

INVACARE CORP  
Form 10-Q  
November 06, 2012

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, 2012

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  
(State or other jurisdiction of  
incorporation or organization)

95-2680965  
(IRS Employer Identification No.)

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

44036  
(Zip Code)

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

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

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

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

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

As of November 5, 2012, the registrant had 30,849,038 Common Shares and 1,084,747 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)

|  | Three Months Ended<br>September 30,   |           | Nine Months Ended<br>September 30, |             |
|--|---------------------------------------|-----------|------------------------------------|-------------|
|  | 2012                                  | 2011      | 2012                               | 2011        |
|  | (In thousands, except per share data) |           |                                    |             |
| Net sales  | \$452,981                             | \$456,519 | \$1,341,470                        | \$1,351,429 |
| Cost of products sold  | 331,327                               | 325,442   | 974,380                            | 962,428     |
| Gross Profit   | 121,654                               | 131,077   | 367,090                            | 389,001     |
| Selling, general and administrative expenses                                       | 111,319                               | 104,135   | 330,589                            | 322,329     |
| Charges related to restructuring activities  | 1,175                                 | 1,311     | 3,722                              | 1,742       |
| Loss on debt extinguishment including debt finance charges and associated fees     | —                                     | 7,462     | 312                                | 24,198      |
| Interest expense   | 1,414                                 | 1,644     | 4,295                              | 6,488       |
| Interest income  | (193 )                                | (625 )    | (698 )                             | (1,171 )    |
| Earnings before Income Taxes   | 7,939                                 | 17,150    | 28,870                             | 35,415      |
| Income taxes   | 5,075                                 | 4,350     | 19,750                             | 4,500       |
| Net Earnings   | \$2,864                               | \$12,800  | \$9,120                            | \$30,915    |
| Dividends Declared per Common Share  | \$0.0125                              | \$0.0125  | \$0.0375                           | \$0.0375    |
| Net Earnings per Share—Basic   | \$0.09                                | \$0.40    | \$0.29                             | \$0.97      |
| Weighted Average Shares Outstanding—Basic  | 31,877                                | 31,873    | 31,838                             | 31,999      |
| Net Earnings per Share—Assuming Dilution   | \$0.09                                | \$0.40    | \$0.29                             | \$0.95      |
| Weighted Average Shares Outstanding—Assuming Dilution                              | 31,901                                | 32,191    | 31,847                             | 32,711      |
| Net Earnings   | \$2,864                               | \$12,800  | \$9,120                            | \$30,915    |
| Other comprehensive income (loss):   |                                       |           |                                    |             |
| Foreign currency translation adjustments   | 15,764                                | (11,852 ) | (24,288 )                          | 49,141      |
| Defined Benefit Plans:   |                                       |           |                                    |             |
| Amortization of prior service costs and unrecognized gains (losses)                | 38                                    | (16 )     | 136                                | (56 )       |
| Amounts arising during the year, primarily due to the addition of new participants | —                                     | (170 )    | (168 )                             | (639 )      |
| Deferred tax adjustment resulting from defined benefit plan activity               | (13 )                                 | 40        | 13                                 | 150         |
| Valuation reserve (reversal) associated with defined benefit plan activity         | 13                                    | (6 )      | (17 )                              | (27 )       |
| Current period unrealized gain (loss) on cash flow hedges                          | (1,322 )                              | (816 )    | (276 )                             | (2,505 )    |
| Deferred tax benefit (loss) related to unrealized gain (loss) on cash flow hedges  | 38                                    | 188       | (73 )                              | 578         |
| Other Comprehensive Income (Loss)  | 14,518                                | (12,632 ) | (24,673 )                          | 46,642      |

|                             |          |       |             |          |
|-----------------------------|----------|-------|-------------|----------|
| Comprehensive Income (Loss) | \$17,382 | \$168 | \$(15,553 ) | \$77,557 |
|-----------------------------|----------|-------|-------------|----------|

See notes to condensed consolidated financial statements.

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Condensed Consolidated Balance Sheets (unaudited)

|  | September 30,<br>2012 | December 31,<br>2011 |
|--|-----------------------|----------------------|
|  | (In thousands)        |                      |
| Assets   |                       |                      |
| Current Assets   |                       |                      |
| Cash and cash equivalents  | \$35,282              | \$34,924             |
| Trade receivables, net   | 250,059               | 247,974              |
| Installment receivables, net   | 2,266                 | 6,671                |
| Inventories, net   | 221,619               | 192,761              |
| Deferred income taxes  | 439                   | 1,620                |
| Other current assets   | 45,540                | 44,820               |
| Total Current Assets   | 555,205               | 528,770              |
| Other Assets   | 41,824                | 42,647               |
| Other Intangibles  | 73,360                | 83,320               |
| Property and Equipment, net  | 122,633               | 129,712              |
| Goodwill   | 472,704               | 496,605              |
| Total Assets   | \$1,265,726           | \$1,281,054          |
| Liabilities and Shareholders' Equity   |                       |                      |
| Current Liabilities  |                       |                      |
| Accounts payable   | \$146,804             | \$148,805            |
| Accrued expenses   | 131,229               | 132,595              |
| Accrued income taxes   | 849                   | 1,495                |
| Short-term debt and current maturities of long-term obligations  | 739                   | 5,044                |
| Total Current Liabilities  | 279,621               | 287,939              |
| Long-Term Debt   | 250,449               | 260,440              |
| Other Long-Term Obligations  | 120,514               | 106,150              |
| Shareholders' Equity   |                       |                      |
| Preferred Shares (Authorized 300 shares; none outstanding)   | —                     | —                    |
| Common Shares (Authorized 100,000 shares; 33,950 and 33,835 issued and outstanding in 2012 and 2011, respectively)—no par      | 8,500                 | 8,471                |
| Class B Common Shares (Authorized 12,000 shares; 1,085 and 1,086 issued and outstanding in 2012 and 2011, respectively)—no par | 272                   | 272                  |
| Additional paid-in-capital   | 226,743               | 221,409              |
| Retained earnings  | 372,237               | 364,300              |
| Accumulated other comprehensive earnings   | 100,203               | 124,876              |
| Treasury shares  | (92,813               | ) (92,803            |
| Total Shareholders' Equity   | 615,142               | 626,525              |
| Total Liabilities and Shareholders' Equity   | \$1,265,726           | \$1,281,054          |

See notes to condensed consolidated financial statements.

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INVACARE CORPORATION AND SUBSIDIARIES  
Condensed Consolidated Statement of Cash Flows (unaudited)

|   | Nine Months Ended<br>September 30, |           |
|---|------------------------------------|-----------|
|   | 2012                               | 2011      |
|   | (In thousands)                     |           |
| Operating Activities  |                                    |           |
| Net earnings  | \$9,120                            | \$30,915  |
| Adjustments to reconcile net earnings to net cash provided by operating activities: |                                    |           |
| Depreciation and amortization   | 29,065                             | 27,555    |
| Provision for losses on trade and installment receivables                           | 4,252                              | 8,966     |
| Provision (Benefit) for deferred income taxes                                       | 628                                | (365)     |
| Provision for other deferred liabilities  | 821                                | 1,663     |
| Provision for stock-based compensation  | 5,198                              | 4,984     |
| Loss on disposals of property and equipment   | 108                                | 152       |
| Loss on debt extinguishment including debt finance charges and associated fees      | 312                                | 24,198    |
| Amortization of convertible debt discount   | 430                                | 1,487     |
| Changes in operating assets and liabilities:  |                                    |           |
| Trade receivables   | (8,149)                            | (3,749)   |
| Installment sales contracts, net  | 4,353                              | (3,161)   |
| Inventories   | (30,936)                           | (21,859)  |
| Other current assets  | (90)                               | (2,796)   |
| Accounts payable  | (329)                              | 5,189     |
| Accrued expenses  | 251                                | (8,867)   |
| Other long-term liabilities   | 11,788                             | 2,276     |
| Net Cash Provided by Operating Activities   | 26,822                             | 66,588    |
| Investing Activities  |                                    |           |
| Purchases of property and equipment   | (14,775)                           | (15,593)  |
| Proceeds from sale of property and equipment  | 97                                 | 46        |
| Business acquisitions, net of cash acquired   | —                                  | (41,465)  |
| Increase in other long-term assets  | 409                                | (1,018)   |
| Other   | (219)                              | —         |
| Net Cash Used for Investing Activities  | (14,488)                           | (58,030)  |
| Financing Activities  |                                    |           |
| Proceeds from revolving lines of credit and long-term borrowings                    | 255,703                            | 362,958   |
| Payments on revolving lines of credit and long-term borrowings                      | (266,721)                          | (336,950) |
| Proceeds from exercise of stock options   | —                                  | 4,126     |
| Payment of financing costs  | (1)                                | (24,116)  |
| Payment of dividends  | (1,183)                            | (1,191)   |
| Purchase of treasury stock  | —                                  | (21,551)  |
| Net Cash Used by Financing Activities   | (12,202)                           | (16,724)  |
| Effect of exchange rate changes on cash   | 226                                | 984       |
| Increase (decrease) in cash and cash equivalents                                    | 358                                | (7,182)   |
| Cash and cash equivalents at beginning of year                                      | 34,924                             | 48,462    |
| Cash and cash equivalents at end of period  | \$35,282                           | \$41,280  |

See notes to condensed consolidated financial statements.



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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2012

## Accounting Policies

**Nature of Operations:** Invacare Corporation is the world's leading manufacturer and distributor in the estimated \$11.0 billion worldwide market for medical equipment and supplies 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, 2012, the results of its operations for the three and nine months ended September 30, 2012 and changes in its cash flow for the nine months ended September 30, 2012 and 2011, 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, 2012 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.

**Stock-Based Compensation Plans:** 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 options and no significant changes have been made regarding the valuation methodologies used to determine the fair value of options granted. The company continues to use a Black-Scholes valuation model. 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.

The amounts of stock-based compensation expense recognized were as follows (in thousands):

|  | Three Months<br>Ended<br>September 30,<br>2012 |         | Nine Months<br>Ended<br>September 30,<br>2011 |         |
|--|--|---------|---|---------|
| Stock-based compensation expense recognized as part of selling, general and administrative expense | \$2,208  | \$2,106 | \$5,198                                       | \$4,984 |

The amounts above reflect compensation expense related to restricted stock awards and nonqualified stock options awarded under the 2003 Performance Plan (the "2003 Plan"). Stock-based compensation is not allocated to the business segments, but is reported as part of All Other as shown in the company's Business Segment Note to the Consolidated Financial Statements.

**Recent Accounting Pronouncements:** In June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2011-05, Presentation of Comprehensive Income (ASU 2011-05 or the ASU). ASU 2011-05 requires comprehensive income to be reported in either a single statement or in two consecutive statements reporting net income and other comprehensive income (OCI). The ASU does not change what is required to be reported in OCI. The company adopted ASU 2011-05 in the first quarter 2012, as reported in its Form 10-Q for the



quarter ended March 31, 2012, with no impact on the company's financial position, results of operations or cash flows other than the modification to the company's Consolidated Statement of Comprehensive Income (Loss).

#### 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 and Europe. A significant portion of products sold to providers, both foreign and domestic, is 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.

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INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2012

The estimated allowance for uncollectible amounts (\$25,910,000 at September 30, 2012 and \$27,947,000 at December 31, 2011) is based primarily on management's evaluation of the financial condition of specific customers. In addition, as a result of the company's third party 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 establishing reserves for specific customers as needed. The company charges 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, Invacare 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. 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 Invacare because third party financing was not available to the customers. 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 risk review of each individual customer with the allowance for doubtful accounts adjusted accordingly. Installment receivables are individually and not collectively reviewed for impairment. The company assesses the bad debt reserve levels based upon the status of the customer's adherence to a contracted payment schedule and the company's ability to enforce judgments, liens, etc.

For purposes of granting or extending credit, the company utilizes a model to generate a composite score that is based on 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 customers desiring credit greater than \$250,000 which typically includes a detailed review of the customer's financials 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. Accrual 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 judicial enforcement process which typically approximates 18 months. Any write-offs are made after the legal process is completed and it is deemed that all reasonable collection efforts have been exhausted. The company has not made any changes to either its accounting policies or methodology to estimation allowances for doubtful accounts in the last twelve months.

Installment receivables consist of the following (in thousands):

September 30, 2012

December 31, 2011

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|                                 | Current  | Long-Term | Total    | Current  | Long-Term | Total    |
|---------------------------------|----------|-----------|----------|----------|-----------|----------|
| Installment receivables         | \$5,089  | \$1,770   | \$6,859  | \$8,990  | \$2,931   | \$11,921 |
| Less:                           |          |           |          |          |           |          |
| Unearned interest               | (71 )    | —         | (71 )    | (171 )   | —         | (171 )   |
|                                 | 5,018    | 1,770     | 6,788    | 8,819    | 2,931     | 11,750   |
| Allowance for doubtful accounts | (2,752 ) | (1,300 )  | (4,052 ) | (2,148 ) | (2,125 )  | (4,273 ) |
|                                 | \$2,266  | \$470     | \$2,736  | \$6,671  | \$806     | \$7,477  |

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2012

Installment receivables purchased from DLL during the nine months ended September 30, 2012 increased the gross installment receivables balance by \$1,883,000. 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<br>September 30, 2012 | Year Ended<br>December 31, 2011 |
|---|---|---------------------------------|
| Balance as of beginning of period               | \$4,273                                 | \$4,841                         |
| Current period provision                        | 499                                     | 1,215                           |
| Direct write-offs charged against the allowance | (720                                    | ) (1,783                        |
| Balance as of end of period                     | \$4,052                                 | \$4,273                         |

Installment receivables by class as of September 30, 2012 consist of the following (in thousands):

|   | Total<br>Installment<br>Receivables | Unpaid<br>Principal<br>Balance | Related<br>Allowance<br>for<br>Doubtful<br>Accounts | Interest<br>Income<br>Recognized |
|---|-------------------------------------|--------------------------------|---|----------------------------------|
| U.S.  |                                     |                                |   |                                  |
| Impaired Installment receivables with a related allowance recorded      | \$4,943                             | \$4,943                        | \$3,595   | \$—                              |
| Canada  |                                     |                                |   |                                  |
| Non-Impaired Installment receivables with no related allowance recorded | 1,459                               | 1,388                          | —   | 96                               |
| Impaired Installment receivables with a related allowance recorded      | 457                                 | 457                            | 457   | —                                |
| Total Canadian Installment Receivables                                  | \$1,916                             | \$1,845                        | \$457   | \$96                             |
| Total   |                                     |                                |   |                                  |
| Non-Impaired Installment receivables with no related allowance recorded | 1,459                               | 1,388                          | —   | 96                               |
| Impaired Installment receivables with a related allowance recorded      | 5,400                               | 5,400                          | 4,052   | —                                |
| Total Installment Receivables   | \$6,859                             | \$6,788                        | \$4,052   | \$96                             |

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2012

Installment receivables by class as of December 31, 2011 consist of the following (in thousands):

|   | Total<br>Installment<br>Receivables | Unpaid<br>Principal<br>Balance | Related<br>Allowance<br>for<br>Doubtful<br>Accounts | Interest<br>Income<br>Recognized |
|---|-------------------------------------|--------------------------------|---|----------------------------------|
| U.S.  |                                     |                                |   |                                  |
| Impaired Installment receivables with a related allowance recorded      | \$6,116                             | \$6,116                        | \$4,240   | \$—                              |
| Canada  |                                     |                                |   |                                  |
| Non-Impaired Installment receivables with no related allowance recorded | 5,696                               | 5,525                          | —   | 271                              |
| Impaired Installment receivables with a related allowance recorded      | 109                                 | 109                            | 33  | —                                |
| Total Canadian Installment Receivables                                  | \$5,805                             | \$5,634                        | \$33  | \$271                            |
| Total   |                                     |                                |   |                                  |
| Non-Impaired Installment receivables with no related allowance recorded | 5,696                               | 5,525                          | —   | 271                              |
| Impaired Installment receivables with a related allowance recorded      | 6,225                               | 6,225                          | 4,273   | —                                |
| Total Installment Receivables   | \$11,921                            | \$11,750                       | \$4,273   | \$271                            |

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, 2012, 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. However, while the full balance may be deemed to be impaired, the company has historically collected a large percentage of the principal of its U.S. installment receivables.

The company had an immaterial amount of Canadian installment receivables which were past due of 90 days or more as of September 30, 2012 and December 31, 2011 for which the company is still accruing interest.

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

|                     | September 30, 2012 |         |         | December 31, 2011 |         |         |
|---------------------|--------------------|---------|---------|-------------------|---------|---------|
|                     | Total              | U.S.    | Canada  | Total             | U.S.    | Canada  |
| Current             | \$1,413            | \$—     | \$1,413 | \$5,612           | \$—     | \$5,612 |
| 0-30 Days Past Due  | 39                 | —       | 39      | 84                | —       | 84      |
| 31-60 Days Past Due | 8                  | —       | 8       | 42                | —       | 42      |
| 61-90 Days Past Due | —                  | —       | —       | 8                 | —       | 8       |
| 90+ Days Past Due   | 5,399              | 4,943   | 456     | 6,175             | 6,116   | 59      |
|                     | \$6,859            | \$4,943 | \$1,916 | \$11,921          | \$6,116 | \$5,805 |

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2012

## Inventories

Inventories consist of the following (in thousands):

|                 | September 30,<br>2012 | December 31,<br>2011 |
|-----------------|-----------------------|----------------------|
| Finished goods  | \$127,240             | \$116,378            |
| Raw materials   | 80,713                | 63,244               |
| Work in process | 13,666                | 13,139               |
|                 | \$221,619             | \$192,761            |

## Property and Equipment

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

|                                  | September 30,<br>2012 | December 31,<br>2011 |
|----------------------------------|-----------------------|----------------------|
| Machinery and equipment          | \$358,078             | \$360,215            |
| Land, buildings and improvements | 93,636                | 95,737               |
| Furniture and fixtures           | 13,332                | 14,034               |
| Leasehold improvements           | 16,023                | 15,750               |
|                                  | 481,069               | 485,736              |
| Less allowance for depreciation  | (358,436)             | (356,024)            |
|                                  | \$122,633             | \$129,712            |

## Acquisitions

In September 2011, the company completed the acquisition of Dynamic Medical Systems (DMS), a solutions-based service organization with a strong presence in the western United States, for \$41,465,000, which was paid in cash. The acquisition gives the company a national rental footprint, which strategically enhances the company's ability to service regional and national long-term care providers. DMS has a clinical solution selling approach for wound therapies, safe patient handling and other rental applications in institutional settings. Pursuant to the purchase agreement, the company agreed to pay contingent consideration of up to \$9,000,000 if certain goals were met over twenty-four months, principally earnings projections, for which the company recorded a liability of \$9,000,000 based on the company's estimate of the probable payout, the majority of which is expected to be paid in 2012.

In October 2011, the company acquired a developed technology intangible asset and inventory related to a negative pressure wound therapy product in the United States for \$965,000.

## Goodwill

The change in goodwill reflected on the balance sheet from December 31, 2011 to September 30, 2012 was the result of foreign currency translation.

## Other Intangibles

All of the company's other intangible assets have been assigned definite lives and continue to be amortized over their useful lives, except for \$30,601,000 related to trademarks, which have indefinite lives. The changes in intangible

balances reflected on the balance sheet from December 31, 2011 to September 30, 2012 were the result of foreign currency translation and amortization.

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2012

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

|                      | September 30, 2012 |                          | December 31, 2011 |                          |
|----------------------|--------------------|--------------------------|-------------------|--------------------------|
|                      | Historical Cost    | Accumulated Amortization | Historical Cost   | Accumulated Amortization |
| Customer Lists       | \$92,105           | \$55,605                 | \$94,790          | \$50,832                 |
| Trademarks           | 30,601             | —                        | 31,777            | —                        |
| License agreements   | 3,223              | 3,223                    | 3,160             | 3,160                    |
| Developed Technology | 9,459              | 5,294                    | 9,823             | 4,870                    |
| Patents              | 6,542              | 5,604                    | 6,358             | 5,266                    |
| Other                | 7,599              | 6,443                    | 7,510             | 5,970                    |
|                      | \$149,529          | \$76,169                 | \$153,418         | \$70,098                 |

Amortization expense related to other intangibles was \$7,622,000 in the first nine months of 2012 and is estimated to be \$9,918,000 in 2012, \$8,909,000 in 2013, \$8,508,000 in 2014, \$6,995,000 in 2015, \$5,670,000 in 2016 and \$2,346,000 in 2017. Amortized intangibles are being amortized on a straight-line basis for periods from 3 to 20 years with the majority of the intangibles being amortized over a life of between 10 and 13 years.

**Warranty Costs**

Generally, the company's products are covered from the date of sale to the customer by warranties against defects in material and workmanship for various periods depending on the product. 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. The increase in the liability for pre-existing warranties in 2012 is primarily the result of product recalls.

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

|   |          |
|---|----------|
| Balance as of January 1, 2012   | \$19,842 |
| Warranties provided during the period   | 8,932    |
| Settlements made during the period  | (9,742)  |
| Changes in liability for pre-existing warranties during the period, including expirations | 3,143    |
| Balance as of September 30, 2012  | \$22,175 |

**Long-Term Debt**

Debt consists of the following (in thousands):

|   | September 30, 2012 | December 31, 2011 |
|---|--------------------|-------------------|
| \$400,000,000 senior secured revolving credit facility, due in October 2015 | \$234,000          | \$247,063         |
| Convertible senior subordinated debentures at 4.125%, due in February 2027  | 9,861              | 9,797             |
| Other notes and lease obligations   | 7,327              | 8,624             |
|   | 251,188            | 265,484           |
| Less current maturities of long-term debt                                   | (739)              | (5,044)           |



\$250,449

\$260,440

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2012

The company's senior secured revolving credit agreement (the "Credit Agreement"), entered into on October 28, 2010, provides for a \$400 million senior secured revolving credit facility maturing in October 2015. Pursuant to the terms of the Credit Agreement, the company may from time to time borrow, repay and re-borrow up to an aggregate outstanding amount at any one time of \$400 million, subject to customary conditions.

In 2007, the company issued \$135,000,000 principal amount of Convertible Senior Subordinated Debentures due 2027. The debentures are unsecured senior subordinated obligations of the company guaranteed by substantially all of the company's domestic subsidiaries, 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 the conversion using any combination of cash or stock, and at the company's discretion. 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 company may from time to time seek to retire or purchase its 4.125% Convertible Senior Subordinated Debentures due 2027, in open market purchases, privately negotiated transactions or otherwise. Such purchases or exchanges, if any, will depend on prevailing market conditions, the company's liquidity requirements, contractual restrictions and other factors. The amounts involved in any such transactions, individually or in the aggregate, may be material.

During the nine months ended September 30, 2012, the company repurchased \$500,000 principal amount of its 4.125% Convertible Senior Subordinated Debentures due 2027. The company retired the debt at par. In accordance with Convertible Debt, ASC 470-20, the company utilized the inducement method of accounting to calculate the loss associated with the early retirement of the convertible debt. The company recorded pre-tax expense of \$312,000 related to the loss on the debt extinguishment including the write-off of \$11,000 deferred financing fees, which were previously capitalized, for the three and nine months ended September 30, 2012.

The liability components of the company's convertible debt consist of the following (in thousands):

|  | September 30,<br>2012 | December 31,<br>2011 |
|--|-----------------------|----------------------|
| Principal amount of liability component    | \$13,350              | \$13,850             |
| Unamortized discount                       | (3,489                | ) (4,053             |
| Net carrying amount of liability component | \$9,861               | \$9,797              |

The company is a party to interest rate swap agreements to effectively convert a portion of floating rate revolving credit facility debt to fixed rate debt to avoid the risk of changes in market interest rates. Specifically, interest rate swap agreements for notional amounts of \$15,000,000 through February 2013, \$20,000,000 and \$25,000,000 through May 2013, \$18,000,000 through June 2013, \$22,000,000 through September 2013 and \$12,000,000 and \$23,000,000 through April 2014 were entered into that fix the LIBOR component of the interest rate on that portion of the revolving credit facility debt at rates of 1.05%, 1.08%, 0.73%, 0.625%, 0.46%, 0.54% and 0.47% respectively, for effective aggregate rates of 2.80%, 2.83%, 2.48%, 2.375%, 2.21%, 2.29% and 2.22%, respectively. As of September 30, 2012, the weighted average floating interest rate on borrowing was 1.98% compared to 2.28% as of December 31, 2011.

## Shareholders' Equity Transactions

The Amended and Restated 2003 Performance Plan, (the “2003 Plan”), allows the Compensation and Management Development Committee of the Board of Directors (the “Committee”) to grant up to 6,800,000 Common Shares in connection with incentive stock options, non-qualified stock options, stock appreciation rights and stock awards (including the use of restricted stock). The maximum aggregate number of Common Shares that may be granted during the term of the 2003 Plan pursuant to all awards, other than stock options, is 1,300,000 Common Shares. 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.

During the nine months ended September 30, 2012, the Committee granted 754,392 non-qualified stock options under the 2003 Plan, each having a term of ten years and generally granted at the fair market value of the company’s Common Shares on the date of grant. In addition, restricted stock awards for 117,200 shares were granted without cost to the recipients which vest ratably over the four years after the award date. Compensation expense of \$1,773,000 was recognized during the quarter ended September 30, 2012 related to restricted stock awards and there were outstanding restricted stock awards totaling 362,999 shares

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2012

that were not vested.

As of September 30, 2012, there was \$15,733,000 of total unrecognized compensation cost from stock-based compensation arrangements granted under the plans, which is related to non-vested options and shares, and includes \$4,980,000 related to restricted stock awards. 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, 2012:

|  | September 30,<br>2012 | Weighted<br>Average<br>Exercise<br>Price |
|--|-----------------------|--|
| Options outstanding at January 1, 2012             | 4,455,365             | \$28.99                                  |
| Granted  | 754,392               | 13.43                                    |
| Exercised  | —                     | —  |
| Canceled   | (419,049              | ) 32.74                                  |
| Options outstanding at September 30, 2012          | 4,790,708             | \$26.24                                  |
| Options exercise price range at September 30, 2012 | \$ 13.37 to<br>47.80  |  |
| Options exercisable at September 30, 2012          | 3,178,536             |  |
| Options available for grant at September 30, 2012* | 1,213,807             |  |

\*Options available for grant as of September 30, 2012 reduced by net restricted stock award activity of 699,507.

The following table summarizes information about stock options outstanding at September 30, 2012:

| Exercise Prices    | Options Outstanding                 |  | Weighted Average<br>Exercise Price | Options Exercisable                 |                                    |
|--------------------|-------------------------------------|--|------------------------------------|-------------------------------------|------------------------------------|
|                    | Number<br>Outstanding<br>At 9/30/12 | Weighted Average<br>Remaining<br>Contractual Life<br>(Years) |                                    | Number<br>Exercisable<br>At 9/30/12 | Weighted Average<br>Exercise Price |
| \$ 13.37 – \$15.00 | 756,853                             | 9.7  | \$13.35                            | 11,403                              | \$11.16                            |
| \$ 15.01 – \$25.00 | 1,789,575                           | 6.7  | 22.50                              | 1,202,737                           | 22.14                              |
| \$ 25.01 – \$35.00 | 1,159,589                           | 6.2  | 26.19                              | 879,705                             | 26.42                              |
| \$ 35.01 – \$47.80 | 1,084,691                           | 1.9  | 41.45                              | 1,084,691                           | 41.45                              |
| Total              | 4,790,708                           | 6.0  | \$26.24                            | 3,178,536                           | \$29.88                            |

When stock options are awarded, they generally become exercisable over a four-year vesting period whereby options vest in equal installments each year. Options granted with graded vesting are accounted for as single options. The fair value of each option grant is 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 is based on the company's historical analysis of option history. The expected stock price volatility is also based on actual historical volatility, and expected dividend yield is based on historical dividends as the company has no current intention of changing its dividend policy.

The 2003 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.

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2012

## Income Taxes

The company had an effective tax rate of 63.9% and 68.4% on earnings before tax for the three and nine month period ended September 30, 2012 compared to an expected rate at the U.S. statutory rate of 35%. The company's effective tax rate for the three and nine months ended September 30, 2012 was greater than the U.S. federal statutory rate, principally due to a foreign discrete tax adjustment in the second quarter aggregating to \$9,173,000 (\$0.29 per share) as of September 30, 2012, including \$3,178,000 in interest, related to prior year periods under audit, which is being contested by the company, and a net loss in countries with a valuation allowance without a tax benefit. This adjustment is partially offset by current year foreign earnings taxed at an effective rate lower than the U.S. statutory rate principally due to foreign taxes recognized at rates below the U.S. statutory rate excluding the results of countries in a valuation allowance. The company had an effective tax rate of 25.4% and 12.7% on earnings before tax for the three and nine month period ended September 30, 2011, respectively, compared to an expected rate at the U.S. statutory rate of 35%. The company's effective tax rate for the three and nine months ended September 30, 2011 was lower than the U.S. federal statutory rate, principally due to foreign taxes recognized at rates below the U.S. statutory rate and a second quarter \$5,100,000 (\$0.16 per share) tax benefit as a result of a tax settlement in Germany. The net impact of tax benefit from countries with valuation allowances on the company's effective tax rate was minimal for the first nine months of 2012 and 2011. The company had a domestic profit in the nine months of 2012, but continued to be in a three-year cumulative loss position in the U.S. principally as a result of recording pre-tax expenses in prior periods related to the extinguishment of convertible debt at a premium and the write-off of goodwill. As a result of the loss position, the majority of the U.S. deferred tax assets continue to be subject to a valuation allowance.

## Net Earnings Per Common Share

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

| (In thousands except per share data)    | For the Three Months     |          | For the Nine Months      |          |
|---|--------------------------|----------|--------------------------|----------|
|   | Ended September 30, 2012 | 2011     | Ended September 30, 2012 | 2011     |
| <b>Basic</b>                            |                          |          |                          |          |
| Average common shares outstanding       | 31,877                   | 31,873   | 31,838                   | 31,999   |
| Net earnings                            | \$2,864                  | \$12,800 | \$9,120                  | \$30,915 |
| Net earnings per common share           | \$0.09                   | \$0.40   | \$0.29                   | \$0.97   |
| <b>Diluted</b>                          |                          |          |                          |          |
| Average common shares outstanding       | 31,877                   | 31,873   | 31,838                   | 31,999   |
| Shares related to convertible debt      | —                        | 251      | —                        | 382      |
| Stock options and awards                | 24                       | 67       | 9                        | 330      |
| Average common shares assuming dilution | 31,901                   | 32,191   | 31,847                   | 32,711   |
| Net earnings                            | \$2,864                  | \$12,800 | \$9,120                  | \$30,915 |
| Net earnings per common share           | \$0.09                   | \$0.40   | \$0.29                   | \$0.95   |

For the three and nine months ended September 30, 2012, 4,639,809 and 4,679,093 shares, respectively, associated with stock options were excluded from the average common shares assuming dilution as they were anti-dilutive. At September 30, 2012, the majority of the anti-dilutive shares were granted at an exercise price of \$41.87, which was higher than the average fair market value prices of \$14.74 and \$15.55 for the three and nine months ended September 30, 2012, respectively. At September 30, 2011, 2,760,783 and 2,510,535 shares associated with stock options, respectively, were excluded from the average common shares assuming dilution for the three and nine months

ended September 30, 2011, respectively, as they were anti-dilutive. At September 30, 2011, the majority of the anti-dilutive shares were granted at an exercise price of \$41.87, which was higher than the average fair market value prices of \$27.18 and \$29.79 for the three and nine months ended September 30, 2011, respectively. For the three and nine months ended September 30, 2011, shares necessary to settle a conversion spread on the convertible notes were included in the common shares assuming dilution as the average market price of the company stock for 2011 did exceed the conversion price.

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INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2012

Concentration of Credit Risk

The company manufactures and distributes durable medical equipment and supplies to the home health care, retail and extended care markets. The company performs credit evaluations of its customers' financial condition. In December 2000, Invacare entered into an agreement with De Lage Landen, Inc. ("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 of \$13,254,000 at September 30, 2012 to DLL for events of default under the contracts, which total \$71,779,000 at September 30, 2012. 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 foreign currency exchange risk and interest rate risk. Foreign currency forward exchange contracts are used to manage the price risk associated with forecasted sales denominated in foreign currencies and the price risk associated with forecasted purchases of inventory over the next twelve months. Interest rate swaps are, at times, utilized to manage interest rate risk associated with the company's fixed and floating-rate borrowings.

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.



During the first nine months of 2012 and 2011, the company was a party to interest rate swap agreements that qualified as cash flow hedges and effectively converted floating-rate debt to fixed-rate debt, so the company could avoid the risk of changes in market interest rates. The gains or losses on interest rate swaps are reflected in interest expense on the consolidated statement of comprehensive income (loss).

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

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2012

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 60% 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 \$50,244,000 and \$134,402,000 matured during the three and nine months ended September 30, 2012, respectively, compared to forward contracts with a total notional amount in USD of \$50,813,000 and \$139,418,000 matured during the three and nine months ended September 30, 2011, respectively.

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

|           | September 30, 2012 |                            | December 31, 2011 |                            |
|-----------|--------------------|----------------------------|-------------------|----------------------------|
|           | Notional Amount    | Unrealized Net Gain (Loss) | Notional Amount   | Unrealized Net Gain (Loss) |
| USD / AUD | \$901              | \$(10                      | ) \$3,324         | \$104                      |
| USD / CAD | 3,154              | 76                         | 8,424             | 29                         |
| USD / CNY | 710                | (5                         | ) 8,130           | (16                        |
| USD / EUR | 18,027             | 819                        | 42,267            | 701                        |
| USD / GBP | 489                | (2                         | ) 1,806           | 19                         |
| USD / NZD | 2,064              | 98                         | 8,256             | 86                         |
| USD / SEK | 3,297              | 48                         | 4,520             | 19                         |
| USD / MXP | 3,178              | 299                        | 14,029            | (146                       |
| EUR / AUD | 260                | (22                        | ) 1,220           | (48                        |
| EUR / CAD | 412                | (27                        | ) —               | —                          |
| EUR / CHF | 1,288              | 13                         | 5,433             | (22                        |
| EUR / GBP | 8,512              | (429                       | ) 17,201          | 9                          |
| EUR / SEK | 400                | (30                        | ) —               | —                          |
| EUR / NOK | 596                | (24                        | ) —               | —                          |
| EUR / NZD | 1,890              | 276                        | 7,009             | 505                        |
| GBP / CHF | 239                | (18                        | ) 929             | (5                         |
| GBP / SEK | 1,087              | 26                         | 1,690             | 12                         |
| CHF / SEK | 98                 | (9                         | ) 271             | (2                         |
| NOK / CHF | 232                | (12                        | ) 436             | (1                         |
|           | \$46,834           | \$1,067                    | \$124,945         | \$1,244                    |

## Fair Value Hedging Strategy

In 2012 and 2011, the company did not utilize any derivatives designated as fair value hedges. However, the company has in the past utilized fair value hedges in the form of forward contracts to manage the foreign currency exchange risk associated with certain firm commitments and has entered into interest rate swaps to effectively convert fixed-rate debt to floating-rate debt in an attempt to avoid paying higher than market interest rates. For derivative instruments designated and qualifying as fair value hedges, the gain or loss on the derivative instrument as well as the offsetting gain or loss on the hedged item associated with the hedged risk are recognized in the same line item associated with the hedged item in earnings.

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

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2012

is offset by the gain/loss on the foreign currency forward contract. No material net gain or loss was realized by the company in 2012 or 2011 related to these forward contracts and the associated short-term intercompany trading receivables and payables.

Foreign currency forward exchange contracts not qualifying or designated for hedge accounting treatment entered into in 2012 and 2011, respectively, and outstanding were as follows (in thousands USD):

|           | September 30, 2012 |                | September 30, 2011 |                |
|-----------|--------------------|----------------|--------------------|----------------|
|           | Notional<br>Amount | Gain<br>(Loss) | Notional<br>Amount | Gain<br>(Loss) |
| CAD / USD | \$ 14,801          | \$434          | \$—                | \$—            |
| EUR / USD | 9,906              | 134            | —                  | —              |
| CHF / USD | 785                | 13             | 915                | 2              |
| NOK / USD | —                  | —              | 6,252              | (262 )         |
| NZD / USD | 3,146              | 40             | —                  | —              |
| DKK / NOK | —                  | —              | 74                 | (2 )           |
| EUR / AUD | 1,908              | 5              | —                  | —              |
| EUR / CAD | 239                | (15 )          | 26,500             | 37             |
| EUR / DKK | (11,203 )          | (27 )          | —                  | —              |
| EUR / SEK | —                  | —              | 9                  | —              |
| AUD / CAD | 3,056              | (38 )          | —                  | —              |
| AUD / NZD | 1,048              | 15             | —                  | —              |
| EUR / NZD | 90                 | (10 )          | —                  | —              |
| EUR / NOK | 6                  | —              | 118                | (3 )           |
|           | \$23,782           | \$551          | \$33,868           | \$(228 )       |

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

|   | September 30, 2012 |             | December 31, 2011 |             |
|---|--------------------|-------------|-------------------|-------------|
|   | Assets             | Liabilities | Assets            | Liabilities |
| Derivatives designated as hedging instruments under ASC 815     |                    |             |                   |             |
| Foreign currency forward contracts                              | \$ 1,751           | \$684       | \$ 1,621          | \$377       |
| Interest rate swap contracts                                    | —                  | 469         | 18                | 388         |
| Derivatives not designated as hedging instruments under ASC 815 |                    |             |                   |             |
| Foreign currency forward contracts                              | 663                | 112         | 64                | 128         |
| Total derivatives   | \$2,414            | \$1,265     | \$ 1,703          | \$893       |

The fair values of the company's foreign currency forward 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, 2012

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

| Derivatives in ASC 815 cash flow hedge relationships            | Amount of Gain (Loss) Recognized in OCI on Derivatives (Effective Portion) | Amount of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion) | Amount of Gain (Loss) Recognized in Income on Derivatives (Ineffective Portion and Amount Excluded from Effectiveness Testing) |
|---|--|---|--|
| Three months ended September 30, 2012                           |  |   |  |
| Foreign currency forward contracts                              | \$(2,522   | ) \$1,241   | \$(38 )  |
| Interest rate swap contracts                                    | (3   | ) —   | —  |
|   | \$(2,525   | ) \$1,241   | \$(38 )  |
| Nine months ended September 30, 2012                            |  |   |  |
| Foreign currency forward contracts                              | \$(2,956   | ) \$2,706   | \$(9 )   |
| Interest rate swap contracts                                    | (99  | ) —   | —  |
|   | \$(3,055   | ) \$2,706   | \$(9 )   |
| Three months ended September 30, 2011                           |  |   |  |
| Foreign currency forward contracts                              | \$(354   | ) \$(104  | ) \$—  |
| Interest rate swap contracts                                    | (117   | ) —   | —  |
|   | \$(471   | ) \$(104  | ) \$—  |
| Nine months ended September 30, 2011                            |  |   |  |
| Foreign currency forward contracts                              | \$(1,192   | ) \$(47   | ) \$3  |
| Interest rate swap contracts                                    | (533   | ) —   | —  |
|   | \$(1,725   | ) \$(47   | ) \$3  |
| Derivatives not designated as hedging instruments under ASC 815 |  |   | Amount of Gain (Loss) Recognized in Income on Derivatives  |
| Three months ended September 30, 2012                           |  |   |  |
| Foreign currency forward contracts                              |  |   | \$569  |
| Nine months ended September 30, 2012                            |  |   |  |
| Foreign currency forward contracts                              |  |   | \$551  |
| Three months ended September 30, 2011                           |  |   |  |
| Foreign currency forward contracts                              |  |   | \$(814 )   |
| Nine months ended September 30, 2011                            |  |   |  |
| Foreign currency forward contracts                              |  |   | \$(228 )   |

The pre-tax 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 or cost of product sold for hedges of inventory purchases. For the three and nine months ended September 30, 2012, net sales were decreased by \$146,000 and increased by \$49,000 and cost of product sold was decreased by \$1,487,000 and decreased by \$2,804,000 for a net realized gain of \$1,341,000 and a net realized gain of \$2,853,000, respectively. For the three and nine months ended September 30, 2011, net sales were increased by \$1,212,000 and increased by \$2,466,000 and cost of product sold was increased by \$1,316,000 and increased by \$2,513,000 for a net realized loss of \$104,000 and a net realized loss of

\$47,000, respectively.

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2012

The company recognized expense of \$147,000 and expense of \$419,000 for the three and nine months ended September 30, 2012, respectively, related to interest rate swap agreements, which is reflected in interest expense on the consolidated statement of comprehensive income (loss). The company recognized expense of \$135,000 and expense of \$253,000 for the three and nine months ended September 30, 2011, respectively, related to interest rate swap agreements, which is reflected in interest expense on the consolidated statement of comprehensive income (loss).

A gain of \$569,000 and a gain of \$551,000 were recognized in selling, general and administrative (SG&A) expenses for the three and nine months ended September 30, 2012, respectively, on no longer effective foreign currency forward contracts as well as those forward contracts not designated as hedging instruments that are entered into to offset gains/losses also recorded in SG&A expenses on intercompany trade 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. In comparison, a loss of \$814,000 and a loss of \$228,000 were recognized in SG&A expenses for the three and nine months ended September 30, 2011, respectively, on ineffective forward contracts and foreign currency forward contracts not designated as hedging instruments which were offset by losses of comparable amounts also recorded in SG&A expenses on the intercompany trade payables.

## 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<br>in Active<br>Markets<br>for Identical<br>Assets /<br>(Liabilities)<br>Level I | Significant<br>Other<br>Observable<br>Inputs<br>Level II | Significant<br>Other<br>Unobservable<br>Inputs<br>Level III |
| September 30, 2012:               |         |  |  |   |
| Forward Exchange Contracts—net    | \$1,618 | —  | \$1,618  | —   |
| Interest Rate Swap Agreements—net | (469)   | ) —  | (469)  | ) —   |
| December 31, 2011:                |         |  |  |   |
| Forward Exchange Contracts—net    | \$1,180 | —  | \$1,180  | —   |
| Interest Rate Swap Agreements—net | (370)   | ) —  | (370)  | ) —   |

Forward Contracts: The company operates internationally and as a result is exposed to foreign currency fluctuations. Specifically, the exposure includes intercompany and third party sales or payments as well as intercompany loans. 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 currency forward exchange contracts are based on quoted market prices for contracts with similar maturities.

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2012

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

|   | September 30, 2012 |            | December 31, 2011 |            |
|---|--------------------|------------|-------------------|------------|
|   | Carrying Value     | Fair Value | Carrying Value    | Fair Value |
| Cash and cash equivalents                                       | \$35,282           | \$35,282   | \$34,924          | \$34,924   |
| Other investments   | 1,277              | 1,277      | 1,362             | 1,362      |
| Installment receivables, net of reserves                        | 2,736              | 2,736      | 7,477             | 7,477      |
| Long-term debt (including current maturities of long-term debt) | (251,188)          | (250,438)  | (265,484)         | (264,112)  |
| Forward contracts in Other Current Assets                       | 2,414              | 2,414      | 1,685             | 1,685      |
| Forward contracts in Accrued Expenses                           | (796)              | (796)      | (505)             | (505)      |
| Interest Rate Swap Agreements in Other Current Assets           | —                  | —          | 18                | 18         |
| Interest Rate Swap Agreements in Accrued Expenses               | (469)              | (469)      | (388)             | (388)      |

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 and the company does not have the ability to easily sell these investments.

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 values for the company's convertible debt and revolving credit facility are based upon the company's estimate of the market for similar borrowing arrangements.

Forward contracts and interest rate swaps: Fair values for the company's forward contracts are based on quoted market prices, while the fair values of the interest rate swaps are based on model-derived calculations using inputs that are observable in active markets.

**Business Segments**

The company operates in five primary business segments: North America/Home Medical Equipment (North America/HME), Invacare Supply Group (ISG), 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. Invacare Supply Group sells distributed products and the Institutional Products Group sells or rents 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. Each business segment sells to the home health care, retail and extended care markets.

The company evaluates performance and allocates resources based on profit or loss from operations before income taxes for each reportable segment. 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. Therefore, intercompany profit or loss on intersegment sales and transfers is not considered in evaluating segment performance except for Asia/Pacific due to its significant intercompany sales volume relative to the segment.

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2012

The information by segment is as follows (in thousands):

|   | For the Three Months<br>Ended September 30, |           | For the Nine Months<br>Ended September 30, |             |
|---|---|-----------|--|-------------|
|   | 2012  | 2011      | 2012                                       | 2011        |
| Revenues from external customers          |   |           |  |             |
| North America/HME                         | \$170,983                                   | \$188,428 | \$527,467                                  | \$564,996   |
| Invacare Supply Group                     | 85,764                                      | 74,197    | 246,434                                    | 223,980     |
| Institutional Products Group              | 38,974                                      | 28,048    | 112,631                                    | 89,579      |
| Europe                                    | 141,705                                     | 142,107   | 401,721                                    | 405,354     |
| Asia/Pacific                              | 15,555                                      | 23,739    | 53,217                                     | 67,520      |
| Consolidated                              | \$452,981                                   | \$456,519 | \$1,341,470                                | \$1,351,429 |
| Intersegment revenues                     |   |           |  |             |
| North America/HME                         | \$24,832                                    | \$21,699  | \$82,040                                   | \$64,766    |
| Invacare Supply Group                     | 20  | 18        | 55   | 58          |
| Institutional Products Group              | 2,222                                       | 1,450     | 5,836                                      | 4,765       |
| Europe                                    | 3,239                                       | 2,635     | 8,448                                      | 7,267       |
| Asia/Pacific                              | 7,737                                       | 7,407     | 27,177                                     | 25,350      |
| Consolidated                              | \$38,050                                    | \$33,209  | \$123,556                                  | \$102,206   |
| Restructuring charges before income taxes |   |           |  |             |
| North America/HME                         | \$352                                       | \$406     | \$2,214                                    | \$406       |
| Invacare Supply Group                     | —   | 59        | (20  | ) 59        |
| Institutional Products Group              | —   | —         | 35   | —           |
| Europe                                    | 481   | 846       | 772  | 1,277       |
| Asia/Pacific                              | 342   | —         | 721  | —           |
| Consolidated                              | \$1,175                                     | \$1,311   | \$3,722                                    | \$1,742     |
| Earnings (loss) before income taxes       |   |           |  |             |
| North America/HME                         | \$1,587                                     | \$11,454  | \$13,102                                   | \$38,332    |
| Invacare Supply Group                     | 2,090                                       | 2,302     | 5,124                                      | 4,986       |
| Institutional Products Group              | 1,805                                       | 3,865     | 8,690                                      | 11,448      |
| Europe                                    | 10,218                                      | 11,379    | 23,504                                     | 25,819      |
| Asia/Pacific                              | (2,301                                      | ) 933     | (4,139                                     | ) 3,826     |
| All Other (1)                             | (5,460                                      | ) (12,783 | ) (17,411                                  | ) (48,996   |
| Consolidated                              | \$7,939                                     | \$17,150  | \$28,870                                   | \$35,415    |

Consists of un-allocated corporate SG&A costs and intercompany profits, which do not meet the quantitative (1) criteria for determining reportable segments. In addition, the "All Other" earnings (loss) before income taxes includes loss on debt extinguishment including debt finance charges, interest and fees.

## Charges Related to Restructuring Activities

During the quarter ended September 30, 2012, as part of the company's ongoing globalization initiative to reduce complexity within its global footprint, the company incurred restructuring charges. The restructuring was also undertaken in response to the continued decline in reimbursement by the U.S. government as well as similar reimbursement pressures abroad and continued pricing pressures faced by the company. As a result, the company recorded restructuring charges of \$3,722,000 in the first nine months of 2012. There have been no material changes in accrued balances related to the charge, either as a result of revisions in the plan or changes in estimates. The majority

of the outstanding charge accruals at September 30, 2012 are expected to be paid out within the next twelve months.

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2012

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

|                        | Severance | Product Line<br>Discontinuance | Contract<br>Terminations | Other  | Total    |   |
|------------------------|-----------|--------------------------------|--------------------------|--------|----------|---|
| December 31, 2010      |           |                                |                          |        |          |   |
| Balance                |           |                                |                          |        |          |   |
| Total                  | \$—       | \$—                            | \$—                      | \$—    | \$—      |   |
| Charges                |           |                                |                          |        |          |   |
| NA/HME                 | 4,756     | —                              | —                        | 4      | 4,760    |   |
| IPG                    | 123       | —                              | —                        | —      | 123      |   |
| ISG                    | 335       | —                              | —                        | —      | 335      |   |
| Europe                 | 3,288     | 277                            | 1,788                    | 113    | 5,466    |   |
| Asia/Pacific           | 186       | —                              | —                        | —      | 186      |   |
| Total                  | 8,688     | 277                            | 1,788                    | 117    | 10,870   |   |
| Payments               |           |                                |                          |        |          |   |
| NA/HME                 | (1,664    | ) —                            | —                        | (4     | ) (1,668 | ) |
| IPG                    | (52       | ) —                            | —                        | —      | (52      | ) |
| ISG                    | (82       | ) —                            | —                        | —      | (82      | ) |
| Europe                 | (1,546    | ) (277                         | ) (1,714                 | ) (113 | ) (3,650 | ) |
| Asia/Pacific           | (186      | ) —                            | —                        | —      | (186     | ) |
| Total                  | (3,530    | ) (277                         | ) (1,714                 | ) (117 | ) (5,638 | ) |
| December 31, 2011      |           |                                |                          |        |          |   |
| Balance                |           |                                |                          |        |          |   |
| NA/HME                 | 3,092     | —                              | —                        | —      | 3,092    |   |
| IPG                    | 71        | —                              | —                        | —      | 71       |   |
| ISG                    | 253       | —                              | —                        | —      | 253      |   |
| Europe                 | 1,742     | —                              | 74                       | —      | 1,816    |   |
| Asia/Pacific           | —         | —                              | —                        | —      | —        |   |
| Total                  | \$5,158   | \$—                            | \$74                     | \$—    | \$5,232  |   |
| Charges                |           |                                |                          |        |          |   |
| NA/HME                 | 117       | —                              | —                        | —      | 117      |   |
| IPG                    | 35        | —                              | —                        | —      | 35       |   |
| ISG                    | (13       | ) —                            | —                        | —      | (13      | ) |
| Europe                 | 257       | —                              | 34                       | —      | 291      |   |
| Asia/Pacific           | 118       | —                              | —                        | —      | 118      |   |
| Total                  | 514       | —                              | 34                       | —      | 548      |   |
| Payments               |           |                                |                          |        |          |   |
| NA/HME                 | (1,130    | ) —                            | —                        | —      | (1,130   | ) |
| IPG                    | (82       | ) —                            | —                        | —      | (82      | ) |
| ISG                    | (99       | ) —                            | —                        | —      | (99      | ) |
| Europe                 | (1,541    | ) —                            | (56                      | ) —    | (1,597   | ) |
| Asia/Pacific           | (118      | ) —                            | —                        | —      | (118     | ) |
| Total                  | (2,970    | ) —                            | (56                      | ) —    | (3,026   | ) |
| March 31, 2012 Balance |           |                                |                          |        |          |   |
| NA/HME                 | 2,079     | —                              | —                        | —      | 2,079    |   |
| IPG                    | 24        | —                              | —                        | —      | 24       |   |
| ISG                    | 141       | —                              | —                        | —      | 141      |   |

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|              |         |     |      |     |         |
|--------------|---------|-----|------|-----|---------|
| Europe       | 458     | —   | 52   | —   | 510     |
| Asia/Pacific | —       | —   | —    | —   | —       |
| Total        | \$2,702 | \$— | \$52 | \$— | \$2,754 |

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2012

|                               | Severance | Product Line<br>Discontinuance | Contract<br>Terminations | Other | Total   |   |
|-------------------------------|-----------|--------------------------------|--------------------------|-------|---------|---|
| Charges                       |           |                                |                          |       |         |   |
| NA/HME                        | \$1,745   | \$—                            | \$—                      | \$—   | \$1,745 |   |
| IPG                           | —         | —                              | —                        | —     | —       |   |
| ISG                           | (7        | ) —                            | —                        | —     | (7      | ) |
| Europe                        | —         | —                              | —                        | —     | —       |   |
| Asia/Pacific                  | 261       | —                              | —                        | —     | 261     |   |
| Total                         | 1,999     | —                              | —                        | —     | 1,999   |   |
| Payments                      |           |                                |                          |       |         |   |
| NA/HME                        | (840      | ) —                            | —                        | —     | (840    | ) |
| IPG                           | (14       | ) —                            | —                        | —     | (14     | ) |
| ISG                           | (36       | ) —                            | —                        | —     | (36     | ) |
| Europe                        | (170      | ) —                            | (25                      | ) —   | (195    | ) |
| Asia/Pacific                  | (261      | ) —                            | —                        | —     | (261    | ) |
| Total                         | (1,321    | ) —                            | (25                      | ) —   | (1,346  | ) |
| June 30, 2012 Balance         |           |                                |                          |       |         |   |
| NA/HME                        | 2,984     | —                              | —                        | —     | 2,984   |   |
| IPG                           | 10        | —                              | —                        | —     | 10      |   |
| ISG                           | 98        | —                              | —                        | —     | 98      |   |
| Europe                        | 288       | —                              | 27                       | —     | 315     |   |
| Asia/Pacific                  | —         | —                              | —                        | —     | —       |   |
| Total                         | \$3,380   | \$—                            | \$27                     | \$—   | \$3,407 |   |
| Charges                       |           |                                |                          |       |         |   |
| NA/HME                        | 352       | —                              | —                        | —     | 352     |   |
| IPG                           | —         | —                              | —                        | —     | —       |   |
| ISG                           | —         | —                              | —                        | —     | —       |   |
| Europe                        | 462       | —                              | 19                       | —     | 481     |   |
| Asia/Pacific                  | 342       | —                              | —                        | —     | 342     |   |
| Total                         | 1,156     | —                              | 19                       | —     | 1,175   |   |
| Payments                      |           |                                |                          |       |         |   |
| NA/HME                        | (833      | ) —                            | —                        | —     | (833    | ) |
| IPG                           | (10       | ) —                            | —                        | —     | (10     | ) |
| ISG                           | (36       | ) —                            | —                        | —     | (36     | ) |
| Europe                        | (247      | ) —                            | (20                      | ) —   | (267    | ) |
| Asia/Pacific                  | (342      | ) —                            | —                        | —     | (342    | ) |
| Total                         | (1,468    | ) —                            | (20                      | ) —   | (1,488  | ) |
| September 30, 2012<br>Balance |           |                                |                          |       |         |   |
| NA/HME                        | 2,503     | —                              | —                        | —     | 2,503   |   |
| IPG                           | —         | —                              | —                        | —     | —       |   |
| ISG                           | 62        | —                              | —                        | —     | 62      |   |
| Europe                        | 503       | —                              | 26                       | —     | 529     |   |
| Asia/Pacific                  | —         | —                              | —                        | —     | —       |   |
| Total                         | \$3,068   | \$—                            | \$26                     | \$—   | \$3,094 |   |





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INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2012

Contingencies

General

In the ordinary course of its business, Invacare 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 have been referred to the company's captive insurance company and/or excess insurance carriers and generally are 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 and other practices of health care suppliers and manufacturers are all subject to government scrutiny. Violations of law or regulations can result in administrative, civil and criminal penalties and sanctions, including disqualification from Medicare and other reimbursement programs, which could have a material adverse effect on the company's business.

FDA Matters

The FDA regulates virtually all aspects of the development, testing, manufacturing, labeling, promotion, distribution and marketing of a medical device. The company's failure to comply with the regulatory requirements of the FDA and other applicable U.S. medical device regulatory requirements may subject the company to administrative or judicially imposed sanctions. These sanctions include warning letters, civil penalties, criminal penalties, injunctions, consent decrees, product seizure or detention, product recalls and total or partial suspension of production.

As part of its regulatory function, the FDA routinely inspects the sites of medical device companies, and in 2011, the FDA inspected certain of the company's facilities. In December 2011, the FDA requested that the company negotiate and agree to a consent decree of injunction related to the company's corporate facility and its wheelchair manufacturing facility in Elyria, Ohio. The company is in the process of negotiating the final terms of the proposed consent decree with the FDA. While the final terms of the consent decree have not been determined, they would result in the suspension of a portion, which could be substantial, of the company's operations at its Elyria, Ohio wheelchair manufacturing facility. The duration of any such suspension would be dependent upon third-party expert certification of the company's compliance with the FDA quality system regulations ("QSR") and then the FDA's determination of such compliance. A suspension of operations likely would have adverse effects on the company's business, including loss of revenues, harm to the company's reputation and customer dissatisfaction. The company believes the proposed consent decree has started to have a negative impact on the company's financial results, even before suspension of operations, as a result of customer uncertainty with the impacts of the decree and the company's withdrawal of bids for certain contracts that require uninterrupted supply. In addition, 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.

The company is devoting additional substantial financial, management and engineering resources to making the systemic improvements necessary to achieve compliance with the QSR requirements. The company's diversion of

resources is impacting other areas of the company's business, such as, for example, delays in new product development and cost reduction and Globalization activities.

The company is cooperating with the FDA in attempting to negotiate the final terms of the consent decree. However, there can be no assurance that negotiations will conclude with mutually agreeable terms of the consent decree which could lead the FDA to pursue judicial, legal or other enforcement action against the company. However, the results of regulatory claims, proceedings, investigations, or litigation are difficult to predict. Such enforcement could include requiring restrictions on the manufacturing, sale or distribution of the company's products, product recalls, or the payment of fines or penalties, which enforcement could result in material adverse consequences to the company.

Any of the above contingencies could have an adverse impact on the company's business, prospects, value, ability to borrow, financial condition, or results of operations.

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2012

## Subsequent Event

At the end of October 2012, the company's management approved a plan to restructure the company's operations in the Asia/Pacific segment. In Australia, the company will consolidate offices / warehouses, decrease staffing and exit various activities while returning to a focus on distribution. At the company's subsidiary which produces microprocessor controllers, the company has initiated a proposal for change that would lead to exiting the contract manufacturing business for companies outside of the healthcare industry. As a result, the company may incur restructuring charges for the Asia/Pacific segment ranging from \$5,000,000 to \$7,000,000 commencing in the fourth quarter of 2012 with the majority being cash charges.

## Supplemental Guarantor Information

Effective February 12, 2007, substantially all of the domestic subsidiaries (the "Guarantor Subsidiaries") of the company became guarantors of the indebtedness of Invacare Corporation under its 4.125% Convertible Senior Subordinated Debentures due 2027 (the "Debentures") with an original aggregate principal amount of \$135,000,000. The majority of the company's subsidiaries are not guaranteeing the indebtedness of the Debentures (the "Non-Guarantor Subsidiaries"). Each of the Guarantor Subsidiaries has fully and unconditionally guaranteed, on a joint and several basis, to pay principal, premium, and interest related to the Debentures and each of the Guarantor Subsidiaries are directly or indirectly wholly-owned subsidiaries of the company.

Presented below are the consolidating condensed financial statements of Invacare Corporation (Parent), its combined Guarantor Subsidiaries and combined Non-Guarantor Subsidiaries with their investments in subsidiaries accounted for using the equity method. The company does not believe that separate financial statements of the Guarantor Subsidiaries are material to investors and accordingly, separate financial statements and other disclosures related to the Guarantor Subsidiaries are not presented.

## CONSOLIDATING CONDENSED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

|  | The<br>Company<br>(Parent) | Combined<br>Guarantor<br>Subsidiaries | Combined<br>Non-Guarantor<br>Subsidiaries | Eliminations | Total     |
|--|----------------------------|---------------------------------------|---|--------------|-----------|
| Three month period ended September 30, 2012  | (in thousands)             |                                       |   |              |           |
| Net sales                                    | \$90,406                   | \$207,802                             | \$183,801                                 | \$(29,028)   | \$452,981 |
| Cost of products sold                        | 70,600                     | 162,906                               | 126,852                                   | (29,031)     | 331,327   |
| Gross Profit                                 | 19,806                     | 44,896                                | 56,949                                    | 3            | 121,654   |
| Selling, general and administrative expenses | 33,712                     | 28,394                                | 45,492                                    | 3,721        | 111,319   |
| Charge related to restructuring activities   | 334                        | 18                                    | 823                                       | —            | 1,175     |
| Income (loss) from equity investee           | 17,302                     | (4,264)                               | ) 228                                     | (13,266)     | —         |
| Interest expense (income)—net                | (1,024)                    | ) 1,474                               | 771                                       | —            | 1,221     |
| Earnings (loss) before Income Taxes          | 4,086                      | 10,746                                | 10,091                                    | (16,984)     | 7,939     |
| Income taxes                                 | 1,222                      | (398)                                 | ) 4,251                                   | —            | 5,075     |
| Net Earnings (loss)                          | \$2,864                    | \$11,144                              | \$5,840                                   | \$(16,984)   | \$2,864   |

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|  |           |           |           |             |           |
|--|-----------|-----------|-----------|-------------|-----------|
| Other Comprehensive Income (Loss),<br>Net of Tax | 14,518    | 3,164     | 11,412    | (14,576 )   | 14,518    |
| Comprehensive Income (Loss)                      | \$ 17,382 | \$ 14,308 | \$ 17,252 | \$(31,560 ) | \$ 17,382 |

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2012

## CONSOLIDATING CONDENSED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

|  | The<br>Company<br>(Parent) | Combined<br>Guarantor<br>Subsidiaries | Combined<br>Non-Guarantor<br>Subsidiaries | Eliminations | Total         |
|--|----------------------------|---------------------------------------|---|--------------|---------------|
| Three month period ended September 30, 2011                                    | (in thousands)             |                                       |   |              |               |
| Net sales  | \$96,992                   | \$191,595                             | \$193,007                                 | \$(25,075)   | ) \$456,519   |
| Cost of products sold  | 70,548                     | 149,783                               | 130,001                                   | (24,890)     | ) 325,442     |
| Gross Profit   | 26,444                     | 41,812                                | 63,006                                    | (185)        | ) 131,077     |
| Selling, general and administrative expenses                                   | 30,314                     | 14,069                                | 47,145                                    | 12,607       | 104,135       |
| Charge related to restructuring activities                                     | —                          | 465                                   | 846                                       | —            | 1,311         |
| Loss on debt extinguishment including debt finance charges and associated fees | 7,462                      | —                                     | —   | —            | 7,462         |
| Income (loss) from equity investee   | 24,452                     | 8,210                                 | 8   | (32,670)     | ) —           |
| Interest expense—net   | (180)                      | ) 363                                 | 836                                       | —            | 1,019         |
| Earnings (loss) before Income Taxes  | 13,300                     | 35,125                                | 14,187                                    | (45,462)     | ) 17,150      |
| Income taxes (benefit)   | 500                        | 100                                   | 3,750                                     | —            | 4,350         |
| Net Earnings (loss)  | \$12,800                   | \$35,025                              | \$10,437                                  | \$(45,462)   | ) \$12,800    |
| Other Comprehensive Income (Loss), Net of Tax                                  | (12,632)                   | ) (7,338)                             | ) (6,703)                                 | ) 14,041     | (12,632)      |
| Comprehensive Income (Loss)  | \$168                      | \$27,687                              | \$3,734                                   | \$(31,421)   | ) \$168       |
| Nine month period ended September 30, 2012                                     |                            |                                       |   |              |               |
| Net sales  | \$275,742                  | \$619,081                             | \$540,535                                 | \$(93,888)   | ) \$1,341,470 |
| Cost of products sold  | 211,115                    | 484,865                               | 371,855                                   | (93,455)     | ) 974,380     |
| Gross Profit   | 64,627                     | 134,216                               | 168,680                                   | (433)        | ) 367,090     |
| Selling, general and administrative expenses                                   | 99,736                     | 88,286                                | 138,207                                   | 4,360        | 330,589       |
| Charge related to restructuring activities                                     | 2,085                      | 19                                    | 1,618                                     | —            | 3,722         |
| Loss on debt extinguishment including debt finance charges and associated fees | 312                        | —                                     | —   | —            | 312           |
| Income (loss) from equity investee   | 45,175                     | 1,954                                 | 391                                       | (47,520)     | ) —           |
| Interest expense (income)—net  | (3,041)                    | ) 4,264                               | 2,374                                     | —            | 3,597         |
| Earnings (loss) before Income Taxes  | 10,710                     | 43,601                                | 26,872                                    | (52,313)     | ) 28,870      |
| Income taxes   | 1,590                      | 100                                   | 18,060                                    | —            | 19,750        |
| Net Earnings (loss)  | \$9,120                    | \$43,501                              | \$8,812                                   | \$(52,313)   | ) \$9,120     |

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|  |           |            |           |             |             |   |
|--|-----------|------------|-----------|-------------|-------------|---|
| Other Comprehensive Income (Loss),<br>Net of Tax | (24,673   | ) 3,179    | (27,878   | ) 24,699    | (24,673     | ) |
| Comprehensive Income (Loss)                      | \$(15,553 | ) \$46,680 | \$(19,066 | ) \$(27,614 | ) \$(15,553 | ) |

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2012

## CONSOLIDATING CONDENSED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

|  | The<br>Company<br>(Parent) | Combined<br>Guarantor<br>Subsidiaries | Combined<br>Non-Guarantor<br>Subsidiaries | Eliminations | Total         |
|--|----------------------------|---------------------------------------|---|--------------|---------------|
| Nine month period ended September 30, 2011                                     | (in thousands)             |                                       |   |              |               |
| Net sales  | \$286,969                  | \$576,799                             | \$562,331                                 | \$(74,670)   | ) \$1,351,429 |
| Cost of products sold  | 208,162                    | 449,838                               | 378,691                                   | (74,263)     | ) 962,428     |
| Gross Profit   | 78,807                     | 126,961                               | 183,640                                   | (407)        | ) 389,001     |
| Selling, general and administrative expenses                                   | 99,464                     | 44,186                                | 141,955                                   | 36,724       | 322,329       |
| Charge related to restructuring activities                                     | —                          | 465                                   | 1,277                                     | —            | 1,742         |
| Loss on debt extinguishment including debt finance charges and associated fees | 24,198                     | —                                     | —   | —            | 24,198        |
| Income (loss) from equity investee   | 78,902                     | 26,271                                | 1,065                                     | (106,238)    | ) —           |
| Interest expense—net   | 1,532                      | 1,144                                 | 2,641                                     | —            | 5,317         |
| Earnings (loss) before Income Taxes  | 32,515                     | 107,437                               | 38,832                                    | (143,369)    | ) 35,415      |
| Income taxes (benefit)   | 1,600                      | 300                                   | 2,600                                     | —            | 4,500         |
| Net Earnings (loss)  | \$30,915                   | \$107,137                             | \$36,232                                  | \$(143,369)  | ) \$30,915    |
| Other Comprehensive Income (Loss), Net of Tax                                  | 46,642                     | (4,382)                               | ) 51,268                                  | (46,886)     | ) 46,642      |
| Comprehensive Income (Loss)  | \$77,557                   | \$102,755                             | \$87,500                                  | \$(190,255)  | ) \$77,557    |

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2012

## CONSOLIDATING CONDENSED BALANCE SHEETS

|   | The<br>Company<br>(Parent)<br>(in thousands) | Combined<br>Guarantor<br>Subsidiaries | Combined<br>Non-Guarantor<br>Subsidiaries | Eliminations  | Total         |
|---|--|---------------------------------------|---|---------------|---------------|
| September 30, 2012  |  |                                       |   |               |               |
| Assets  |  |                                       |   |               |               |
| Current Assets  |  |                                       |   |               |               |
| Cash and cash equivalents                                       | \$5,419                                      | \$2,665                               | \$27,198                                  | \$—           | \$35,282      |
| Trade receivables, net  | 77,152                                       | 75,819                                | 97,088                                    | —             | 250,059       |
| Installment receivables, net                                    | —  | 966                                   | 1,300                                     | —             | 2,266         |
| Inventories, net  | 44,721                                       | 59,965                                | 119,124                                   | (2,191)       | ) 221,619     |
| Deferred income taxes   | —  | 45                                    | 394                                       | —             | 439           |
| Other current assets  | 10,053                                       | 7,665                                 | 35,862                                    | (8,040)       | ) 45,540      |
| Total Current Assets  | 137,345                                      | 147,125                               | 280,966                                   | (10,231)      | ) 555,205     |
| Investment in subsidiaries                                      | 1,581,517                                    | 526,343                               | —   | (2,107,860)   | ) —           |
| Intercompany advances, net                                      | 83,184                                       | 862,794                               | 215,132                                   | (1,161,110)   | ) —           |
| Other Assets  | 41,025                                       | 382                                   | 417                                       | —             | 41,824        |
| Other Intangibles   | 743  | 23,623                                | 48,994                                    | —             | 73,360        |
| Property and Equipment, net                                     | 40,974                                       | 21,210                                | 60,449                                    | —             | 122,633       |
| Goodwill  | —  | 56,010                                | 416,694                                   | —             | 472,704       |
| Total Assets  | \$1,884,788                                  | \$1,637,487                           | \$1,022,652                               | \$(3,279,201) | ) \$1,265,726 |
| Liabilities and Shareholders' Equity                            |  |                                       |   |               |               |
| Current Liabilities   |  |                                       |   |               |               |
| Accounts payable  | \$72,038                                     | \$21,005                              | \$53,761                                  | \$—           | \$146,804     |
| Accrued expenses  | 33,382                                       | 22,872                                | 83,015                                    | (8,040)       | ) 131,229     |
| Accrued income taxes  | 289  | —                                     | 560                                       | —             | 849           |
| Short-term debt and current maturities of long-term obligations | 80   | 7                                     | 652                                       | —             | 739           |
| Total Current Liabilities                                       | 105,789                                      | 43,884                                | 137,988                                   | (8,040)       | ) 279,621     |
| Long-Term Debt  | 243,879                                      | 164                                   | 6,406                                     | —             | 250,449       |
| Other Long-Term Obligations                                     | 49,910                                       | 8,000                                 | 62,604                                    | —             | 120,514       |
| Intercompany advances, net                                      | 870,068                                      | 198,670                               | 92,372                                    | (1,161,110)   | ) —           |
| Total Shareholders' Equity                                      | 615,142                                      | 1,386,769                             | 723,282                                   | (2,110,051)   | ) 615,142     |
| Total Liabilities and Shareholders' Equity                      | \$1,884,788                                  | \$1,637,487                           | \$1,022,652                               | \$(3,279,201) | ) \$1,265,726 |



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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2012

## CONSOLIDATING CONDENSED BALANCE SHEETS

|   | The<br>Company<br>(Parent)<br>(in thousands) | Combined<br>Guarantor<br>Subsidiaries | Combined<br>Non-Guarantor<br>Subsidiaries | Eliminations  | Total         |
|---|--|---------------------------------------|---|---------------|---------------|
| December 31, 2011                             |  |                                       |   |               |               |
| Assets  |  |                                       |   |               |               |
| Current Assets                                |  |                                       |   |               |               |
| Cash and cash equivalents                     | \$3,642                                      | \$2,104                               | \$29,178                                  | \$—           | \$34,924      |
| Trade receivables, net                        | 83,522                                       | 74,161                                | 90,291                                    | —             | 247,974       |
| Installment receivables, net                  | —  | 1,180                                 | 5,491                                     | —             | 6,671         |
| Inventories, net                              | 45,937                                       | 49,336                                | 99,006                                    | (1,518)       | ) 192,761     |
| Deferred income taxes                         | 422  | 45                                    | 1,153                                     | —             | 1,620         |
| Other current assets                          | 10,171                                       | 6,517                                 | 33,812                                    | (5,680)       | ) 44,820      |
| Total Current Assets                          | 143,694                                      | 133,343                               | 258,931                                   | (7,198)       | ) 528,770     |
| Investment in subsidiaries                    | 1,560,693                                    | 524,800                               | —   | (2,085,493)   | ) —           |
| Intercompany advances, net                    | 79,598                                       | 846,829                               | 200,157                                   | (1,126,584)   | ) —           |
| Other Assets                                  | 40,813                                       | 698                                   | 1,136                                     | —             | 42,647        |
| Other Intangibles                             | 821  | 26,838                                | 55,661                                    | —             | 83,320        |
| Property and Equipment, net                   | 45,459                                       | 17,770                                | 66,483                                    | —             | 129,712       |
| Goodwill                                      | —  | 54,894                                | 441,711                                   | —             | 496,605       |
| Total Assets                                  | \$1,871,078                                  | \$1,605,172                           | \$1,024,079                               | \$(3,219,275) | ) \$1,281,054 |
| Liabilities and Shareholders'<br>Equity       |  |                                       |   |               |               |
| Current Liabilities                           |  |                                       |   |               |               |
| Accounts payable                              | \$73,948                                     | \$18,078                              | \$56,779                                  | \$—           | \$148,805     |
| Accrued expenses                              | 37,708                                       | 21,038                                | 79,529                                    | (5,680)       | ) 132,595     |
| Accrued income taxes                          | 508  | —                                     | 987                                       | —             | 1,495         |
| Short-term debt and current<br>maturities of  | 4,210  | 4                                     | 830                                       | —             | 5,044         |
| long-term obligations                         |  |                                       |   |               |               |
| Total Current Liabilities                     | 116,374                                      | 39,120                                | 138,125                                   | (5,680)       | ) 287,939     |
| Long-Term Debt                                | 252,855                                      | 227                                   | 7,358                                     | —             | 260,440       |
| Other Long-Term Obligations                   | 47,873                                       | 7,312                                 | 50,965                                    | —             | 106,150       |
| Intercompany advances, net                    | 827,451                                      | 210,005                               | 89,128                                    | (1,126,584)   | ) —           |
| Total Shareholders' Equity                    | 626,525                                      | 1,348,508                             | 738,503                                   | (2,087,011)   | ) 626,525     |
| Total Liabilities and<br>Shareholders' Equity | \$1,871,078                                  | \$1,605,172                           | \$1,024,079                               | \$(3,219,275) | ) \$1,281,054 |

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2012

## CONSOLIDATING CONDENSED STATEMENTS OF CASH FLOWS

|  | The<br>Company<br>(Parent) | Combined<br>Guarantor<br>Subsidiaries | Combined<br>Non-Guarantor<br>Subsidiaries | Eliminations | Total     |
|--|----------------------------|---------------------------------------|---|--------------|-----------|
| Nine month period ended September 30, 2012                       | (in thousands)             |                                       |   |              |           |
| Net Cash Provided (Used) by Operating Activities                 | \$18,260                   | \$5,405                               | \$7,527                                   | \$(4,370)    | \$26,822  |
| Investing Activities   |                            |                                       |   |              |           |
| Purchases of property and equipment                              | (1,353)                    | (7,854)                               | (5,568)                                   | —            | (14,775)  |
| Proceeds from sale of property and equipment                     | 18                         | 14                                    | 65  | —            | 97        |
| Other long-term assets   | (214)                      | —                                     | 623                                       | —            | 409       |
| Other  | (158)                      | (117)                                 | 56  | —            | (219)     |
| Net Cash Used for Investing Activities                           | (1,707)                    | (7,957)                               | (4,824)                                   | —            | (14,488)  |
| Financing Activities   |                            |                                       |   |              |           |
| Proceeds from revolving lines of credit and long-term borrowings | 252,590                    | 3,113                                 | —   | —            | 255,703   |
| Payments on revolving lines of credit and long-term borrowings   | (266,182)                  | —                                     | (539)                                     | —            | (266,721) |
| Payment of financing costs                                       | (1)                        | —                                     | —   | —            | (1)       |
| Payment of dividends   | (1,183)                    | —                                     | (4,370)                                   | 4,370        | (1,183)   |
| Net Cash Provided (Used) by Financing Activities                 | (14,776)                   | 3,113                                 | (4,909)                                   | 4,370        | (12,202)  |
| Effect of exchange rate changes on cash                          | —                          | —                                     | 226                                       | —            | 226       |
| Increase (decrease) in cash and cash equivalents                 | 1,777                      | 561                                   | (1,980)                                   | —            | 358       |
| Cash and cash equivalents at beginning of year                   | 3,642                      | 2,104                                 | 29,178                                    | —            | 34,924    |
| Cash and cash equivalents at end of period                       | \$5,419                    | \$2,665                               | \$27,198                                  | \$—          | \$35,282  |

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## INVACARE CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements (unaudited) - September 30, 2012

## CONSOLIDATING CONDENSED STATEMENTS OF CASH FLOWS

|  | The<br>Company<br>(Parent) | Combined<br>Guarantor<br>Subsidiaries | Combined<br>Non-Guarantor<br>Subsidiaries | Eliminations | Total     |
|--|----------------------------|---------------------------------------|---|--------------|-----------|
| Nine month period ended September 30, 2011                       | (in thousands)             |                                       |   |              |           |
| Net Cash Provided (Used) by Operating Activities                 | \$12,235                   | \$49,075                              | \$42,002                                  | \$(36,724)   | \$66,588  |
| Investing Activities   |                            |                                       |   |              |           |
| Purchases of property and equipment                              | (5,751)                    | (3,127)                               | (6,715)                                   | —            | (15,593)  |
| Proceeds from sale of property and equipment                     | —                          | 15                                    | 31  | —            | 46        |
| Other long-term assets   | (1,021)                    | —                                     | 3   | —            | (1,018)   |
| Other  | (26)                       | (2)                                   | 28  | —            | —         |
| Net Cash Used for Investing Activities                           | (6,798)                    | (44,579)                              | (6,653)                                   | —            | (58,030)  |
| Financing Activities   |                            |                                       |   |              |           |
| Proceeds from revolving lines of credit and long-term borrowings | 362,958                    | —                                     | —   | —            | 362,958   |
| Payments on revolving lines of credit and long-term borrowings   | (324,370)                  | (4,371)                               | (8,209)                                   | —            | (336,950) |
| Proceeds from exercise of stock options                          | 4,126                      | —                                     | —   | —            | 4,126     |
| Payment of financing costs                                       | (24,116)                   | —                                     | —   | —            | (24,116)  |
| Payment of dividends   | (1,191)                    | —                                     | (36,724)                                  | 36,724       | (1,191)   |
| Purchase of treasury stock                                       | (21,551)                   | —                                     | —   | —            | (21,551)  |
| Net Cash Provided (Used) by Financing Activities                 | (4,144)                    | (4,371)                               | (44,933)                                  | 36,724       | (16,724)  |
| Effect of exchange rate changes on cash                          | —                          | —                                     | 984                                       | —            | 984       |
| Increase (Decrease) in cash and cash equivalents                 | 1,293                      | 125                                   | (8,600)                                   | —            | (7,182)   |
| Cash and cash equivalents at beginning of year                   | 4,036                      | 2,476                                 | 41,950                                    | —            | 48,462    |
| Cash and cash equivalents at end of period                       | \$5,329                    | \$2,601                               | \$33,350                                  | \$—          | \$41,280  |

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

OUTLOOK

Throughout the year the company has faced several internal and external challenges that have lowered the company's sales and margins. Internally, one of the key pressures is the delay of new products, particularly higher margin products. The company has temporarily ceased most new product development because the majority of its engineers are currently focused on remediation to achieve compliance with the FDA's Quality System Regulation ("QSR"). When the quality systems improvements are complete, the company will re-energize its new product development activity. Externally, the company's sales in the domestic home medical equipment (HME) industry are being impacted as its customers cope with prepayment reviews and post-payment audits by payors, as well as uncertainty related to their participation in the next round of National Competitive Bidding. While the company believes these are not generally long-term issues, it is continuously assessing the domestic market, including analyzing data from the Centers for Medicare and Medicaid Services about demand trends for home medical equipment. If it is determined that there are structural changes to the HME industry, the company will take an appropriate course of action. Also, the senior management team is working closely with the general manager for the Australian and New Zealand distribution businesses to return the segment to profitability. In an effort to restore the Asia/Pacific segment to profitability, at the end of October 2012, the company's management approved a plan to restructure the company's operations in the Asia/Pacific segment. In Australia, the company will consolidate offices / warehouses, decrease staffing and exit various activities while returning to a focus on distribution. At the company's subsidiary which produces microprocessor controllers, the company has initiated a proposal for change that would lead to exiting the contract manufacturing business for companies outside of the healthcare industry. As a result, the company may incur restructuring charges for the Asia/Pacific segment ranging from \$5,000,000 to \$7,000,000 commencing in the fourth quarter of 2012 with the majority being cash charges.

Regarding the status of the company's negotiations with the FDA and its related quality systems remediation program, the company is continuing to negotiate the terms of the FDA's proposed consent decree of injunction related to the company's corporate and wheelchair manufacturing facilities in Elyria, Ohio. While the final terms of the consent decree have not been determined, they would result in the suspension of a portion, which could be substantial, of the company's operations at its Elyria wheelchair manufacturing facility. The duration of any such suspension would be dependent upon third-party expert certification of the company's compliance with the FDA QSR and then the FDA's determination of such compliance. A suspension of operations likely would have adverse effects on the company's business, including loss of revenues, harm to the company's reputation and customer dissatisfaction. The company believes the proposed consent decree has started to have a negative impact on the company's financial results, even before suspension of operations, as a result of customer uncertainty with the impacts of the decree and the company's withdrawal of bids for certain contracts that require uninterrupted supply. In addition, 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.

The company is devoting additional substantial financial, management and engineering resources to making the systemic improvements necessary to achieve compliance with the QSR requirements. The company's diversion of resources is impacting other areas of the company's business, such as, for example, delays in new product development and cost reduction and Globalization activities. However, the company continues to make significant progress on its quality systems remediation. Throughout the remediation, the company has engaged subject matter experts to assess the compliance of its new quality processes during the development and implementation stages to ensure they are in line with the FDA's QSR requirements. At this point, the company is confident that it will initiate its third-party expert certification audit in December, and the company expects the audit to be completed in the first quarter of 2013. The expert certification audit would be followed by an FDA re-inspection. 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 OPERATIONS

Net Sales. Consolidated net sales for the third quarter decreased 0.8% to \$452,981,000 versus \$456,519,000 for the same period last year. Foreign currency translation decreased net sales 4.0 percentage points while an acquisition increased sales by 1.0 percentage point. Organic net sales for the quarter increased by 2.2% over the same period a year ago driven by increases in the Europe, Invacare Supply Group (ISG) and Institutional Products Group (IPG) segments, which were offset by declines in the North America/Home Medical Equipment (HME) and Asia/Pacific segments. For the nine months ended September 30, 2012, net sales decreased 0.7% to \$1,341,470,000 versus \$1,351,429,000 for the same period last year. Foreign currency translation decreased net sales 2.3 percentage points while an acquisition increased net sales by 1.2 percentage points. Year-to-date organic net sales increased by 0.4% over the same period last year as increases in the Europe, ISG and IPG segments were offset by declines in the North America/HME and Asia/Pacific segments.

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North America/Home Medical Equipment (HME)

North America/HME net sales decreased 9.3% for the quarter to \$170,983,000 as compared to \$188,428,000 for the same period a year ago, with foreign currency translation decreasing net sales by 0.2 of a percentage point. The organic net sales decrease of 9.1% was driven by declines in all three product categories. The sales decline in the segment was primarily related to the Company's previously mentioned delay of new product introductions. The sales decline also is related to slowness in power wheelchair sales in the United States due to the ongoing uncertainty and general slowness in the market where mobility and seating customers are dealing with prepayment reviews and post-payment audits of power mobility devices by Medicare and Medicaid. Also in the United States, customers in the 91 metropolitan statistical areas in the next round of National Competitive Bidding continue to leverage their existing inventory as they wait for the Fall 2012 announcement of the bid rates and the related contracting process for the bid winners. Uncertainty regarding the resolution of the company's consent decree with the FDA impacted the company's ability to renegotiate those existing contracts that require the company to provide uninterrupted supply of products, and likely led some customers to be cautious in their spending with Invacare. For the nine months ended September 30, 2012, net sales decreased 6.6% to \$527,467,000 as compared to \$564,996,000 for the same period a year ago, with foreign currency decreasing net sales by 0.2 of a percentage point. The year-to-date organic net sales decrease of 6.4% was driven by declines in all three product categories.

Invacare Supply Group (ISG)

ISG net sales for the quarter increased 15.6% to \$85,764,000 compared to \$74,197,000 for the same period last year as net sales increased across most product categories. For the first nine months of 2012, net sales increased 10.0% to \$246,434,000 as compared to \$223,980,000 for the same period last year due to increases in diabetic, incontinence and ostomy products.

Institutional Products Group (IPG)

IPG net sales for the third quarter increased 39.0% to \$38,974,000 compared to \$28,048,000 for the third quarter last year as an acquisition increased net sales by 16.8 percentage points. Organic net sales increased by 22.2%. For the first nine months of 2012, net sales increased 25.7% to \$112,631,000 as compared to \$89,579,000 for the same period a year ago. Organic net sales increased 7.7%, foreign currency translation decreased net sales by 0.1 of a percentage point and an acquisition increased net sales by 18.1 percentage points. The organic net sales increase for the quarter and year-to-date was driven by strong net sales for interior design projects for long-term care facilities, institutional beds and dialysis chairs.

Europe

For the third quarter, European net sales decreased 0.3% to \$141,705,000 versus \$142,107,000 for the third quarter last year as the organic net sales increase of 12.3% was more than offset by foreign currency translation which decreased net sales by 12.6 percentage points. For the first nine months of 2012, net sales decreased 0.9% to \$401,721,000 as compared to \$405,354,000 for the same period last year. Organic net sales increased 6.7% for the first nine months of the year as foreign currency translation decreased net sales by 7.6 percentage points. The organic net sales increase for the quarter and year-to-date was principally due to increases in respiratory therapy products partially offset by declines in lifestyle and mobility and seating products.

Asia/Pacific

Asia/Pacific net sales decreased 34.5% for the quarter to \$15,555,000 as compared to \$23,739,000 for the same period a year ago. Organic net sales decreased 33.0% and foreign currency translation decreased net sales by 1.5 percentage points. The organic sales decline for the quarter was caused by declines in all three subsidiaries in the segment. The Company's Australian and New Zealand distribution businesses experienced declines in mobility and seating and lifestyle products. The decline in the Company's subsidiary which produces microprocessor controllers was primarily

related to decreases in its contract manufacturing business for companies outside of the healthcare industry. For the first nine months of 2012, net sales decreased 21.2% to \$53,217,000 as compared to \$67,520,000 for the same period a year ago. Foreign currency translation had no material impact on the organic net sales of 21.2% for the first nine months of 2012. The Asia/Pacific year-to-date net sales decrease was driven by declines in all three subsidiaries in the segment for the reasons described above.

**Gross Profit.** Consolidated gross profit as a percentage of net sales for the three and nine month period ended September 30, 2012 was 26.9% and 27.4%, respectively, compared to 28.7% and 28.8% in the same periods last year. The margin decline was principally related to sales mix favoring lower margin product lines and lower margin customers, which was partially offset by the favorable impact of an acquisition finalized in the third quarter of 2011. For the first nine months of the year, gross profit as a percentage of net sales for all segments except IPG were unfavorable as compared to the prior year.

For the first nine months of the year, North America/HME gross profit as a percentage of net sales decreased by 1.8 percentage points compared to the same period last year. The decline in margins was principally due to volume declines, unfavorable sales mix favoring lower margin customers and unfavorable product mix away from higher margin products.

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For the first nine months of the year, ISG gross profit as a percentage of net sales decreased by 0.5 of a percentage point compared to the same period last year. The decline in margins was principally due to higher freight costs.

For the first nine months of the year, IPG gross profit as a percentage of net sales increased 2.9 percentage points compared to the same period last year. The increase in margin is primarily attributable to the favorable impact of an acquisition finalized in the third quarter of 2011 and volume increases partially offset by increased research and development costs.

For the first nine months of the year, gross profit in Europe as a percentage of net sales decreased 2.1 percentage points compared to the same period last year. The decline was primarily a result of unfavorable sales mix favoring lower margin product lines and lower margin customers, pricing pressures, primarily in lifestyle and power mobility products, and increased warranty costs.

For the first nine months of the year, gross profit in Asia/Pacific as a percentage of net sales decreased by 1.3 percentage points compared to the same period last year. The decline was primarily as a result of volume declines in the Australian distribution business.

Selling, General and Administrative. Consolidated selling, general and administrative (SG&A) expenses as a percentage of net sales for the three and nine month period ended September 30, 2012 was 24.6% and 24.6%, respectively, compared to 22.8% and 23.9%, respectively, for each of the same periods a year ago. The increase was \$7,184,000 or 6.9% for the quarter and an increase of \$8,260,000 or 2.6% for the first nine months of the year, as compared to the same periods a year ago. Foreign currency translation decreased expenses by \$4,495,000 in the quarter and \$7,252,000 in the first nine months of the year while acquisitions increased expenses by \$3,189,000 in the quarter and \$10,263,000 in the first nine months of the year compared to the same periods a year ago. Excluding acquisitions and the impact of foreign currency translation, SG&A expenses increased 8.2% for the quarter and 1.6% for the first nine months of the year compared to the same periods a year ago. The dollar increase, excluding foreign currency translation and acquisitions, was \$8,490,000 and \$5,249,000 for the quarter and first nine months of the year, as compared to the same periods a year ago. The first nine months increase is primarily related to increased regulatory and compliance costs related to quality systems improvements in the North America/HME segment (\$17,280,000 pre-tax expense) partially offset by reduced associate and bad debt expense.

SG&A expenses for North America/HME increased 5.5% or \$2,759,000 for the quarter and increased 0.4% or \$616,000 in the first nine months of 2012 as compared to the same periods a year ago. For the quarter, foreign currency translation decreased SG&A expenses by \$50,000 or 0.1 of a percentage point. For the first nine months of 2012, foreign currency translation decreased SG&A expenses by \$292,000 or 0.2 of a percentage point. Excluding the foreign currency translation, SG&A expenses increased \$2,812,000 or 5.6 percentage points for the quarter and increased \$908,000 or 0.6 of a percentage point for the first nine months of the year. The first nine months expense increase was due to increased regulatory and compliance costs related to quality systems improvements partially offset by reduced associated and bad debt expense.

SG&A expenses for ISG increased by 29.1% or \$1,674,000 for the quarter and increased by 7.5% or \$1,525,000 in the first nine months of 2012 as compared to the same periods a year ago. The increased SG&A expense for the quarter and first nine months is principally due to increased bad debt expense.

SG&A expenses for IPG increased by 75.6% or \$5,519,000 for the quarter and increased by 56.5% or \$12,778,000 in the first nine months of 2012 as compared to the same periods a year ago. An acquisition increased SG&A expenses by 43.7 percentage points or \$3,189,000 for the quarter and 45.4 percentage points or \$10,263,000 for the first nine months of the year, while foreign currency translation decreased expense by \$12,000 or 0.2 of a percentage point for



the quarter and decreased expense by \$32,000 or 0.1 of a percentage point for the first nine months of the year. Excluding the impact of acquisitions and foreign currency translation, SG&A expenses increased by \$2,342,000 or 32.1% for the quarter and increased by \$2,547,000 or 11.3% for the first nine months of year was primarily attributable to increased associate costs, including commission expense, and unfavorable foreign currency transactions.

European SG&A expenses decreased by 7.9% or \$2,607,000 for the quarter and decreased by 6.8% or \$6,714,000 in the first nine months of 2012 as compared to the same periods a year ago. Foreign currency translation decreased SG&A expenses by approximately \$4,297,000 or 13.0 percentage points for the quarter and decreased expenses by \$6,917,000 or 7.0 percentage points for the first nine months of the year. Excluding the foreign currency translation impact, SG&A expenses increased by \$1,690,000 or 5.1% for the quarter and increased by \$203,000 or 0.2% for the first nine months of the year principally attributable to increased associate costs.

Asia/Pacific SG&A expenses decreased 2.0% or \$161,000 for the quarter and increased 0.2% or \$55,000 in the first nine months of 2012 as compared to the same periods a year ago. Foreign currency translation decreased expenses by \$136,000 for the

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quarter and decreased expenses by \$11,000 for the first nine months of the year. Excluding the foreign currency translation impact, SG&A expenses decreased \$25,000 or 0.3% for the quarter and increased \$66,000 or 0.3% for the first nine months of the year.

**Debt Finance Charges and Fees.** During the three and nine months ended September 30, 2012, the company repurchased and retired \$0 and \$500,000 principal amount of its par value 4.125% Convertible Senior Subordinated Debentures due 2027 compared to the three and nine months ended September 30, 2011 in which the company repaid \$17,445,000 and \$63,259,000 principal amount, respectively. The company retired the debt at a premium above par. In accordance with Convertible Debt, ASC 470-20, the company utilized the inducement method of accounting to calculate the loss associated with the early retirement of the convertible debt. For the three and nine months ended September 30, 2012, the company recorded expense of \$0 and \$312,000 related to the loss on the debt extinguishment, respectively, including the write-off of \$0 and \$11,000 of pre-tax deferred financing fees, respectively, which were previously capitalized. For the three and nine months ended September 30, 2011, the company recorded expense of \$7,462,000 and \$24,198,000, respectively, related to the loss on the debt extinguishment including the write-off of \$424,000 and \$1,552,000, respectively, of pre-tax deferred financing fees, which were previously capitalized. All of these charges are included in the All Other segment.

**Charge Related to Restructuring Activities.** During the quarter ended September 30, 2012, the company incurred restructuring charges as part of the company's ongoing globalization initiative to reduce complexity within its global footprint. The restructuring was also undertaken in response to the continued decline in reimbursement by the U.S. government as well as similar reimbursement pressures abroad and continued pricing pressures faced by the company. As a result, the company recorded restructuring charges of \$3,722,000 in the first nine months of 2012. There have been no material changes in accrued balances related to the charge, either as a result of revisions in the plan or changes in estimates. The majority of the outstanding charge accruals at September 30, 2012 are expected to be paid out within the next twelve months.

**Interest.** Interest expense decreased to \$1,414,000 and \$4,295,000 for the third quarter and first nine months of 2012 compared to \$1,644,000 and \$6,488,000, respectively, for the same periods a year ago, representing a 14.0% decrease and 33.8% decrease, respectively. This year-to-date decline is attributable to reduced debt levels and lower borrowing costs in 2012 as compared to 2011. Interest income for the third quarter and first nine months of 2012 was \$193,000 and \$698,000, respectively, compared to \$625,000 and \$1,171,000, respectively, in 2011.

**Income Taxes.** The company had an effective tax rate of 63.9% and 68.4%, respectively, on earnings before tax for the three and nine month period ended September 30, 2012 compared to an expected rate at the U.S. statutory rate of 35%. The company's effective tax rate for the three and nine months ended September 30, 2012 was greater than the U.S. federal statutory rate, principally due to a foreign discrete tax adjustment in the second quarter aggregating to \$9,173,000 (\$0.29 per share) as of September 30, 2012, including \$3,178,000 in interest, related to prior year periods under audit, which is being contested by the company, and a net loss in countries with a valuation allowance without a tax benefit. This adjustment is partially offset by current year foreign earnings taxed at an effective rate lower than the U.S. statutory rate principally due to foreign taxes recognized at rates below the U.S. statutory rate excluding the results of countries in a valuation allowance. The company had an effective tax rate of 25.4% and 12.7% on earnings before tax for the three and nine month period ended September 30, 2011, respectively, compared to an expected rate at the U.S. statutory rate of 35%. The company's effective tax rate for the three and nine months ended September 30, 2011 was lower than the U.S. federal statutory rate, principally due to foreign taxes recognized at rates below the U.S. statutory rate and a second quarter \$5,100,000 (\$0.16 per share) tax benefit as a result of a tax settlement in Germany. The net impact of tax benefit from countries with valuation allowances on the company's effective tax rate was minimal for the first nine months of 2012 and 2011. The company had a domestic profit in the nine months of 2012, but continued to be in a three-year cumulative loss position in the U.S. principally as a result of recording pre-tax

expenses in prior periods related to the extinguishment of convertible debt at a premium and the write-off of goodwill. As a result of the loss position, the majority of the U.S. deferred tax assets continue to be subject to a valuation allowance.

#### 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 included in equity in accordance with FSB APB 14-1, decreased by \$14,860,000 to \$254,677,000 at September 30, 2012 from \$269,537,000 as of December 31, 2011. The company's balance sheet reflects the impact of ASC 470-20, which reduced debt and increased equity by \$3,489,000 and \$4,053,000 as of September 30, 2012 and December 31, 2011, respectively. The debt discount decline during the first nine months of the year was a result of the extinguishment of convertible debt and the amortization of the convertible debt discount. The company's cash and cash equivalents were \$35,282,000 at September 30, 2012, up slightly from \$34,924,000 at the end of 2011. At September 30, 2012, the company had outstanding \$234,000,000 on its revolving line of credit versus \$247,063,000 as of December 31, 2011.

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The company's borrowing capacity and cash on hand were principally utilized for normal operations as there were no acquisitions or buybacks of shares and minimal repurchases of convertible debt during the first nine months of the year. Debt repurchases, acquisitions, the timing of vendor payments and other activity can have a significant impact on the company's 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. During the first nine months of the year, the outstanding borrowings on the company's revolving credit facility varied from a low of \$234,000,000 to a high of \$282,400,000. While the company has cash balances in various jurisdictions around the world, there are no material restrictions under the credit facility regarding the use of such cash for dividends, loans or other purposes.

The company's senior secured revolving credit agreement (the "Credit Agreement") provides for a \$400 million senior secured revolving credit facility maturing in October 2015. Pursuant to the terms of the Credit Agreement, the company may from time to time borrow, repay and re-borrow up to an aggregate outstanding amount at any one time of \$400 million, subject to customary conditions. The Credit Agreement also provides for the issuance of swing line loans. Borrowings under the Credit Agreement bear interest, at the company's election, at (i) the London Inter-Bank Offer Rate ("LIBOR") plus a margin; or (ii) a Base Rate Option plus a margin. The applicable margin is currently 1.75% per annum for LIBOR loans and 0.75% for the Base Rate Option loans based on the company's leverage ratio. In addition to interest, the company is required to pay commitment fees on the unused portion of the Credit Agreement. The commitment fee rate is currently 0.30% per annum. Like the interest rate spreads, the commitment fee is subject to adjustment based on the company's leverage ratio. The obligations of the borrowers under the Credit Agreement are secured by substantially all of the company's U.S. assets and are guaranteed by substantially all of the company's material domestic and foreign subsidiaries.

The Credit Agreement contains certain covenants that are customary for similar credit arrangements, including covenants relating to, among other things, financial reporting and notification, compliance with laws, preservation of existence, maintenance of books and records, use of proceeds, maintenance of properties and insurance, and limitations on liens, dispositions, issuance of debt, investments, payment of dividends, repurchases of capital stock, acquisitions, transactions with affiliates, and capital expenditures. There also are financial covenants that require the company to maintain a maximum leverage ratio (consolidated funded indebtedness to consolidated EBITDA, each as defined in the Credit Agreement) of no greater than 3.5 to 1, and a minimum interest coverage ratio (consolidated EBITDA to consolidated interest charges, each as defined in the Credit Agreement) of no less than 3.5 to 1. As of September 30, 2012, the company's leverage ratio was 2.19 and the company's interest coverage ratio was 22.64 compared to a leverage ratio of 1.81 and an interest coverage ratio of 23.80 as of December 31, 2011. As of September 30, 2012, the company was in compliance with all covenant requirements and under the most restrictive covenant of the company's borrowing arrangements, the company had the capacity to borrow up to an additional \$157,762,000.

The company may from time to time seek to retire or purchase its 4.125% Convertible Senior Subordinated Debentures due 2027, in open market purchases, privately negotiated transactions or otherwise. Such purchases or exchanges, if any, will depend on prevailing market conditions, the company's liquidity requirements, contractual restrictions and other factors. The amounts involved in any such transactions, individually or in the aggregate, may be material. In the first nine months of 2012, the company repurchased and extinguished \$500,000 par value of its Convertible Senior Subordinated Debentures. At September 30, 2012, the company had \$13,350,000 aggregate principal amount outstanding of its Convertible Senior Subordinated Debentures.

While there is general concern about the potential for rising interest rates, the company believes that its exposure to interest rate fluctuations is manageable given that portions of the company's debt are at fixed rates into 2014, the company has the ability to utilize swaps to exchange variable rate debt for fixed rate debt, if needed, and the company

expects that its free cash flow will allow it to absorb any modest rate increases in the months ahead without any material impact on its liquidity or capital resources. The company is a party to interest rate swap agreements to effectively convert a portion of floating rate revolving credit facility debt to fixed rate debt to avoid the risk of changes in market interest rates. As of September 30, 2012, interest associated with \$135,000,000 of the outstanding revolver balance of \$234,000,000 was fixed via interest rate swap agreements. Specifically, interest rate swap agreements for notional amounts of \$15,000,000 through February 2013, \$20,000,000 and \$25,000,000 through May 2013, \$18,000,000 through June 2013, \$22,000,000 through September 2013 and \$12,000,000 and \$23,000,000 through April 2014 were entered into that fix the LIBOR component of the interest rate on that portion of the revolving credit facility debt at rates of 1.05%, 0.73%, 0.625%, 0.46%, 0.54% and 0.47%, respectively, for effective aggregate rates of 2.80%, 2.83%, 2.48%, 2.375%, 2.21%, 2.29% and 2.22%, respectively. As of September 30, 2012, the weighted average floating interest rate on borrowings was 1.98% compared to 2.28% as of December 31, 2011.

In the current economic environment, the company is exposed to a number of risks. These risks include the possibility, among other things, that: one or more of the lenders participating in the company's revolving credit facility may be unable or unwilling to extend credit to the company, including as the result of any of the FDA-related issues; the third party company that provides lease financing to the company's customers may refuse or be unable to fulfill its financing obligations or extend credit

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to the company's customers; interest rates on the company's variable rate debt could increase significantly; one or more customers of the company may be unable to pay for purchases of the company's products on a timely basis; one or more key suppliers may be unable or unwilling to provide critical goods or services to the company; and one or more of the counterparties to the company's hedging arrangements may be unable to fulfill its obligations to the company. Although the company has taken actions in an effort to mitigate these risks, during periods of economic downturn, the company's exposure to these risks increases. Events of this nature may adversely affect the company's liquidity or sales and revenues, and therefore have an adverse effect on the company's business and results of operations.

**CAPITAL EXPENDITURES**

There are no individually material capital expenditure commitments outstanding as of September 30, 2012. The company estimates that capital investments for 2012 could approximate between \$25,000,000 and \$30,000,000, compared to actual capital expenditures of \$22,160,000 in 2011. The company believes that its balances of cash and cash equivalents, together with funds generated from operations and existing borrowing facilities, will be sufficient to meet its operating cash requirements and fund required capital expenditures for the foreseeable future.

**CASH FLOWS**

Cash flows provided by operating activities were \$26,822,000 in for the first nine months of 2012, compared \$66,588,000 in the first nine months of 2011. The decline in operating cash flows in 2012 was primarily attributable to reduced net earnings and an increase in net working capital, primarily inventory and accounts receivable.

Cash flows used for investing activities were \$14,488,000 for the first nine months of 2012, compared to \$58,030,000 in the first nine months of 2011. The decrease in cash used was primarily attributable to an acquisition occurring in 2011 versus no acquisitions in 2012.

Cash flows used by financing activities were \$12,202,000 in the first nine months of 2012 compared to \$16,724,000 in the first nine months of 2011. Cash flows used in the first nine months of 2012 reflect a net pay down in debt compared to a net borrowing in the first nine months of last year when borrowing were used to help finance the repurchase of outstanding common stock of \$21,551,000 and make payments related to early retirement of debt of \$24,116,000.

During the first nine months of 2012, the company generated free cash flow of \$17,894,000 compared to \$51,975,000 in the first nine months of 2011. The decrease is due primarily to reduced net earnings and an increase in net working capital assets. Free cash flow is a non-GAAP financial measure that is comprised of net cash provided by operating activities, excluding net cash flow impact related to restructuring activities, less net purchases of property and equipment, net of 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<br>September 30, |           |
|---|------------------------------------|-----------|
|   | 2012                               | 2011      |
| Net cash provided by operating activities                 | \$26,822                           | \$66,588  |
| Plus: Net cash impact related to restructuring activities | 5,750                              | 934       |
| Less: Purchases of property and equipment—net             | (14,678                            | ) (15,547 |

|                |          |          |
|----------------|----------|----------|
| Free Cash Flow | \$17,894 | \$51,975 |
|----------------|----------|----------|

DIVIDEND POLICY

On August 14, 2012, the company's Board of Directors declared a quarterly cash dividend of \$0.0125 per Common Share to shareholders of record as of October 4, 2012, which was paid on October 12, 2012. At the current rate, the cash dividend will amount to \$0.05 per Common Share on an annual basis.

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CRITICAL ACCOUNTING POLICIES

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.

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. During the first quarter of 2011, the Centers for Medicare and Medicaid Services implemented the single payment amounts for Round 1 of the National Competitive Bidding program in nine metropolitan statistical areas (MSAs). The single payment amounts are used to determine the price that Medicare pays for certain durable medical equipment, prosthetics, orthotics and supplies. The company believes the changes announced could have a significant impact on the collectability of accounts receivable for those customers which are in the MSA 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.

Invacare 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.

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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. 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 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. Furthermore, goodwill and other long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.

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 the 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 method (DCF) 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 9.27% in 2011 for the company's annual impairment analysis compared to 9.59% in 2010.

The company also utilizes an EV (Enterprise Value) to EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization) 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.

A future potential impairment is possible, for each or 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 2011 impairment analysis and determined that there still would not be any indicator of potential impairment for the Europe, ISG or IPG segments.

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

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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's captive insurance company, Invatection Insurance Co., currently has a policy year that runs from September 1 to August 31 and insures annual policy losses of \$10,000,000 per occurrence and \$13,000,000 in the aggregate of the company's North American product liability exposure. The company also has additional layers of external insurance coverage insuring up to \$75,000,000 in aggregate losses per policy 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 Invacare'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 indications from the third-party actuary. Additional reserves, in excess of the specific individual case reserves, are provided for incurred but not reported claims based upon third-party actuarial valuations at the time such valuations are conducted. Historical claims experience and other assumptions are taken into consideration by the third-party actuary to estimate 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 from the date of sale to the customer by warranties against defects in material and workmanship for various periods depending on the product. 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 Warranty Costs in the Notes to the Condensed Consolidated Financial Statements included in this report 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 options and no changes have been made regarding the valuation methodologies or assumptions used to determine the fair value of options granted and the company continues to use a Black-Scholes valuation model. As of September 30, 2012, there was \$15,733,000 of total unrecognized compensation cost from stock-based compensation arrangements granted under the 2003 Performance Plan, which is related to non-vested options and shares, and includes \$4,980,000 related to restricted stock awards. The company expects the compensation expense to be recognized over a four-year period for a weighted-average period of approximately two years.

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.

#### 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 exposure, including assessing the risks associated with tax audits, 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 or liabilities. Substantially all of the company's U.S. and New Zealand deferred tax assets are offset by a valuation allowance. The company also must estimate the likelihood that its deferred tax assets will be recovered from future taxable income and whether or not valuation allowances should be established. In the event that actual results differ from its estimates, the company's provision for income taxes could be materially impacted. The company does

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not believe that there is a substantial likelihood that materially different amounts would be reported related to its critical accounting policies.

### RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2011-05, Presentation of Comprehensive Income (ASU 2011-05 or the ASU). ASU 2011-05 requires comprehensive income to be reported in either a single statement or in two consecutive statements reporting net income and other comprehensive income (OCI). The ASU does not change what is required to be reported in OCI or the requirement to disclose reclassifications of items from OCI to net income. The company adopted ASU 2011-05 in the first quarter 2012 Form 10-Q with no impact on the company's financial position, results of operations or cash flows other than the modification to the company's Consolidated Statement of Earnings.

### 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 does at times use interest swap agreements to mitigate its exposure to interest rate fluctuations. Based on September 30, 2012 debt levels, a 1% change in interest rates would impact annual interest expense by approximately \$990,000. 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 a party to interest rate swap agreements to effectively convert a portion of floating rate revolving credit facility debt to fixed rate debt to avoid the risk of changes in market interest rates. Specifically, interest rate swap agreements for notional amounts of \$15 million through February 2013, \$20 million and \$25 million through May 2013, \$18 million through June 2013, \$22 million through September 2013 and \$12 million and \$23 million through April 2014 were entered into that fix the LIBOR component of the interest rate on that portion of the revolving credit facility debt at rates of 1.05%, 1.08%, 0.73%, 0.625%, 0.46%, 0.54% and 0.47%, respectively, for effective aggregate rates of 2.80%, 2.83%, 2.48%, 2.375%, 2.21%, 2.29% and 2.22%, respectively.

On October 28, 2010, the company entered into the Credit Agreement which provides for a \$400,000,000 senior secured revolving credit facility maturing in October 2015 at variable rates. As of September 30, 2012, the company had outstanding \$13,350,000 in principal amount of 4.125% Convertible Senior Subordinated Debentures due in February 2027, of which \$3,489,000 is included in equity. 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 does not currently need to re-finance any of its debt. However, the company's Credit Agreement contains covenants with respect to, among other items, consolidated funded indebtedness to consolidated earnings before interest, taxes, depreciation and amortization (EBITDA) and interest coverage, as defined in the agreement. As of September 30, 2012, the company was in compliance with all covenant requirements, but should it fall out of compliance with these requirements, the company would have to attempt to obtain alternative financing and thus likely be required to pay much higher interest rates.

### 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, are forward-looking in nature 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: compliance costs, limitations on the design, production and/or distribution of the Company's products, inability to bid on or win certain contracts, or other adverse effects of enforcement actions from the current, ongoing FDA investigations and the proposed consent decree of injunction, as well as the risk that the Company and the FDA may not reach agreement on the terms of a consent decree; unforeseen circumstances that might delay or adversely impact the results of the third party expert certification audits or FDA re-inspections of the Company's quality systems; 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 Medicare national competitive bidding program covering nine metropolitan statistical areas that started in 2011 and an additional 91 metropolitan statistical areas beginning in July 2013), impacts of the U.S. Affordable Care Act that was enacted in 2010 (such as, for example, the excise tax beginning in 2013 on certain medical devices); legal actions, 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

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the United States or abroad; product liability claims; exchange rate or tax rate fluctuations; inability to design, manufacture, distribute and achieve market acceptance of new products with greater functionality or lower costs; consolidation of health care providers; lower cost imports; uncollectible accounts receivable; difficulties in implementing/upgrading Enterprise Resource Planning systems; risks inherent in managing and operating businesses in many different foreign jurisdictions; ineffective cost reduction and restructuring efforts; potential product recalls; possible adverse effects of being leveraged, including interest rate or event of default risks (particularly as might result from the FDA-related issues); 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 arising from depressed market prices for Company shares; provisions of Ohio law or in the Company's debt agreements, shareholder rights plan or charter documents that may prevent or delay a change in control, as well as the risks described from time to time in Invacare's reports as filed with the Securities and Exchange Commission. Except to the extent required by law, we do not undertake and specifically decline 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.

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, 2012, 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, 2012, 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, Invacare 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 have been referred to the company's captive insurance company and/or excess insurance carriers and generally are 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 2011, the FDA requested that the company agree to a consent decree of injunction at the company's corporate facility and its wheelchair manufacturing facility in Elyria, Ohio. The proposed terms of the consent decree would require the suspension of a portion, which could be substantial, of the company's operations at those facilities until they are certified by an independent, third party auditor and then determined by FDA to be in compliance with the FDA's Quality System Regulation. A suspension of operations likely would have adverse effects on the company's business, including loss of revenues, harm to the company's reputation and customer dissatisfaction. The company is in the process of negotiating with the FDA on the final terms of the consent decree. There can be no assurance that the company will be able to successfully conclude its negotiations with the FDA. In addition, 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. At the time of this filing, these matters remain pending. See "Notes to Condensed Consolidated Financial Statements - Contingencies."

The company received a subpoena in 2006 from the U.S. Department of Justice seeking documents relating to three long-standing and well-known promotional and rebate programs maintained by the company. The company believes that the programs described in the subpoena are in compliance with all applicable laws and the company has cooperated fully with the government investigation. As of November 2012, the subpoena remains pending.

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, 2011.

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## 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, 2012.

| 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) |
|----------------------|--------------------------------------|------------------------------|--|--|
| 7/1/2012 - 7/31/2012 | —                                    | \$—                          | —  | 2,453,978  |
| 8/1/2012 - 8/30/2012 | —                                    | —                            | —  | 2,453,978  |
| 9/1/2012 - 9/30/2012 | —                                    | —                            | —  | 2,453,978  |
| Total                | —                                    | \$—                          | —  | 2,453,978  |

No shares were repurchased during the quarter or surrendered to the company by employees for minimum tax (1) withholding purposes in conjunction with the vesting of restricted shares awarded to the employees under the company's 2003 Performance Plan.

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 (2) program on November 5, 2010, and on August 17, 2011 authorized an additional 2,046,500 shares for repurchase under the plan. To date, the company has purchased 1,592,522 shares under this program, with authorization remaining to purchase 2,453,978 shares. The company purchased no shares pursuant to this Board authorized program during the quarter ended September 30, 2012.

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Item 6. Exhibits

Exhibit  
No.

- 31.1 Chief Executive Officer Rule 13a-14(a)/15d-14(a) Certification (filed herewith).
- 31.2 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.

SIGNATURES

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

INVACARE CORPORATION

Date: November 6, 2012

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)