INVACARE CORP
Form 10-Q
August 06, 2010

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

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2010

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission File Number 001-15103

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

Ohio	95-2680965
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No)
One Invacare Way, P.O. Box 4028, Elyria, Ohio	44036
(Address of principal executive offices)	(Zip Code)

(440) 329-6000
(Registrant's telephone number, including area code)

____

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 (the “Exchange Act”) during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes X No__

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

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

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

As of August 4, 2010, the registrant had 31,288,927 Common Shares and 1,097,516 Class B Common Shares outstanding.

INVACARE CORPORATION

INDEX

Index

Part I. FINANCIAL INFORMATION
Item 1. Financial Statements.

INVACARE CORPORATION AND SUBSIDIARIES
Condensed Consolidated Balance Sheets (unaudited)

	June 30, 2010	December 31, 2009
ASSETS	(In thousands)	
CURRENT ASSETS		
Cash and cash equivalents	$ 31,205	$ 37,501
Trade receivables, net	250,701	263,014
Installment receivables, net	3,217	3,565
Inventories, net	170,955	172,222
Deferred income taxes	648	390
Other current assets	43,707	51,772
TOTAL CURRENT ASSETS	500,433	528,464
OTHER ASSETS	43,702	48,006
OTHER INTANGIBLES	71,936	85,305
PROPERTY AND EQUIPMENT, NET	130,189	141,633
GOODWILL	476,292	556,093
TOTAL ASSETS	$ 1,222,552	$ 1,359,501
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	$ 148,964	$ 141,059
Accrued expenses	127,571	142,293
Accrued income taxes	2,710	5,884
Short-term debt and current maturities of long-term obligations	1,046	1,091
TOTAL CURRENT LIABILITIES	280,291	290,327
LONG-TERM DEBT	261,469	272,234
OTHER LONG-TERM OBLIGATIONS	93,834	95,703
SHAREHOLDERS' EQUITY		
Preferred shares	-	-
Common shares	8,348	8,273
Class B common shares	275	278
Additional paid-in-capital	227,953	229,272
Retained earnings	347,909	346,272
Accumulated other comprehensive earnings	65,992	174,204
Treasury shares	(63,519)	(57,062)
TOTAL SHAREHOLDERS' EQUITY	586,958	701,237
	$ 1,222,552	$ 1,359,501

TOTAL LIABILITIES AND SHAREHOLDERS'
EQUITY

See notes to condensed consolidated financial statements.

3

Index

INVACARE CORPORATION AND SUBSIDIARIES
Condensed Consolidated Statement of Operations - (unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
(In thousands except per share data)	2010	2009	2010	2009
Net sales	$ 430,828	$ 412,541	$ 833,068	$ 810,536
Cost of products sold	304,338	294,486	588,865	584,013
Gross profit	126,490	118,055	244,203	226,523
Selling, general and administrative expense	104,421	97,939	206,197	192,072
Loss on debt extinguishment including debt finance charges and associated fees	14,048	-	18,434	-
Charge related to restructuring activities	-	1,124	-	1,900
Interest expense	5,770	8,783	12,162	18,336
Interest income	(163)	(352)	(310)	(793)
Earnings before income taxes	2,414	10,561	7,720	15,008
Income taxes	3,025	2,900	5,225	4,950
NET EARNINGS (LOSS)	$ (611)	$ 7,661	$ 2,495	$ 10,058
DIVIDENDS DECLARED PER COMMON SHARE	.0125	.0125	.0250	.0250
Net earnings (loss) per share – basic	$ (0.02)	$ 0.24	$ 0.08	$ 0.31
Weighted average shares outstanding - basic	32,386	31,935	32,367	31,933
Net earnings (loss) per share – assuming dilution	$ (0.02)	$ 0.24	$ 0.08	$ 0.31
Weighted average shares outstanding - assuming dilution	32,386	31,939	32,669	31,936

See notes to condensed consolidated financial statements.

Index

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

	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
OPERATING ACTIVITIES	(In thousands)	
Net earnings	$ 2,495	$ 10,058
Adjustments to reconcile net earnings to net cash provided (used) by operating activities:		
Amortization of convertible debt discount	1,706	2,012
Loss on debt extinguishment including debt finance charges and associated fees	18,434	-
Depreciation and amortization	18,245	19,825
Provision for losses on trade and installment receivables	8,112	8,397
Provision for other deferred liabilities	1,421	1,378
Provision (benefit) for deferred income taxes	(117)	259
Provision for stock-based compensation	2,840	1,782
Gain on disposals of property and equipment	9	99
Changes in operating assets and liabilities:		
Trade receivables	(5,132)	4,648
Installment sales contracts, net	(466)	(1,362)
Inventories	(9,807)	6,588
Other current assets	6,916	10,501
Accounts payable	13,780	(839)
Accrued expenses	(6,499)	(24,984)
Other deferred liabilities	2,143	750
NET CASH PROVIDED BY OPERATING ACTIVITIES	54,080	39,112
INVESTING ACTIVITIES		
Purchases of property and equipment	(8,422)	(7,186)
Proceeds from sale of property and equipment	313	1,049
Other long term assets	813	(1,147)
Business acquisitions, net of cash acquired	(13,725)	-
Other	(223)	(145)
NET CASH USED FOR INVESTING ACTIVITIES	(21,244)	(7,429)
FINANCING ACTIVITIES		
Proceeds from revolving lines of credit and long-term borrowings	201,661	191,811
Payments on revolving lines of credit and long-term debt and capital lease obligations	(236,396)	(223,815)
Proceeds from exercise of stock options	1,002	-
Payment of dividends	(808)	(800)
NET CASH USED BY FINANCING ACTIVITIES	(34,541)	(32,804)
Effect of exchange rate changes on cash	(4,591)	3,314
Increase (decrease) in cash and cash equivalents	(6,296)	2,193
Cash and cash equivalents at beginning of period	37,501	47,516

Cash and cash equivalents at end of period	$	31,205	$	49,709

See notes to condensed consolidated financial statements.

Index

INVACARE CORPORATION AND SUBSIDIARIES
Notes to Condensed Consolidated
Financial Statements
(Unaudited)
June 30, 2010

Nature of Operations - Invacare Corporation is the world's leading manufacturer and distributor in the estimated $8.0 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 June 30, 2010, the results of its operations for the three and six months ended June 30, 2010 and changes in its cash flow. Certain foreign subsidiaries, represented by the European segment, are consolidated using a May 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 six months ended June 30, 2010 are not necessarily indicative of the results to be expected for the full year.

Recent Accounting Pronouncements - On January 21, 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2010-06, Improving Disclosures about Fair Value Measurements (ASU 2010-06). The ASU 2010-06 amends ASC 820 to require a number of additional disclosures regarding fair value measurements. The amended guidance requires entities to disclose additional information regarding assets and liabilities that are transferred between levels of the fair value hierarchy. Entities are also required to disclose information in the Level 3 roll forward about purchases, sales, issuances and settlements on a gross basis. In addition to these new disclosure requirements, ASU 2010-06 also amends Topic 820 to further clarify existing guidance pertaining to the level of disaggregation at which fair value disclosures should be made and the requirements to disclose information about the valuation techniques and inputs used in estimating Level 2 and Level 3 fair value measurements. The company adopted ASU 2010-06 effective January 1, 2010 and it was utilized in preparing the fair value measurement disclosures.

On July 21, 2010, the FASB issued Accounting Standards Update No. 2010-20, Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses (ASU 2010-20). ASU 2010-20 requires entities to provide extensive new disclosures regarding credit-risk exposures, including how credit risk is analyzed and assessed, and allowances for credit losses, including reasons for changes each period. The company is analyzing the impact of ASU 2010-20, which is currently expected to impact disclosures regarding the company's installment receivable disclosures in the company's 2010 Form 10-K. The company does not believe ASU 2010-20 will have any material impact on the company's financial position, results of operations or cash flows.

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.

Business Segments - The company operates in five primary business segments: North America/Home Medical Equipment (NA/HME), Invacare Supply Group (ISG), Institutional Products Group (IPG), Europe and Asia/Pacific.

The NA/HME segment sells each of three primary product lines, which includes: standard, rehab and respiratory products. Invacare Supply Group sells distributed product and the Institutional Products Group sells health care furnishings and accessory products. Europe and Asia/Pacific sell the same product lines as NA/HME and the Institutional Products Group. 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.

Index

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

	Three Months Ended June 30, 2010	Three Months Ended June 30, 2009	Six Months Ended June 30, 2010	Six Months Ended June 30, 2009
Revenues from external customers				
North America / HME	$ 190,089	$ 188,076	$ 365,075	$ 374,779
Invacare Supply Group	72,826	68,550	142,544	133,863
Institutional Products Group	22,700	21,233	44,978	44,007
Europe	123,105	117,218	240,833	225,605
Asia/Pacific	22,108	17,464	39,638	32,282
Consolidated	$ 430,828	$ 412,541	$ 833,068	$ 810,536
Intersegment Revenues				
North America / HME	$ 22,396	$ 14,454	$ 43,343	$ 28,684
Invacare Supply Group	19	107	32	198
Institutional Products Group	1,540	279	2,997	1,150
Europe	2,491	1,928	5,333	3,851
Asia/Pacific	8,547	7,058	15,784	15,393
Consolidated	$ 34,993	$ 23,826	$ 67,489	$ 49,276
Charge related to restructuring before income taxes				
North America / HME	$ -	$ 117	$ -	$ 335
Institutional Products Group	-	-	-	171
Europe	-	338	-	624
Asia/Pacific	-	669	-	770
Consolidated	$ -	$ 1,124	$ -	$ 1,900
Earnings (loss) before income taxes				
North America / HME	$ 10,479	$ 10,588	$ 22,026	$ 15,307
Invacare Supply Group	1,331	1,011	2,199	1,875
Institutional Products Group	3,331	610	5,138	3,092
Europe	9,293	7,421	13,827	11,021
Asia/Pacific	2,534	(612)	3,351	(337)
All Other *	(24,554)	(8,457)	(38,821)	(15,950)
Consolidated	$ 2,414	$ 10,561	$ 7,720	$ 15,008

* “All Other” consists of un-allocated corporate selling, general and administrative costs, which do not meet the quantitative criteria for determining reportable segments. In addition, “All Other” loss before income taxes includes loss on debt extinguishment including finance charges and associated fees.

Index

Net Earnings (Loss) Per Common Share - The following table sets forth the computation of basic and diluted net earnings (loss) per common share for the periods indicated (amounts in thousands, except per share amounts).

	Three Months Ended June 30,				Six Months Ended June 30,			
		2010		2009		2010		2009
	(In thousands, except per share data)							
Basic								
Average common shares outstanding		32,386		31,935		32,367		31,933
Net earnings (loss)	$	(611)	$	7,661	$	2,495	$	10,058
Net earnings (loss) per common share	$	(0.02)	$	0.24	$	.08	$	0.31
Diluted								
Average common shares outstanding		32,386		31,935		32,367		31,933
Stock options and awards		-		4		302		3
Average common shares assuming dilution		32,386		31,939		32,669		31,936
Net earnings (loss)	$	(611)	$	7,661	$	2,495	$	10,058
Net earnings (loss) per common share	$	(0.02)	$	0.24	$	0.08	$	0.31

At June 30, 2010, 3,213,910 and 2,780,343 shares were excluded from the average common shares assuming dilution for the three and six months ended June 30, 2010, respectively, as they were anti-dilutive. At June 30, 2009, 4,478,099 and 4,495,782 shares were excluded from the average common shares assuming dilution for the three and six months ended June 30, 2009, respectively, as they were anti-dilutive. For the three and six months ended June 30, 2010, 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 $24.59 and $25.76, respectively. For the three and six months ended June 30, 2009, 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 $16.56 for both periods, respectively. For the six months ended June 30, 2010, the company included the impact of 178,000 shares necessary to settle the conversion spread related to the company's 4.125% Senior Subordinated Convertible Debentures due 2027. This is attributable to the company's average stock price during the first six months being greater than the conversion price of $24.79, established under the indenture governing the convertible debentures.

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 to DLL, which was $29,020,000 at June 30, 2010, for events of default under the contracts, which total $76,306,000 at June 30, 2010. Guarantees, ASC 460, requires the company to record a guarantee liability as it relates to the limited recourse obligation. As such, the company has recorded a liability of $881,000 for this guarantee obligation within accrued expenses. 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 and the company has seen a significant shift in reimbursement to customers from managed care entities. Government reimbursement program changes such as the Competitive Bidding Program in the U.S. announced in the second quarter of 2010 which is scheduled to start January 1, 2011 in nine metropolitan statistical areas (MSAs) can 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. Changes in reimbursement 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.

Index

Goodwill and Other Intangibles - The decrease in goodwill reflected on the balance sheet from December 31, 2009 to June 30, 2010 was the result of foreign currency translation offset by an increase of $6,290,000 as the result of an acquisition included in the Institutional Products Group segment for which the entire amount is deductible for tax purposes.

All of the company's other intangible assets have been assigned definite lives and continue to be amortized over their useful lives, except for $29,460,000 related to trademarks, which have indefinite lives. The changes in intangible balances reflected on the balance sheet from December 31, 2009 to June 30, 2010 were the result of foreign currency translation and amortization except for $2,430,000 recorded for customer lists as the result of an acquisition made during the quarter which is included in the Institutional Products Group segment.

As of June 30, 2010 and December 31, 2009, other intangibles consisted of the following (in thousands):

	June 30, 2010		December 31, 2009	
	Historical Cost	Accumulated Amortization	Historical Cost	Accumulated Amortization
Customer lists	$ 69,826	$ 34,702	$ 78,780	$ 36,359
Trademarks	29,460	—	34,953	—
License agreements	3,067	2,860	4,326	4,051
Developed technology	8,159	3,525	7,409	2,434
Patents	6,874	5,113	7,020	5,246
Other	5,927	5,177	5,905	4,998
	$ 123,313	$ 51,377	$ 138,393	$ 53,088

Amortization expense related to other intangibles was $4,028,000 in the first six months of 2010 and is estimated to be $8,412,000 in 2010, $8,216,000 in 2011, $8,011,000 in 2012, $6,855,000 in 2013, $6,516,000 in 2014 and $5,307,000 in 2015. Definite lived 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.

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 significant changes have been made regarding the valuation methodologies used to determine the fair value of options granted since 2005 and 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 based on the market value at the date of grant.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Stock-based compensation expense recognized as part of selling, general and administrative expense	$ 1,283	$ 885	$ 2,840	$ 1,782

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.

Stock Incentive Plans - 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 Committee has the authority to determine which employees and directors will receive awards, the amount of the awards and the other terms and conditions of the awards. During the first six months of 2010, the Committee granted 10,232 non-qualified stock options with a term of ten years at the fair market value of the company's Common Shares on the date of grant under the 2003 Plan, which vest ratably in annual installments over the four years following the grant date.

Index

Under the terms of the company's outstanding restricted stock awards, all of the shares granted vest ratably over the four years after the grant date. Compensation expense of $988,000 was recognized related to restricted stock awards in the first six months of 2010 and as of June 30, 2010, outstanding restricted stock awards totaling 239,920 were not yet vested.

As of June 30, 2010, there was $11,877,000 of total unrecognized compensation cost from stock-based compensation arrangements granted under the 2003 Plan, which is related to non-vested options and shares, and includes $3,878,000 related to restricted stock awards. The company expects the compensation expense to be recognized over a weighted-average period of approximately two years.

Stock option activity during the six months ended June 30, 2010 was as follows:

		2010	Weighted Average Exercise Price
Options outstanding at January 1		4,619,528	$ 29.28
Granted		10,232	25.30
Exercised		(292,888)	23.37
Canceled		(46,662)	23.41
Options outstanding at June 30		4,290,210	$ 29.73
Options price range at June 30	$	10.70 to	
	$	47.80	
Options exercisable at June 30		2,825,619	
Options available for grant at June 30*		3,167,697	

* Options available for grant as of June 30, 2010 reduced by net restricted stock award activity of 400,278.

The following table summarizes information about stock options outstanding at June 30, 2010:

	Options Outstanding			Options Exercisable	
Exercise Prices	Number Outstanding At 6/30/10	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable At 6/30/10	Weighted Average Exercise Price
$ 10.70 - $14.89	23,892	2.0 years	$ 10.83	23,142	$ 10.70
$ 16.55 - $24.43	1,517,638	7.8	$ 21.65	484,288	$ 22.67
$ 24.90 - $36.40	1,590,289	3.9	$ 29.13	1,159,798	$ 30.36
$ 37.70 - $47.80	1,158,391	4.2	$ 41.53	1,158,391	$ 41.53
Total	4,290,210	5.3	$ 29.73	2,825,619	$ 33.46

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 participants to exchange shares for minimum withholding taxes, which results in the company acquiring treasury shares.

Index

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. No material adjustments to warranty reserves were necessary in the first six months of 2010.

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

Balance as of January 1, 2010	$	21,506
Warranties provided during the period		2,899
Settlements made during the period		(5,384)
Changes in liability for pre-existing warranties during the period, including expirations		208
Balance as of June 30, 2010	$	19,229

Long-Term Debt - On May 9, 2008, Staff Position APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement) (FSP APB 14-1) as codified in Debt with Conversion and Other Options, ASC 470-20, was issued to provide clarification of the accounting for convertible debt that can be settled in cash upon conversion. The FASB believed this clarification was needed because the accounting that was being applied for convertible debt prior to FSP APB 14-1 did not fully reflect the true economic impact on the issuer since the conversion option was not captured as a borrowing cost and its full dilutive effect was not included in earnings per share. ASC 470-20 required separate accounting for the liability and equity components of the convertible debt in a manner that would reflect Invacare’s nonconvertible debt borrowing rate. Accordingly, the company initially split the total debt amount of $135,000,000 attributable to its 4.125% Senior Subordinated Convertible Debentures due 2027 into a convertible debt amount of $75,988,000 and a stockholders’ equity (debt discount) amount of $59,012,000 as of the retrospective adoption date of February 12, 2007 and is accreting the resulting debt discount as interest expense over a ten year life. The Consolidated Balance Sheet as of June 30, 2010 reflects a decrease in long-term debt and an offsetting increase in paid in capital of $30,600,000 and a deferred tax liability of $10,710,000 offset by a valuation reserve of the same amount compared to comparable amounts of $48,272,000 and $16,895,000, respectively, as of December 31, 2009.

During the three and six months ended June 30, 2010, the company paid down $59,131,000 and $74,903,000 par value of debt, respectively, comprised of $31,131,000 ($19,681,000 reduction of debt and $11,450,00 reduction of equity) and $45,903,000 ($28,231,000 reduction of debt and $17,672,00 reduction of equity), respectively, related to its 4.125% Senior Subordinated Convertible Debentures and $28,000,000 and $29,000,000, respectively, related to its 9 ¾% Senior Notes due 2015. 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 six months ended June 30, 2010, the company recorded pre-tax expense of $14,048,000 and $18,434,000, respectively, related to the loss on the debt extinguishment including the write-off of $1,471,000 and $1,885,000, respectively of pre-tax of deferred financing fees, which were previously capitalized.

The company utilized its cash and cash flows from operations as well as its revolving line of credit primarily to pay down the debt noted above. At June 30, 2010, the company had outstanding $50,118,000 on its revolving line of credit compared to $1,725,000 as of December 31, 2009.

Charges Related to Restructuring Activities - On July 28, 2005, the company announced multi-year cost reductions and profit improvement actions, which included: reducing global headcount, outsourcing improvements utilizing the company's China manufacturing capability and third parties, shifting substantial resources from product development to manufacturing cost reduction activities and product rationalization, reducing freight exposure through freight auctions and changing the freight policy, general expense reductions and exiting four facilities. The restructuring was necessitated by 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 of outsourcing by competitors to lower cost locations.

The company's previous restructuring activities concluded in the fourth quarter of 2009 thus no additional charges were incurred in the first half of 2010. There are no material accrual balances related to the charge remaining as of June 30, 2010.

Index

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

	Severance	Product Line Discontinuance	Contract Terminations	Other	Total
December 31, 2009 Balance					
NA/HME	46	1	23	—	70
IPG	5	—	—	—	5
Europe	816	—	—	343	1,159
Asia/Pacific	42	—	—	—	42
Total	$ 909	$ 1	$ 23	$ 343	$ 1,276
Payments					
NA/HME	(46)	(1)	(23)	—	(70)
IPG	(5)		—		(5)
Europe	(816)	—	—	(343)	(1,159)
Asia/Pacific	(42)	—	—	—	(42)
Total	$ (909)	$ (1)	$ (23)	$ (343)	$ (1,276)
June 30, 2010 Balance					
NA/HME	—	—	—	—	—
IPG	—	—	—	—	—
Europe	—	—	—	—	—
Asia/Pacific	—	—	—	—	—
Total	$ —	$ —	$ —	$ —	$ —

Comprehensive Earnings (loss) - Total comprehensive earnings (loss) were as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2010	2009	2010	2009
Net earnings (loss)	$ (611)	$ 7,661	$ 2,495	$ 10,058
Foreign currency translation gain (loss)	(60,747)	80,747	(110,887)	71,950
Unrealized gain on available for sale securities	-	33	-	47
SERP/DBO amortization of prior service costs and unrecognized losses	151	132	308	191
Current period unrealized gain (loss) on cash flow hedges, net of tax	(146)	(338)	2,367	1,937
Total comprehensive earnings (loss)	$ (61,353)	$ 88,235	$ (105,717)	$ 84,183

Inventories - Inventories determined under the first in, first out method consist of the following components (in thousands):

	June 30, 2010	December 31, 2009

Finished goods	$	101,115	$	99,701
Raw Materials		56,789		59,451
Work in Process		13,051		13,070
	$	170,955	$	172,222

Index

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

	June 30, 2010	December 31, 2009
Machinery and equipment	$ 318,566	$ 329,181
Land, buildings and improvements	87,571	98,160
Furniture and fixtures	25,246	26,635
Leasehold improvements	15,705	14,744
	447,088	468,720
Less allowance for depreciation	(316,899)	(327,087)
	$ 130,189	$ 141,633

Acquisitions- In June 2010, Invacare Corporation acquired an equipment rental company focused on skilled nursing and long-term care providers for $13,725,000, which was paid in cash. Pursuant to the purchase agreement, the company agreed to pay contingent consideration of up to $1,000,000 if certain revenue growth and earnings projections are met for which the company has estimated a de minimis fair value based on the company's assessment of the probability of payout. In October 2008, Invacare Corporation purchased a billing company operating as Homecare Collection Services (HCS) for $6,268,000. Pursuant to the HCS purchase agreement, the company agreed to pay contingent consideration based upon earnings before interest, taxes and depreciation over the three years subsequent to the acquisition up to a maximum of $3,000,000. When the contingency related to the acquisition is determinable, any additional consideration paid will increase the respective purchase price and reported goodwill. No contingent consideration was payable based on the results of HCS in the first year.

Derivatives -Derivatives and Hedging, 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 commodity price risk, foreign currency exchange risk and interest rate risk. Foreign 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.

The company was not a party to any interest rate swap agreements during 2010. During 2009, 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 and or losses on interest rate swaps are reflected in interest expense on the consolidated statement of operations.

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 operations. If it is later determined that a hedged forecasted transaction is unlikely to occur, any gains or losses on the forward contracts associated with the forecasted transactions that are no longer probable of occurring would be reclassified from other comprehensive income into earnings. The company does not expect any material amount of hedge ineffectiveness related to forward contract cash flow hedges during the next twelve months.

Index

The company has historically not recognized any material amount of ineffectiveness related to forward contract cash flow hedges because the company generally limits it 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 $41,683,000 and $82,081,000 matured during the three and six months ended June 30, 2010, respectively.

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

	June 30, 2010				December 31, 2009			
		Notional Amount		Unrealized Gain (Loss)		Notional Amount		Unrealized Gain (Loss)
USD / AUD	$	1,650	$	106	$	3,294	$	(41)
USD / CAD		25,934		41		49,345		202
USD / EUR		13,347		2,062		22,119		(526)
USD / GBP		1,762		201		3,640		(72)
USD / NZD		4,694		(48)		8,286		130
USD / SEK		5,762		85		8,965		(100)
USD / MXN		3,400		210		2,520		217
EUR / CHF		4,201		(51)		2,755		(9)
EUR / GBP		8,105		(570)		22,258		27
EUR / SEK		2,471		43		3,800		15
EUR / NZD		4,054		480		8,029		359
GBP / CHF		208		-		501		14
GBP / SEK		951		18		2,169		37
GBP / DKK		82		(3)		765		17
DKK / CHF		228		(8)		-		-
DKK / SEK		2,992		(47)		7,439		52
DKK / NOK		927		(52)		2,236		19
NOK / EUR		-		-		342		6
NOK / CHF		828		6		592		(9)
NOK / SEK		518		-		1,190		(21)
	$	82,114	$	2,473	$	150,245	$	317

Fair Value Hedging Strategy

In 2010 and 2009, 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 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 although they could qualify for hedge accounting treatment. These contracts are entered into to eliminate the risk associated with the settlement of short-term intercompany trading receivables and payables between Invacare

Corporation and its foreign subsidiaries. The currency forward contracts are entered into at the same time as the intercompany receivables or payables are created so that upon settlement, the gain/loss on the settlement is offset by the gain/loss on the foreign currency forward contract. No material net gain or loss was realized by the company for the quarter or six month period ended June 30, 2010 related to these forward contracts and the associated short-term intercompany trading receivables and payables.

Index

Foreign exchange forward contracts not qualifying or designated for hedge accounting treatment entered into in and outstanding as of June 30, 2010 and 2009 were as follows (in thousands USD):

	June 30, 2010		June 30, 2009	
	Notional Amount	Gain (Loss)	Notional Amount	Gain (Loss)
CAD / USD	$ 9,350	$ (231)	$ 7,666	$ 82
NZD / USD	13,396	(174)	-	-
NOK / USD	-	-	2,771	26
SEK / USD	3,187	22	8,218	216
DKK / USD	2,539	(76)	3,234	159
GBP / USD	-	-	4,382	393
EUR / USD	11,912	(290)	14,988	454
EUR / GBP	1,544	(68)	-	-
EUR / SEK	118	(6)	-	-
	$ 42,046	$ (823)	$ 41,259	$ 1,330

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

	June 30, 2010		December 31, 2009	
	Assets	Liabilities	Assets	Liabilities
Derivatives designated as hedging instruments under ASC 815				
Foreign currency forward contracts	$ 3,877	$ 1,404	$ 1,815	$ 1,498
Derivatives not designated as hedging instruments under ASC 815				
Foreign currency forward contracts	56	879	92	675
Total derivatives	$ 3,933	$ 2,283	$ 1,907	$ 2,173

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.

The effect of derivative instruments on the Statement of Operations and Other Comprehensive Income (OCI) for the quarter and six months ended June 30, 2010 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)
Quarter ended June 30, 2010:			
	$ (918)	$ 840	$ (65)

Foreign currency forward contracts						
Six months ended June 30, 2010:						
Foreign currency forward contracts	$	1,338	$	779	$	(39)
Quarter ended June 30, 2009:						
Foreign currency forward contracts	$	(2,000)	$	113	$	-
Interest rate swap contracts		2,454		(1,240)		-
	$	454	$	(1,127)	$	-
Six months ended June 30, 2009:						
Foreign currency forward contracts	$	(367)	$	68	$	-
Interest rate swap contracts		4,699		(2,393)		-
	$	4,332	$	(2,325)	$	-

Index

Derivatives not designated as hedging instruments under ASC 815	Amount of Gain (Loss) Recognized in Income on Derivatives
Quarter ended June 30, 2010:	
Foreign currency forward contracts	$(1,144)
Six months ended June 30, 2010:	
Foreign currency forward contracts	$ (823)
Quarter ended June 30, 2009:	
Foreign currency forward contracts	$ 1,834
Six months ended June 30, 2009:	
Foreign currency forward contracts	$ 2,503

The gains or losses recognized as the result of the settlement of cash flow hedge foreign currency forward contracts are recognized in net sales for hedges of inventory sales or cost of product sold for hedges of inventory purchases. For the quarter and six months ended June 30 2010, net sales were increased by $426,000 and $540,000, respectively, and cost of product sold was decreased by $414,000 and $239,000 for net realized gains of $840,000 and $779,000, respectively. For the quarter and six months ended June 30, 2009, net sales were increased by $946,000 and $830,000, respectively, and cost of product sold was increased by $833,000 and $762,000, respectively, for net realized gains of $113,000 and $68,000, respectively. No swap agreements were outstanding in 2010 while swaps were outstanding in 2009 which resulted in losses of $1,240,000 and $2,393,000 for the quarter and six months ended June 30, 2009 which were recorded in interest expense for those periods.

Losses of $1,144,000 and $823,000 were recognized in selling, general and administrative (SG&A) expenses in the quarter and six months ended June 30, 2010, respectively, compared to gains of $1,834,000 and $2,503,000 in the quarter and six months ended June 30, 2009, respectively, on foreign currency forward contracts not designated as hedging instruments, which were substantially offset by losses also recorded in SG&A expenses on the intercompany trade payables for which the derivatives were entered into to offset. In addition, losses of $65,000 and $39,000 were recognized in the quarter and six months ended June 30, 2010, respectively, related to derivatives no longer qualifying for hedge accounting treatment as the forecasted transactions hedged by those derivatives are no longer probable of occurring and as a result, the hedging relationship is ineffective. No comparable gain or loss was recognized in the quarter or six months ended June 30, 2009.

Fair Value Measurements - Pursuant to ASC 820, the inputs used to derive the fair value of assets and liabilities are analyzed and assigned a level I, II or III priority, with level I being the highest and level III being the lowest in the hierarchy. Level I inputs are quoted prices in active markets for identical assets or liabilities. Level II inputs are quoted prices for similar assets or liabilities in active markets: quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs are observable in active markets. Level III inputs are based on valuations derived from valuation techniques in which one or more significant inputs are unobservable.

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

Basis for Fair Value Measurements at Reporting Date

	June 30, 2010	Quoted Prices in Active Markets for Identical Assets / (Liabilities) Level I	Significant Other Observable Inputs Level II	Significant Other Unobservable Inputs Level III
Forward Exchange Contracts	$ 1,650	$ -	$ 1,650	$ -

Index

Forward Contracts: The company operates internationally and as a result is exposed to foreign currency fluctuations. Specifically, the exposure includes intercompany trade receivables/payables and loans as well as third party sales or purchases. 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 various currencies. The company does not use derivative financial instruments for speculative purposes. Fair values for the company's foreign exchange forward contracts are based on quoted market prices for contracts with similar maturities.

The carrying amounts and fair values of the company's financial instruments at June 30, 2010 and December 31, 2009 are as follows (in thousands):

	June 30, 2010		December 31, 2009	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Cash and cash equivalents	$ 31,205	$ 31,205	$ 37,501	$ 37,501
Other investments	1,547	1,547	1,521	1,521
Installment receivables, net	5,547	5,547	7,106	7,106
Long-term debt (including current maturities of long-term debt) *	(262,515)	(281,706)	(273,325)	(299,288)
Forward contracts in other current assets	3,933	3,933	1,907	1,907
Forward contracts in accrued expenses	(2,283)	(2,283)	(2,173)	(2,173)

* The carrying amounts and fair values exclude convertible debt classified as equity in accordance with FSP APB 14-1 ($30,600,000 and $48,272,000 as of June 30, 2010 and December 31, 2009, respectively).

Income Taxes - The Company had an effective tax rate of 125.3% and 67.7% on earnings before tax for the three and six month periods ended June 30, 2010, respectively, compared to an expected rate at the US statutory rate of 35%. For the three and six month periods ended June 30, 2009, the Company had an effective rate of 27.5% and 33.0%, respectively, compared to an expected rate at the US statutory rate of 35%. The Company's effective tax rate for the three and six month periods ended June 30, 2010 was higher than the U.S. federal statutory rate as a result of the significant negative impact of the Company not being able to record tax benefits related to losses in countries which had tax valuation allowances. The Company's foreign subsidiaries, as a group excluding those with tax valuation allowances, recognized an effective tax rate lower than the US statutory rate. The Company continued to be in a loss position in the U.S. principally as a result of recording expense of $14,048,000 and $18,434,000 for the three and six months ended June 30, 2010, respectively, related to the extinguishment of convertible and senior debt at a premium.

For the three and six month periods ended June 30, 2009, the effective tax rate was lower than the U.S. federal statutory rate as a result of the negative impact of the Company not being able to record tax benefits related to losses in countries which had tax valuation allowances, which was more than offset by normal tax expense recognized in countries without tax allowances. The Company's foreign subsidiaries, as a group excluding those with tax valuation allowances, recognized an effective tax rate lower than the US statutory rate.

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 9 ¾% Senior Notes due 2015 (the "Senior Notes") with an aggregate principal amount of $175,000,000 and under its 4.125% Convertible Senior Subordinated Debentures due 2027 (the "Debentures") with an initial aggregate principal amount of $135,000,000. The majority of the Company's subsidiaries are not guaranteeing the indebtedness of the Senior Notes or 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 Senior Notes and 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.

Index

CONSOLIDATING CONDENSED STATEMENTS OF OPERATIONS

(in thousands)

Three month period ended June 30, 2010	The Company (Parent)	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Eliminations	Total
Net sales	$ 101,403	$ 184,190	$ 171,337	$ (26,102)	$ 430,828
Cost of products sold	72,635	143,762	113,978	(26,037)	304,338
Gross Profit	28,768	40,428	57,359	(65)	126,490
Selling, general and administrative expenses	35,501	28,367	40,553	-	104,421
Loss on debt extinguishment including debt finance charges and associated fees	14,048	-	-	-	14,048
Income (loss) from equity investee	25,203	7,239	(395)	(32,047)	-
Interest expense - net	4,703	202	702	-	5,607
Earnings (loss) before Income Taxes	(281)	19,098	15,709	(32,112)	2,414
Income taxes	330	403	2,292	-	3,025
Net Earnings (loss)	$ (611)	$ 18,695	$ 13,417	$ (32,112)	$ (611)
Three month period ended June 30, 2009					
Net sales	$ 95,693	$ 173,208	$ 160,897	$ (17,257)	$ 412,541
Cost of products sold	66,892	135,846	109,123	(17,375)	294,486
Gross Profit	28,801	37,362	51,774	118	118,055
Selling, general and administrative expenses	31,336	30,313	36,290	-	97,939
Charge related to restructuring activities	117	-	1,007	-	1,124
Income (loss) from equity investee	18,388	5,066	(3,209)	(20,245)	-
Interest expense - net	7,705	(1,003)	1,729	-	8,431
Earnings (loss) before Income Taxes	8,031	13,118	9,539	(20,127)	10,561
Income taxes	370	100	2,430	-	2,900
Net Earnings (loss)	$ 7,661	$ 13,018	$ 7,109	$ (20,127)	$ 7,661

Index

CONSOLIDATING CONDENSED STATEMENTS OF OPERATIONS

(in thousands)

Six month period ended June 30, 2010	The Company (Parent)	Combined Guarantor Subsidiaries	Combined Non-Guarantor Subsidiaries	Eliminations	Total
Net sales	$ 195,241	$ 355,437	$ 332,782	$ (50,392)	$ 833,068
Cost of products sold	138,773	278,970	221,523	(50,401)	588,865
Gross Profit	56,468	76,467	111,259	9	244,203
Selling, general and administrative expenses	67,214	53,202	85,781	-	206,197
Loss on debt extinguishment including debt finance charges and associated fees	18,434	-	-	-	18,434
Income (loss) from equity investee	42,447	8,834	(384)	(50,897)	-
Interest expense - net	9,779	309	1,764	-	11,852
Earnings (loss) before Income Taxes	3,488	31,790	23,330	(50,888)	7,720
Income taxes	993	553	3,679	-	5,225
Net Earnings (loss)	$ 2,495	$ 31,237	$ 19,651	$ (50,888)	$ 2,495
Six month period ended June 30, 2009					
Net sales	$ 184,079	$ 351,577	$ 309,548	$ (34,668	