

Hill-Rom Holdings, Inc.
Form 10-Q
August 07, 2015

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

FORM 10-Q

(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended June 30, 2015

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 No. 1-6651

HILL-ROM HOLDINGS, INC.
(Exact name of registrant as specified in its charter)

Indiana
(State or other jurisdiction of incorporation or organization)

35-1160484
(I.R.S. Employer Identification No.)

Two Prudential Plaza, Suite 4100
Chicago, IL
(Address of principal executive offices)

60601
(Zip Code)

(312) 819-7200
(Registrant's telephone number, including area code)
1069 State Route 46 East
Batesville, Indiana 47006-8835
(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 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

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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 (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer Accelerated filer Non-accelerated filer 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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Common Stock, without par value – 56,719,589 shares as of July 30, 2015.

HILL-ROM HOLDINGS, INC.

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PART I – FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

Hill-Rom Holdings, Inc. and Subsidiaries

Condensed Consolidated Statements of Income (Unaudited)

(In millions, except per share data)

| | Quarter Ended June 30 | | Year to Date Ended June 30 | |
|--|-----------------------|----------|----------------------------|-----------|
| | 2015 | 2014 | 2015 | 2014 |
| Net Revenue | | | | |
| Capital sales | \$376.8 | \$302.8 | \$ 1,125.9 | \$ 911.9 |
| Rental revenue | 97.7 | 94.8 | 288.4 | 294.4 |
| Total revenue | 474.5 | 397.6 | 1,414.3 | 1,206.3 |
| Cost of Revenue | | | | |
| Cost of goods sold | 217.9 | 168.2 | 652.3 | 508.9 |
| Rental expenses | 47.1 | 42.3 | 138.4 | 130.8 |
| Total cost of revenue | 265.0 | 210.5 | 790.7 | 639.7 |
| Gross Profit | 209.5 | 187.1 | 623.6 | 566.6 |
| Research and development expenses | 23.3 | 17.5 | 67.3 | 50.3 |
| Selling and administrative expenses | 150.5 | 128.6 | 455.5 | 396.7 |
| Special charges (Note 8) | 4.4 | 3.0 | 11.9 | 32.4 |
| Operating Profit | 31.3 | 38.0 | 88.9 | 87.2 |
| Interest expense | (3.3) | (2.5) | (9.5) | (6.8) |
| Investment income and other, net | - | 0.8 | 2.2 | 0.6 |
| Income Before Income Taxes | 28.0 | 36.3 | 81.6 | 81.0 |
| Income tax expense (Note 9) | 9.3 | 10.2 | 24.7 | 45.0 |
| Net Income | 18.7 | 26.1 | 56.9 | 36.0 |
| Less: Net loss attributable to noncontrolling interests | (0.4) | - | (0.4) | - |
| Net Income Attributable to Common Shareholders | \$19.1 | \$26.1 | \$ 57.3 | \$ 36.0 |
| Net Income Attributable to Common Shareholders per Common Share - Basic | \$0.34 | \$0.46 | \$ 1.01 | \$ 0.62 |
| Net Income Attributable to Common Shareholders per Common Share - Diluted | \$0.33 | \$0.45 | \$ 0.99 | \$ 0.61 |
| Dividends per Common Share | \$0.1600 | \$0.1525 | \$ 0.4725 | \$ 0.4425 |

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| | | | | |
|--|--------|--------|--------|--------|
| Average Common Shares Outstanding - Basic (thousands) (Note 10) | 56,670 | 57,273 | 56,777 | 57,612 |
| Average Common Shares Outstanding - Diluted (thousands) (Note 10) | 57,899 | 58,160 | 57,943 | 58,499 |

See Notes to Condensed Consolidated Financial Statements

Hill-Rom Holdings, Inc. and Subsidiaries
Condensed Consolidated Statements of Comprehensive Income (Unaudited)
(In millions)

| | Quarter Ended June 30 | | Year to Date Ended June 30 | |
|---|-----------------------|--------|----------------------------|---------|
| | 2015 | 2014 | 2015 | 2014 |
| Net Income | \$18.7 | \$26.1 | \$ 56.9 | \$ 36.0 |
| Other Comprehensive Income (Loss), net of tax (Note 7): | | | | |
| Available-for-sale securities and currency hedges | 0.1 | (0.5) | (0.5) | (0.3) |
| Foreign currency translation adjustment | 19.4 | 1.1 | (51.2) | 6.7 |
| Change in pension and postretirement defined benefit plans | 0.8 | 0.6 | 2.6 | 1.7 |
| Total Other Comprehensive Income (Loss), net of tax | 20.3 | 1.2 | (49.1) | 8.1 |
| Total Comprehensive Income | 39.0 | 27.3 | 7.8 | 44.1 |
| Less: Comprehensive loss attributable to noncontrolling interests | (0.4) | - | (0.4) | - |
| Total Comprehensive Income Attributable to Common Shareholders | \$39.4 | \$27.3 | \$ 8.2 | \$ 44.1 |

See Notes to Condensed Consolidated Financial Statements

Hill-Rom Holdings, Inc. and Subsidiaries
Condensed Consolidated Balance Sheets (Unaudited)
(In millions)

| | June 30, 2015 | September 30, 2014 |
|--|---------------|-----------------------|
| ASSETS | | |
| Current Assets | | |
| Cash and cash equivalents | \$ 123.4 | \$ 99.3 |
| Trade accounts receivable, net of allowances (Note 2) | 390.6 | 411.0 |
| Inventories (Note 2) | 169.9 | 176.2 |
| Deferred income taxes (Notes 1 and 9) | 43.1 | 40.9 |
| Other current assets | 54.4 | 51.9 |
| Total current assets | 781.4 | 779.3 |
| Property, plant and equipment, net (Note 2) | 287.5 | 261.5 |
| Goodwill (Note 4) | 406.3 | 399.8 |
| Software and other intangible assets, net (Note 2) | 235.0 | 261.1 |
| Deferred income taxes (Notes 1 and 9) | 22.9 | 23.0 |
| Other assets | 24.4 | 27.4 |
| Total Assets | \$ 1,757.5 | \$ 1,752.1 |
| LIABILITIES | | |
| Current Liabilities | | |
| Trade accounts payable | \$ 85.2 | \$ 112.7 |
| Short-term borrowings (Note 5) | 130.0 | 126.9 |
| Accrued compensation | 82.8 | 89.2 |
| Accrued product warranties (Note 12) | 29.4 | 28.4 |
| Other current liabilities | 81.1 | 85.1 |
| Total current liabilities | 408.5 | 442.3 |
| Long-term debt (Note 5) | 447.8 | 364.9 |
| Accrued pension and postretirement benefits (Note 6) | 75.7 | 76.9 |
| Deferred income taxes (Notes 1 and 9) | 23.9 | 31.0 |
| Other long-term liabilities | 32.4 | 30.5 |
| Total Liabilities | 988.3 | 945.6 |
| Commitments and Contingencies (Note 14) | | |
| SHAREHOLDERS' EQUITY | | |
| Common stock (Note 2) | 4.4 | 4.4 |
| Additional paid-in-capital | 144.6 | 134.1 |
| Retained earnings | 1,530.1 | 1,499.8 |
| Accumulated other comprehensive loss (Note 7) | (123.2) | (74.1) |
| Treasury stock, at cost (Note 2) | (797.2) | (757.7) |
| Total Shareholders' Equity Attributable to Common Shareholders | 758.7 | 806.5 |

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| | | |
|--|------------|------------|
| Noncontrolling Interests | 10.5 | - |
| Total Shareholders' Equity | 769.2 | 806.5 |
| Total Liabilities and Shareholders' Equity | \$ 1,757.5 | \$ 1,752.1 |

See Notes to Condensed Consolidated Financial Statements

Hill-Rom Holdings, Inc. and Subsidiaries
Condensed Consolidated Statements of Cash Flows (Unaudited)
(In millions)

| | Year to Date Ended June 30 | |
|---|----------------------------|---------|
| | 2015 | 2014 |
| Operating Activities | | |
| Net income | \$ 56.9 | \$ 36.0 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 53.1 | 49.5 |
| Amortization | 8.3 | 9.6 |
| Acquisition-related intangible asset amortization | 23.4 | 20.9 |
| Provision for deferred income taxes | (12.3) | 4.6 |
| Loss on disposal of property, equipment leased to others, intangible assets and impairments | - | 7.3 |
| Stock compensation | 14.0 | 13.2 |
| Excess tax benefits from employee stock plans | (1.7) | 0.5 |
| Change in working capital excluding cash, current debt, acquisitions and dispositions: | | |
| Trade accounts receivable | 4.7 | 29.8 |
| Inventories | (3.4) | (1.2) |
| Other current assets | (5.1) | (4.2) |
| Trade accounts payable | (18.1) | (9.4) |
| Accrued expenses and other liabilities | 0.3 | (23.1) |
| Other, net | 4.3 | 0.7 |
| Net cash provided by operating activities | 124.4 | 134.2 |
| Investing Activities | | |
| Capital expenditures and purchases of intangible assets | (102.6) | (44.4) |
| Proceeds on sale of property and equipment leased to others | 1.2 | 1.8 |
| Payment for acquisition of businesses, net of cash acquired | (5.1) | (15.5) |
| Refund on acquisition of businesses | - | 4.6 |
| Other | 2.1 | 3.2 |
| Net cash used in investing activities | (104.4) | (50.3) |
| Financing Activities | | |
| Net change in short-term debt | (0.7) | (0.2) |
| Borrowings on revolving credit facility | 95.0 | 35.0 |
| Payments on revolving credit facility | - | (40.0) |
| Proceeds from long-term debt | - | 0.6 |
| Payment of long-term debt | (11.5) | (7.6) |
| Debt issuance costs | (1.6) | - |
| Purchase of noncontrolling interest of former joint venture | (1.6) | (1.3) |
| Payment of cash dividends | (26.7) | (25.4) |
| Proceeds on exercise of stock options | 10.2 | 10.2 |
| Proceeds from stock issuance | 2.1 | 1.8 |

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| | | |
|---|----------|----------|
| Excess tax benefits from employee stock plans | 1.7 | (0.5) |
| Treasury stock acquired | (57.4) | (71.6) |
| Net cash provided by (used in) financing activities | 9.5 | (99.0) |
| Effect of exchange rate changes on cash | (5.4) | (0.4) |
| Net Cash Flows | 24.1 | (15.5) |
| Cash and Cash Equivalents: | | |
| At beginning of period | 99.3 | 127.4 |
| At end of period | \$ 123.4 | \$ 111.9 |

See Notes to Condensed Consolidated Financial Statements

Hill-Rom Holdings, Inc. and Subsidiaries
Notes to Condensed Consolidated Financial Statements (Unaudited)
(Dollars in millions except per share data)

1. Summary of Significant Accounting Policies

Basis of Presentation and Principles of Consolidation

Unless the context otherwise requires, the terms “Hill-Rom,” “we,” “our” and “us” refer to Hill-Rom Holdings, Inc. and our consolidated subsidiaries. The unaudited Condensed Consolidated Financial Statements appearing in this Quarterly Report on Form 10-Q should be read in conjunction with the audited Consolidated Financial Statements and notes thereto included in our latest Annual Report on Form 10-K for the fiscal year ended September 30, 2014 (“2014 Form 10-K”) as filed with the United States (“U.S.”) Securities and Exchange Commission. The September 30, 2014 Condensed Consolidated Balance Sheet was derived from audited Consolidated Financial Statements, but does not include all disclosures required by accounting principles generally accepted in the U.S. In the opinion of management, the Condensed Consolidated Financial Statements herein include all adjustments, consisting only of normal recurring adjustments, necessary to state fairly the financial position, results of operations and cash flows for the interim periods presented. Quarterly results are not necessarily indicative of annual results.

The Condensed Consolidated Financial Statements include the accounts of Hill-Rom and its wholly-owned subsidiaries. In addition, we also consolidate variable interest entities (VIEs) where Hill-Rom is deemed to have a controlling financial interest. Intercompany accounts and transactions have been eliminated in consolidation, including the intercompany transactions with consolidated VIEs. Where our ownership interest is less than 100 percent, the noncontrolling interests are reported in our Condensed Consolidated Financial Statements.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the U.S. requires our management to make estimates and assumptions that affect the reported amounts of certain assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expense during the period. Actual results could differ from those estimates. Examples of such estimates include our income taxes (Notes 1 and 9), accounts receivable reserves (Note 2), accrued warranties (Note 12), and commitments and contingencies (Note 14), among others.

Fair Value Measurements

Fair value measurements are classified and disclosed in one of the following three categories:

- Level 1: Financial instruments with unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets and liabilities.
- Level 2: Financial instruments with observable inputs other than those included in Level 1 such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.
- Level 3: Financial instruments with unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities. Unobservable inputs reflect our own assumptions that market participants would use in pricing the asset or liability (including assumptions about

risk). Unobservable inputs shall be developed based on the best information available in the circumstances, which might include our own data.

We record cash and cash equivalents, as disclosed on our Condensed Consolidated Balance Sheets, as Level 1 instruments and certain other insignificant derivatives and investments as either Level 2 or 3 instruments. Refer to Note 5 for disclosure of our debt instrument fair values.

Taxes Collected from Customers and Remitted to Governmental Units

Taxes assessed by a governmental authority that are directly imposed on a revenue producing transaction between us and our customers, including but not limited to sales taxes, use taxes and value added taxes, are accounted for on a net (excluded from revenue and costs) basis.

Income Taxes

We and our eligible domestic subsidiaries file a consolidated U.S. income tax return. Foreign operations file income tax returns in a number of jurisdictions. Deferred income taxes are computed using an asset and liability approach to reflect the net tax effects of temporary differences between the financial reporting carrying amounts of assets and liabilities and the corresponding income tax amounts. We have a variety of deferred tax assets in numerous tax jurisdictions. These deferred tax assets are subject to periodic assessment as to recoverability. If it is determined that it is more likely than not that the benefits will not be realized, valuation allowances are recognized. In evaluating whether it is more likely than not that we would recover these deferred tax assets, future taxable income, the reversal of existing temporary differences and tax planning strategies are considered.

As of June 30, 2015, we had \$23.8 million of valuation allowances on deferred tax assets, on a tax-effected basis, primarily related to foreign operating loss carryforwards and other tax attributes. The valuation allowance was decreased in the current year to date period by \$1.9 million to reflect the expected realization of certain deferred assets in Australia. We believe that our estimates for the valuation allowances recorded against deferred tax assets are appropriate based on current facts and circumstances.

We account for uncertain income tax positions using a threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The difference between the tax benefit recognized in the financial statements for an uncertain income tax position and the tax benefit claimed in the tax return is referred to as an unrecognized tax benefit.

Employee Benefits Change

During the second quarter of fiscal 2014, we implemented a new paid time off policy as part of our employee benefits programs, replacing certain previously existing vacation and sick time policies. In conjunction with these changes in policies, the vesting provisions with respect to the accumulation of paid time off were delayed resulting in the recognition and utilization of paid time off in the same benefits year. As a result of this change, significant portions of our existing accrued vacation balance were no longer necessary and we reversed \$12.2 million in the second quarter of fiscal 2014 and an additional \$1.2 million in the third quarter of fiscal 2014 to reflect the change in vesting provisions.

Recently Issued Accounting Standards

In May 2014, the FASB issued Accounting Standards Update (“ASU”) 2014-09, “Revenue from Contracts with Customers,” which provides guidance for revenue recognition. The standard’s core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services.

In July 2015, the FASB approved delaying the effective date of the new standard by one year. As a result, this guidance will be effective for us in the first quarter of fiscal 2019, ending December 31, 2018. Early adoption is permitted as of the original effective date, but not earlier. We are currently in the process of evaluating the impact of adoption of this ASU on our Consolidated Financial Statements.

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In April 2015, the FASB issued ASU 2015-03, "Simplifying the Presentation of Debt Issuance Costs." The amendments in this ASU require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. This guidance is effective for us in the first quarter of fiscal 2017, ending December 31, 2016. Early adoption is permitted. We do not expect the adoption of this standard to materially impact our Consolidated Financial Statements.

Except as noted above, there have been no significant changes to our assessment of the impact of recently issued accounting standards included in Note 1 of Notes to Consolidated Financial Statements in our 2014 Form 10-K.

2. Supplementary Balance Sheet Information

| | June 30, 2015 | September 30, 2014 |
|--|---------------|-----------------------|
| Allowance for possible losses and discounts on trade receivables | \$ 26.1 | \$ 31.4 |
| Inventories: | | |
| Finished products | \$ 88.8 | \$ 93.5 |
| Raw materials and work in process | 81.1 | 82.7 |
| Total inventory | \$ 169.9 | \$ 176.2 |
| Accumulated depreciation of property, plant and equipment | \$ 599.5 | \$ 588.1 |
| Accumulated amortization of software and other intangible assets | \$ 302.0 | \$ 283.3 |
| Preferred stock, without par value: | | |
| Shares authorized | 1,000,000 | 1,000,000 |
| Shares issued | None | None |
| Common stock, without par value: | | |
| Shares authorized | 199,000,000 | 199,000,000 |
| Shares issued | 80,323,912 | 80,323,912 |
| Shares outstanding | 56,715,942 | 57,439,911 |
| Treasury shares | 23,607,970 | 22,884,001 |

3. Acquisitions

Trumpf Medical

On August 1, 2014, we completed the acquisition of Trumpf Medical (“Trumpf”) and funded the transaction with a combination of cash on hand and borrowings under our revolving credit facility. Trumpf provides a portfolio of well-established operating room (OR) infrastructure products such as surgical tables, surgical lighting, and supply units and expands our product offerings in the surgical suite.

The purchase price was \$232.9 million (\$226.6 million net of cash acquired). The results of Trumpf are included in the Condensed Consolidated Financial Statements since the date of acquisition.

The following summarizes the fair value of assets acquired and liabilities assumed at the date of the acquisition. In fiscal 2015, we made certain adjustments to the opening balance sheet as of the acquisition date to reflect certain fair value adjustments and, in the second quarter, recorded a \$3.0 million liability to reflect the final settlement of certain purchase agreement provisions with the seller, which has subsequently been paid. These adjustments were not material to prior period financial statements and therefore, the 2014 comparative period presented has not been revised to reflect these adjustments. Fair values of assets and liabilities acquired are still considered preliminary and subject to further adjustments.

| | Amount |
|---|----------|
| Trade receivables | \$ 65.6 |
| Inventory | 63.6 |
| Other current assets | 24.2 |
| Property, plant, and equipment | 42.1 |
| Goodwill | 63.6 |
| Trade name (5-year useful life) | 6.7 |
| Customer relationships (10-year weighted average useful life) | 15.8 |
| Developed technology (8-year weighted average useful life) | 17.8 |
| Other intangibles | 4.8 |
| Other noncurrent assets | 0.7 |
| Deferred tax asset | 15.5 |
| Current liabilities | (73.4) |
| Long term debt | (6.0) |
| Noncurrent liabilities | (8.1) |
| Total purchase price | \$ 232.9 |

Goodwill was allocated entirely to our Surgical and Respiratory Care segment. The goodwill related to the acquired German operations will be tax deductible in Germany while the remaining goodwill will not be deductible for tax purposes.

On an unaudited proforma basis, as if the Trumpf acquisition had been consummated prior to the earliest date of the financial results presented, our revenue would have been higher by approximately \$79 million and \$202 million for the quarter and year to date periods ended June 30, 2014. As previously disclosed, the impact to net income on an unaudited proforma basis would not have been significant to our financial results for fiscal 2014. The unaudited proforma results are based on the Company's historical financial statements and those of the Trumpf business and do not necessarily indicate the results of operations that would have resulted had the acquisition been completed at the beginning of the comparable period presented and are not indicative of the results of operations in future periods.

Other

We have used cash on hand for other business acquisitions and equity investments which we do not consider individually material to the Company's financial position or results of operations. These included one equity investment in which the investee was determined to be a VIE and Hill-Rom was determined to have a controlling financial interest, resulting in consolidation of the investee. The portion of this investee's assets, liabilities, and operating results which are not attributable to Hill-Rom's equity investment are recognized in our Condensed Consolidated Financial Statements as attributable to noncontrolling interests.

Welch Allyn

In June 2015, we announced entry into a definitive agreement under which Hill-Rom will acquire Welch Allyn Holdings, Inc. ("Welch Allyn") for \$1.625 billion in cash and approximately 8.1 million newly-issued shares of Hill-Rom common stock, for a total combined purchase price of approximately \$2.05 billion. The purchase price is subject to adjustment for changes in stock price and normal true-up provisions in the merger agreement. Welch Allyn is a leading manufacturer of medical diagnostic equipment and offers a diversified portfolio of devices that assess, diagnose, treat, and manage a wide variety of illnesses and diseases. The transaction is expected to close on or prior to October 1, 2015 and will be financed with a combination of new borrowings and Hill-Rom common stock. See the

Liquidity and Capital Resources section of Management's Discussion and Analysis of Financial Condition and Results of Operations for further details related to the funding of the acquisition.

4. Goodwill and Indefinite-Lived Intangible Assets

The following summarizes goodwill activity by reportable segment:

| | North America | Surgical and Respiratory Care | International | Total |
|--|------------------|-------------------------------------|---------------|----------|
| Balances at September 30, 2014: | | | | |
| Goodwill | \$ 390.6 | \$ 333.5 | \$ 148.5 | \$872.6 |
| Accumulated impairment losses | (358.1) | - | (114.7) | (472.8) |
| Goodwill, net at September 30, 2014 | 32.5 | 333.5 | 33.8 | 399.8 |
| Changes in Goodwill during the period: | | | | |
| Goodwill related to acquisitions | - | 18.4 | - | 18.4 |
| Currency translation effect | - | (8.8) | (3.1) | (11.9) |
| Balances at June 30, 2015: | | | | |
| Goodwill | 390.6 | 343.1 | 145.4 | 879.1 |
| Accumulated impairment losses | (358.1) | - | (114.7) | (472.8) |
| Goodwill, net at June 30, 2015 | \$ 32.5 | \$ 343.1 | \$ 30.7 | \$406.3 |

As discussed in Note 3, we recorded adjustments to goodwill during fiscal 2015 related to the Trumpf acquisition completed during the fourth quarter of fiscal 2014. We also consolidated an investment made in fiscal 2015 that was determined to be a VIE in which we have a controlling financial interest. The consolidation resulted in \$12.1 million of goodwill being recorded within our Surgical and Respiratory Care segment.

As discussed in Note 13, we operate in three reportable business segments. Goodwill impairment testing is performed at the reporting unit level, which is one level below a reportable business segment. We have determined that we have ten reporting units. Goodwill is assigned to reporting units at the date the goodwill is initially recorded and has been reallocated as necessary based on the restructuring of reporting units over time. Once goodwill has been assigned to reporting units, it no longer retains its association with a particular acquisition, and all of the activities within a reporting unit, whether acquired or organically grown, are available to support the value of the goodwill.

Testing for impairment must be performed annually, or on an interim basis upon the occurrence of a triggering event or change in circumstances that would more likely than not reduce the fair value of a reporting unit below its carrying amount. The annual evaluation of goodwill performed during the third quarter of fiscal 2015 and 2014 did not result in any impairments.

A 10 percent reduction in the fair value of any of our reporting units would not result in an impairment charge.

Indefinite-lived intangible assets

We have various indefinite-lived intangible assets representing trade names with a carrying value of \$32.9 million at both June 30, 2015 and September 30, 2014. Testing for impairment must be performed annually, or on an interim basis upon the occurrence of a triggering event or change in circumstances that would more likely than not reduce the fair value of an indefinite-lived intangible asset below its carrying amount. The annual evaluation of indefinite-lived intangible assets performed during the third quarter of fiscal 2015 and 2014 did not result in impairment.

5. Financing Agreements

Total debt consists of the following:

| | June 30, 2015 | September 30, 2014 |
|---|-----------------|--------------------|
| Revolving credit facility | \$ 360.0 | \$ 265.0 |
| Term loan current portion | 20.0 | 16.2 |
| Term loan long-term portion | 145.0 | 160.0 |
| Unsecured 7.00% debentures due on February 15, 2024 | 19.4 | 19.4 |
| Unsecured 6.75% debentures due on December 15, 2027 | 29.8 | 29.8 |
| Other | 3.6 | 1.4 |
| Total debt | 577.8 | 491.8 |
| Less current portion of debt | 130.0 | 126.9 |
| Total long-term debt | \$ 447.8 | \$ 364.9 |

Prior to May 1, 2015, we had a credit facility that provided for revolving loans of up to \$500.0 million, plus a term loan in the aggregate amount of \$200.0 million. Borrowings under the credit facility and term loan bore interest at variable rates specified therein, that were less than 2.0 percent.

On May 1, 2015, we entered into an Amended and Restated Credit Agreement (the “Current Credit Facility”) with the lenders named therein, JPMorgan Chase Bank, N.A., as Administrative agent, and each of Citizens Bank, N.A. Bank of America, N.A. and PNC Bank, National Association, as Co-Syndication Agents, which amended and restated our prior credit facility, entered into August 24, 2012. The Current Credit Facility provides for revolving loans outstanding of up to \$900.0 million at any time, plus term loans in the current principal amount of \$165.0 million. We currently have \$360.0 million of outstanding borrowings and undrawn letters of credit of \$5.1 million under the revolving loan portion of the Current Credit Facility, leaving \$534.9 million of available borrowing capacity.

All revolving loans under the Current Credit Facility mature May 1, 2020. The term loans will continue to amortize so that \$40.0 million of the remaining principal will be repaid through August 24, 2017, with the balance due at such date.

Borrowings under the Current Credit Facility bear interest based on a margin (which varies dependent upon the Company’s credit rating) over certain pre-defined index rates, selected at the Company’s option that are currently less than 2 percent. The Current Credit Facility is guaranteed by several fully owned subsidiaries of the Company. The Current Credit Facility contains terms and conditions, events of default, and customary covenants, including requiring that (1) the Company maintain a ratio of Consolidated Indebtedness to Consolidated EBITDA of not more than 3.50:1.0; and (2) a ratio of Consolidated EBITDA to interest expense of not less than 3.00:1.0. We are in compliance with all of our debt covenants as of June 30, 2015.

Unsecured debentures outstanding at June 30, 2015 have fixed rates of interest. We have deferred gains included in the amounts above from the termination of previous interest rate swap agreements, and those deferred gains amounted to less than \$1.0 million at both June 30, 2015 and September 30, 2014. The deferred gains are being amortized and recognized as a reduction of interest expense over the remaining term of the related debt through 2024, and as a result, the effective interest rates on that debt have been and will continue to be lower than the stated interest rates.

We have trade finance credit lines and uncommitted letter of credit facilities. These lines are associated with the normal course of business and we had \$1.3 million of outstanding standby letters of credit as of June 30, 2015.

We are exposed to market risk from fluctuations in interest rates. The Company sometimes manages its exposure to interest rate fluctuations through the use of interest rate swaps (cash flow hedges). As of June 30, 2015, we had one interest rate swap agreement with a notional amount of \$115.0 million to hedge the variability of cash flows associated with a portion of the term loan variable interest rate payments for the period of January 2014 to August 2017. The interest rate swap has been designated as a cash flow hedge. The interest rate swap fair value was a \$0.4 million liability as of June 30, 2015 and an asset of \$0.2 million as of September 30, 2014. The fair value measurement for our interest rate swap is classified as Level 2, as described in Note 1.

The fair value of our debt is estimated based on the quoted market prices for the same or similar issues or on the current rates offered to us for debt of the same remaining maturities. The book values of our short-term debt instruments approximate fair value. The estimated fair values of our long-term unsecured debentures were \$55.5 million at both June 30, 2015 and September 30, 2014, and were based on observable inputs such as quoted prices in markets that are not active. The estimated fair value of our term loan was \$164.4 million and \$175.2 million at June 30, 2015 and September 30, 2014 based on quoted prices for similar liabilities as of those dates. The fair value measurements for both our long-term unsecured debentures and our term loan were classified as Level 2, as described in Note 1.

In conjunction with the pending acquisition of Welch Allyn, as outlined in Note 3, we intend to refinance our debt. See the Liquidity and Capital Resources section of Management's Discussion and Analysis of Financial Condition and Results of Operations for further details.

6. Retirement and Postretirement Plans

We sponsor five defined benefit retirement plans: a master defined benefit retirement plan, a nonqualified supplemental executive defined benefit retirement plan and three defined benefit retirement plans covering employees in Germany and France. Benefits for such plans are based primarily on years of service and the employee's level of compensation during specific periods of employment. We contribute funds to trusts as necessary to provide for current service and for any unfunded projected future benefit obligation over a reasonable period of time for our funded plans. All of our plans have an annual measurement date of September 30. The following table includes the components of net pension expense for our defined benefit plans.

| | Quarter Ended June 30 | | Year to Date Ended June 30 | |
|--|-----------------------|--------|----------------------------|---------|
| | 2015 | 2014 | 2015 | 2014 |
| Service cost | \$1.4 | \$1.2 | \$ 4.1 | \$ 3.7 |
| Interest cost | 3.7 | 3.6 | 11.1 | 10.8 |
| Expected return on plan assets | (4.3) | (4.2) | (12.8) | (12.6) |
| Amortization of unrecognized prior service cost, net | 0.2 | 0.2 | 0.5 | 0.5 |
| Amortization of net loss | 1.3 | 0.8 | 4.0 | 2.4 |
| Net pension expense | 2.3 | 1.6 | 6.9 | 4.8 |
| Special termination benefits | - | - | - | 2.4 |
| Net pension expense | \$2.3 | \$1.6 | \$ 6.9 | \$ 7.2 |

We also sponsor a domestic postretirement health care plan that provides health care benefits to qualified retirees and dependents until eligible for Medicare. Annual costs related to the domestic postretirement health care plan are not significant.

In April, 2015, we offered all terminated vested participants of our domestic master defined benefit retirement plan an option to receive a lump sum cash payout in lieu of their right to future periodic benefit payments under the plan upon their retirement. The election window has closed, with initial participant elections received, and we anticipate the lump sum payments to be made in September 2015. Based on the voluntary elections of participants during the window, we expect to incur a non-cash settlement charge of \$7 to \$10 million in the fourth quarter of fiscal 2015 with respect to this action. The amount of the charge may vary due to possible changes in discount rates and asset returns before the measurement date, which will occur once the settlements are paid.

During the second quarter of fiscal 2014, we initiated a domestic early retirement program, which offered certain special termination benefits relating to our pension and postretirement health care plans. This program and the related special termination benefits resulted in a non-cash charge of \$4.5 million, \$2.4 million of which related to our master

defined benefit retirement plan and \$2.1 million for our postretirement health care plan. During the third and fourth quarters of fiscal 2014, we reversed a cumulative \$1.3 million of the \$2.1 million postretirement health care plan charge as certain participants elected alternative coverage separate from the postretirement health care plan. The employee elections were not known until the third and fourth quarters of fiscal 2014. Refer to Note 8 for more details.

We have defined contribution savings plans that cover substantially all U.S. employees and certain non-U.S. employees. The general purpose of these plans is to provide additional financial security during retirement by providing employees with an incentive to make regular savings. Company contributions to the plans are based on eligibility and employee contributions. Expense under these plans was \$4.6 million and \$4.1 million in each of the quarterly periods ended June 30, 2015 and 2014; and \$12.6 million and \$11.5 million in the year to date periods ended June 30, 2015 and 2014.

7. Other Comprehensive Income

The following tables describe the changes in accumulated other comprehensive loss by component:

Quarter Ended June 30, 2015

| | Other comprehensive income (loss) | | | | | Accumulated other comprehensive loss | | |
|--|-----------------------------------|--------------------------|---------|------------|------------|--------------------------------------|--------------|----------------|
| | Prior reclassification | to Reclassification from | Pre-tax | Tax effect | Net of tax | Beginning balance | Net activity | Ending balance |
| Available-for-sale securities and currency hedges | \$ 0.2 | \$ - | \$ 0.2 | \$ (0.1) | \$ 0.1 | \$ (0.6) | \$ 0.1 | \$ (0.5) |
| Foreign currency translation adjustment | 19.4 | - | 19.4 | - | 19.4 | (104.8) | 19.4 | (85.4) |
| Change in pension and postretirement defined benefit plans | - | 1.4 | 1.4 | (0.6) | 0.8 | (38.1) | 0.8 | (37.3) |
| Total | \$ 19.6 | \$ 1.4 | \$ 21.0 | \$ (0.7) | \$ 20.3 | \$ (143.5) | \$ 20.3 | \$ (123.2) |

Quarter Ended June 30, 2014

| | Other comprehensive income (loss) | | | | | Accumulated other comprehensive loss | | |
|--|-----------------------------------|--------------------------|-----------|------------|------------|--------------------------------------|--------------|----------------|
| | Prior reclassification | to Reclassification from | Pre-tax | Tax effect | Net of tax | Beginning balance | Net activity | Ending balance |
| Available-for-sale securities and currency hedges | \$ (0.7) | \$ - | \$ (0.7) | \$ 0.2 | \$ (0.5) | \$ (0.1) | \$ (0.5) | \$ (0.6) |
| Foreign currency translation adjustment | 1.1 | - | 1.1 | - | 1.1 | 1.0 | 1.1 | 2.1 |
| Change in pension and postretirement defined benefit plans | - | 1.0 | 1.0 | (0.4) | 0.6 | (29.7) | 0.6 | (29.1) |
| Total | \$ 0.4 | \$ 1.0 | \$ 1.4 | \$ (0.2) | \$ 1.2 | \$ (28.8) | \$ 1.2 | \$ (27.6) |

Year to Date Ended June 30, 2015

| | Other comprehensive income (loss) | | | | | Accumulated other comprehensive loss | | |
|--|-----------------------------------|--------------------------|------------|------------|------------|--------------------------------------|--------------|----------------|
| | Prior reclassification | to Reclassification from | Pre-tax | Tax effect | Net of tax | Beginning balance | Net activity | Ending balance |
| Available-for-sale securities and currency hedges | \$ (0.8) | \$ - | \$ (0.8) | \$ 0.3 | \$ (0.5) | \$ - | \$ (0.5) | \$ (0.5) |
| Foreign currency translation adjustment | (51.2) | - | (51.2) | - | (51.2) | (34.2) | (51.2) | (85.4) |
| Change in pension and postretirement defined benefit plans | 0.1 | 4.1 | 4.2 | (1.6) | 2.6 | (39.9) | 2.6 | (37.3) |
| Total | \$ (51.9) | \$ 4.1 | \$ (47.8) | \$ (1.3) | \$ (49.1) | \$ (74.1) | \$ (49.1) | \$ (123.2) |

Year to Date Ended June 30, 2014

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| | Other comprehensive income (loss) | | | | Accumulated other comprehensive loss | | | |
|--|-----------------------------------|-----------------------|-----------|------------|--------------------------------------|-------------------|--------------|----------------|
| | Prior reclassification | Reclassification from | Pre-tax | Tax effect | Net of tax | Beginning balance | Net activity | Ending balance |
| Available-for-sale securities and currency hedges | \$ (0.6) | \$ 0.1 | \$ (0.5) | \$ 0.2 | \$ (0.3) | \$ (0.3) | \$ (0.3) | \$ (0.6) |
| Foreign currency translation adjustment | 6.7 | - | 6.7 | - | 6.7 | (4.6) | 6.7 | 2.1 |
| Change in pension and postretirement defined benefit plans | 0.2 | 2.7 | 2.9 | (1.2) | 1.7 | (30.8) | 1.7 | (29.1) |
| Total | \$ 6.3 | \$ 2.8 | \$ 9.1 | \$ (1.0) | \$ 8.1 | \$ (35.7) | \$ 8.1 | \$ (27.6) |

The following table represents the items reclassified out of accumulated other comprehensive loss and the related tax effects:

| | Quarter Ended June 30 | | | | | |
|--|----------------------------|------------|------------|---------------------|------------|------------|
| | 2015 | | | 2014 | | |
| | Amount reclassified | Tax effect | Net of tax | Amount reclassified | Tax effect | Net of tax |
| Change in pension and postretirement defined benefit plans (a) | \$1.4 | \$(0.6) | \$0.8 | \$1.0 | \$(0.4) | \$0.6 |
| | Year to Date Ended June 30 | | | | | |
| | 2015 | | | 2014 | | |
| | Amount reclassified | Tax effect | Net of tax | Amount reclassified | Tax effect | Net of tax |
| Change in pension and postretirement defined benefit plans (a) | \$4.1 | \$(1.6) | \$2.5 | \$2.7 | \$(1.1) | \$1.6 |
| Available-for-sale securities and currency hedges (b) | - | - | - | 0.1 | - | 0.1 |

(a) Reclassified from accumulated other comprehensive loss into cost of goods sold and selling and administrative expenses. These components are included in the computation of net periodic pension expense.

(b) Reclassified from accumulated other comprehensive loss into other income (expense), net.

8. Special Charges

Site Consolidation

In the third quarter of fiscal 2015, we initiated a plan to streamline our operations and simplify our supply chain by consolidating certain manufacturing and distribution operations. As part of this action, we have announced the closure of sites in Redditch, England and Charleston, South Carolina. Upon closure, each site's operations will either be relocated to other existing Company facilities or outsourced to third-party suppliers. For the quarter and year to date ended June 30, 2015, we recorded severance and benefit charges of \$2.0 million for approximately 160 employees to be displaced by the closures, as well as \$0.2 million of other related costs. We expect to incur approximately \$4 million of additional charges over the next year for personnel costs and site closure expenses related to this action until the closures are complete.

Global Restructuring Program

During the second quarter of fiscal 2014, we announced a global restructuring program focused on improving our cost structure. This action included early retirement and reduction in force programs that eliminated over 200 net positions, primarily in the U.S., where the action was substantially completed in fiscal 2014 with cash expenditures continuing during fiscal 2015. The program also included a reduction of our European manufacturing capacity and a streamlining of global operations by, among other things, executing a back office process transformation program in Europe. The restructuring in Europe is in process and has resulted in severance and benefit charges of \$0.4 million and \$5.0 million for the quarter and year to date ended June 30, 2015, as well as other costs of \$1.8 and \$5.2 million over the same periods related to legal and professional fees, temporary labor, project management, and other administrative functions. In the second quarter of fiscal 2015, we also reversed \$0.5 million of previously recorded severance and benefit charges due to certain plan participants declining continuing healthcare coverage.

Since the inception of the global restructuring program through June 30, 2015, we have recognized aggregate special charges of \$34.6 million, which are recorded in both fiscal 2014 and 2015. Charges of \$3.2 and \$20.1 million were

recorded in the quarter and year to date ended June 30, 2014, net of reversals. We expect to incur \$8 to \$13 million of additional European restructuring costs through the completion of the program.

Discontinuance of Third-Party Payer Rentals

Also during the second quarter of fiscal 2014, we initiated a plan to discontinue third-party payer rentals of therapy products occurring primarily in home care settings. Special charges recorded for this action included a \$7.7 million non-cash tangible asset impairment charge, a \$2.0 million charge for severance and other benefits for approximately 70 eliminated positions, and \$1.6 million in other related costs, net of a reversal of \$0.2 million which was recorded in the third quarter of fiscal 2014. This action is substantially complete.

Batesville Manufacturing Early Retirement Program

During the first quarter of fiscal 2014, we initiated a plan to improve our cost structure and streamline our organization by offering an early retirement program to certain manufacturing employees in our Batesville, Indiana plant, meeting specific eligibility requirements, and other minor reduction in force actions. These programs resulted in the elimination of approximately 35 positions and required recognition of a special charge of approximately \$1 million for lump sum payments under the program and severance and other benefits provided to other affected employees. This action was substantially complete by the end of the second quarter of fiscal 2014.

For all accrued severance and other benefit charges described above, we record restructuring reserves within other current liabilities and other long-term liabilities. The reserve activity for severance and other benefits during fiscal 2015 was as follows:

| | |
|-------------------------------|---------|
| Balance at September 30, 2014 | \$ 11.7 |
| Expenses | 7.0 |
| Cash Payments | (8.5) |
| Reversals | (0.5) |
| Balance at June 30, 2015 | \$ 9.7 |

9. Income Taxes

The effective tax rate was 33.2 and 30.3 percent for the quarterly and year to date periods ended June 30, 2015 compared to 28.1 and 55.6 percent for the comparable prior year periods.

The effective rate for the current quarter is higher than the comparable period in fiscal 2014 due primarily to lower earnings in favorable rate jurisdictions. The effective tax rate for the first nine months of fiscal 2015 is lower than the comparable period in fiscal 2014 due primarily to the \$19.6 million of tax expense recognized in the prior year to establish a valuation allowance on the net deferred tax assets in France. This compares to \$3.5 million of tax benefits for the year to date period ended June 30, 2015 primarily related to the reversal of previously recorded valuation allowances in Australia, and the one-time catch-up tax benefit from the reinstatement of the research and development tax credit.

On December 19, 2014, the Tax Increase Prevention Act of 2014 (the Tax Act) was signed into law. The Tax Act retroactively extended the research and development tax credit for one year beginning January 1, 2014 through December 31, 2014. This credit had previously expired effective December 31, 2013.

We expect the reinstatement of the research and development tax credit to favorably impact the effective tax rate for fiscal 2015 by nearly \$2 million through a combination of a one-time catch-up adjustment from the reinstatement of the credit recorded in our first quarter of fiscal 2015 and the inclusion of the limited current year research credit into the fiscal 2015 effective tax rate.

10. Earnings per Common Share

Basic earnings per share is calculated based upon the weighted average number of outstanding common shares for the period, plus the effect of deferred vested shares. Diluted earnings per share is calculated consistent with the basic earnings per share calculation plus the effect of dilutive unissued common shares related to stock-based employee compensation programs. For all periods presented, anti-dilutive stock options were excluded from the calculation of diluted earnings per share. Cumulative treasury stock acquired, less cumulative shares reissued, have been excluded in determining the average number of shares outstanding.

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Earnings per share are calculated as follows (share information in thousands):

| | Quarter Ended June 30 | | Year to Date Ended June 30 | |
|--|-----------------------|---------|----------------------------|---------|
| | 2015 | 2014 | 2015 | 2014 |
| Net income attributable to common shareholders | \$ 19.1 | \$ 26.1 | \$ 57.3 | \$ 36.0 |
| Average shares outstanding - Basic | 56,670 | 57,273 | 56,777 | 57,612 |
| Add potential effect of exercise of stock options and other unvested equity awards | 1,229 | 887 | 1,166 | 887 |
| Average shares outstanding - Diluted | 57,899 | 58,160 | 57,943 | 58,499 |
| Net income attributable to common shareholders per common share - Basic | \$ 0.34 | \$ 0.46 | \$ 1.01 | \$ 0.62 |
| Net income attributable to common shareholders per common share - Diluted | \$ 0.33 | \$ 0.45 | \$ 0.99 | \$ 0.61 |
| Shares with anti-dilutive effect excluded from the computation of Diluted EPS | 239 | 746 | 457 | 497 |

11. Common Stock

The stock-based compensation cost that was charged against income, net of tax, for all plans was \$2.5 million and \$8.9 million for the quarterly and year to date periods ended June 30, 2015 and \$2.7 million and \$8.4 million for the comparable prior year periods.

12. Guarantees

We routinely grant limited warranties on our products with respect to defects in material and workmanship. The terms of these warranties are generally one year, however, certain components and products have substantially longer warranty periods. We recognize a reserve with respect to these obligations at the time of product sale, with subsequent warranty claims recorded directly against the reserve. The amount of the warranty reserve is determined based on historical trend experience for the covered products. For more significant warranty-related matters which might require a broad-based correction, separate reserves are established when such events are identified and the cost of correction can be reasonably estimated. The existing broad-based corrections do not limit the manufacture, sale or ongoing use of these products.

A reconciliation of changes in the warranty reserve for the periods covered in this report is as follows:

| | Quarter Ended June 30 | | Year to Date Ended June 30 | |
|--|-----------------------|---------|----------------------------|---------|
| | 2015 | 2014 | 2015 | 2014 |
| Balance at beginning of period | \$ 27.2 | \$ 34.1 | \$ 28.4 | \$ 38.1 |
| Provision for warranties during the period | 5.8 | 0.7 | 12.3 | 7.9 |
| Warranty reserves acquired | 1.1 | - | 2.2 | - |
| Warranty claims during the period | (4.7) | (5.8) | (13.5) | (17.0) |
| Balance at end of period | \$ 29.4 | \$ 29.0 | \$ 29.4 | \$ 29.0 |

In the normal course of business we enter into various other guarantees and indemnities in our relationships with suppliers, service providers, customers, business partners and others. Examples of these arrangements would include guarantees of product performance, indemnifications to service providers and indemnifications of our actions to business partners. These guarantees and indemnifications have not historically had, nor do we expect them to have, a material impact on our financial condition or results of operations, although indemnifications associated with our actions generally have no dollar limitations.

In conjunction with our acquisition and divestiture activities, we have entered into select guarantees and indemnifications of performance with respect to the fulfillment of commitments under applicable purchase and sale agreements. With respect to sale transactions, we also routinely enter into non-competition agreements for varying periods of time. Guarantees and indemnifications with respect to acquisition and divestiture activities, if triggered, could have a materially adverse impact on our financial condition and results of operations.

13. Segment Reporting

We disclose segment information that is consistent with the way in which management operates and views the business. Our operating structure contains the following reporting segments:

- North America - sells and rents our patient support and near-patient technologies and services, as well as our clinical workflow solutions, in the U.S. and Canada.
 - Surgical and Respiratory Care - sells and rents our surgical and respiratory care products.
- International - sells and rents similar products as our North America segment in regions outside of the U.S. and Canada.

Our performance under each reportable segment is measured on a divisional income basis before non-allocated operating and administrative costs, acquisition-related intangible asset amortization, impairments, litigation, and special charges. Divisional income generally represents the division's gross profit less its direct operating costs along with an allocation of manufacturing and distribution costs, research and development and certain corporate functional expenses.

Non-allocated operating and administrative costs include functional expenses that support the entire organization such as administration, finance, legal and human resources, expenses associated with strategic developments, acquisition-related intangible asset amortization, and other events that are not indicative of operating trends. We exclude such amounts from divisional income to allow management to evaluate and understand divisional operating trends without the effects of such items.

| | Quarter Ended June 30 | | Year to Date Ended June 30 | |
|--|-----------------------|---------|----------------------------|------------|
| | 2015 | 2014 | 2015 | 2014 |
| Revenue: | | | | |
| North America | \$252.4 | \$211.6 | \$ 724.5 | \$ 641.6 |
| Surgical and Respiratory Care | 119.7 | 66.2 | 366.0 | 195.1 |
| International | 102.4 | 119.8 | 323.8 | 369.6 |
| Total revenue | \$474.5 | \$397.6 | \$ 1,414.3 | \$ 1,206.3 |
| Divisional income: | | | | |
| North America | \$51.3 | \$40.0 | \$ 142.1 | \$ 115.5 |
| Surgical and Respiratory Care | 18.2 | 17.5 | 55.9 | 47.8 |
| International | 1.9 | 4.7 | 9.1 | 15.4 |
| Other operating costs: | | | | |
| Non-allocated operating and administrative costs | 35.7 | 21.2 | 106.3 | 59.1 |
| Special charges | 4.4 | 3.0 | 11.9 | 32.4 |
| Operating profit | 31.3 | 38.0 | 88.9 | 87.2 |
| Interest expense | (3.3) | (2.5) | (9.5) | (6.8) |
| Investment income and other, net | - | 0.8 | 2.2 | 0.6 |
| Income before income taxes | \$28.0 | \$36.3 | \$ 81.6 | \$ 81.0 |

14. Commitments and Contingencies

General

We are subject to various claims and contingencies arising out of the normal course of business, including those relating to governmental investigations and proceedings, commercial transactions, product liability, employee related matters, antitrust, safety, health, taxes, environmental and other matters. Litigation is subject to many uncertainties and the outcome of individual litigated matters is not predictable with assurance. It is possible that some litigation matters for which reserves have not been established could be decided unfavorably to us, and that any such unfavorable decisions could have a material adverse effect on our financial condition, results of operations and cash flows.

We are also involved in other possible claims, including product and general liability, workers' compensation, auto liability and employment related matters. Such claims in the United States have deductibles and self-insured retentions ranging from \$25 thousand to \$1.0 million per occurrence or per claim, depending upon the type of coverage and policy period. International deductibles and self-insured retentions are lower. We are also generally self-insured up to certain stop-loss limits for certain employee health benefits, including medical, drug and dental. Our policy is to estimate reserves based upon a number of factors including known claims, estimated incurred but not reported claims and outside actuarial analysis, which are based on historical information along with certain assumptions about future events. Such estimated reserves are classified as Other Current Liabilities and Other Long-Term Liabilities within the Condensed Consolidated Balance Sheets.

Universal Hospital Services, Inc. Litigation

On January 13, 2015, Universal Hospital Services, Inc. filed a complaint against us in the United States District Court for the Western District of Texas. The plaintiff alleges, among other things, that we engaged in certain customer contracting practices in violation of state and federal antitrust laws. The plaintiff also has asserted claims for tortious interference with business relationships. The plaintiff seeks injunctive relief and money damages in an unspecified amount. On March 23, 2015, we filed a motion to dismiss the complaint, however no ruling has been yet made on such motion, and we can make no assurances as to the outcome of such ruling. We believe that the allegations are without merit and intend to defend this matter vigorously.

Stryker Litigation

On April 4, 2011, we filed two separate actions against Stryker Corporation alleging infringement of certain Hill-Rom patents covering proprietary communications networks, status information systems and powered wheels used in our beds or stretchers. Both suits sought monetary damages and injunctions against Stryker for selling or distributing any beds, stretchers or ancillary products that infringe on Hill-Rom's patents. On August 14, 2012, we entered into a confidential favorable settlement agreement with Stryker Corporation to resolve our claims about our powered wheel patents, and on March 26, 2015, we entered into a confidential favorable settlement agreement with Stryker Corporation to resolve our claims about our status information systems. No trial date for the remaining claims covering proprietary communications networks has been set, and accordingly we cannot, at this time, assess the likelihood of any potential outcome or damages or other relief.

Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements and Factors That May Affect Future Results

Certain statements in this Quarterly Report on Form 10-Q contain forward-looking statements, within the meanings of the Private Securities Litigation Reform Act of 1995, regarding the Company's future plans, objectives, beliefs, expectations, representations and projections.

Forward-looking statements are not guarantees of future performance, and the Company's actual results could differ materially from those set forth in any forward-looking statements. For a more in depth discussion of factors that could cause actual results to differ from those contained in forward-looking statements, see the discussions under the heading "Risk Factors" in the Company's previously filed most recent Annual Report on Form 10-K for the fiscal year ended September 30, 2014 ("2014 Form 10-K"). The Company assumes no obligation to update or revise any forward-looking statements.

Overview

The following discussion and analysis should be read in conjunction with the accompanying interim financial statements and our 2014 Form 10-K.

Hill-Rom Holdings, Inc. ("we," "us," or "our") is a leading global medical technology company with approximately 8,000 employees worldwide. We partner with health care providers in more than 100 countries by focusing on patient care solutions that improve clinical and economic outcomes in five core areas: Advancing Mobility, Wound Care and Prevention, Clinical Workflow, Surgical Safety and Efficiency, and Respiratory Health. Around the world, Hill-Rom's people, products, and programs work towards one mission: Enhancing outcomes for patients and their caregivers.

Use of Non-GAAP Financial Measures

The accompanying Condensed Consolidated Financial Statements, including the related notes, are presented in accordance with accounting principles generally accepted in the U.S. ("GAAP"). We provide non-GAAP measures, including adjusted income before taxes, income tax expense and diluted earnings per share results, because we use these measures internally for planning, forecasting and evaluating the performance of the business.

In addition, we analyze net revenue on a constant currency basis to better measure the comparability of results between periods. We believe that evaluating growth in net revenue on a constant currency basis provides an additional and meaningful assessment to both management and investors.

We use these measures internally for planning, forecasting and evaluating the performance of the business. These measures should not, however, be considered in isolation, as a substitute for, or as superior to measures of financial performance prepared in accordance with GAAP.

Consolidated Results of Operations

In this section, we provide a high-level overview of our consolidated results of operations. Immediately following this section is a discussion of our results of operations by reportable segment. We disclose segment information that is consistent with the way in which management operates and views the business.

Our performance under each reportable segment is measured on a divisional income basis before non-allocated operating and administrative costs, acquisition-related intangible asset amortization, impairments, litigation, and special charges. Divisional income generally represents the division's gross profit less its direct operating costs along with an allocation of manufacturing and distribution costs, research and development and certain corporate functional expenses.

Net Revenue

| | Quarter Ended June 30 | | Percentage Change Constant | |
|----------------|----------------------------|------------|-------------------------------|----------|
| | 2015 | 2014 | As | Currency |
| | | | Reported | |
| Revenue: | | | | |
| Capital sales | \$ 376.8 | \$ 302.8 | 24.4 | 32.7 |
| Rental revenue | 97.7 | 94.8 | 3.1 | 5.5 |
| Total Revenue | \$ 474.5 | \$ 397.6 | 19.3 | 26.2 |
| | | | | |
| | Year to Date Ended June 30 | | Percentage Change Constant | |
| | 2015 | 2014 | As | Currency |
| | | | Reported | |
| Revenue: | | | | |
| Capital sales | \$ 1,125.9 | \$ 911.9 | 23.5 | 30.4 |
| Rental revenue | 288.4 | 294.4 | (2.0) | (0.1) |
| Total Revenue | \$ 1,414.3 | \$ 1,206.3 | 17.2 | 23.0 |

Capital sales increased for the three- and nine-month periods ended June 30, 2015 due to the Trumpf acquisition and higher patient support systems and clinical workflow solutions sales in our North America segment, partially offset by lower sales in our International segment on a reported basis, though they were flat on a constant currency basis. Additionally, somewhat higher organic sales in our Surgical and Respiratory segment favorably impacted both the three- and nine-month periods. Excluding Trumpf, organic sales increased 7.3 and 5.3 percent on a reported basis, or 12.8 and 9.9 percent on a constant currency basis, for the quarterly and year to date periods.

Rental revenue increased 3.1 percent for the quarter due to higher volumes resulting from recent contract wins in North America. For the year to date period, rental revenue decreased 2.0 percent due to lower revenue in both the International and North America segments, partially offset by an increase in the Surgical and Respiratory segment. On a constant currency basis, year to date rental revenue was essentially flat. Excluding the effects of our discontinuance of third-party payer therapy product rentals, rental revenue increased 6.8 and 2.9 percent for the three- and nine-month periods ended June 30, 2015. The North America decrease for the nine-month period was driven by the discontinuance of third-party payer therapy product rentals and continued pricing pressure, but was partially offset by improving volumes due to recent contract wins. International rental revenue was down sharply on a reported basis in both the three- and nine-month periods, but was down only approximately 2 percent on a constant currency basis. In Surgical and Respiratory Care, rental revenue has been relatively flat year over year.

Gross Profit

| | Quarter Ended June 30 | | Percentage Change | |
|----------------------------|----------------------------|----------|-------------------|-------|
| | 2015 | 2014 | | |
| Gross Profit | | | | |
| Capital | \$ 158.9 | \$ 134.6 | | 18.1 |
| Percent of Related Revenue | 42.2 | 44.5 | % | % |
| Rental | | | | |
| | 50.6 | 52.5 | | (3.6) |
| Percent of Related Revenue | 51.8 | 55.4 | % | % |
| Total Gross Profit | | | | |
| | \$ 209.5 | \$ 187.1 | | 12.0 |
| Percent of Total Revenue | 44.2 | 47.1 | % | % |
| | Year to Date Ended June 30 | | Percentage Change | |
| | 2015 | 2014 | | |
| Gross Profit | | | | |
| Capital | \$ 473.6 | \$ 403.0 | | 17.5 |
| Percent of Related Revenue | 42.1 | 44.2 | % | % |
| Rental | | | | |
| | 150.0 | 163.6 | | (8.3) |
| Percent of Related Revenue | 52.0 | 55.6 | % | % |
| Total Gross Profit | | | | |
| | \$ 623.6 | \$ 566.6 | | 10.1 |
| Percent of Total Revenue | 44.1 | 47.0 | % | % |

Capital gross profit increased 18.1 percent for the quarter and 17.5 percent the year, while gross margin decreased 230 basis points and 210 basis points for the three- and nine-month periods ended June 30, 2015. The margin rate decrease for the three- and nine-month periods is primarily driven by the impact of dilutive Trumpf margins, incremental field corrective action charges of \$3.6 million and \$6.6 million for the three- and nine-months ended June 30, 2015, respectively, and the prior year recognition of a \$0.3 million and \$2.8 million benefit from a change in our employee benefits program. The nine-month period ended June 30, 2015 also includes recognition of \$4.8 million of inventory step-up associated with purchase accounting for the Trumpf acquisition. Excluding the aforementioned items, organic capital margins decreased 60 basis points for the quarter and increased 40 basis points for the year to date. The margin changes for the quarter and year to date periods are primarily driven by pricing pressure, which has been more than offset by portfolio mix on a year to date basis.

Rental gross profit decreased 3.6 and 8.3 percent and gross margin decreased 360 basis points for both the three- and nine-month periods ended June 30, 2015. The margin declines for the three- and nine-month periods are partially driven by the prior year recognition of a \$0.2 million and \$2.9 million benefit from the employee benefit program change referenced earlier, in addition to continued pricing pressure and higher field service costs and depreciation on the incremental capital expenditures necessary to serve recent contract wins in North America.

Other

| | Quarter Ended June 30 | | Year to Date Ended June 30 | |
|-------------------------------------|-----------------------|---------|----------------------------|---------|
| | 2015 | 2014 | 2015 | 2014 |
| Research and development expenses | \$23.3 | \$17.5 | \$67.3 | \$50.3 |
| Percent of Total Revenue | 4.9 | % 4.4 | % 4.8 | % 4.2 |
| Selling and administrative expenses | \$150.5 | \$128.6 | \$455.5 | \$396.7 |
| Percent of Total Revenue | 31.7 | % 32.3 | % 32.2 | % 32.9 |
| Special charges | \$4.4 | \$3.0 | \$11.9 | \$32.4 |
| Interest expense | \$(3.3) | \$(2.5) | \$(9.5) | \$(6.8) |
| Investment income and other, net | \$- | \$0.8 | \$2.2 | \$0.6 |

Research and development expenses increased 33.1 and 33.8 percent for the three- and nine-month periods ended June 30, 2015 primarily due to the addition of Trumpf spending and additional investment in organic product development initiatives. Selling and administrative expenses as a percent of total revenue decreased 60 basis points for the three-month period and 70 basis points for the nine-month period despite higher variable compensation costs due to an unusually low comparable in the prior year. The improvements were due to operating leverage associated with higher revenue and ongoing cost control initiatives. Selling and administrative expenses include acquisition and integration costs, acquisition-related intangible asset amortization, FDA remediation expenses, and litigation settlements and expenses that totaled \$16.1 million and \$40.5 million for the quarter and year to date ended June 30, 2015 and \$10.6 million and \$29.7 million in the prior year comparable periods. Excluding these items, as well as the favorable impact of an employee benefits change of \$0.6 million and \$6.6 million recorded in the comparable prior year periods, selling and administrative expenses decreased 150 and 170 basis points as a percentage of revenue for the three- and nine-month periods ended June 30, 2015, respectively.

Site Consolidation

In the third quarter of fiscal 2015, we initiated a plan to streamline our operations and simplify our supply chain by consolidating certain manufacturing and distribution operations. As part of this action, we have announced the closure of sites in Redditch, England and Charleston, South Carolina. Upon closure, each site's operations will either be relocated to other existing Company facilities or outsourced to third-party suppliers. For the quarter and year to date ended June 30, 2015, we recorded severance and benefit charges of \$2.0 million for approximately 160 employees to be displaced by the closures, as well as \$0.2 million of other related costs. We expect to incur approximately \$4 million of additional charges over the next year for personnel costs and site closure expenses related to this action until the closures are complete.

Global Restructuring Program

During the second quarter of fiscal 2014, we announced a global restructuring program focused on improving our cost structure. This action included early retirement and reduction in force programs that eliminated over 200 net positions, primarily in the U.S., where the action was substantially completed in fiscal 2014 with cash expenditures continuing during fiscal 2015. The program also included a reduction of our European manufacturing capacity and a streamlining of global operations by, among other things, executing a back office process transformation program in Europe. The restructuring in Europe is in process and has resulted in severance and benefit charges of \$0.4 million and \$5.0 million for the quarter and year to date ended June 30, 2015, as well as other costs of \$1.8 and \$5.2 million over the same periods related to legal and professional fees, temporary labor, project management, and other administrative functions. In the second quarter of fiscal 2015, we also reversed \$0.5 million of previously recorded

severance and benefit charges due to certain plan participants declining continuing healthcare coverage.

Since the inception of the global restructuring program through June 30, 2015, we have recognized aggregate special charges of \$34.6 million, which are recorded in both fiscal 2014 and 2015. Charges of \$3.2 and \$20.1 million were recorded in the quarter and year to date ended June 30, 2014, net of reversals. We expect to incur \$8 to \$13 million of additional European restructuring costs through the completion of the program. Upon completion and full implementation, we expect this program to yield annual cost savings of approximately \$30 million. These amounts remain consistent with our initially disclosed estimates.

Discontinuance of Third-Party Payer Rentals

Also during the second quarter of fiscal 2014, we initiated a plan to discontinue third-party payer rentals of therapy products occurring primarily in home care settings. Special charges recorded for this action included a \$7.7 million non-cash tangible asset impairment charge, a \$2.0 million charge for severance and other benefits for approximately 70 eliminated positions, and \$1.6 million in other related costs, net of a reversal of \$0.2 million which was recorded in the third quarter of fiscal 2014. This action is substantially complete.

Batesville Manufacturing Early Retirement Program

During the first quarter of fiscal 2014, we initiated a plan to improve our cost structure and streamline our organization by offering an early retirement program to certain manufacturing employees in our Batesville, Indiana plant, meeting specific eligibility requirements, and other minor reduction in force actions. These programs resulted in the elimination of approximately 35 positions and required recognition of a special charge of approximately \$1 million for lump sum payments under the program and severance and other benefits provided to other affected employees. This action was substantially complete by the end of the second quarter of fiscal 2014.

Reported and Adjusted Earnings

| | Quarter Ended June 30, 2015 | | | | Quarter Ended June 30, 2014 | | |
|---|-----------------------------|--------------------|----------|--------------|-----------------------------|--------------------|-------------|
| | Income Before Taxes | Income Tax Expense | NCI | Diluted EPS# | Income Before Taxes | Income Tax Expense | Diluted EPS |
| GAAP Earnings | \$28.0 | \$9.3 | \$(0.4) | \$0.33 | \$36.3 | \$ 10.2 | \$0.45 |
| Adjustments: | | | | | | | |
| Acquisition and integration costs | 6.8 | 2.3 | - | 0.08 | 2.8 | 1.0 | 0.03 |
| Acquisition-related intangible asset amortization | 7.7 | 2.1 | - | 0.10 | 7.1 | 2.1 | 0.08 |
| Employee benefits change | - | - | - | - | (1.2) | (0.4) | (0.01) |
| FDA remediation expenses | 1.3 | 0.4 | - | 0.02 | 1.1 | 0.5 | 0.01 |
| Field corrective actions | 2.6 | 0.8 | - | 0.03 | (1.0) | 0.2 | (0.02) |
| Litigation settlements and expenses | 0.3 | 0.1 | - | - | - | - | - |
| Special charges | 4.4 | 0.9 | - | 0.06 | 3.0 | 0.2 | 0.05 |
| Adjusted Earnings | \$51.1 | \$15.9 | \$(0.4) | \$0.62 | \$48.1 | \$ 13.8 | \$0.59 |

| | Year to Date Ended June 30, 2015 | | | | Year to Date Ended June 30, 2014 | | |
|---|----------------------------------|--------------------|----------|---------------|----------------------------------|--------------------|-------------|
| | Income Before Taxes | Income Tax Expense | NCI | Diluted EPS** | Income Before Taxes | Income Tax Expense | Diluted EPS |
| GAAP Earnings | \$81.6 | \$24.7 | \$(0.4) | \$0.99 | \$81.0 | \$ 45.0 | \$0.61 |
| Adjustments: | | | | | | | |
| Acquisition and integration costs | 19.5 | 6.3 | - | 0.23 | 6.4 | 2.2 | 0.07 |
| Acquisition-related intangible asset amortization | 23.4 | 6.5 | - | 0.29 | 20.9 | 6.3 | 0.25 |
| Employee benefits change | - | - | - | - | (13.4) | (5.1) | (0.14) |
| FDA remediation expenses | 3.0 | 1.0 | - | 0.03 | 2.8 | 1.1 | 0.03 |

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| | | | | | | | |
|-------------------------------------|---------|--------|----------|---------|---------|---------|---------|
| Field corrective actions | 4.9 | 1.5 | - | 0.06 | (1.7) | (0.6) | (0.02) |
| Litigation settlements and expenses | (0.6) | (0.2) | - | (0.01) | - | - | - |
| Special charges | 11.9 | 1.2 | - | 0.18 | 32.4 | 10.5 | 0.37 |
| Foreign valuation allowance | - | 1.9 | - | (0.03) | - | (19.6) | 0.34 |
| Adjusted Earnings | \$143.7 | \$42.9 | \$(0.4) | \$1.75 | \$128.4 | \$39.8 | \$1.51 |

* Does not add due to rounding.

Diluted EPS column is shown on an attributable to common shareholders basis.

NCI = Net loss attributable to noncontrolling interests.

The effective tax rates for the three- and nine-month periods ended June 30, 2015 were 33.2 percent and 30.3 percent compared to 28.1 and 55.6 percent for the comparable periods in the prior year.

The effective rate for the current quarter is higher than the comparable period in fiscal 2014 due primarily to lower earnings in favorable rate jurisdictions. The effective tax rate for the first nine months of fiscal 2015 is lower than the comparable period in fiscal 2014 due primarily to the \$19.6 million of tax expense recognized in the prior year to establish a valuation allowance on the net deferred tax assets in France. This compares to \$3.5 million of tax benefits for the year to date period ended June 30, 2015 primarily related to the reversal of previously recorded valuation allowances in Australia, and the one-time catch-up tax benefit from the reinstatement of the research and development tax credit.

On December 19, 2014, the Tax Increase Prevention Act of 2014 (the Tax Act) was signed into law. The Tax Act retroactively extended the research and development tax credit for one year beginning January 1, 2014 through December 31, 2014. This credit had previously expired effective December 31, 2013.

We expect the reinstatement of the research and development tax credit to favorably impact the effective tax rate for fiscal 2015 by nearly \$2 million through a combination of a one-time catch-up adjustment from the reinstatement of the credit recorded in our first quarter of fiscal 2015 and the inclusion of the limited current year research credit into the fiscal 2015 effective tax rate.

The adjusted effective tax rate for the three- and nine-month periods ended June 30, 2015 was 31.1 and 29.9 percent compared to 28.7 and 31.0 percent for the comparable periods in the prior year.

Net income attributable to common shareholders was \$19.1 million for the quarter ended June 30, 2015 compared to \$26.1 million in the prior year period. On an adjusted basis, quarterly net income attributable to common shareholders increased \$1.3 million, or 3.8 percent. Diluted earnings per share for the quarter decreased 26.7 percent from the prior year on a reported basis but increased 5.1 percent on an adjusted basis. Net income attributable to common shareholders for the year to date period was \$57.3 million compared to \$36.0 million in the prior year. On an adjusted basis, year to date net income attributable to common shareholders increased \$12.6 million, or 14.2 percent. Diluted earnings per share for the year to date increased 62.3 percent on a reported basis and 15.9 percent on an adjusted basis.

Business Segment Results of Operations

| | Quarter Ended June 30 | | Percentage Change Constant | |
|-------------------------------|-----------------------|----------|-------------------------------|----------|
| | 2015 | 2014 | As Reported | Currency |
| Revenue: | | | | |
| North America | \$ 252.4 | \$ 211.6 | 19.3 | 20.0 |
| Surgical and Respiratory Care | 119.7 | 66.2 | 80.8 | 94.0 |
| International | 102.4 | 119.8 | (14.5) | (0.3) |
| Total revenue | \$ 474.5 | \$ 397.6 | 19.3 | 26.2 |

| | | | | |
|-------------------------------|---------|---------|---------|--|
| Divisional income: | | | | |
| North America | \$ 51.3 | \$ 40.0 | 28.3 | |
| Surgical and Respiratory Care | \$ 18.2 | \$ 17.5 | 4.0 | |
| International | \$ 1.9 | \$ 4.7 | (59.6) | |

| | Year to Date Ended June 30 | | Percentage Change Constant | |
|-------------------------------|----------------------------|------------|-------------------------------|----------|
| | 2015 | 2014 | As Reported | Currency |
| Revenue: | | | | |
| North America | \$ 724.5 | \$ 641.6 | 12.9 | 13.5 |
| Surgical and Respiratory Care | 366.0 | 195.1 | 87.6 | 99.3 |
| International | 323.8 | 369.6 | (12.4) | (1.0) |
| Total revenue | \$ 1,414.3 | \$ 1,206.3 | 17.2 | 23.0 |

Divisional income:

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| | | | |
|-------------------------------|----------|----------|---------|
| North America | \$ 142.1 | \$ 115.5 | 23.0 |
| Surgical and Respiratory Care | \$ 55.9 | \$ 47.8 | 16.9 |
| International | \$ 9.1 | \$ 15.4 | (40.9) |

North America

North America revenue increased 19.3 and 12.9 percent on a reported basis for the three- and nine-month periods ended June 30, 2015. Capital sales were up 23.9 and 19.5 percent for the three- and nine-month periods primarily due to higher sales of patient support system and clinical workflow solution products. Rental revenue increased by 8.9 percent for the three-month period and decreased 0.8 percent for the nine-month period. The increase in the three-month period is the result of improved volumes from recent contract wins. Negatively impacting rental revenue in both the three- and nine-month periods is the discontinuance of third-party payer therapy product rentals in the second half of fiscal 2014, along with continued pricing pressure. Excluding the effects of our discontinuance of third-party payer therapy product rentals, rental revenue increased 14.7 and 6.3 percent for the three- and nine-month periods ended June 30, 2015.

North America divisional income increased 28.3 and 23.0 percent for the three- and nine-month periods ended June 30, 2015 due primarily to increased revenue and the resulting increase in gross profit. Capital margins decreased slightly for the three-month period due to pricing pressure and were essentially flat for the nine-month period. Rental margins declined during both periods as a result of continued pricing pressure, along with our increased investment in additional capacity to meet the higher volumes in fiscal 2015 from recent contract wins. Divisional income benefited from improved leverage of operating expenses on higher revenue for both the quarterly and year to date periods.

Surgical and Respiratory Care

Surgical and Respiratory Care revenue increased 80.8 and 87.6 percent for the three- and nine-month periods ended June 30, 2015. Excluding Trumpf, revenue for the three-month period increased 2.1 percent on a reported basis driven by surgical sales. Organic revenue for the nine-month period ended June 30, 2015 increased 2.5 percent on a reported basis due to both higher respiratory and surgical sales. Capital sales increased 107.8 and 113.2 percent for the three- and nine-month periods primarily due to the Trumpf acquisition. Rental revenue in respiratory care has been relatively flat over the year.

Surgical and Respiratory Care divisional income increased 4.0 and 16.9 percent for the three- and nine-month periods ended June 30, 2015 due to the incremental gross profit from the Trumpf acquisition, but at a lower rate given the lower Trumpf margins. Divisional income excluding Trumpf was impacted by increased investments in research and development and sales channel to support growth initiatives.

International

International revenue decreased 14.5 and 12.4 percent on a reported basis, or 0.3 and 1.0 percent on a constant currency basis for the three- and nine-month periods ended June 30, 2015. Capital sales decreased 14.1 and 12.1 percent on a reported basis, and 0.2 and 0.9 percent on a constant currency basis due to lower volumes in Europe and Latin America. International rental revenue decreased 18.0 and 14.6 percent on a reported basis, and 1.5 and 2.0 percent on a constant currency basis for the three- and nine-month periods ended June 30, 2015 due to continued volume and pricing pressures.

International divisional income decreased for the three- and nine-month periods ended June 30, 2015 due primarily to lower revenue and the resulting decline in gross profit, partially offset by lower selling and administrative expenses, along with some unfavorable foreign currency impact. Capital margins decreased for the quarter, but were essentially flat for the year to date period. Rental margins decreased for the nine-month period ended June 30, 2015 due to reduced leverage of our fleet and field service infrastructure as revenue has declined quicker than our field service costs, along with continued pricing pressure.

Liquidity and Capital Resources

| | Year to Date Ended June 30 | |
|--|----------------------------|------------|
| | 2015 | 2014 |
| Cash Flows Provided By (Used In): | | |
| Operating activities | \$ 124.4 | \$ 134.2 |
| Investing activities | (104.4) | (50.3) |
| Financing activities | 9.5 | (99.0) |
| Effect of exchange rate changes on cash | (5.4) | (0.4) |
| Increase (Decrease) in Cash and Cash Equivalents | \$ 24.1 | \$ (15.5) |

Operating Activities

Cash provided by operating activities totaled \$124.4 million year to date in fiscal 2015. Operating cash flows were driven by net income adjusted up for non-cash expenses, partially offset by changes in working capital. Cash provided by operating activities decreased 7 percent from the comparable period in fiscal 2014, primarily due to changes in working capital, most notably in accounts receivable and through higher payments of restructuring liabilities and income taxes during the current year.

Investing Activities

Cash used for investing activities was \$104.4 million during fiscal 2015. The investing activities consist mainly of capital expenditures, which increased significantly from the prior year due to investments in our rental fleet to support volume increases from recent rental contract wins.

Financing Activities

Cash provided by financing activities was \$9.5 million during fiscal 2015 and consisted mainly of borrowings on the revolving credit facility, offset by treasury stock acquired and dividend payments. The financing proceeds support the higher rental fleet investment referenced earlier and treasury stock repurchases. The net cash provided by financing activities in fiscal 2015 compares to a net use of cash in fiscal 2014, with the fluctuation primarily driven by increased borrowings, lower treasury stock purchases, and lower debt payments compared with the prior year.

Other Liquidity Matters

Net cash flows from operating activities and selected borrowings have represented our primary sources of funds for growth of the business, including capital expenditures and acquisitions.

Prior to May 1, 2015, we had a credit facility that provided for revolving loans of up to \$500.0 million, plus a term loan in the aggregate amount of \$200.0 million. Borrowings under the credit facility and term loan bore interest at variable rates specified therein, that were less than 2.0 percent.

On May 1, 2015, we entered into an Amended and Restated Credit Agreement (the "Current Credit Facility") with the lenders named therein, JPMorgan Chase Bank, N.A., as Administrative agent, and each of Citizens Bank, N.A. Bank of America, N.A. and PNC Bank, National Association, as Co-Syndication Agents, which amended and restated our prior credit facility, entered into August 24, 2012. The Current Credit Facility provides for revolving loans of up to \$900.0 million at any time outstanding plus term loans in the current principal amount of \$165.0 million. We currently have \$360.0 million of outstanding borrowings and undrawn letters of credit of \$5.1 million under the revolving loan portion of the Current Credit Facility, leaving \$534.9 million of available borrowing capacity.

All revolving loans under the Current Credit Facility mature May 1, 2020. The term loans will continue to amortize so that \$40.0 million of the remaining principal will be repaid through August 24, 2017, with the balance due at such date.

Borrowings under the Current Credit Facility bear interest based on a margin (which varies dependent upon the Company's credit rating) over certain pre-defined index rates, selected at the Company's option that are currently less than 2 percent. The Current Credit Facility is guaranteed by several fully owned subsidiaries of the Company. The Current Credit Facility contains terms and conditions, events of default, and customary covenants, including requiring that (1) the Company maintain a ratio of Consolidated Indebtedness to Consolidated EBITDA of not more than 3.50:1.0; and (2) a ratio of Consolidated EBITDA to interest expense of not less than 3.00:1.0. We are in compliance with all of our debt covenants as of June 30, 2015.

We believe that cash on hand and generated from operations, along with amounts available under the Current Credit Facility, will be sufficient to fund operations, working capital needs, capital expenditure requirements and financing obligations. However, disruption and volatility in the credit markets could impede our access to capital. As of May 1, 2015, our \$900 million revolving credit facility is with a syndicate of banks. The syndication group consists of twelve financial institutions, which we believe reduces our exposure to any one institution and would still leave us with

significant borrowing capacity in the event that any one of the institutions within the group is unable to comply with the terms of our agreement

We have trade finance credit lines and uncommitted letter of credit facilities. These lines are associated with the normal course of business and we had \$1.3 million of outstanding standby letters of credit as of June 30, 2015.

We are exposed to market risk from fluctuations in interest rates. The Company sometimes manages its exposure to interest rate fluctuations through the use of interest rate swaps (cash flow hedges). As of June 30, 2015, we had one interest rate swap agreement with a notional amount of \$115.0 million to hedge the variability of cash flows associated with a portion of the term loan variable interest rate payments for the period of January 2014 to August 2017. The interest rate swap has been designated as a cash flow hedge. The interest rate swap fair value was a \$0.4 million liability as of June 30, 2015 and an asset of \$0.2 million as of September 30, 2014.

We have \$49.2 million of senior notes outstanding at various fixed interest rates as of June 30, 2015, classified as long-term in the Condensed Consolidated Balance Sheet.

Our primary pension plan invests in a variety of equity and debt securities. At September 30, 2014, our latest measurement date, our pension plans were underfunded by approximately \$67.7 million. Given the current funded status, we currently do not anticipate any further contributions to our master pension plan in fiscal 2015.

We intend to continue to pay quarterly cash dividends comparable to those paid in the periods covered by these financial statements. However, the declaration and payment of dividends by us will be subject to the sole discretion of our Board and will depend upon many factors, including our financial condition, earnings, capital requirements, covenants associated with debt obligations, legal requirements and other factors deemed relevant by our Board.

Over the long term, we intend to continue to pursue inorganic growth in certain areas of our business, but the timing, size or success of any acquisition effort and the related potential capital commitments cannot be predicted.

During the first quarter of fiscal 2015, we purchased 1.2 million shares of our common stock for \$54.8 million in the open market, leaving \$64.7 million available for purchase. The common stock was acquired under a \$190 million share repurchase program approved by the Board of Directors in September 2013, which does not have an expiration date. There are no plans to terminate this program in the future, but with the pending acquisition of Welch Allyn as outlined in Note 3 of the Notes to Condensed Consolidated Financial Statements and the increased borrowings we intend to incur to finance the acquisition, we will suspend our share repurchase activity temporarily to focus on deleveraging. Repurchases may be made on the open market or via private transactions, and are used for general business purposes.

As of June 30, 2015, \$55.0 million of the Company's cash and cash equivalents are held by our subsidiaries in foreign countries. Portions of this may be subject to U.S. income taxation if repatriated to the U.S. However, cash and cash equivalents held by foreign subsidiaries are largely used for operating needs outside the U.S. Therefore, we have no need to repatriate this cash for other uses. We believe that cash on hand and generated from operations, along with amounts available under our credit facility, will be sufficient to fund operations, working capital needs, capital expenditure requirements and financing obligations.

Financing of Welch Allyn Acquisition

In connection with the Welch Allyn acquisition, Hill-Rom intends to refinance its existing debt and fund the purchase price of the acquisition with a combination of new debt and the issuance of Hill-Rom common stock. With respect to the new debt structure, Hill-Rom expects to enter into (i) a \$1.0 billion senior secured term loan A facility (the "TLA Facility"), (ii) an \$800 million senior secured term loan B facility (the "TLB Facility") and (iii) a \$500 million senior secured revolving facility (collectively with the TLA Facility and the TLB Facility, the "Senior Secured Facilities"). In addition, Hill-Rom may issue up to an additional \$425 million in debt pursuant to an unsecured note offering or unsecured bridge facility (the "Additional Debt Financing"). In connection with the execution of the merger agreement, Hill-Rom entered into a commitment letter with Goldman Sachs Bank USA and Goldman Sachs Lending Partners LLC and certain other financial institutions with respect to the above financing.

Proceeds from the Senior Secured Facilities and the Additional Debt Financing will be used to finance, in part, the cash consideration for the merger and to pay fees and expenses incurred in connection with the merger. Hill-Rom's debt outstanding as of June 30, 2015 was approximately \$578 million and, immediately after the completion of the merger, the combined company's debt is anticipated to be approximately \$2.3 billion. Based on assumed interest rates, leverage ratios and credit ratings, the combined company's debt service obligations, comprised of principal and interest (excluding capital leases), during the 12 months following the completion of the merger is expected to be

approximately \$150 million.

Credit Ratings

In July 2015, following the announcement and proposed financing of the Welch Allyn acquisition, Standard and Poor's Rating Services and Moody's Investor Service provided a credit rating downgrade to BB+ and (P)Ba2 with stable outlooks.

Contractual Obligations and Contingent Liabilities and Commitments

Other than the additional long-term borrowings on our revolving credit facility referenced in Note 5 of Notes to Condensed Consolidated Financial Statements in this Form 10-Q, there have not been any significant changes since September 30, 2014 impacting our contractual obligations and contingent liabilities and commitments.

Critical Accounting Policies

Our accounting policies require management to make significant estimates and assumptions using information available at the time the estimates are made. Such estimates and assumptions significantly affect various reported amounts of assets, liabilities, revenue and expenses. If future experience differs materially from these estimates and assumptions, our results of operations and financial condition could be affected. A detailed description of our accounting policies is included in Note 1 of Notes to Consolidated Financial Statements and the Critical Accounting Policies Section of Management's Discussion and Analysis of Financial Condition and Results of Operations included in our 2014 Form 10-K. There have been no material changes to such policies since September 30, 2014.

For a further summary of certain accounting policies and estimates and recently issued accounting pronouncements applicable to us, see Note 1 of Notes to Condensed Consolidated Financial Statements in this Form 10-Q.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

We are exposed to various market risks, including fluctuations in interest rates, collection risk associated with our accounts and notes receivable portfolio and variability in currency exchange rates. We have established policies, procedures and internal processes governing our management of market risks and the use of financial instruments to manage our exposure to such risks.

We are subject to variability in foreign currency exchange rates in our international operations. Exposure to this variability is periodically managed primarily through the use of natural hedges, whereby funding obligations and assets are both managed in the local currency. We, from time-to-time, enter into currency exchange agreements to manage our exposure arising from fluctuating exchange rates related to specific and forecasted transactions. We operate this program pursuant to documented corporate risk management policies and do not enter into derivative transactions for speculative purposes. The sensitivity of earnings and cash flows to variability in exchange rates is assessed by applying an appropriate range of potential rate fluctuations to our assets, obligations and projected results of operations denominated in foreign currencies.

Our currency risk consists primarily of foreign currency denominated firm commitments and forecasted foreign currency denominated intercompany and third-party transactions. At June 30, 2015, the notional amount of open foreign exchange contracts was \$4.0 million. The maximum length of time over which we hedge transaction exposures is 15 months. Derivative gains/(losses), initially reported as a component of Accumulated Other Comprehensive Loss, are reclassified to earnings in the period when the transaction affects earnings.

We are exposed to market risk from fluctuations in interest rates. The Company sometimes manages its exposure to interest rate fluctuations through the use of interest rate swaps (cash flow hedges). As of June 30, 2015, we had one interest rate swap agreement with a notional amount of \$115.0 million to hedge the variability of cash flows associated with a portion of the term loan variable interest rate payments for the period of January 2014 to August 2017. The interest rate swap has been designated as a cash flow hedge. The interest rate swap fair value was a \$0.4 million liability as of June 30, 2015 and an asset of \$0.2 million as of September 30, 2014.

For additional information on market risks related to our pension plan assets, see Item 7A, Quantitative and Qualitative Disclosures About Market Risk, in our 2014 Form 10-K.

Item 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, with the supervision and participation of our President and Chief Executive Officer and our Senior Vice President and Chief Financial Officer (the “Certifying Officers”), has evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of June 30, 2015. Our disclosure controls and procedures are designed to ensure that information required to be disclosed in the reports we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms and such information is accumulated and communicated to management, including our Certifying Officers and our Board of Directors, as appropriate to allow timely decisions regarding required disclosure. Based upon that evaluation, the Certifying Officers concluded that our disclosure controls and procedures were effective as of June 30, 2015.

Changes in Internal Control Over Financial Reporting

We completed the acquisition of Trumpf during our fiscal year 2014. Management considers this transaction to be material to our consolidated financial statements and believes that the internal controls and procedures of Trumpf have a material effect on our internal control over financial reporting. We are currently in the process of incorporating the internal controls and procedures of Trumpf into our internal controls over financial reporting and extending our Section 404 compliance program under the Sarbanes-Oxley Act of 2002 and the applicable rules and regulations under such Act to include Trumpf. We will report on our assessment of the consolidated operations within the time period provided by the Act and the applicable SEC rules and regulations concerning business combinations.

Additionally, during the first quarter of fiscal 2015, we transitioned certain Völker transaction processing functions to our primary enterprise resource planning (“ERP”) system and completed the migration in our third quarter of fiscal 2015. In connection with this transition, the affected Völker transactions are now subject to the internal controls applicable to our primary ERP system.

Other than the changes noted above, there have been no other changes to our internal controls over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during our most recent completed fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

Refer to Note 14 of Notes to Condensed Consolidated Financial Statements in this Form 10-Q for further information on our legal proceedings.

Item 1A. RISK FACTORS

For information regarding the risks we face, see the discussion under “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the year ended September 30, 2014. Except as described in the following paragraphs, there have been no material changes to the risk factors described in that report.

On June 16, 2015, we entered into an agreement to acquire Welch Allyn Holdings, Inc. (“Welch Allyn”), via a plan of merger. Below are risk factors related to such transaction, which we expect to close on or before October 1, 2015. Such risk factors have been adopted from our previously filed registration statement on Form S-4. They may not necessarily be indicative of risks which shareholders of Hill-Rom as of the date of the filing of this Form 10-Q may face.

Risks Relating to the Merger

There is no assurance when or if the merger will be completed. Any delay in completing the merger may substantially reduce the benefits that Hill-Rom and Welch Allyn expect to obtain from the merger.

Completion of the merger is subject to the satisfaction or waiver of a number of conditions as set forth in the merger agreement. There can be no assurance that Hill-Rom and Welch Allyn will be able to satisfy the closing conditions or that closing conditions beyond their control will be satisfied or waived. If the merger and the integration of the companies’ respective businesses are not completed within the expected timeframe, such delay may materially and adversely affect the synergies and other benefits that Hill-Rom and Welch Allyn expect to achieve as a result of the merger and could result in additional transaction costs, loss of revenue or other effects associated with uncertainty about the merger.

Hill-Rom and Welch Allyn can agree at any time to terminate the merger agreement, even if Welch Allyn shareholders have already adopted the merger agreement and thereby approved the merger and the other transactions contemplated by the merger agreement. Hill-Rom and Welch Allyn can also terminate the merger agreement under other specified circumstances.

Hill-Rom is expected to incur substantial expenses related to the merger and the integration of Welch Allyn.

Hill-Rom is expected to incur substantial expenses in connection with the merger and the integration of Welch Allyn. Specifically, based on estimates as of July 9, 2015, Hill-Rom expects to incur approximately \$30 million of transaction costs related to the merger. Additionally, there are a large number of processes, policies, procedures, operations, technologies and systems that must be integrated, including purchasing, accounting and finance, sales, billing, payroll, manufacturing, marketing and employee benefits. While Hill-Rom expects to incur integration and restructuring costs and other costs incurred to execute the transaction following completion of the merger in 2015 that are estimated to range between