVACARE CORPORATION AND SUBSIDIARIES

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Charges for the year ended December 31, 2014 totaled \$11,112,000 including charges for severance (\$9,841,000), other charges in IPG and Europe (\$1,286,000) principally related to building write-downs, and lease termination cost reversals (\$15,000). Severance charges were incurred in the North America/HME segment (\$4,404,000), Other (\$2,978,000), IPG segment (\$1,163,000), Asia/Pacific segment (\$769,000) and Europe segment (\$527,000). The North America/HME segment severance was principally related to additional positions eliminated due to lost sales volumes resulting from the continued impact of the FDA consent decree. The Other severance related to the elimination of two senior corporate executive positions. IPG segment severance related principally to the closure of the London, Canada facility. Europe and Asia/Pacific severance related to the elimination of certain positions as a result of general restructuring efforts. The savings from these charges will be reflected primarily in reduced selling, general and administrative expenses and manufacturing expenses for the company. Payments for the year ended December 31, 2014 were \$11,131,000 and were funded with operating cash flows and cash on hand. The majority of the 2014 charges have been paid out other than certain executive charge payments which will be paid out over the next few years.

Charges for the year ended December 31, 2015 totaled \$1,971,000 including charges for severance (\$1,678,000) and charges primarily in the North America/HME segment (\$293,000) principally related to a building lease termination. Severance charges were incurred in the North America/HME segment (\$1,069,000), Europe segment (\$510,000), IPG segment (\$73,000) and Asia/Pacific segment (\$26,000) related to the elimination of certain positions as a result of general restructuring efforts. The savings from these charges will be reflected primarily in reduced selling, general and administrative expenses and manufacturing expenses for the company. Payments for the year ended December 31, 2015 were \$3,723,000 and were funded with operating cash flows and cash on hand. The majority of the 2015 charges are expected to be paid out in 2016.

Restructuring charges continued in 2016 resulting in charges of \$1,299,000 in the first nine months of 2016 related to severance costs incurred in the North America/HME segment (\$808,000) and the Asia/Pacific segment (\$86,000) and building lease termination costs in the North America/HME segment (\$405,000). Restructuring payments/utilization for the nine months ended September 30, 2016 were \$2,190,000 and the cash payments were funded with company's cash on hand. The majority of the 2016 charges are expected to be paid out within twelve months.

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.

A progression by reporting segment of the accruals recorded as a result of the restructuring is as follows (in thousands):

	Severance	Product Line Discontinuance	Contract Terminations	Other	Total
December 31, 2010 Balance	\$ —	\$ —	\$ —	\$ —	\$ —
Charges					
NA/HME	4,755	—	—	4	4,759
IPG	123	—	—	—	123
Europe	3,288	277	1,788	113	5,466
Asia/Pacific	186	—	—	—	186
Total	8,352	277	1,788	117	10,534
Payments					
NA/HME	(1,663 )	—	—	(4 )	(1,667 )
IPG	(52 )	—	—	—	(52 )

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Europe	(1,546 )	(277 )	(1,714 )	(113 )	(3,650 )
Asia/Pacific	(186 )	—	—	—	(186 )
Total	\$(3,447 )	\$( 277 )	\$( 1,714 )	\$(117)	\$(5,555)

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2016

	Severance	Product Line Discontinuance	Contract Terminations	Other	Total
December 31, 2011 Balance					
NA/HME	\$ 3,092	\$ —	\$ —	\$ —	\$3,092
IPG	71	—	—	—	71
Europe	1,742	—	74	—	1,816
Total	4,905	—	74	—	4,979
Charges					
NA/HME	4,242	—	5	—	4,247
IPG	35	—	—	—	35
Europe	817	—	53	1,223	2,093
Asia/Pacific	1,681	491	1,667	1,181	5,020
Total	6,775	491	1,725	2,404	11,395
Payments					
NA/HME	(3,587 )	—	(5 )	—	(3,592 )
IPG	(106 )	—	—	—	(106 )
Europe	(1,964 )	—	(127 )	(1,223 )	(3,314 )
Asia/Pacific	(812 )	(340 )	(42 )	(1,175 )	(2,369 )
Total	(6,469 )	(340 )	(174 )	(2,398 )	(9,381 )
December 31, 2012 Balance					
NA/HME	3,747	—	—	—	3,747
Europe	595	—	—	—	595
Asia/Pacific	869	151	1,625	6	2,651
Total	5,211	151	1,625	6	6,993
Charges					
NA/HME	5,405	—	164	353	5,922
IPG	267	—	—	—	267
Europe	1,640	—	—	—	1,640
Asia/Pacific	970	—	534	3	1,507
Total	8,282	—	698	356	9,336
Payments					
NA/HME	(6,347 )	—	(164 )	(353 )	(6,864 )
IPG	(175 )	—	—	—	(175 )
Europe	(1,146 )	—	—	—	(1,146 )
Asia/Pacific	(1,839 )	(151 )	(1,660 )	(9 )	(3,659 )
Total	(9,507 )	(151 )	(1,824 )	(362 )	(11,844 )
December 31, 2013 Balance					
NA/HME	2,805	—	—	—	2,805
IPG	92	—	—	—	92
Europe	1,089	—	—	—	1,089
Asia/Pacific	—	—	499	—	499
Total	\$ 3,986	\$ —	\$ 499	\$ —	\$4,485

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2016

	Severance	Product Line Discontinuance	Contract Terminations	Other	Total
Charges					
NA/HME	\$ 4,404	\$ —	—\$ —	\$ —	\$4,404
IPG	1,163	—	—	761	1,924
Europe	527	—	—	525	1,052
Asia/Pacific	769	—	(15 )	—	754
Other	2,978	—	—	—	2,978
Total	9,841	—	(15 )	1,286	11,112
Payments					
NA/HME	(6,547 )	—	—	—	(6,547 )
IPG	(1,107 )	—	—	(761)	(1,868 )
Europe	(1,195 )	—	—	(525)	(1,720 )
Asia/Pacific	(769 )	—	(227 )	—	(996 )
Total	(9,618 )	—	(227 )	(1,286)	(11,131)
December 31, 2014 Balance					
NA/HME	662	—	—	—	662
IPG	148	—	—	—	148
Europe	421	—	—	—	421
Asia/Pacific	—	—	257	—	257
Other	2,978	—	—	—	2,978
Total	4,209	—	257	—	4,466
Charges					
NA/HME	1,069	—	292	—	1,361
IPG	73	—	—	—	73
Europe	510	—	—	—	510
Asia/Pacific	26	—	1	—	27
Total	1,678	—	293	—	1,971
Payments					
NA/HME	(1,069 )	—	(55 )	—	(1,124 )
IPG	(221 )	—	—	—	(221 )
Europe	(619 )	—	—	—	(619 )
Asia/Pacific	(26 )	—	(258 )	—	(284 )
Other	(1,475 )	—	—	—	(1,475 )
Total	(3,410 )	—	(313 )	—	(3,723 )
December 31, 2015 Balance					
NA/HME	662	—	237	—	899
Europe	312	—	—	—	312
Other	1,503	—	—	—	1,503
Total	2,477	—	237	—	2,714
Charges					
NA/HME	61	—	—	—	61
Asia/Pacific	41	—	—	—	41
Total	\$ 102	\$ —	—\$ —	\$ —	\$ 102

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2016

	Severance	Product Line Discontinuance	Contract Terminations	Other	Total
Payments					
NA/HME	\$ (488 )	\$ —	—\$ (133 )	\$ —	—\$(621 )
Europe	(292 )	—	—	—	(292 )
Asia/Pacific	(41 )	—	—	—	(41 )
Other	(236 )	—	—	—	(236 )
Total	(1,057 )	—	(133 )	—	(1,190 )
March 31, 2016 Balance					
NA/HME	235	—	104	—	339
Europe	20	—	—	—	20
Other	1,267	—	—	—	1,267
Total	1,522	—	104	—	1,626
Charges					
NA/HME	271	—	391	—	662
Asia/Pacific	27	—	—	—	27
Total	298	—	391	—	689
Payments					
NA/HME	(291 )	—	(86 )	—	(377 )
Europe	(20 )	—	—	—	(20 )
Asia/Pacific	(27 )	—	—	—	(27 )
Total	(338 )	—	(86 )	—	(424 )
June 30, 2016 Balance					
NA/HME	215	—	409	—	624
Other	1,267	—	—	—	1,267
Total	1,482	—	409	—	1,891
Charges					
NA/HME	476	—	14	—	490
Asia/Pacific	18	—	—	—	18
Total	494	—	14	—	508
Payments					
NA/HME	(260 )	—	(298 )	—	(558 )
Asia/Pacific	(18 )	—	—	—	(18 )
Total	(278 )	—	(298 )	—	(576 )
September 30, 2016 Balance					
NA/HME	431	—	125	—	556
Other	1,267	—	—	—	1,267
Total	\$ 1,698	\$ —	—\$ 125	\$ —	—\$1,823

## Income Taxes

The company had an effective tax rate of 743.7% and 48.2% on losses before tax from continuing operations for the three and nine months ended September 30, 2016, respectively, compared to an expected benefit at the U.S. statutory rate of 35% on the continuing operations pre-tax losses for each period. The company's effective tax rate for the three and nine months ended September 30, 2016 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 reduced by certain taxes outside the United States, excluding countries with tax valuation allowances, that were at an effective rate lower than the U.S. statutory rate. Installment payments were made in the first

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2016

half of 2016 related to a previously disclosed liability for uncertain tax positions and current taxes payable, and during the second quarter of 2016, the company accelerated and paid the balance of the installment obligation, in order to reduce interest costs.

The company had an effective tax rate of 886.1% and 90.9% on losses before tax from continuing operations for the three and nine months ended September 30, 2015, respectively, compared to an expected benefit at the U.S. statutory rate of 35% on the continuing operations pre-tax losses for each period. The company's effective tax rate for the three and nine months ended September 30, 2015 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 reduced by certain taxes outside the United States, excluding countries with tax valuation allowances, that were at an effective rate lower than the U.S. statutory rate.

## Net Earnings (Loss) Per Common Share

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

(In thousands except per share data)	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2016	2015	2016	2015
<b>Basic</b>				
Average common shares outstanding	32,465	32,175	32,484	32,144
Net loss from continuing operations	\$(5,020)	\$(7,790)	\$(25,216)	\$(23,521)
Net earnings from discontinued operations	\$—	\$—	\$—	\$260
Net loss	\$(5,020)	\$(7,790)	\$(25,216)	\$(23,261)
Net loss per common share from continuing operations	\$(0.15 )	\$(0.24 )	\$(0.78 )	\$(0.73 )
Net earnings per common share from discontinued operations	\$—	\$—	\$—	\$0.01
Net loss per common share	\$(0.15 )	\$(0.24 )	\$(0.78 )	\$(0.72 )
<b>Diluted</b>				
Average common shares outstanding	32,465	32,175	32,484	32,144
Stock options and awards	145	540	105	511
Average common shares assuming dilution	32,610	32,715	32,589	32,655
Net loss from continuing operations	\$(5,020)	\$(7,790)	\$(25,216)	\$(23,521)
Net earnings from discontinued operations	\$—	\$—	\$—	\$260
Net loss	\$(5,020)	\$(7,790)	\$(25,216)	\$(23,261)
Net loss per common share from continuing operations *	\$(0.15 )	\$(0.24 )	\$(0.78 )	\$(0.73 )
Net earnings per common share from discontinued operations	\$—	\$—	\$—	\$0.01
Net loss per common share *	\$(0.15 )	\$(0.24 )	\$(0.78 )	\$(0.72 )

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

At September 30, 2016, 2,462,288 and 2,502,427 shares associated with stock options were excluded from the average common shares assuming dilution for the three and nine months ended September 30, 2016 as they were anti-dilutive. At September 30, 2016, 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 prices of \$12.03 and \$12.64 for the three and nine months ended September 30, 2016, respectively.

At September 30, 2015, 1,694,498 and 1,449,612 shares associated with stock options were excluded from the average common shares assuming dilution for the three and nine months ended September 30, 2015 as they were anti-dilutive. At September 30, 2015, 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 prices of \$17.50 and \$18.67 for the three and nine months ended September 30, 2015, respectively.

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INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2016

For both the three months ended September 30, 2016 and September 30, 2015, respectively, there were no shares necessary to settle a conversion spread on the convertible notes due February 2027 to be included in the common shares assuming dilution as the average market price of the company stock for these periods did not exceed the conversion price. In addition, 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.

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 the majority of future lease financing to the company's North America customers. The DLL agreement provides for direct leasing between DLL and the Invacare customer. The company retains a recourse obligation of \$6,221,000 at September 30, 2016 to DLL for events of default under the contracts, which total \$36,039,000 at September 30, 2016. 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, considering activity between the biannual dates and excluding any receivables repurchased 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 of 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.

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 and interest rate 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 generally 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 generally 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.

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2016

The company does not expect any material amount of hedge ineffectiveness related to forward contract cash flow hedges during the periods covered by the hedges.

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, the majority 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 \$59,663,000 and \$171,889,000 matured for the three and nine months ended September 30, 2016, respectively, compared to \$38,020,000 and \$100,657,000 matured for the three and nine months ended and September 30, 2015, respectively.

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

	September 30, 2016		December 31, 2015	
	Notional Amount	Unrealized Net Gain (Loss)	Notional Amount	Unrealized Net Gain (Loss)
USD / AUD	\$ 1,848	\$ (68 )	\$ 2,910	\$ (83 )
USD / CAD	2,860	139	3,893	181
USD / CNY	8,440	(97 )	16,786	(282 )
USD / EUR	20,380	(175 )	72,758	2,681
USD / GBP	470	64	3,862	22
USD / NZD	1,205	10	4,893	37
USD / SEK	1,156	(2 )	5,128	39
USD / MXP	8,015	(271 )	8,494	(284 )
EUR / AUD	172	(9 )	669	(10 )
EUR / CAD	55	6	1,283	(17 )
EUR / CHF	615	(16 )	1,944	(17 )
EUR / GBP	8,845	1,151	36,567	(424 )
EUR / SEK	509	9	2,464	(42 )
EUR / NOK	760	(10 )	3,375	(55 )
EUR / NZD	1,328	248	3,609	476
AUD / NZD	90	4	352	8
GBP / AUD	214	(48 )	830	(46 )
GBP / CHF	146	20	463	(7 )
GBP / SEK	562	77	2,067	(1 )
DKK / SEK	9,358	(41 )	37,293	46
NOK / SEK	930	(43 )	3,524	(39 )
	\$ 67,958	\$ 948	\$ 213,164	\$ 2,183

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2016

## Derivatives Not Qualifying or Designated for Hedge Accounting Treatment

The company also 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 2016 or 2015 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 2016 and 2015, respectively, and outstanding were as follows (in thousands USD):

	September 30, 2016	December 31, 2015		
	Notional Gain Amount	Notional Gain Amount	(Loss)	(Loss)
AUD / USD	\$10,101	\$8,051	\$(122)	\$337
CAD / USD	—	5,762	(4)	( )
CNY / USD	5,978	9,943	(15)	(441)
EUR / USD	—	2,118	—	53
DKK / USD	—	7,927	—	125
GBP / USD	626	4,526	85	(106)
MXP / USD	416	—	(54)	—
NOK / USD	—	1,838	—	(18)
EUR / NOK	7	—	(1)	—
EUR / SEK	65	—	1	—
	\$17,193	\$40,165	\$(106)	\$(54)

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

	September 30, 2016		December 31, 2015	
	Assets	Liabilities	Assets	Liabilities
Derivatives designated as hedging instruments under ASC 815				
Foreign currency forward exchange contracts	\$1,907	\$ 959	\$3,626	\$ 1,443
Derivatives not designated as hedging instruments under ASC 815				
Foreign currency forward exchange contracts	72	178	517	571
Total derivatives	\$1,979	\$ 1,137	\$4,143	\$ 2,014

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.

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2016

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

	Amount of Gain (Loss) Recognized in Accumulated OCI on Derivatives (Effective Portion)	Amount of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	Amount of Gain (Loss) Recognized in Income on Derivatives (Ineffective Portion and Amount Excluded from Effectiveness Testing)
Derivatives in ASC 815 cash flow hedge relationships			
Three months ended September 30, 2016			
Foreign currency forward exchange contracts	\$ 828	\$ 698	\$ 30
Nine months ended September 30, 2016			
Foreign currency forward exchange contracts	\$ (103 )	\$ 1,072	\$ 72
Three months ended September 30, 2015			
Foreign currency forward exchange contracts	\$ (833 )	\$ (281 )	\$ —
Nine months ended September 30, 2015			
Foreign currency forward exchange contracts	\$ 854	\$ 457	\$ —
Derivatives not designated as hedging instruments under ASC 815			Amount of Gain (Loss) Recognized in Income on Derivatives
Three months ended September 30, 2016			
Foreign currency forward exchange contracts			\$ 271
Nine months ended September 30, 2016			
Foreign currency forward exchange contracts			\$ (106 )
Three months ended September 30, 2015			
Foreign currency forward exchange contracts			\$ 172
Nine months ended September 30, 2015			
Foreign currency forward exchange contracts			\$ 113

The gains or losses recognized as the result of the settlement of cash flow hedge foreign currency forward contracts are recognized in net sales for hedges of inventory sales and in cost of product sold for hedges of inventory purchases. For the three and nine months ended September 30, 2016, net sales were increased by \$1,417,000 and \$2,826,000 while cost of product sold was increased by \$619,000 and \$1,576,000 for net pre-tax realized gains of \$798,000 and \$1,250,000, respectively. For the three and nine months ended September 30, 2015, net sales were decreased by \$1,087,000 and \$1,865,000 while cost of product sold was decreased by \$971,000 and \$2,935,000 for a net realized pre-tax loss of \$116,000 and a net realized pre-tax gain of \$1,070,000, respectively.

A gain of \$271,000 and a loss of \$106,000 were recognized in selling, general and administrative (SG&A) expenses for the three and nine months ended September 30, 2016 compared to gains of \$172,000 and \$113,000 for the three and nine months ended September 30, 2015, respectively, principally related to forward contracts not designated as hedging instruments that were entered into to offset gains/losses that were also recorded in SG&A expenses on

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

The company's derivative agreements provide the counterparties with a right of set off in the event of a default that 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 Amended and Restated Credit Agreement to reduce any derivative settlement amounts owed to the company under the derivative contract by any amounts owed to the counterparty

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## INVACARE CORPORATION AND SUBSIDIARIES

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by the company under the Amended and Restated Credit Agreement. In addition, the agreements contain cross-default provisions that could trigger a default by the company under the agreement in the event of a default by the company under another agreement with the same counterparty. The company does not present any derivatives on a net basis in its financial statements, other than the conversion and bond hedge derivatives which are presented net on the Condensed Consolidated Statement of Comprehensive Income (Loss), and all derivative balances presented are subject to provisions that are similar to master netting agreements.

During the first quarter of 2016, the company entered into privately negotiated convertible note hedges and 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 warrants, which increased paid in capital by \$12,376,000, are clearly and closely related to the convertible notes and thus classified as equity. The note hedge assets and conversion liabilities 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. See "Long-Term Debt" in the notes to the Consolidated Financial Statements included elsewhere in this report for more detail. The fair values of the outstanding convertible note derivatives as of September 30, 2016 and their effect on the Statement of Comprehensive Income (Loss) were as follows (in thousands):

	Fair Value	Gain (Loss)	
		Three Months Ended September 30, 2016	Nine Months Ended September 30, 2016
Convertible debt conversion long-term liability	\$(20,901)	\$7,732	\$13,579
Convertible note hedge long-term asset	16,678	(6,540)	(11,297)
	\$(4,223)	\$1,192	\$2,282

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

## 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):

	Total	Basis for Fair Value Measurements at Reporting Date		
		Quoted Prices in Active Markets for Identical Assets / (Liabilities)	Significant Other Observable Inputs	Significant Other Unobservable Inputs
		Level I	Level II	Level III
September 30, 2016				
Forward exchange contracts—net	\$842	—	\$842	—

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Convertible debt conversion liability (20,901) —	(20,901 ) —
Convertible note hedge asset 16,678 —	16,678 —
December 31, 2015	
Forward exchange contracts—net \$2,129 —	\$ 2,129 —

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

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2016

are based on quoted market prices for contracts with similar maturities. The carrying values and fair values of the company's financial instruments are as follows (in thousands):

	September 30, 2016		December 31, 2015	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Cash and cash equivalents	\$ 138,427	\$ 138,427	\$ 60,055	\$ 60,055
Other investments	125	125	160	160
Installment receivables, net of reserves	1,810	1,810	1,793	1,793
Long-term debt (including current maturities of long-term debt) *	(160,094 )	157,902	(47,120 )	(47,369 )
Convertible debt conversion liability in Other Long-Term Obligations	(20,901 )	(20,901 )	—	—
Convertible note hedge in Other Long-Term Assets	16,678	16,678	—	—
Forward contracts in Other Current Assets	1,979	1,979	4,143	4,143
Forward contracts in Accrued Expenses	(1,137 )	(1,137 )	(2,014 )	(2,014 )

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

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 other investments in limited partnerships and non-marketable equity securities, which are accounted for using the cost method, adjusted for any estimated declines in value. These investments were acquired in private placements and there are no quoted market prices or stated rates of return. The company does not have the ability to easily sell these investments. The company completes an evaluation of the residual value related to these 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: Fair values for the company's foreign exchange forward contracts are based on quoted market prices for contracts with similar maturities.

**Business Segments**

The company operates in four primary business segments: North America/Home Medical Equipment (North America/HME), Institutional Products Group (IPG), Europe and Asia/Pacific. The North America/HME segment sells each of three primary product lines, which includes: lifestyle, mobility and seating and respiratory therapy products. IPG sells, and rented prior to the disposition of the rentals businesses, long-term care medical equipment, health care furnishings and accessory products. Europe and Asia/Pacific sell product lines similar to North America/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.

As of the third quarter of 2016, the company redefined the measure by which it evaluates segment profit or loss. 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

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2016

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 write-downs and gain or loss on sales of businesses (as applicable). The previous performance measure was earnings before income taxes. With the issuance of convertible debt during 2016, this performance measure has not been utilized by the Chief Operating Decision Maker (CODM) as the interest expense incurred by the company is related to the company's financing decision to issue convertible debt as compared to the operating decisions resulting from allocation of resources and segment operating income performance. In addition, earlier this year, the company included an operating income line on the consolidated statement of comprehensive income (loss) to emphasize the CODM's emphasis on operating income (loss).

As noted, this performance measure, 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. The information by segment is as follows (in thousands):

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2016	2015	2016	2015
Revenues from external customers				
North America/HME	\$98,023	\$114,605	\$313,957	\$358,792
Institutional Products Group	15,343	17,604	49,702	68,888
Europe	143,038	140,514	403,242	397,736
Asia/Pacific	11,741	11,053	33,833	33,657
Consolidated	\$268,145	\$283,776	\$800,734	\$859,073
Intersegment revenues				
North America/HME	\$25,259	\$29,753	\$79,963	\$85,026
Institutional Products Group	998	469	2,201	823
Europe	2,320	2,776	7,577	7,411
Asia/Pacific	4,663	5,110	14,802	16,222
Consolidated	\$33,240	\$38,108	\$104,543	\$109,482
Restructuring charges before income taxes				
North America/HME	\$490	\$20	\$1,213	\$710
Institutional Products Group	—	1	—	73
Europe	—	—	—	160
Asia/Pacific	18	(10)	86	(3)
Consolidated	\$508	\$11	\$1,299	\$940
Operating profit (loss)				
North America/HME	\$(10,991)	\$(8,402)	\$(23,899)	\$(23,599)
Institutional Products Group	1,497	1,437	4,453	6,067
Europe	11,622	13,609	24,384	27,731
Asia/Pacific	(559)	(362)	(1,599)	(2,537)
All Other(1)	(5,832)	(6,106)	(17,703)	(16,029)
Charge expense related to restructuring activities	(508)	(11)	(1,299)	(940)
Gain on sale of business	7,386	24	7,386	24
Consolidated operating income (loss)	2,615	189	(8,277)	(9,283)
Net gain on convertible derivatives	1,192	—	2,282	—
Net Interest expense	(4,402)	(979)	(11,021)	(3,038)
Loss from continuing operations before income taxes	\$(595)	\$(790)	\$(17,016)	\$(12,321)

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(1) Consists of un-allocated corporate SG&A costs and intercompany profits, which do not meet the quantitative criteria for determining reportable segments, and gain or loss on convertible debt derivatives.

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INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2016

Contingencies

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 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.

On September 12, 2014, an amended complaint, in a lawsuit originally instituted on August 26, 2013, was filed against Invacare Corporation, former officer and director Gerald B. Blouch, former officer and director A. Malachi Mixon III and the company's senior Vice President, Human Resources, Patricia Stumpp, as well as outside directors Dale C. LaPorte and Michael F. Delaney and former outside director Charles S. Robb, in the U.S. District Court for the Northern District of Ohio, alleging that the defendants breached their fiduciary duties and violated the Employee Retirement Income Security Act (ERISA) in the administration and maintenance of the company stock fund in the company's Retirement Savings Plan (401(k) Plan). The lawsuit seeks class certification and unspecified damages and attorneys' fees for participants in the company's stock fund of the 401(k) Plan between July 22, 2010 and the present. On August 28, 2015, the Court limited plaintiff's claim to the time period between July 22, 2010 and December 8, 2011. This lawsuit has been referred to the company's insurance carriers. Following mediation, the parties entered into a written settlement agreement which was preliminarily approved by the Court on August 1, 2016, and which is subject to final court approval. The settlement amount is expected to be paid by the company's insurance carriers.

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 reached agreement with the FDA on the terms of a consent decree of injunction with respect to the company's Corporate facility and its Taylor Street wheelchair 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. The consent decree limits the company's manufacture and distribution of power and manual wheelchairs, wheelchair components and wheelchair sub-assemblies at or from its Taylor Street manufacturing facility. The decree also initially limited design activities related to wheelchairs and power beds that take place at the impacted Elyria, Ohio facilities. The company is entitled to continue to produce from the Taylor Street manufacturing facility certain medically necessary wheelchairs provided that documentation and record-keeping requirements are followed, as well as ongoing replacement, service and repair of products already in use, under terms delineated in the consent decree. Under the terms of the consent decree, in order to resume full operations at the impacted facilities, the company must successfully complete third-party expert certification audits

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INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2016

at the impacted Elyria facilities, which are comprised of three distinct reports that must be submitted to, and accepted by, the FDA. During 2013, the company completed the first two of the third-party expert certification audits, and the FDA found the results of both to be acceptable. In these reports, the third-party expert certified that the company's equipment and process validation procedures and its design control systems are compliant with the FDA's QSR. As a result of the FDA's acceptance of the first certification report on May 13, 2013, the Taylor Street facility was able to resume supplying parts and components for the further manufacturing of medical devices at other company facilities. The company's receipt of the FDA's acceptance of the second certification report on July 15, 2013, resulted in the company being able to resume design activities at the impacted facilities related to power wheelchairs and power beds. In February, 2016, the independent expert auditor issued its certification report for the third phase of the consent decree indicating substantial compliance with the FDA's QSR and the report was submitted to the FDA. Similar to the first and second certification processes, the FDA has responded to this report with clarifying questions to which the company and the independent expert have responded.

In December 2015, the FDA issued Form 483 observations following a 2015 inspection of approximately 5 months at the Corporate and Taylor Street facilities in Elyria, Ohio which included a review of the company's compliance with the terms of the consent decree and the matters covered by the first and second expert certification reports previously accepted in 2013 (the "December 2015 Form 483"). The company has filed its responses to this Form 483 and continues to work on addressing the FDA's observations.

On June 7, 2016, the company received a letter from the FDA in follow up to the December 2015 Form 483 and the company's subsequent responses. To satisfy FDA's design control requirements, the FDA letter outlined additional steps the company must take. In particular, the FDA clarified its requirement for the company to complete the remediation of certain design history files (DHF's) referenced in the December 2015 Form 483 and in the consent decree. Before the company can design any new Taylor Street wheelchair devices, the specified DHF's must be completed, then recertified by the company's third-party expert, whose updated report must be accepted by the FDA. The FDA also clarified that its acceptance of the expert's updated report on these DHF's is a prerequisite to proceeding further with the third certification process.

Under the terms of the consent decree, the company must submit its own written report to the FDA regarding its compliance status together with its written responses to any observations in the independent expert's certification report. Both the independent expert's third certification report, submitted in February 2016, as well as the company's own report must be accepted by the FDA before the agency reinspects the impacted Elyria facilities. If the FDA is satisfied with the company's compliance, the FDA will provide written notification that the company is permitted to resume full operations at the impacted facilities. The company cannot predict the acceptance of these reports by the FDA, the timing of the inspection, nor any remaining work that may be needed to meet the FDA's requirements to resume full operations at the impacted facilities. The FDA has the authority to inspect any FDA registered facility at any time.

After resumption of full operations, the company must undergo five years of audits by a third-party expert auditor to determine whether the facilities are in continuous compliance with FDA's QSR and the consent decree. The auditor will inspect the Corporate and Taylor Street facilities' activities every six months during the first year following the resumption of full operations and then every 12 months for the next four years thereafter.

As described above, because the limitations on production are not expected to be permanent in nature, and partial production is allowed, the company does not anticipate any major repair, replacement or scrapping of its fixed assets at the Taylor Street manufacturing facility. Based on the company's expectations at the time of filing of this Quarterly Report on Form 10-Q with respect to the utilization of such raw material and with respect to expected future cash flows from production at the Taylor Street manufacturing facility, the company concluded that there is no impairment in the value of the fixed assets related to the Taylor Street manufacturing facility at September 30, 2016.

The majority of the production from the Taylor Street facility is "made to order" custom wheelchairs for customers and, as a result, there was not a significant amount of finished goods inventory on hand at September 30, 2016, and the inventory is expected to be fully utilized. Accordingly, the company concluded that there was not an impairment

of the work in process and finished goods at the Taylor Street facility at September 30, 2016. Further, based on its analysis of the raw material inventory at the Taylor Street facility and the company's expectations at the time of filing of this Quarterly Report on Form 10-Q with respect to the time frame for FDA's acceptance of the third-party expert certification audit and FDA inspection, the company concluded that the value of the inventory was not excessive nor impaired at September 30, 2016. However, if the company's expectations regarding the impacts of the limitations in the consent decree or the time frame for acceptance of the third-party expert certification

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INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2016

audit and FDA inspection were to change, the company may, in future periods, conclude that an impairment exists with respect to its fixed assets or inventory at the Taylor Street facility.

Although the North America/HME segment is the segment primarily impacted by the limitations in the FDA consent decree, the Asia/Pacific segment also is negatively affected as a result of the consent decree due to the lower sales volume of microprocessor controllers. During 2012, before the effective date of the consent decree, the company started to experience decreases in net sales in the North America/HME and Asia/Pacific segments. The company believes that those decreases, which continued beyond 2012, were driven in large part by the consent decree which led to delays in new product introductions and to uncertainty regarding the timing of exiting the consent decree, which limited the company's ability to renegotiate and bid on certain customer contracts and otherwise led to a decline in customer orders. The negative effect of the consent decree on customer orders and net sales in these segments has been considerable, and the company expects to continue to experience low levels of net sales in the North America/HME and Asia/Pacific segments at least until it has successfully completed the previously-described FDA re-inspection and has received written notification from the FDA that the company may resume full operations at the Corporate and Taylor Street facilities. Even after the company is permitted to resume full operations at the affected facilities, 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 limitations in the consent decree had, and likely will continue to have, a material adverse effect on the company's business, financial condition and results of operations. Separately, net sales in the North America/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 contemplated their participation in the National Competitive Bidding ("NCB") process. In addition, net sales in the North America/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.

For additional information regarding the consent decree, please see the following sections of company's Annual Report on Form 10-K for the year ended December 31, 2015: 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.

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.

In December 2010, the company received a warning letter from the FDA related to quality system processes and procedures at the company's Sanford, Florida facility. In January 2014, the FDA conducted inspections at the company's manufacturing facility in Suzhou, China and at the company's electronic components subsidiary in Christchurch, New Zealand, covering quality systems and current Good Manufacturing Practice regulations. In August 2014, the FDA inspected Alber GmbH in Albstadt, Germany. The FDA issued its inspectional observations on Forms 483 to the company after these inspections, and the company submitted its responses to the agency in a timely manner. In October 2014, the FDA conducted an inspection at the Sanford facility and, at the conclusion, issued its Form 483 observations. In December 2015, the FDA issued Form 483 observations following a 2015 inspection of approximately 5 months at the Corporate and Taylor Street facilities in Elyria, Ohio. In July 2016, the FDA inspected Motion Concepts L.P. in Concord, Ontario, Canada and issued its inspectional observations on Form 483. The company has timely filed its responses to these Forms 483 with the FDA and continues to work on addressing the FDA's observations. The results of regulatory claims, proceedings, investigations, or litigation are difficult to predict. An unfavorable resolution or outcome of the FDA warning letter or other FDA enforcement related to the Sanford or other company facilities could materially and adversely affect the company's business, financial condition, and results

of operations.

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

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

OUTLOOK

The company continued to execute its transformation from being a generalist durable home medical equipment company to one more focused on solutions for clinically complex and post-acute care. The company offers a robust portfolio of clinically complex products through its core business and subsidiaries, including complex rehabilitation technology, therapeutic support surfaces and wound prevention, safe patient handling, respiratory therapy technology, and bariatric products.

The first phase of the transformation, which began late in 2015, included building the North America/HME complex rehabilitation sales force. This rehabilitation sales force and commercial processes are being enhanced to provide clinical solutions to select customer call points and to understand the benefits of the company's mobility and seating product portfolio, which comprises a majority of the company's clinically complex portfolio, as well as related products from its subsidiaries. Over time the company expects the net sales weakness from its Taylor Street power wheelchair manufacturing facility, as a result of the consent decree, to be offset by the integration and expanded product sales from its other complex rehab facilities. This phase of transformation will include periods of net sales declines, investments in selling, general and administrative (SG&A) expense, and negative cash flow. The company is actively managing to improve sales mix as reflected in gross margin as a percentage of net sales. In the third quarter of 2016, the company's gross margin percentage was flat compared to third quarter last year with the improvement in North America/HME gross margin percentage offset, in part, by additional investments in research and development (R&D).

Progress continued in the third quarter consistent with the first phase of the company's transformation plan. The company made good progress strengthening its North America salesforce with the addition of new members and clinical training for its complex rehabilitation team. The early stages of recruiting and training for the company's post-acute care team is progressing well after starting in the second quarter of 2016. In the third quarter, the company saw positive results of mix shift in the complex rehabilitation products and the focus away from less strategic product groups, including the sale of our Garden City Medical business and decrease in sales of other less accretive product lines. Also in support of the transformation, the company launched two significant new products in the third quarter: the LiNX<sup>®</sup> control system, the industry's first wirelessly programmable complex power wheelchair control system, which leads the industry's next generation of complex control systems with substantial benefits for chair operators, clinicians and the company's customers; and the Alber Twion<sup>®</sup> power assist system for active manual wheelchair users, which has a novel smartphone interface and leading features for simple daily use.

Transformation of the IPG segment, which is principally the post-acute care part of our business, began in the second quarter 2016. Post-acute care can be provided in a variety of clinical settings outside of hospitals. Over the past quarter, the company began developing a specialized post-acute care sales force, with investments in clinical sales training, assessment of customer call points, and recruitment.

To support the transformation, the company continued with investments in SG&A expense during the third quarter of 2016, and expects to continue this spending throughout this year and into 2017, to deepen clinical expertise and increase commercial effectiveness. The investments, notably the hiring of sales representatives to support the new strategy, as well as increasing the quantity of demonstration units at clinical call points, are expected to take several quarters to be accretive. Over time, as the turnaround continues to produce results, the company expects these investments to yield greater consolidated gross margin as a percentage of net sales and greater gross profit dollars.

As a result of the business transformation, which includes a focus on sales growth in lines of business with longer working capital cycles, the company expects expanded working capital balances and a resulting interim negative impact on cash flow as that expansion occurs. The company may also explore streamlining its operations and better aligning its infrastructure to efficiently deliver an improved mix of clinically complex products. To finance this transformation, grow related working capital, fund ongoing quality initiatives, and to support the company through historic seasonal performance cycles and continued foreign currency pressure, the company completed the issuance in the first quarter of 2016 of \$150,000,000 aggregate principal amount of 5.00% convertible senior notes, which mature in 2021.

The strategic shift from lower margin, less differentiated products along with external market dynamics, resulted in lower consolidated net sales and constant currency net sales for the third quarter of 2016. The company balanced margin shift resulting from the mix of declining and increasing businesses to keep gross margin percentage flat. The company continued to make measured

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SG&A investments as part of its transformation, and the company had positive free cash flow for the quarter. The company ended the quarter with a cash balance of \$138.4 million.

Between this shift and the ongoing pressure on lifestyle and respiratory products from National Competitive Bidding (NCB) in the United States, the company expects consolidated net sales to decline through the remainder of the year. However, the company's short-term metric for assessing the success of its transformation to becoming more clinically oriented and having better long-term financial results is a gross margin improvement with an initial improvement in gross margin as a percentage of net sales, and later with an increase in gross profit dollars. Despite the focus on clinically complex products, the company's gross margin was flat for the three months ended September 30, 2016 as a percentage of net sales, as the improvement in the North America/HME gross margin percentage was offset, in part, by additional investments in research and development.

In October, the company named a new leader for its European business, Ralf Ledda, who has been with the company for 21 years as leader of the company's Alber GmbH business in Germany. Also in October, the company resized certain parts of the North America business in line with shifts in staffing needs. This action is expected to generate annual cost savings of approximately \$2.6 million.

For the nine months ended September 30, 2016, net sales, excluding foreign currency translation, increased in the Europe and Asia/Pacific segments but declined in the North America/HME and IPG segments. In addition, the European and Institutional Products Group segments contributed positive operating income while the North America/HME and Asia/Pacific recognized operating losses for the nine month ended September 30, 2016, resulting in a net loss from continuing operations of \$0.78 per share compared to a net loss of \$0.73 per share for each period, respectively.

The company expects to take advantage of opportunities for growth across its many product lines and businesses by providing clinical solutions to the growing demographic in need of the company's products. The company also remains focused on building an enterprise-wide quality culture, which it believes will ultimately be a competitive advantage. The company will move forward with its transformation, managing through external uncertainty, including foreign currency fluctuations and changes in payor reimbursement policies. The company is demonstrating some improvements in the key short-term metrics as a result of its strategic shift. However, in spite of this, there may be interim periods where the company's investments do not fully yield expected financial improvements, particularly in light of various external factors.

## STATUS OF THE CONSENT DECREE

See the "Contingencies" note to the financial statements contained in Item 1 of this Form 10-Q and "Forward-Looking Statements" contained below in this Item.

## RESULTS OF CONTINUING OPERATIONS

Except for free cash flow, the financial information for all periods excludes the results of three businesses which were sold and classified as discontinued operations. On July 2, 2015, the company divested its United States medical device rentals businesses for long-term care facilities (rentals businesses), which were a part of the IPG segment. On September 30, 2016, the company completed the sale of its subsidiary, Garden City Medical Inc. ("GCM"), to Compass Health Brands for \$13,829,000 in cash, subject to certain post-closing adjustments. GCM, doing business as PMI and Pinnacle Medsource, sourced and distributed primarily single-use products under the brand ProBasics® by PMI. GCM was part of the North America/Home Medical Equipment (HME) segment. This divestiture further refines the company's focus on other lines of business where the company's resources can best generate returns in areas of

complex rehabilitation and post-acute care. Both CGM and the rentals businesses were not deemed discontinued operations for financial reporting purposes, and therefore are included in the results below unless otherwise noted. For more information, see the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q.

With the implementation of ASU 2015-03, "Simplifying the Presentation of Debt Issuance Costs", the company re-assessed the classification of amortization of debt fees. Historically, these costs were reflected in Selling, General and Administrative (SG&A) expenses, however, the company has determined it is more appropriate to classify the costs as interest expense. The amounts now classified as interest expense versus SG&A are \$526,000 and \$1,435,000 for the three and nine months ended September 30, 2016, respectively; and \$137,000 and \$997,000 for the three and nine months ended September 30, 2015.

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Net Sales

Consolidated net sales for the quarter ended September 30, 2016 decreased 5.5% to \$268,145,000 versus \$283,776,000 for the same period last year. Foreign currency translation decreased net sales by 1.0 percentage point. Constant currency net sales, which is a non-GAAP financial measure that the company defines as net sales excluding the impact of foreign currency translation, decreased by 4.5% for the quarter compared to the same period last year. Constant currency net sales are reconciled to the related GAAP financial measures in the "Business Segment Net Sales" tables on page I-10 and I-11. Constant currency net sales increased in the European and Asia/Pacific segments, but were more than offset by declines in the North America/HME and IPG segments.

Net sales for the nine months ended September 30, 2016 decreased 6.8% to \$800,734,000 versus \$859,073,000 for the same period last year. Foreign currency translation decreased net sales by 1.5 percentage points. Constant currency net sales decreased by 5.3% for the for the nine months ended September 30, 2016 compared to the same period last year. Excluding the impact from the divested rentals businesses, constant currency net sales decreased 3.6% for the first nine months compared to the same period last year. Constant currency net sales increased in the European and Asia/Pacific segments, but were more than offset by declines in the North America/HME and IPG segments.

Europe

European net sales for the three months ended September 30, 2016 increased 1.8% to \$143,038,000 versus \$140,514,000 for the third quarter last year, with foreign currency translation decreasing net sales by 2.6 percentage points. Constant currency net sales for the quarter increased by 4.4% compared to the same period last year. The improvement in net sales and constant currency net sales was driven by respiratory, lifestyle and mobility and seating products.

European net sales for the nine months ended September 30, 2016 increased 1.4% to \$403,242,000 versus \$397,736,000 for the same period last year as foreign currency translation decreased net sales by 2.7 percentage points. Constant currency net sales for the nine months ended September 30, 2016 increased by 4.1% compared to the same period last year. The improvement in net sales and constant currency net sales was driven by mobility and seating, lifestyle and respiratory products.

North America/Home Medical Equipment (HME)

North America/HME net sales for the three months ended September 30, 2016 decreased 14.5% to \$98,023,000 as compared to \$114,605,000 for the same period a year ago, with no material impact from foreign currency translation. Constant currency net sales decreased 14.5% for the quarter compared to the third quarter last year. The decrease in net sales and constant currency net sales was driven by lifestyle and respiratory products partially offset by mobility and seating products.

North America/HME net sales for the nine months ended September 30, 2016 decreased 12.5% to \$313,957,000 as compared to \$358,792,000 for the same period a year ago with foreign currency translation decreasing net sales by 0.3 of a percentage point. Constant currency net sales for the nine months ended September 30, 2016 decreased by 12.2% compared to the same period last year. The decrease in net sales and constant currency net sales was driven by lifestyle and respiratory products partially offset by mobility and seating products.

Institutional Products Group (IPG)

IPG net sales for the three months ended September 30, 2016 decreased 12.8% to \$15,343,000 compared to \$17,604,000 for the same period last year, as foreign currency increased net sales by 0.1 of a percentage point. Constant currency net sales decreased 12.9% compared to the same period last year. The decrease in net sales and constant currency net sales was driven by case goods and interior design projects. As previously disclosed, the company is transforming its go-to-market strategy in the post-acute care (PAC) channel. As part of this transformation, the IPG segment has launched robust clinical training programs for its PAC salesforce, and it is hiring new sales associates to complete its North America footprint.

IPG net sales for the nine months ended September 30, 2016 decreased 27.9% to \$49,702,000 compared to \$68,888,000 for the same period last year, as foreign currency decreased net sales by 0.3 of a percentage point. Constant currency net sales decreased 27.6% compared to the first nine months of last year. Excluding the net sales impact of the divested rentals businesses, reported net sales decreased by 8.9%, and by 8.5% on a constant currency basis. The decrease in net sales and constant currency net sales, excluding the divested rentals businesses, was driven by lower sales of beds and case goods.

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Asia/Pacific

Asia/Pacific net sales for the three months ended September 30, 2016 increased 6.2% to \$11,741,000 as compared to \$11,053,000 for the same period a year ago, as foreign currency increased net sales by 5.7 percentage points. Constant currency net sales increased 0.5% compared to the same period last year. The improvements in net sales and constant currency net sales were driven by the New Zealand distribution business.

Asia/Pacific net sales for the nine months ended September 30, 2016 increased 0.5% to \$33,833,000 as compared to \$33,657,000 for the same period a year ago, as foreign currency decreased net sales by 3.3 percentage points. Constant currency net sales increased 3.8% compared to the same period last year due to net sales increases in the Australian distribution business and at the company's subsidiary that produces microprocessor controllers.

Gross Profit

Consolidated gross margin as a percentage of net sales for both the three months ended September 30, 2016 and September 30, 2015 was 27.4%. Gross profit was impacted by reduced manufacturing costs and favorable sales mix offset by increased R&D expense. Gross margin as a percentage of net sales increased for the North America/HME and IPG segments with declines in Europe and Asia/Pacific segments. Gross profit dollars declined principally in the North America/HME segment.

Consolidated gross margin as a percentage of net sales for the nine months ended September 30, 2016 was 26.8% compared to 27.0% in the same period last year. Excluding the impact of the divested rentals businesses, gross margin as a percentage of net sales increased by 0.7 of a percentage point as compared to the same period last year driven by favorable sales mix and manufacturing costs partially offset by unfavorable warranty expense.

Europe

For the three months ended September 30, 2016, Europe gross margin as a percentage of net sales decreased 0.5 of a percentage point, or \$166,000, compared to the same period last year. The decrease in gross profit dollars was driven by unfavorable sales mix and pricing partially offset by increased sales volumes and reduced warranty costs.

For the nine months ended September 30, 2016, Europe gross margin as a percentage of net sales decreased 0.4 of a percentage point, or \$124,000, compared to the same period last year. The decrease in gross profit dollars was driven by unfavorable sales mix and pricing and increased warranty expense, driven by a specific recall expense of \$1,670,000 for a component of a lifestyles product, partially offset by increased sales volumes.

North America/Home Medical Equipment (HME)

For the three months ended September 30, 2016, North America/HME gross margin as a percentage of net sales increased by 0.1 percentage points, while gross profit dollars decreased \$3,798,000, compared to the same period last year. The decrease in gross profit dollars was primarily as a result of sales volume declines and increased research and development expenses partially offset by favorable sales mix.

For the nine months ended September 30, 2016, North America/HME gross margin as a percentage of net sales increased by 1.2 percentage points, while the gross profit dollars decreased by \$3,897,000, compared to the same period last year. The decrease in gross profit dollars was primarily as a result of sales volume declines and increased warranty expense, driven by a specific recall expense of \$1,220,000 for a component on a lifestyles product, partially offset by favorable sales mix.

Institutional Products Group (IPG)

For the three months ended September 30, 2016, IPG gross margin as a percentage of net sales increased 1.7 percentage points, while gross profit dollars decreased \$160,000, compared to the same period last year. The decrease in gross profit dollars was driven by volume declines partially offset by reduced freight costs and favorable sales mix.

For the nine months ended September 30, 2016, IPG gross margin as a percentage of net sales decreased 12.3 percentage points, or \$13,103,000, compared to the same period last year. Excluding the divested rentals business, gross margin as a percentage

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of net sales declined by 1.6 percentage points, or \$1,744,000, compared to the same period last year driven by sales volume declines and increased warranty costs partially offset by favorable sales mix.

### Asia/Pacific

For the three months ended September 30, 2016, Asia/Pacific gross margin as a percentage of net sales decreased by 0.4 of a percentage point, or \$26,000, compared to the same period last year. The slight decrease in gross profit dollars was primarily as a result of increased research and development expense partially offset by favorable sales mix.

For the nine months ended September 30, 2016, Asia/Pacific margin as a percentage of net sales increased by 1.2 percentage points, or \$349,000, compared to the same period last year. The increase in gross profit dollars was primarily as a result of reduced manufacturing and freight costs partially offset by reduced sales volumes and increased research and development expense.

### Selling, General and Administrative

Consolidated selling, general and administrative (SG&A) expenses as a percentage of net sales for the three and nine months ended September 30, 2016 was 29.0% and 28.6%, respectively, compared to 27.3% and 28.0%, respectively, for the same periods a year ago. SG&A expenses increased by \$242,000, or 0.3%, and decreased by \$11,127,000, or 4.6%, for the three and nine months ended September 30, 2016, respectively, compared to the same periods a year ago, with foreign currency translation decreasing SG&A expenses by \$388,000, or 0.5 of a percentage point, and by \$3,536,000, or 1.5 percentage points, respectively. On a constant currency basis, SG&A expense increased by \$630,000, or 0.8%, and decreased by \$7,591,000, or 3.1%, for the three and nine months ended September 30, 2016, respectively, compared to the same periods a year ago. Excluding the impacts of the divested rentals businesses and foreign currency translation, SG&A expense for the nine months ended September 30, 2016 increased \$3,647,000, or 1.6%, compared to the same period last year. The increase in SG&A expense for the quarter was primarily driven by increases in employment costs. The year to date increase in SG&A expense, excluding the divested rentals businesses, was primarily driven by increased employment and product liability costs partially offset by reduced regulatory and compliance costs.

### Europe

European SG&A expenses increased by 6.3%, or \$1,820,000, for the three months ended September 30, 2016 compared to the same period a year ago with foreign currency translation decreasing SG&A expenses by approximately \$639,000, or 2.2 percentage points. Constant currency SG&A expenses increased by \$2,459,000, or 8.5%, primarily attributable to increased employment costs.

For the nine months ended September 30, 2016, European SG&A expenses increased by 3.7%, or \$3,223,000, compared to the same period a year ago with foreign currency translation decreasing SG&A expenses by approximately \$2,436,000, or 2.7 percentage points. Constant currency SG&A expenses increased by \$5,659,000, or 6.4%, with the increase primarily attributable to increased employment costs.

### North America/Home Medical Equipment (HME)

SG&A expenses for North America/HME decreased 3.4%, or \$1,204,000, for the three months ended September 30, 2016 compared to the same period a year ago with foreign currency translation having no material impact. Constant currency SG&A expenses decreased \$1,208,000, or 3.5%, driven primarily by reduced regulatory and compliance costs and employment costs.

For the nine months ended September 30, 2016, SG&A expenses for North America/HME decreased 3.5%, or \$3,597,000, compared to the same period a year ago with foreign currency translation decreasing SG&A expenses by \$725,000, or 0.7 of a percentage point. Constant currency SG&A expenses decreased \$2,872,000, or 2.8%, with the decrease primarily related to reductions in regulatory and compliance costs partially offset by increased product liability expense.

Institutional Products Group (IPG)

SG&A expenses for IPG decreased by 7.3%, or \$221,000, for the three months ended September 30, 2016 compared to the same period a year ago with foreign currency translation having no material impact. The reduction in SG&A expense for the quarter was primarily related to employment costs.

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For the nine months ended September 30, 2016, SG&A expenses for IPG decreased by 56.5%, or \$11,489,000, compared to the same period a year ago with foreign currency translation having no material impact. The reduction in SG&A expense for the first nine months was primarily related to the sale of the rentals businesses in July 2015, which decreased SG&A expense by \$11,238,000. The remaining decline was the result of reduced employment costs.

Asia/Pacific

Asia/Pacific SG&A expenses increased 4.4%, or \$170,000, for the three months ended September 30, 2016 compared to the same period a year ago with foreign currency translation increasing SG&A expenses by \$249,000, or 6.4 percentage points. Constant currency SG&A expenses decreased by \$79,000, or 2.0%, primarily driven by unfavorable foreign currency transactions.

For the nine months ended September 30, 2016, Asia/Pacific SG&A expenses decreased 4.7%, or \$589,000, compared to the same period a year ago with foreign currency translation decreasing SG&A expenses by \$355,000, or 2.8 percentage points. Constant currency SG&A expenses decreased slightly by \$234,000, or 1.9%, primarily driven by unfavorable foreign currency transactions.

Other

For the three and nine months ended September 30, 2016, SG&A expenses related to the Other Segment decreased by 5.3%, or \$323,000, and increased by 8.4%, or \$1,325,000, respectively, compared to the same periods a year ago with the decrease in the quarter primarily driven by lower consulting costs while the increase year to date is primarily attributable to higher employment costs primarily related to equity compensation expense.

Gain on Sale of Business. As a result of the sale of GCM on September 30, 2016, the company recorded a gain in the third quarter of 2016 on the sale of \$7,386,000 which represents the excess of the net sales price over the book value of the net assets of GCM. As a result of the sale of the rentals business on July 2, 2015, the company recorded a gain of \$24,000 in the third quarter of 2015, which represented the excess of the net sales price over the book value of the assets and liabilities of the rentals businesses.

Charge Related to Restructuring Activities. Restructuring charges totaled \$1,299,000 in the first nine months of 2016 related to severance and contract terminations in the NA/HME segment (\$1,213,000) and severance in the Asia/Pacific segment (\$86,000). In the first nine months of 2015, the company incurred restructuring charges of \$940,000 related principally to severance costs (\$939,000) incurred primarily in the NA/HME segment (\$710,000) and to a lesser extent the Europe segment (\$160,000). The majority of the outstanding restructuring accruals at September 30, 2016 are expected to be paid out in the next twelve months other than certain executive payments which will be paid out over the next few years.

Net Gain on Convertible Debt Derivatives. For the three and nine months ended September 30, 2016, the company recognized losses of \$6,540,000 and \$11,297,000, respectively, related to the convertible note hedge derivative long-term asset and recognized gains of \$7,732,000 and \$13,579,000, respectively, related to the convertible debt conversion liability derivative which resulted in net gains of \$1,192,000 and \$2,282,000, respectively, related to the fair value of the convertible debt derivatives. See "Long-Term Debt" in the notes to the Consolidated Financial Statements included elsewhere in this report for more detail.

Interest. Interest expense increased to \$4,481,000 and \$11,228,000 for the three and nine months ended September 30, 2016, respectively, compared to \$1,021,000 and \$3,160,000, respectively, for the same respective periods a year ago, representing increases of 338.9% and 255.3%, respectively. The increases in interest expense for the third quarter and

year to date as compared to the same periods a year ago was primarily due to the convertible notes issuance in the first quarter of 2016 and to capital lease interest as a result of the real estate sale and leaseback transaction finalized in the second quarter of 2015. Interest expense for the first nine months of 2015 included \$668,000 for the write-off of bank fees. With the implementation of ASU 2015-03, "Simplifying the Presentation of Debt Issuance Costs", the company re-assessed the classification of amortization of debt fees. Historically, these costs were reflected in SG&A expenses; however, the company determined it was more appropriate to classify the costs as interest expense. See the "Reclassifications" disclosure in the Accounting Policies note to the Consolidated Financial Statements included elsewhere in this report for more detail. Interest income was \$79,000 and \$207,000 for the three and nine months ended September 30, 2016, respectively, compared to \$42,000 and \$122,000, for the same respective periods last year.

Income Taxes. The company had an effective tax rate of 743.7% and 48.2% on losses before tax from continuing operations for the three and nine months ended September 30, 2016, respectively, compared to an expected benefit at the U.S. statutory rate

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of 35.0% on the continuing operations pre-tax losses for each period. The company's effective tax rate for the three and nine months ended September 30, 2016 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 reduced by certain taxes outside the United States, excluding countries with tax valuation allowances, that were at an effective rate lower than the U.S. statutory rate. Installment payments were made in the first half of 2016 related to a previously disclosed liability for uncertain tax positions and current taxes payable, and during the second quarter of 2016, the company accelerated and paid the balance of the installment obligation, in order to reduce interest costs.

The company had an effective tax rate of 886.1% and 90.9% on losses before tax from continuing operations for the three and nine months ended September 30, 2015, respectively, compared to an expected benefit at the U.S. statutory rate of 35.0% on the continuing operations pre-tax losses for each period. The company's effective tax rate for the three and nine months ended September 30, 2015 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 reduced by certain taxes outside the United States, excluding countries with tax valuation allowances, that were at an effective rate lower than the U.S. statutory rate.

## LIQUIDITY AND CAPITAL RESOURCES

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

The company's total debt outstanding, inclusive of the debt discount related to the convertible senior subordinated debentures due 2027 included in equity in accordance with FSB APB 14-1 as well as the debt discount and fees associated with the convertible senior notes due 2021, increased by \$148,865,000 to \$197,188,000 at September 30, 2016 from \$48,323,000 as of December 31, 2015. The company's balance sheet reflects the impact of ASC 470-20, which reduced debt and increased equity by \$544,000 and \$1,203,000 as of September 30, 2016 and December 31, 2015, respectively, related to the convertible senior subordinated debentures due 2027. The debt discount and fees associated with the convertible senior notes due 2021 reduced the company's reported debt balance by \$31,330,000 and \$5,220,000, respectively, as of September 30, 2016. The debt increase during the first nine months of 2016 was principally a result of issuing \$150,000,000 aggregate principal amount of 5.00% Convertible Senior Notes due 2021. The company's cash and cash equivalents were \$138,427,000 at September 30, 2016, compared to \$60,055,000 as of December 31, 2015. At September 30, 2016 and December 31, 2015, the company had zero borrowings outstanding under its revolving credit facility. Cash balances increased in the third quarter of 2016 compared to second quarter of 2016 primarily due to the sale of its subsidiary, GCM for \$13,829,000. The increase in cash balances compared to December 31, 2015 was primarily the result of the net proceeds received from the issuance of convertible debt in the first quarter of 2016 and the sale proceeds from the sale of GCM partially offset by cash flow usage.

The company's cash balances were utilized for normal operations during the nine-month period ended September 30, 2016. Debt repayments, acquisitions, divestitures, the timing of vendor 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 debt reported at the end of a given period may be materially different than debt levels during a given period. While the company has cash balances in various jurisdictions around the world, there are no material restrictions regarding the use of such cash for dividends within the company, loans or other purposes, except in China where the cash balance as of September 30, 2016 was approximately \$6,495,000.

The company has an asset-based lending Amended and Restated Revolving Credit and Security Agreement (the "Credit Agreement"), which provides for a revolving line of credit, letter of credit and swing line facility for the company's U.S. and Canadian borrowers in an aggregate principal amount of up to \$100,000,000 (the "U.S. and Canadian Credit Facility") and a similar facility for European borrowers in an aggregate principal amount of up to \$30,000,000 (the "European Credit Facility") each of which is subject to variable rates and availability based on a borrowing base formula. The initial borrowings under the Credit Agreement were used to repay approximately \$17,000,000 in aggregate principal amount of borrowings and terminate the company's previous credit agreement, which was scheduled to mature in October 2015. As determined pursuant to the borrowing base formula for the U.S. and Canadian borrowers, the company's borrowing base including the period ending September 30, 2016 under the U.S. and Canadian Credit Facility of the Credit Agreement was approximately \$60,078,000, with aggregate borrowing availability of approximately \$38,687,000, taking into account the \$5,000,000 minimum availability reserve, then-outstanding letters of credit, other reserves and the \$11,250,000 dominion trigger amount noted below. As determined pursuant to the borrowing base formula

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for the European borrowers, the company's borrowing base including the period ending September 30, 2016 under the European Credit Facility of the Credit Agreement was approximately \$22,631,000, with aggregate borrowing availability of approximately \$16,256,000, taking into account the \$3,000,000 minimum availability reserve and the \$3,375,000 dominion trigger amount noted below. See Long-Term Debt in the Notes to the Consolidated Financial Statements for more details regarding the Credit Agreement.

As a result of entering into the Credit Agreement, the company incurred \$1,954,000 in fees, which were capitalized and are being amortized as interest expense through January 2018. In addition, as a result of terminating the previous credit agreement, which was scheduled to mature in October 2015, the company wrote off \$668,000 in previously capitalized fees in the first quarter of 2015, which is reflected in interest expense for the North America / HME segment.

As of September 30, 2016, the company was in compliance with all covenant requirements under the Credit Agreement. The Credit Agreement contains customary representations, warranties and covenants including dominion triggers requiring the company to maintain borrowing capacity of not less than \$11,250,000 on an given business day or \$12,500,000 for five consecutive days related to the U.S. and Canadian borrowers and \$3,375,000 on an given business day or 12.5% of the maximum amount that may be drawn under the European Credit Facility for five consecutive days related to European borrowers 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.

If the company is unable to comply with the provisions in the Credit Agreement, it could result in a default, which could trigger acceleration of, or the right to accelerate, the related debt. Because of cross-default provisions in its agreements and instruments governing certain of the company's indebtedness, a default under the Credit Agreement could result in a default under, and the acceleration of, certain other company indebtedness. In addition, the company's lenders would be entitled to proceed against the collateral securing the indebtedness.

Based on the company's current expectations, the company believes that its cash balances, available borrowing capacity under its Credit Agreement and any cash generated by operations 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, the company may be unable to comply with its obligations under the Credit Agreement, and its lenders could demand repayment of the amounts outstanding under the company's credit facilities.

In the first quarter of 2016, the company issued \$150,000,000 aggregate principal amount of 5.00% Convertible Senior Notes due 2021 in a private offering. The notes bear interest at a rate of 5.00% per year payable semi-annually and will mature in February 2021, unless repurchased or converted in accordance with their terms prior to such date. Prior to August 15, 2020, the 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 notes will be convertible, subject to certain conditions, into cash. If the company obtains such shareholder approval, the 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.

In connection with the offering of the 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 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 notes. 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 net proceeds from the offering were \$144,034,000, after deducting fees and estimated offering expenses payable by the company. Approximately \$5,000,000 of the net proceeds from the offering was used to repurchase the company's common shares, and \$15,600,000 of the net proceeds was used to pay the net cost of the convertible note hedge and warrant transactions. The company incurred \$5,966,000 in fees, which were capitalized and are being amortized as interest expense through February 2021, of which all \$5,966,000 was paid by September 30, 2016. The company intends to use the remaining net proceeds from the

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offering for working capital and general corporate purposes, which may include funding portions of the company's ongoing turnaround and addressing potential risks and contingencies. The net proceeds will allow the company to invest in new products, people, marketing initiatives and working capital to transform the business and pursue growth.

The company also has an agreement with De Lage Landen, Inc. ("DLL"), a third party financing company, to provide the majority of future lease financing to the company's North America 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 the Credit Agreement 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. As of September 30, 2016, the weighted average floating interest rate on revolving credit borrowings, excluding capital leases, was 4.93% compared to 3.83% as of December 31, 2015.

## CAPITAL EXPENDITURES

The company estimates that capital investments for 2016 could approximate between \$11,000,000 and \$13,000,000, compared to actual capital expenditures of \$7,522,000 in 2015. The anticipated increase considers the company's investments to transform the company. The company believes that its balances of cash and cash equivalents and existing borrowing facilities, will be sufficient to meet its operating cash requirements and fund required capital expenditures for the foreseeable future. The Credit Agreement, as amended in February 2016, limits the company's annual capital expenditures to \$35,000,000. As of September 30, 2016, 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, 2015.

## CASH FLOWS

Cash flows used by operating activities were \$49,385,000 for the first nine months of 2016 compared to cash flows used of \$35,549,000 in the first nine months of 2015. The decrease in operating cash flow in the first nine months of 2016 compared to the first nine months of last year was principally due to a higher net loss, the negative cash flow impact of higher inventories and tax payments of approximately \$12,500,000 related to a previously disclosed liability for uncertain tax positions and current taxes. Operating cash flows for the first nine months of 2015 were negatively impacted by retirement payments of \$24,651,000 related to the retirement of two executive officers of the company.

Cash flows provided by investing activities were \$6,967,000 for the first nine months of 2016 compared to cash flows provided of \$44,353,000 in the first nine months of 2015. Cash flows provided by investing activities for the first nine months of 2016 included net proceeds of \$13,829,000 from the sale of GCM. Cash flows provided by investing activities for the first nine months of 2015 included the receipt of \$23,000,000 in proceeds from the company's real estate sale leaseback transaction as well as the surrender of corporate-owned life insurance totaling \$11,900,000 used to fund benefit payments related to the retirement of executive officers. In addition, the company received net proceeds of \$13,700,000 from the sale of its rental businesses in July 2015.

Cash flows provided by financing activities were \$119,362,000 in the first nine months of 2016 compared to cash flows used of \$11,955,000 in the first nine months of 2015. Cash flows provided in the first nine months of 2016 reflect net proceeds received as a result of the issuance of Convertible Senior Notes due 2021, including the net proceeds used for the related convertible note hedge transactions, repurchase of common shares and payment of financing costs.

During the first nine months of 2016, free cash flow was negative \$56,153,000 compared to negative \$18,352,000 in the first nine months of 2015. The first nine months 2016 and 2015 free cash flow was negatively impacted by the same items that affected cash flows used by operation activities. In addition, free cash flow for the first nine months of 2015 included a positive free cash flow impact of \$23,000,000 as a result of the proceeds from the company's real estate sale leaseback transaction. Excluding the negative impact of the \$12,500,000 tax payment noted above, free cash flow in the first nine months of 2016 was negative \$43,653,000. Excluding the \$23,000,000 positive impact of the real estate sale and leaseback transaction and the \$24,651,000 negative impact of the retirement payments noted above, free cash flow in the first nine months of 2015 was negative \$16,701,000. Free cash flow is a non-GAAP financial measure that is comprised of net cash used by operating activities less purchases of property

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and equipment plus 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.).

The non-GAAP financial measure is reconciled to the GAAP measure as follows (in thousands):

	Nine Months Ended	
	September 30, 2016	
	2016	2015
Net cash used by operating activities	\$(49,385)	\$(35,549)
Plus: Sales of property and equipment	29	23,093
Less: Purchases of property and equipment	(6,797 )	(5,896 )
Free Cash Flow	\$(56,153)	\$(18,352)

**BUSINESS SEGMENT NET SALES**

Business Segment Net Sales - The following tables provide net sales change for continuing operations as reported and as adjusted to exclude the impact of foreign exchange translation (constant currency net sales) as well as net sales further adjusted to exclude the impact of the sale of the rentals businesses, which were sold in July 2015 and not deemed a discontinued operation from an external reporting perspective. "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 current 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. Management believes that this financial measure provides meaningful information for evaluating the core operating performance of the company.

Constant currency net sales for the three months ended September 30, 2016 compared to September 30, 2015:

	Reported	Foreign Exchange Translation Impact		Constant Currency
North America / HME	(14.5 )%	—	%	(14.5 )%
Institutional Products Group	(12.8 )%	0.1	%	(12.9 )%
Europe	1.8 %	(2.6 )%		4.4 %
Asia/Pacific	6.2 %	5.7 %		0.5 %
Consolidated	(5.5 )%	(1.0 )%		(4.5 )%

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Constant currency net sales for the nine months ended September 30, 2016 compared to September 30, 2015:

	Reported	Foreign Exchange Translation Impact	Constant Currency
North America / HME	(12.5 )%	(0.3 )%	(12.2 )%
Institutional Products Group	(27.9 )%	(0.3 )%	(27.6 )%
Europe	1.4 %	(2.7 )%	4.1 %
Asia/Pacific	0.5 %	(3.3 )%	3.8 %
Consolidated	(6.8 )%	(1.5 )%	(5.3 )%

	Reported	Impact of Rentals Businesses	Reported excluding Rentals Businesses
Institutional Products Group	(27.9 )%	(19.0 )%	(8.9 )%
Consolidated	(6.8 )%	(1.6 )%	(5.2 )%

	Constant Currency	Impact of Rentals Businesses	Constant Currency excluding Rentals Businesses
Institutional Products Group	(27.6 )%	(19.1 )%	(8.5 )%
Consolidated	(5.3 )%	(1.7 )%	(3.6 )%

## DIVIDEND POLICY

On August 26, 2016, the company's Board of Directors declared a quarterly cash dividend of \$0.0125 per Common Share to shareholders of record as of October 13, 2016, which was paid on October 21, 2016. At the current rate, the cash dividend will amount to \$0.05 per Common Share on an annual basis, subject to Board of Directors approval of future dividend payments.

## 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, as a result, actual results could differ from these estimates.

The following critical accounting policies, among others, affect the more significant judgments and estimates used in preparation of the company's consolidated financial statements.

### Revenue Recognition

Invacare's revenues are recognized when products are shipped or services provided to unaffiliated customers. Revenue Recognition, ASC 605, provides guidance on the application of generally accepted accounting principles to selected revenue recognition issues. The company has concluded that its revenue recognition policy is appropriate and in accordance with GAAP and ASC 605. Shipping and handling costs are included in cost of goods sold.

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.

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The company offers discounts and rebates, which are accounted for as reductions to revenue in the period in which the sale is recognized. Discounts offered include: cash discounts for prompt payment, base and trade discounts based on contract level for specific classes of customers. Volume discounts and rebates are given based on large purchases and the achievement of certain sales volumes. Product returns are accounted for as a reduction to reported sales with estimates recorded for anticipated returns at the time of sale. The company does not ship any goods on consignment.

Distributed products sold by the company are accounted for in accordance with the revenue recognition guidance in ASC 605-45-05. 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.

Product sales that give rise to installment receivables are recorded at the time of sale when the risks and rewards of ownership are transferred. Interest income is recognized on installment agreements in accordance with the terms of the agreements. Installment accounts are monitored and if a customer defaults on payments, interest income is no longer recognized. All installment accounts are accounted for using the same methodology, regardless of duration of the installment agreements.

### Allowance for Uncollectible Accounts Receivable

The estimated allowance for uncollectible amounts is based primarily on management's evaluation of the financial condition of the customer. In addition, as a result of the third party financing arrangement, 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 establishing reserves for specific customers as needed.

The company continues to closely monitor the credit-worthiness of its customers and adhere to tight credit policies. In 2013, the Centers for Medicare and Medicaid Services announced new Medicare prices which became effective in July 2013 for the second round of the NCB program, which was expanded to include 91 additional MSAs. The reimbursement reductions to the rural areas began in January 2016 and continued in July 2016. Further reductions may occur if private payors elect to adopt their own reimbursement changes. The company believes the changes could have a significant impact on the collectability of accounts receivable for those customers which are in the rural locations impacted and which have a portion of their revenues tied to Medicare reimbursement. As a result, this is an additional risk factor which the company considers when assessing the collectability of accounts receivable.

The company has an agreement with DLL, a third party financing company, to provide the majority of future lease financing to Invacare's North America customers. The DLL agreement provides for direct leasing between DLL and the Invacare customer. The company retains a recourse obligation for events of default under the contracts. The company monitors the collections status of these contracts and has provided amounts for estimated losses in its allowances for doubtful accounts.

### Inventories and Related Allowance for Obsolete and Excess Inventory

Inventories are stated at the lower of cost or market with cost determined by the first-in, first-out method. Inventories have been reduced by an allowance for excess and obsolete inventories. The estimated allowance is based on management's review of inventories on hand compared to estimated future usage and sales. A provision for excess and obsolete inventory is recorded as needed based upon the discontinuation of products, redesigning of existing products, new product introductions, market changes and safety issues. Both raw materials and finished goods are reserved for on the balance sheet.

In general, Invacare reviews inventory turns as an indicator of obsolescence or slow moving product as well as the impact of new product introductions and product line discontinuations. Depending on the situation, the company may partially or fully reserve for the individual item. The company continues to increase its overseas sourcing efforts,

increase its emphasis on the development and introduction of new products, and decrease the cycle time to bring new product offerings to market. These initiatives are potential sources of inventory obsolescence for both raw material and finished goods.

#### Goodwill, Intangible and Other Long-Lived Assets

Property, equipment, intangibles and certain other long-lived assets are amortized over their useful lives. Useful lives are based on management's estimates of the period that the assets will generate revenue. Under Intangibles-Goodwill and Other, ASC 350, goodwill and intangible assets deemed to have indefinite lives are subject to annual impairment tests. The company's measurement date for its annual goodwill impairment test is October 1 and the analysis is completed in the fourth quarter. Furthermore, goodwill and other long-lived assets are reviewed for impairment whenever events or changes in circumstances

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indicate that the carrying amount of an asset may not be recoverable. The majority of the company's goodwill and intangible assets relate to the company's Europe and IPG segments which are profitable.

To review goodwill for impairment in accordance with ASC 350, the company first estimates the fair value of each reporting unit and compares the calculated fair value to the carrying value of each reporting unit. A reporting unit is defined as an operating segment or one level below. The company has determined that its reporting units are the same as its operating segments. The company completes its annual impairment tests in the fourth quarter of each year. To estimate the fair values of the reporting units, the company utilizes a discounted cash flow (DCF) method in which the company forecasts income statement and balance sheet amounts based on assumptions regarding future sales growth, profitability, inventory turns, days' sales outstanding, etc. to forecast future cash flows. The cash flows are discounted using a weighted average cost of capital discount rate where the cost of debt is based on quoted rates for 20-year debt of companies of similar credit risk and the cost of equity is based upon the 20-year treasury rate for the risk free rate, a market risk premium, the industry average beta and a small cap stock adjustment. The discount rates used have a significant impact upon the discounted cash flow methodology utilized in the company's annual impairment testing as higher discount rates decrease the fair value estimates. The assumptions used are based on a market participant's point of view and yielded a discount rate of 9.41% in 2015 for the company's annual impairment analysis compared to 9.89% in 2014 and 10.00% in 2013.

The company also utilizes an Enterprise Value (EV) to Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA) Method to compute the fair value of its reporting units which considers potential acquirers and their EV to EBITDA multiples adjusted by an estimated premium. While more weight is given to the discounted cash flow method, the EV to EBITDA method does provide corroborative evidence of the reasonableness of the discounted cash flow method results.

In 2015, the company performed a review for potential impairments of any other assets, including the company's Taylor Street facility which is subject to the FDA consent decree that limits the company's manufacture and distribution of custom power and manual wheelchairs, wheelchair components and wheelchair subassemblies at the Taylor Street facility. The company determined there was no impairment of the property, plant and equipment of the Taylor Street facility based on a comparison of the forecasted undiscounted cash flows to the carrying value of the net assets in accordance with ASC 360. In addition, the company determined there was no impairment of inventory associated with the facility. There were no changes during the first nine months of 2016 which would result in an impairment of inventory or other assets at the Taylor Street facility.

While there was no indication of impairment in 2015 related to goodwill for the Europe or IPG segments, a future potential impairment is possible for any of the company's segments should actual results differ materially from forecasted results used in the valuation analysis. Furthermore, the company's annual valuation of goodwill can differ materially if the market inputs used to determine the discount rate change significantly. For instance, higher interest rates or greater stock price volatility would increase the discount rate and thus increase the chance of impairment. In consideration of this potential, the company reviewed the results if the discount rate used were 100 basis points higher for the 2015 impairment analysis and determined that there still would not be any indicator of potential impairment for the segments with goodwill which are Europe and IPG.

The company's intangible assets consist of intangible assets with defined lives as well as intangible assets with indefinite lives. Defined-lived intangible assets consist principally of customer lists, developed technology, license agreements, patents and other miscellaneous intangibles such as non-compete agreements. The company's indefinite lived intangible assets consist entirely of trademarks.

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.

**Product Liability**

The company is self-insured in North America for product liability exposures through its captive insurance company, Invatection Insurance company, which currently has a policy year that runs from September 1 to August 31 and insures annual policy losses up to \$10,000,000 per occurrence and \$13,000,000 in the aggregate. The company also has additional layers of external insurance coverage, related to all lines of insurance coverage, insuring up to \$75,000,000 in aggregate losses per policy

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year arising from individual claims anywhere in the world that exceed the captive insurance company policy limits or the limits of the company's per country foreign liability limits, as applicable. There can be no assurance that the company's current insurance levels will continue to be adequate or available at affordable rates.

Product liability reserves are recorded for individual claims based upon historical experience, industry expertise and other indicators. Additional reserves, in excess of the specific individual case reserves, are provided for incurred but not reported claims based upon actuarial valuations at the time such valuations are conducted. Historical claims experience and other assumptions are taken into consideration by the company in estimating the ultimate reserves. For example, the actuarial analysis assumes that historical loss experience is an indicator of future experience, that the distribution of exposures by geographic area and nature of operations for ongoing operations is expected to be very similar to historical operations with no dramatic changes and that the government indices used to trend losses and exposures are appropriate. Estimates made are adjusted on a regular basis and can be impacted by actual loss awards and settlements on claims. While actuarial analysis is used to help determine adequate reserves, the company is responsible for the determination and recording of adequate reserves in accordance with accepted loss reserving standards and practices.

### Warranty

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. The company continuously assesses the adequacy of its product warranty accrual 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 warrant additional warranty reserve provision. See Current Liabilities in the Notes to the Consolidated Financial Statements for a reconciliation of the changes in the warranty accrual.

### Accounting for Stock-Based Compensation

The company accounts for share based compensation under the provisions of Compensation—Stock Compensation, ASC 718. The company has not made any modifications to the terms of any previously granted awards and no changes have been made regarding the valuation methodologies or assumptions used to determine the fair value of awards granted. As of September 30, 2016, there was \$13,343,000 of total unrecognized compensation cost from stock-based compensation arrangements, which is related to non-vested options and shares, and includes \$9,618,000 related to restricted stock awards, \$255,000 related to non-qualified stock options and \$3,470,000 related to performance share awards.

The substantial majority of the options awarded have been granted at exercise prices equal to the market value of the underlying stock on the date of grant. Restricted stock awards granted without cost to the recipients are expensed on a straight-line basis over the vesting periods. Performance awards granted are expensed based on estimated achievement of the performance objectives over the relevant performance award periods.

### Income Taxes

As part of the process of preparing its financial statements, the company is required to estimate income taxes in various jurisdictions. The process requires estimating the company's current tax liability, including assessing uncertainties related to tax return filing positions, as well as estimating temporary differences due to the different treatment of items for tax and accounting policies. The temporary differences are reported as deferred tax assets and liabilities. The company also must estimate whether it will more likely than not realize its deferred tax assets and whether a valuation allowance should be established. Substantially all of the company's U.S., Australia and New Zealand deferred tax assets are offset by a valuation allowance. In the event that actual results differ from its

estimates, the company's provision for income taxes could be materially impacted. The company does not believe that there is a substantial likelihood that materially different amounts would be reported related to its critical accounting policies.

#### Accounting for Convertible Debt and Related Derivatives

In the first quarter of 2016, the company issued \$150,000,000 aggregate principal amount of 5.00% Convertible Senior Notes due 2021 (the "notes"). In connection with the offering of the 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 notes, and are expected

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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 notes. 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 strike price of the warrants will initially be \$22.4175 per share and is subject to certain adjustments under the terms of the warrant transactions.

The convertible debt conversion liability and the convertible note hedges are accounted for as derivatives that are fair valued quarterly while the warrants are included as equity. The fair value of the convertible debt conversion liability and the convertible note hedges are estimated using a lattice model incorporating the terms and conditions of the notes and considering, for example, changes in the prices of the company's common stock, company stock price volatility, risk-free rates and changes in market rates. The valuations are, among other things, subject to changes in both the company's credit worthiness and the counter-parties to the instruments as well as change in general market conditions. While the change in fair value of the convertible debt conversion liability and the convertible note hedges are generally expected to move in opposite directions, the net change in any given period may be material.

## 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.

## QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

The company is exposed to market risk through various financial instruments, including fixed rate and floating rate debt instruments. The company has at times used interest swap agreements to mitigate its exposure to interest rate fluctuations. As of September 30, 2016, a 1% change in interest rates would have no impact on annual interest expense as the company did not have any variable rate debt outstanding. Additionally, the company operates internationally and, as a result, is exposed to foreign currency fluctuations. Specifically, the exposure results from intercompany loans, intercompany sales or payments and third party sales or payments. In an attempt to reduce this exposure, foreign currency forward contracts are utilized to hedge intercompany purchases and sales as well as third party purchases and sales. The company does not believe that any potential loss related to these financial instruments would have a material adverse effect on the company's financial condition or results of operations.

The company is party to the Credit Agreement which was originally entered into on January 16, 2015 and matures in January 2018. Accordingly, while the company is exposed to increases in interest rates, its exposure to the volatility of the current market environment is limited as the company recently entered into its Credit 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 ten consecutive days. Should the company fail to comply with these requirements, the company would potentially have to attempt to obtain alternative financing and in those circumstances likely would be required to pay much higher interest rates.

As of September 30, 2016, the company had no borrowings outstanding under its Credit Agreement, which provides for a senior secured revolving credit facility for U.S. and Canadian borrowers of up to \$100,000,000 at variable rates, subject to availability based on a borrowing base formula, and in addition provides for a revolving credit, letter of

credit and swing line loan facility for European borrowers allowing borrowing up to an aggregate principal amount of \$30,000,000 at variable rates, subject to availability based on a borrowing base formula. As of September 30, 2016, the company had \$13,350,000 in principal amount outstanding in principal on its 4.125% Convertible Senior Subordinated Debentures due in February 2027, of which \$544,000 is included in equity, and \$150,000,000 in principal amount outstanding on its 5.00% Convertible Senior Notes due 2021, unless repurchased or converted in accordance with their terms prior to such date.

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## 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, limitations on the production and/or distribution of the company's products, inability to bid on or win certain contracts, unabsorbed capacity utilization, including fixed costs and overhead, or limitations on the company’s ability to design new power wheelchairs at its Corporate and Taylor Street facilities; any circumstances or developments that might delay or adversely impact the FDA’s acceptance of the expert’s updated report on the remediation of specified design history files, FDA’s acceptance of the third, most comprehensive expert certification audit report, FDA’s acceptance of the company’s own written report as required by the consent decree, or FDA’s inspection of the company’s quality systems at the Elyria, Ohio, facilities impacted by the consent decree, including any possible failure to comply with the consent decree or FDA regulations, requirement to perform additional remediation activities or further resultant delays in receipt of FDA’s written notification to resume operations; 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 enforcement actions; circumstances or developments that may make the company unable to implement or realize the anticipated benefits of its current business initiatives; product liability or warranty claims; product recalls, including more extensive recall experience than expected; the failure or refusal of customers or healthcare professionals to sign verification of medical necessity (VMN) documentation or other certification forms required by the exceptions to the FDA consent decree; 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 potential impacts of the Brexit referendum; 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 Bidding program); impacts of the U.S. Affordable Care Act of 2010; 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 lower costs 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.



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Item 3. Quantitative and Qualitative Disclosures About Market Risk.

The information called for by this item is provided under the same caption under Item 2 - Management's Discussion and Analysis of Financial Condition and Results of Operations.

Item 4. Controls and Procedures.

(a) Evaluation of Disclosure Controls and Procedures

As of September 30, 2016, an evaluation was performed, under the supervision and with the participation of the company's management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)). Based on that evaluation, the company's management, including the Chief Executive Officer and Chief Financial Officer, concluded that the company's disclosure controls and procedures were effective as of September 30, 2016, 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.



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## 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 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 the FDA on the terms of a consent decree of injunction with respect to the company's Corporate facility and its Taylor Street wheelchair 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. The consent decree limits the company's manufacture and distribution of power and manual wheelchairs, wheelchair components and wheelchair sub-assemblies at or from its Taylor Street manufacturing facility. The decree also initially limited design activities related to wheelchairs and power beds that take place at the impacted Elyria, Ohio facilities. The company is entitled to continue to produce from the Taylor Street manufacturing facility certain medically necessary wheelchairs provided that documentation and record-keeping requirements are followed, as well as ongoing replacement, service and repair of products already in use, under terms delineated in the consent decree. Under the terms of the consent decree, in order to resume full operations at the impacted facilities, the company must successfully complete third-party expert certification audits at the impacted Elyria facilities, which is comprised of three distinct reports that must be submitted to, and accepted by, the FDA. During 2013, the company completed the first two of the third-party expert certification audits, and the FDA found the results of both to be acceptable. In these reports, the third-party expert certified that the company's equipment and process validation procedures and its design control systems are compliant with the FDA's QSR. As a result of the FDA's acceptance of the first certification report on May 13, 2013, the Taylor Street facility was able to resume supplying parts and components for the further manufacturing of medical devices at other company facilities. The company's receipt of the FDA's acceptance of the second certification report on July 15, 2013, resulted in the company being able to resume design activities at the impacted facilities related to power wheelchairs and power beds. In February, 2016, the independent expert auditor issued its certification report for the third phase of the consent decree indicating substantial compliance with the FDA's QSR and the report was submitted to the FDA. Similar to the first and second certification processes, the FDA has responded to this report with clarifying questions to which the company and the independent expert have responded. When the FDA's questions are satisfactorily addressed, the company intends to request a meeting with the FDA prior to submitting its own written report required by the terms of the consent decree.

In December 2015, the FDA issued Form 483 observations following a 2015 inspection of approximately 5 months at the Corporate and Taylor Street facilities in Elyria, Ohio which included a review of the company's compliance with the terms of the consent decree and the matters covered by the first and second expert certification reports previously accepted in 2013 (the "December 2015 Form 483"). The company has timely filed its responses to this Form 483 and continues to work on addressing the FDA's observations.

On June 7, 2016, the company received a letter from the FDA in follow up to the December 2015 Form 483 and the company's subsequent responses to the Form 483. To satisfy FDA's design control requirements, the FDA letter outlined additional steps the company must take. In particular, the FDA clarified its requirement for the company to complete the remediation of certain design history files (DHF's) referenced in the December 2015 Form 483 and in the consent decree. Before the company can design any new Taylor Street wheelchair devices, the specified DHF's must

be completed, then recertified by the company's third-party expert, whose updated report must be accepted by the FDA. The FDA also clarified that its acceptance of the expert's updated report on these DHFs is a prerequisite to proceeding further with the third certification process. The FDA has clarified that the DHFs associated with certain power wheelchair and power bed products which the company is planning to discontinue by year end would not need to be remediated.

Under the terms of the consent decree, the company must submit its own written report to the FDA regarding its compliance status together with its written responses to any observations in the independent expert's report. The independent third-party expert auditor's third certification report, as well as the company's own report, both must be accepted by the FDA before the agency

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reinspects the impacted Elyria facilities. If the FDA is satisfied with the company's compliance, the FDA will provide written notification that the company is permitted to resume full operations at the impacted facilities. The company cannot predict the acceptance of these reports by the FDA, the timing of the inspection, nor any remaining work that may be needed to meet the FDA's requirements to resume full operations at the impacted facilities. The FDA has the authority to inspect any FDA registered facility at any time.

After resumption of full operations, the company must undergo five years of audits by a third-party expert auditor to determine whether the facilities are in continuous compliance with FDA regulations and the consent decree. The auditor will inspect the Corporate and Taylor Street facilities' activities every six months during the first year following the resumption of full operations and then once every 12 months for the next four years thereafter.

Under the consent decree, the FDA has the authority to inspect the Corporate and Taylor Street facilities 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 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, 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.

The 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 regulations or the federal Food, Drug, and Cosmetic Act. The FDA also may assess liquidated damages for shipments of adulterated or misbranded devices, except as permitted by the consent decree, 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 the FDA, including civil money penalties.

For additional information regarding the consent decree, please see the following sections of company's Annual Report on Form 10-K for the period ending December 31, 2015: Item 1. Business - Government Regulation; Item 1A. Risk Factors; and Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - Outlook and - Liquidity and Capital Resources.

In December 2010, the company received a warning letter from the FDA related to quality system processes and procedures at the company's Sanford, Florida facility. In January 2014, the FDA conducted inspections at the company's manufacturing facility in Suzhou, China and at the company's electronic components subsidiary in Christchurch, New Zealand, covering quality systems and current Good Manufacturing Practice regulations. In August 2014, the FDA inspected Alber GmbH in Albstadt, Germany. The FDA issued its inspectional observations on Forms 483 to the company after these inspections, and the company submitted its responses to the agency in a timely manner. In October 2014, the FDA conducted an inspection at the Sanford facility and, at the conclusion, issued its Form 483 inspectional observations. In December 2015, the FDA issued Form 483 observations following a 2015 inspection of approximately 5 months at the Corporate and Taylor Street facilities in Elyria, Ohio. In July 2016, the FDA inspected Motion Concepts L.P. in Concord, Ontario, Canada and issued its inspectional observations on Form 483. The company has timely filed its responses to these Forms 483 with the FDA and continues to work on addressing the FDA's observations. The results of regulatory claims, proceedings, investigations, or litigation are difficult to predict. An unfavorable resolution or outcome of the FDA warning letter or other FDA enforcement related to the Sanford facility or other company facilities could materially and adversely affect the company's business, financial condition, and results of operations. See Item 1. Business - Government Regulation - Other FDA Matters and 1A. Risk Factors in company's Annual Report on Form 10-K for the period ending December 31, 2015. On September 12, 2014, an amended complaint, in a lawsuit originally instituted on August 26, 2013, was filed against Invacare Corporation, former officer and director Gerald B. Blouch, former officer and director A. Malachi Mixon III, and the company's Senior Vice President, Human Resources, Patricia Stumpp, as well as outside directors Dale C. LaPorte and Michael F. Delaney and former outside director Charles S. Robb, in the U.S. District Court for the Northern District of Ohio, alleging that the defendants breached their fiduciary duties and violated the Employee Retirement Income Security Act (ERISA) in the administration and maintenance of the company stock fund in the company's Retirement Savings Plan (401(k) Plan). The lawsuit seeks class certification and unspecified damages and

attorneys' fees for participants in the company's stock fund of the 401(k) Plan between July 22, 2010 and the present. On August 28, 2015, the Court limited plaintiff's claim to the time period between July 22, 2010 and December 8, 2011. This lawsuit has been referred to the company's insurance carriers. Following mediation,

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the parties entered into a written settlement agreement which was preliminarily approved by the Court on August 1, 2016, and which is subject to final court approval. The settlement amount is expected to be paid by the company's insurance carriers.

Additional information regarding the company's commitments and contingencies is included in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations and in Contingencies in the Notes to the Condensed Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.

## 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, 2015.

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

The following table presents information with respect to repurchases of common shares made by the company during the three months ended September 30, 2016.

Period	Total Number of Shares Purchased (1)	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs (2)
7/1/2016-7/31/2016—		\$ —	—	2,453,978
8/1/2016-8/31/2016—		—	—	2,453,978
9/1/2016-9/30/2016—		—	—	2,453,978
Total	—	\$ —	—	2,453,978

No shares were repurchased between July 1, 2016 and September 30, 2016 and surrendered to the company by (1) employees for minimum tax withholding purposes in conjunction with the vesting of restricted shares awarded to the employees by the company.

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 (2) under the plan. To date, the company has purchased 1,592,522 shares under this program, with authorization remaining to purchase 2,453,978 shares. The company purchased no shares pursuant to this Board authorized program during the quarter ended September 30, 2016. 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.

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Item 6. Exhibits

Exhibit

No.	
31.1	Chief Executive Officer Rule 13a-14(a)/15d-14(a) Certification (filed herewith).
32.1	Chief Financial Officer Rule 13a-14(a)/15d-14(a) Certification (filed herewith).
32.1	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).
32.2	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.

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SIGNATURES

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

INVACARE  
CORPORATION

Date: November 4, 2016 By: /s/ Robert K.  
Gudbranson  
Name: Robert  
K.  
Gudbranson  
Title: Chief  
Financial  
Officer  
(As Principal  
Financial and  
Accounting  
Officer and on  
behalf of the  
registrant)