

Hill-Rom Holdings, Inc.
Form 10-Q
February 03, 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 December 31, 2014

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 35-1160484
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

1069 State Route 46 East
Batesville, Indiana 47006-8835
(Address of principal executive offices) (Zip Code)

(812) 934-7777
(Registrant's telephone number, including area code)

Not Applicable
(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

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(§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes

No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company (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 – 56,506,661 shares as of January 26, 2015.

HILL-ROM HOLDINGS, INC.

INDEX TO FORM 10-Q

| | Page | |
|--------------------------------|--|----|
| PART I - FINANCIAL INFORMATION | | |
| Item 1 - | Financial Statements | |
| | <u>Condensed Consolidated Statements of Income</u> <u>(Unaudited) for the Quarterly Periods</u> <u>Ended December 31, 2014 and 2013</u> | 3 |
| | <u>Condensed Consolidated Statements of Comprehensive Income</u> <u>(Loss)</u> <u>(Unaudited) for the Quarterly Periods</u> <u>Ended December 31, 2014 and 2013</u> | 4 |
| | <u>Condensed Consolidated Balance Sheets (Unaudited) at</u> <u>December 31, 2014 and September 30, 2014</u> | 5 |
| | <u>Condensed Consolidated Statements of Cash Flows</u> <u>(Unaudited) for the Quarterly Periods</u> <u>Ended December 31, 2014 and 2013</u> | 6 |
| | <u>Notes to Condensed Consolidated Financial Statements</u> <u>(Unaudited)</u> | 7 |
| <u>Item 2 -</u> | <u>Management's Discussion and Analysis of</u> <u>Financial Condition and Results of Operations</u> | 17 |
| <u>Item 3 -</u> | <u>Quantitative and Qualitative Disclosures About Market Risks</u> | 24 |
| <u>Item 4 -</u> | <u>Controls and Procedures</u> | 24 |
| PART II - OTHER INFORMATION | | |
| <u>Item 1 -</u> | <u>Legal Proceedings</u> | 26 |
| <u>Item 1A -</u> | <u>Risk Factors</u> | 26 |
| <u>Item 2 -</u> | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 26 |
| <u>Item 6 -</u> | <u>Exhibits</u> | 27 |
| <u>SIGNATURES</u> | | 28 |

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 December 31 | |
|---|---------------------------|-----------|
| | 2014 | 2013 |
| Net Revenue | | |
| Capital sales | \$ 373.4 | \$ 295.5 |
| Rental revenue | 91.6 | 97.9 |
| Total revenue | 465.0 | 393.4 |
| Cost of Revenue | | |
| Cost of goods sold | 220.5 | 171.2 |
| Rental expenses | 44.6 | 45.4 |
| Total cost of revenue | 265.1 | 216.6 |
| Gross Profit | 199.9 | 176.8 |
| Research and development expenses | 21.8 | 16.4 |
| Selling and administrative expenses | 155.1 | 138.0 |
| Special charges (Note 8) | 3.7 | 1.0 |
| Operating Profit | 19.3 | 21.4 |
| Interest expense | (3.2) | (2.0) |
| Investment income and other, net | 0.9 | - |
| Income Before Income Taxes | 17.0 | 19.4 |
| Income tax expense (Note 9) | 4.9 | 6.2 |
| Net Income | \$ 12.1 | \$ 13.2 |
| Net Income per Common Share - Basic | \$ 0.21 | \$ 0.23 |
| Net Income per Common Share - Diluted | \$ 0.21 | \$ 0.22 |
| Dividends per Common Share | \$ 0.1525 | \$ 0.1375 |
| Average Common Shares Outstanding - Basic (thousands) (Note 10) | 57,137 | 58,230 |
| Average Common Shares Outstanding - Diluted (thousands) (Note 10) | 58,154 | 59,142 |

See Notes to Condensed Consolidated Financial Statements

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

| | Quarter Ended December 31 | |
|--|---------------------------|---------|
| | 2014 | 2013 |
| Net Income | \$ 12.1 | \$ 13.2 |
| Other Comprehensive Income (Loss), net of tax (Note 7): | | |
| Available-for-sale securities and currency hedges | (0.4) | 0.1 |
| Foreign currency translation adjustment | (22.6) | 5.8 |
| Change in pension and postretirement defined benefit plans | 0.9 | 0.6 |
| Total Other Comprehensive Income (Loss), net of tax | (22.1) | 6.5 |
| Total Comprehensive Income (Loss) | \$ (10.0) | \$ 19.7 |

See Notes to Condensed Consolidated Financial Statements

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

| | December 31, 2014 | September 30, 2014 |
|---|----------------------|-----------------------|
| ASSETS | | |
| Current Assets | | |
| Cash and cash equivalents | \$ 113.7 | \$ 99.3 |
| Trade accounts receivable, net of allowances (Note 2) | 374.9 | 411.0 |
| Inventories (Note 2) | 171.3 | 176.2 |
| Deferred income taxes (Notes 1 and 9) | 41.5 | 40.9 |
| Other current assets | 54.8 | 51.9 |
| Total current assets | 756.2 | 779.3 |
| Property, plant and equipment, net (Note 2) | 287.4 | 261.5 |
| Goodwill (Note 4) | 395.7 | 399.8 |
| Software and other intangible assets, net (Note 2) | 247.6 | 261.1 |
| Deferred income taxes (Notes 1 and 9) | 22.8 | 23.0 |
| Other assets | 26.5 | 27.4 |
| Total Assets | \$ 1,736.2 | \$ 1,752.1 |
| LIABILITIES | | |
| Current Liabilities | | |
| Trade accounts payable | \$ 100.7 | \$ 112.7 |
| Short-term borrowings (Note 5) | 127.5 | 126.9 |
| Accrued compensation | 62.2 | 89.2 |
| Accrued product warranties (Note 12) | 28.0 | 28.4 |
| Other current liabilities | 81.2 | 85.1 |
| Total current liabilities | 399.6 | 442.3 |
| Long-term debt (Note 5) | 454.8 | 364.9 |
| Accrued pension and postretirement benefits (Note 6) | 76.3 | 76.9 |
| Deferred income taxes (Notes 1 and 9) | 32.1 | 31.0 |
| Other long-term liabilities | 31.1 | 30.5 |
| Total Liabilities | 993.9 | 945.6 |
| Commitments and Contingencies (Note 14) | | |
| SHAREHOLDERS' EQUITY | | |
| Common Stock (Note 2) | 4.4 | 4.4 |
| Additional paid-in-capital | 135.4 | 134.1 |
| Retained earnings | 1,503.2 | 1,499.8 |
| Accumulated other comprehensive loss (Note 7) | (96.2) | (74.1) |
| Treasury stock, at cost (Note 2) | (804.5) | (757.7) |
| Total Shareholders' Equity | 742.3 | 806.5 |
| Total Liabilities and Shareholders' Equity | \$ 1,736.2 | \$ 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)

| | Quarter Ended December 31 | |
|---|---------------------------|---------|
| | 2014 | 2013 |
| Operating Activities | | |
| Net income | \$ 12.1 | \$ 13.2 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 17.3 | 16.9 |
| Amortization | 2.9 | 4.0 |
| Acquisition-related intangible asset amortization | 8.1 | 6.9 |
| Provision for deferred income taxes | 0.3 | (6.6) |
| Gain on disposal of property, equipment leased to others, intangible assets and impairments | (0.3) | (0.2) |
| Stock compensation | 4.7 | 3.6 |
| Excess tax benefits from employee stock plans | (1.0) | 0.8 |
| Change in working capital excluding cash, current investments, current debt, acquisitions and dispositions: | | |
| Trade accounts receivable | 36.1 | 35.5 |
| Inventories | 4.3 | (2.3) |
| Other current assets | (3.2) | 3.0 |
| Trade accounts payable | (16.0) | (9.6) |
| Accrued expenses and other liabilities | (30.6) | (26.6) |
| Other, net | (3.7) | 3.7 |
| Net cash provided by operating activities | 31.0 | 42.3 |
| Investing Activities | | |
| Capital expenditures and purchases of intangible assets | (44.9) | (16.8) |
| Proceeds on sale of property and equipment leased to others | 0.5 | 0.5 |
| Payment for acquisition of businesses, net of cash acquired | - | (1.3) |
| Refund on acquisition of businesses | - | 4.6 |
| Net cash used in investing activities | (44.4) | (13.0) |
| Financing Activities | | |
| Net change in short-term debt | (0.7) | (0.1) |
| Borrowings on revolving credit facility | 95.0 | 7.0 |
| Proceeds from long-term debt | - | 0.6 |
| Payment of long-term debt | (3.8) | (2.5) |
| Purchase of noncontrolling interest | (1.0) | (0.7) |
| Payment of cash dividends | (8.6) | (7.9) |
| Proceeds on exercise of stock options | 4.7 | 6.5 |
| Proceeds from stock issuance | 0.7 | 0.7 |
| Excess tax benefits from employee stock plans | 1.0 | (0.8) |
| Treasury stock acquired | (56.9) | (42.1) |
| Net cash provided by (used in) financing activities | 30.4 | (39.3) |

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| | | |
|---|----------|----------|
| Effect of exchange rate changes on cash | (2.6) | 0.2 |
| Net Cash Flows | 14.4 | (9.8) |
| Cash and Cash Equivalents: | | |
| At beginning of period | 99.3 | 127.4 |
| At end of period | \$ 113.7 | \$ 117.6 |

See Notes to Condensed Consolidated Financial Statements

6

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 wholly-owned 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. Intercompany accounts and transactions have been eliminated in consolidation.

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 December 31, 2014, we had \$27.4 million of valuation allowances on deferred tax assets, on a tax-effected basis, primarily related to foreign operating loss carryforwards and other tax attributes. 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.

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. This guidance will be effective for us in the first quarter of fiscal 2018, ending December 31, 2017. Early adoption is not permitted. We are currently in the process of evaluating the impact of adoption of this ASU on our Consolidated Financial Statements.

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

| | December 31, 2014 | September 30, 2014 |
|--|----------------------|-----------------------|
| Allowance for possible losses and discounts on trade receivables | \$ 30.0 | \$ 31.4 |
| Inventories: | | |
| Finished products | \$ 88.8 | \$ 93.5 |
| Raw materials and work in process | 82.5 | 82.7 |
| Total inventory | \$ 171.3 | \$ 176.2 |
| Accumulated depreciation of property, plant and equipment | \$ 593.3 | \$ 588.1 |
| Accumulated amortization of software and other intangible assets | \$ 291.4 | \$ 283.3 |

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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 | 56,495,427 | 57,439,911 |

| | | |
|-----------------|------------|------------|
| Treasury shares | 23,828,485 | 22,884,001 |
|-----------------|------------|------------|

8

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 the 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 \$229.9 million (\$223.6 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. During the first quarter of 2015, we made certain adjustments to the opening balance sheet as of the acquisition date. These results are preliminary and subject to normal true-up provisions in the purchase agreement and other fair value adjustments.

| | Amount |
|---|----------|
| Trade receivables | \$ 66.3 |
| Inventory | 63.9 |
| Other current assets | 24.3 |
| Property, plant, and equipment | 42.1 |
| Goodwill | 59.0 |
| 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 | 14.9 |
| Current liabilities | (72.3) |
| Long term debt | (6.0) |
| Noncurrent liabilities | (8.1) |
| Total purchase price | \$ 229.9 |

Goodwill was allocated entirely to our Surgical and Respiratory Care segment. The goodwill related to the acquired German operations will be tax deductible 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 \$60 million for the quarter ended December 31, 2013. 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 pro forma 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.

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 | - | 1.7 | - | 1.7 |
| Currency translation effect | - | (4.6) | (1.2) | (5.8) |
| Balances at December 31, 2014: | | | | |
| Goodwill | 390.6 | 330.6 | 147.3 | 868.5 |
| Accumulated impairment losses | (358.1) | - | (114.7) | (472.8) |
| Goodwill, net at December 31, 2014 | \$ 32.5 | \$ 330.6 | \$ 32.6 | \$395.7 |

As discussed in Note 3, we recorded an adjustment to goodwill during the first quarter of fiscal 2015 related to the Trumpf acquisition completed during the fourth quarter of fiscal 2014.

5. Financing Agreements

Total debt consists of the following:

| | December 31, 2014 | September 30, 2014 |
|---|----------------------|-----------------------|
| Revolving credit facility | \$ 360.0 | \$ 265.0 |
| Term loan current portion | 17.5 | 16.2 |
| Term loan long-term portion | 155.0 | 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 | 0.6 | 1.4 |
| Total debt | 582.3 | 491.8 |
| Less current portion of debt | 127.5 | 126.9 |
| Total long-term debt | \$ 454.8 | \$ 364.9 |

We have a credit facility that provides for revolving loans of up to \$500.0 million, plus a term loan in the aggregate amount of \$200.0 million. The Company may request to increase the revolving loan commitment and the amount of the term loan by up to an additional \$250.0 million. All amounts due under the credit facility mature upon expiration on August 24, 2017. The related term loan amortizes so that 37.5 percent of the principal will be repaid over the five year term, with the balance due at maturity. Borrowings under the credit facility and term loan bear interest at variable rates specified therein, that are currently less than 2.0 percent, and the availability of borrowings is subject to our ability at the time of borrowing to meet certain specified conditions, including compliance with covenants contained in the credit agreement governing the facility. The credit facility contains covenants that, among other

matters, require us to maintain a ratio of consolidated indebtedness to consolidated EBITDA (each as defined in the credit agreement) of not more than 3.5:1.0 and a ratio of consolidated EBITDA to interest expense of not less than 3.5:1.0. As of December 31, 2014, we had outstanding borrowings of \$360.0 million and undrawn letters of credit of \$5.3 million under the revolving credit facility, leaving \$134.7 million of borrowing capacity available. We are in compliance with all of our debt covenants as of December 31, 2014.

Unsecured debentures outstanding at December 31, 2014 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 December 31, 2014 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 \$40.9 million and \$42.4 million of outstanding standby letters of credit as of December 31, 2014 and September 30, 2014. As of December 31, 2014, \$38.3 million relates to one standby letter of credit issued in connection with the Trumpf acquisition to guarantee Trumpf's outstanding debt, which we paid off during the fourth quarter of fiscal 2014. The expiration date for this letter of credit is January 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 December 31, 2014, we had one interest rate swap agreement with a notional amount of \$122.5 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 \$0.1 million liability as of December 31, 2014 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 \$56.3 million at December 31, 2014 and \$55.5 million at 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 \$171.7 million and \$175.2 million based on quoted prices for similar liabilities at December 31, 2014 and September 30, 2014. 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.

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 December 31 | |
|--|---------------------------|--------|
| | 2014 | 2013 |
| Service cost | \$ 1.4 | \$ 1.2 |
| Interest cost | 3.7 | 3.6 |
| Expected return on plan assets | (4.3) | (4.2) |
| Amortization of unrecognized prior service cost, net | 0.1 | 0.2 |
| Amortization of net loss | 1.4 | 0.8 |
| Net pension expense | \$ 2.3 | \$ 1.6 |

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.

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 \$4.2 million and \$3.7 million in each of the quarterly periods ended December 31, 2014 and 2013.

7. Other Comprehensive Income

The following table represents the changes in accumulated other comprehensive loss by component:

| | Quarter Ended December 31, 2014 | | | | | | Accumulated other comprehensive loss | | |
|--|-----------------------------------|-----------------------|-----------|----------|------------|-----------|--------------------------------------|--------------|----------------|
| | Other comprehensive income (loss) | | | Tax | | | Beginning balance | Net activity | Ending balance |
| | Prior reclassification | Reclassification from | Pre-tax | effect | Net of tax | tax | | | |
| Available-for-sale securities and currency hedges | \$(0.6) | \$ - | \$(0.6) | \$0.2 | \$(0.4) | \$ - | \$(0.4) | \$(0.4) | |
| Foreign currency translation adjustment | (22.6) | - | (22.6) | - | (22.6) | (34.2) | (22.6) | (56.8) | |
| Change in pension and postretirement defined benefit plans | 0.1 | 1.3 | 1.4 | (0.5) | 0.9 | (39.9) | 0.9 | (39.0) | |
| Total | \$(23.1) | \$ 1.3 | \$(21.8) | \$(0.3) | \$(22.1) | \$(74.1) | \$(22.1) | \$(96.2) | |

| | Quarter Ended December 31, 2013 | | | | | | Accumulated other comprehensive loss | | |
|--|---------------------------------|--------------------------|---------|----------|------------|-----------|--------------------------------------|--------------|----------------|
| | Other comprehensive income | | | Tax | | | Beginning balance | Net activity | Ending balance |
| | Prior reclassification | to Reclassification from | Pre-tax | effect | Net of tax | tax | | | |
| Available-for-sale securities and currency hedges | \$0.1 | \$ - | \$0.1 | \$- | \$0.1 | \$(0.3) | \$ 0.1 | \$(0.2) | |
| Foreign currency translation adjustment | 5.8 | - | 5.8 | - | 5.8 | (4.6) | 5.8 | 1.2 | |
| Change in pension and postretirement defined benefit plans | 0.2 | 0.8 | 1.0 | (0.4) | 0.6 | (30.8) | 0.6 | (30.2) | |
| Total | \$6.1 | \$ 0.8 | \$6.9 | \$(0.4) | \$6.5 | \$(35.7) | \$ 6.5 | \$(29.2) | |

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

| | Quarter Ended December 31 | | | | | |
|--|---------------------------|------------|------------|---------------------|------------|------------|
| | 2014 | | | 2013 | | |
| | Amount reclassified | Tax effect | Net of tax | Amount reclassified | Tax effect | Net of tax |
| Change in pension and postretirement defined benefit plans (a) | \$1.3 | \$(0.5) | \$0.8 | \$0.8 | \$(0.3) | \$0.5 |

(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.

8. Special Charges

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., which was substantially completed in fiscal 2014 with cash expenditures continuing during fiscal 2015. The program is also reducing our European manufacturing capacity and streamlining our global operations by, among other things, executing a back office process transformation program in Europe. The restructuring in Europe is in process and, for the first quarter of fiscal 2015, has resulted in severance and benefit charges of \$2.3 million and other costs of \$1.4 million related to legal and professional fees, temporary labor, project management, and other administrative functions. Since the inception of the global restructuring program through December 31, 2014, we have recognized aggregate special charges of \$28.6 million, which are recorded in both fiscal 2014 and 2015. We expect to incur \$15 million to \$20 million of additional European restructuring costs through the completion of the 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. The reserve activity for severance and other benefits during fiscal 2015 was as follows:

| | |
|-------------------------------|--------|
| Balance at September 30, 2014 | \$11.7 |
| Expenses | 2.3 |
| Cash Payments | (3.5) |
| Reversals | - |
| Balance at December 31, 2014 | \$10.5 |

9. Income Taxes

On December 19, 2014, the President signed into law the Tax Increase Prevention Act of 2014 (the Tax Act). 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.

The effective tax rate for the three-month period ended December 31, 2014 was 28.8 percent compared to 32.0 percent for the comparable period in the prior year. The lower tax rate is due to the recognition of period tax benefits principally related to the retroactive reinstatement of the research and development tax credit in the current year.

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.

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

| | Quarterly Period Ended December | |
|--|---------------------------------|---------|
| | 2014 | 2013 |
| Net income | \$ 12.1 | \$ 13.2 |
| Average shares outstanding - Basic | 57,137 | 58,230 |
| Add potential effect of exercise of stock options and other unvested equity awards | 1,017 | 912 |
| Average shares outstanding - Diluted | 58,154 | 59,142 |
| Net income per common share - Basic | \$ 0.21 | \$ 0.23 |

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| | | |
|---|---------|---------|
| Net income per common share - Diluted | \$ 0.21 | \$ 0.22 |
| Shares with anti-dilutive effect excluded from the computation of Diluted EPS | 461 | 375 |

13

11. Common Stock

The stock-based compensation cost that was charged against income, net of tax, for all plans was \$3.0 million for the quarterly period ended December 31, 2014 and \$2.3 million for the comparable prior year period.

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 December 31 | |
|--|---------------------------|---------|
| | 2014 | 2013 |
| Balance at beginning of period | \$ 28.4 | \$ 38.1 |
| Provision for warranties during the period | 2.9 | 4.6 |
| Warranty reserves acquired | 1.1 | - |
| Warranty claims during the period | (4.4) | (5.4) |
| Balance at end of period | \$ 28.0 | \$ 37.3 |

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 December 31 | |
|--|---------------------------|----------|
| | 2014 | 2013 |
| Revenue: | | |
| North America | \$ 225.2 | \$ 205.5 |
| Surgical and Respiratory Care | 126.3 | 63.3 |
| International | 113.5 | 124.6 |
| Total revenue | \$ 465.0 | \$ 393.4 |
| Divisional income: | | |
| North America | \$ 38.5 | \$ 28.0 |
| Surgical and Respiratory Care | 19.4 | 14.6 |
| International | 2.8 | 5.5 |
| Other operating costs: | | |
| Non-allocated operating and administrative costs | 37.7 | 25.7 |
| Special charges | 3.7 | 1.0 |
| Operating profit | 19.3 | 21.4 |
| Interest expense | (3.2) | (2.0) |
| Investment income and other, net | 0.9 | - |
| Income before income taxes | \$ 17.0 | \$ 19.4 |

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. We believe that the allegations are without merit and intend to defend this matter vigorously.

15. Subsequent Events

During January 2015, we acquired access to two new technologies in our clinical focus areas of respiratory care and surgical safety and efficiency. Total investment spending was \$7.5 million, along with the potential for an additional investment of up to \$2.5 million over time. These investments were funded with available cash on hand.

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") as well as the discussions in this "Management's Discussion and Analysis". 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 more than 7,000 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 December 31 | | Percentage Change | |
|----------------|---------------------------|----------|-------------------|-------------------|
| | 2014 | 2013 | As Reported | Constant Currency |
| Revenue: | | | | |
| Capital sales | \$ 373.4 | \$ 295.5 | 26.4 | 30.4 |
| Rental revenue | 91.6 | 97.9 | (6.4) | (5.4) |
| Total Revenue | \$ 465.0 | \$ 393.4 | 18.2 | 21.5 |

Capital sales increased for the three-month period ended December 31, 2014 due to the Trumpf acquisition and higher patient support systems sales in our North America segment, partially offset by lower sales in our International segment. Excluding Trumpf, organic sales increased 6.3 percent, or 8.9 percent on a constant currency basis, and orders in our North America segment improved year over year. Our International segment sales declined due to order delays in Europe.

Rental revenue declined in the North America and International segments for the three-month period, which was partially offset by improved Surgical and Respiratory Care rental revenue. The North America decline was driven primarily by the discontinuance of third-party payer therapy product rentals and continued pricing pressure. In Surgical and Respiratory Care, revenue increased on higher respiratory care volumes and organic growth from recent product introductions. International rental revenue decreased 11.8 percent on a reported basis and 5.9 percent on a constant currency basis due to continued volume and pricing pressure.

Gross Profit

| | Quarter Ended December | | Percentage Change |
|----------------------------|------------------------|------------|-------------------|
| | 2014 | 31 2013 | |
| Gross Profit | | | |
| Capital | \$ 152.9 | \$ 124.3 | 23.0 |
| Percent of Related Revenue | 40.9% | 42.1% | |
| Rental | \$ 47.0 | \$ 52.5 | (10.5) |
| Percent of Related Revenue | 51.3% | 53.6% | |
| Total Gross Profit | \$ 199.9 | \$ 176.8 | 13.1 |
| Percent of Total Revenue | 43.0% | 44.9% | |

Capital gross profit increased 23.0 percent, while gross margin decreased 120 basis points for the three-month period ended December 31, 2014. The margin rate decrease is due to the recognition of \$4.8 million of inventory step-up during the first quarter of fiscal 2015 associated with purchase accounting for the Trumpf acquisition. All inventory step-up related to the Trumpf acquisition has now been recognized. We experienced improved margins in our North America and International segments and in our organic Surgical and Respiratory Care product lines, but these were offset by the lower Trumpf margins currently being experienced.

Rental gross profit decreased 10.5 percent and gross margin decreased 230 basis points for the three-month period ended December 31, 2014. This margin decline is due to continued pricing pressure, along with reduced leverage of our fleet and field service infrastructure as we have invested in additional capacity in anticipation of higher volumes in fiscal 2015 from recent contract wins.

Other

| | Quarter Ended December 31 | |
|-------------------------------------|---------------------------|-----------|
| | 2014 | 2013 |
| Research and development expenses | \$ 21.8 | \$ 16.4 |
| Percent of Total Revenue | 4.7% | 4.2% |
| Selling and administrative expenses | \$ 155.1 | \$ 138.0 |
| Percent of Total Revenue | 33.4% | 35.1% |
| Special charges | \$ 3.7 | \$ 1.0 |
| Interest expense | \$ (3.2) | \$ (2.0) |
| Investment income and other, net | \$ 0.9 | \$ - |

Research and development expenses increased 32.9 percent for the three-month period ended December 31, 2014 primarily due to the addition of Trumpf spending and additional investment in new product development initiatives. As a percentage of total revenue, selling and administrative expenses decreased for the period by 170 basis points due to higher revenue and ongoing cost control initiatives. However, the \$17.1 million increase in selling and administrative expenses is driven primarily by the acquisition of Trumpf, along with higher acquisition and integration, medical device tax, and variable compensation costs, all of which are partially offset by ongoing cost control initiatives.

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., which was substantially completed in fiscal 2014 with cash expenditures continuing during fiscal 2015. The program is also reducing our European manufacturing capacity and streamlining our global operations by, among other things, executing a back office process transformation program in Europe. The restructuring in Europe is in process and, for the first quarter of fiscal 2015, has resulted in severance and benefit charges of \$2.3 million and other costs of \$1.4 million related to legal and professional fees, temporary labor, project management, and other administrative functions. Since the inception of the global restructuring program through December 31, 2014, we have recognized aggregate special charges of \$28.6 million, which are recorded in both fiscal 2014 and 2015. We expect to incur \$15 million to \$20 million of additional European restructuring costs through the completion of the program. All these actions are anticipated to yield annual cost savings of approximately \$30 million, once all actions are fully implemented.

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 December 31, 2014 | | | Quarter Ended December 31, 2013 | | |
|---|-------------------------------------|--------------------------|----------------|-------------------------------------|--------------------------|-----------------|
| | Income Before Income Taxes | Income Tax Expense | Diluted EPS | Income Before Income Taxes | Income Tax Expense | Diluted EPS* |
| GAAP Earnings | \$17.0 | \$4.9 | \$0.21 | \$19.4 | \$6.2 | \$ 0.22 |
| Adjustments: | | | | | | |
| Acquisition and integration costs | 8.9 | 2.8 | 0.10 | 1.9 | 0.6 | 0.02 |
| Acquisition-related intangible asset amortization | 8.1 | 2.2 | 0.10 | 6.9 | 2.2 | 0.08 |
| FDA remediation expenses | 0.5 | 0.2 | 0.01 | 0.9 | 0.4 | 0.01 |
| Field corrective actions | 1.1 | 0.5 | 0.01 | 1.2 | 0.4 | 0.01 |
| Special charges | 3.7 | 0.2 | 0.06 | 1.0 | 0.4 | 0.01 |
| Adjusted Earnings | \$39.3 | \$10.8 | \$0.49 | \$31.3 | \$10.2 | \$ 0.36 |

* Does not add due to rounding.

On December 19, 2014, the President signed into law the Tax Increase Prevention Act of 2014 (the Tax Act). 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.

The effective tax rate for the three-month period ended December 31, 2014 was 28.8 percent compared to 32.0 percent for the comparable period in the prior year. The lower tax rate is due to the recognition of period tax benefits principally related to the retroactive reinstatement of the research and development tax credit in the current year.

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-month period ended December 31, 2014 was 27.5 compared to 32.6 percent for the comparable period in the prior year. The lower rate in fiscal 2015 is due primarily to the benefit of lower taxes on foreign earnings and the effect of the research and development tax credit as outlined above.

Net income was \$12.1 million for the first quarter ended December 31, 2014 compared to \$13.2 million in the prior year period. On an adjusted basis, net income increased \$7.4 million, or 35.1 percent. Diluted earnings per share decreased 4.5 percent on a reported basis and increased 36.1 percent on an adjusted basis.

Business Segment Results of Operations

| | Quarter Ended December 31 | | Percentage Change | |
|---------------|---------------------------|----------|-------------------|----------------------|
| | 2014 | 2013 | As Reported | Constant Currency |
| Revenue: | | | | |
| North America | \$ 225.2 | \$ 205.5 | 9.6 | 9.9 |

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| | | | | |
|-------------------------------|----------|----------|--------|-------|
| Surgical and Respiratory Care | 126.3 | 63.3 | 99.5 | 106.2 |
| International | 113.5 | 124.6 | (8.9) | (2.5) |
| Total revenue | \$ 465.0 | \$ 393.4 | 18.2 | 21.5 |
| Divisional income: | | | | |
| North America | \$ 38.5 | \$ 28.0 | 37.5 | |
| Surgical and Respiratory Care | \$ 19.4 | \$ 14.6 | 32.9 | |
| International | \$ 2.8 | \$ 5.5 | (49.1) | |

20

North America

North America revenue increased 9.6 percent for the three-month period ended December 31, 2014. Capital sales were up for the quarter by 19.0 percent primarily due to higher patient support system sales. Rental revenue declined in the period by 8.9 percent, which is primarily due to our discontinuance of third-party payer therapy product rentals in the second half of fiscal 2014 and continued pricing pressure. Excluding the effects of our discontinuance of third-party payer therapy product rentals, rental revenue would have declined 1 percent.

North America divisional income increased 37.5 percent for the three-month period due primarily to increased revenue, slightly lower operating costs as a result of our restructuring programs, and lower research and development costs. Capital margins improved for the three-month period due to higher volume and lower direct input costs. Rental margins declined during the period as a result of continued pricing pressures along with decreased leverage of our fleet and field service infrastructure due to lower rental revenue.

Surgical and Respiratory Care

Surgical and Respiratory Care revenue doubled for the three-month period ended December 31, 2014. Excluding the impact of Trumpf, organic revenue grew approximately 6 percent on a reported and constant currency basis. Capital sales increased 127.1 percent related to the impact of the Trumpf acquisition and higher volumes in the organic business. Rental revenue increased 10.1 percent for the three-month period on higher respiratory care volumes and organic growth from recent product introductions.

Surgical and Respiratory Care divisional income increased on the higher sales volumes and the resulting higher gross profit, despite the lower gross margins currently being experienced at Trumpf. Divisional income was also favorably impacted by improved leverage of operating expenses as a percentage of revenue.

International

International revenue decreased 8.9 percent on a reported basis and 2.5 percent on a constant currency basis for the three-month period ended December 31, 2014. Capital sales decreased 8.6 percent on a reported basis and 2.1 percent on a constant currency basis due to order delays in Europe. Sales in our other international regions tend to fluctuate based on the timing of large tender deals, while Europe's healthcare environment continues to face pressure on capital spending. Rental revenue decreased 11.8 percent on a reported basis or 5.9 percent on a constant currency basis, due to continued volume and pricing pressure.

International divisional income decreased for the three-month period due primarily to lower revenue and the resulting decline in gross profit, partially offset by slightly lower operating costs. Capital margins improved for the three-month period on favorable product mix, but rental margins decreased 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. Overall, gross margins were nearly flat year over year.

Liquidity and Capital Resources

| | Quarter Ended December 31 | |
|---|---------------------------|---------|
| | 2014 | 2013 |
| Cash Flows Provided By (Used In): | | |
| Operating activities | \$ 31.0 | \$ 42.3 |
| Investing activities | (44.4) | (13.0) |
| Financing activities | 30.4 | (39.3) |
| Effect of exchange rate changes on cash | (2.6) | 0.2 |

| | | |
|--|---------|-----------|
| Increase (Decrease) in Cash and Cash Equivalents | \$ 14.4 | \$ (9.8) |
|--|---------|-----------|

Operating Activities

Cash provided by operating activities during the first quarter of fiscal 2015 was driven primarily by net income, adjusted for the non-cash effects of depreciation, amortization, and stock compensation expense, along with traditional collections of high year-end receivables. These sources of cash were offset by the payout of our performance-based compensation related to our 2014 fiscal year and other working capital activities. Cash provided by operating activities was down compared to the prior year primarily on higher payments of taxes, restructuring obligations, and high year-end accounts payable.

Investing Activities

Cash used for investing activities consists mainly of capital expenditures, which increased significantly from the prior year due to investments in our rental fleet to support expected future volume increases from recent contract wins, along with the additional capital expenditures from our Trumpf acquisition.

Financing Activities

Cash provided by financing activities during fiscal 2015 consisted mainly of borrowings on the revolving credit facility, partially 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 in fiscal 2015 compares to net cash used in fiscal 2014 to pay down debt, acquire treasury stock, and pay dividends.

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.

We have a credit facility that provides for revolving loans of up to \$500.0 million, plus a term loan in the aggregate amount of \$200.0 million. The Company may request to increase the revolving loan commitment and the amount of the term loan by up to an additional \$250.0 million. All amounts due under the credit facility mature upon expiration on August 24, 2017. The related term loan amortizes so that 37.5 percent of the principal will be repaid over the five year term, with the balance due at maturity. Borrowings under the credit facility and term loan bear interest at variable rates specified therein, that are currently less than 2.0 percent, and the availability of borrowings is subject to our ability at the time of borrowing to meet certain specified conditions, including compliance with covenants contained in the credit agreement governing the facility. The credit facility contains covenants that, among other matters, require us to maintain a ratio of consolidated indebtedness to consolidated EBITDA (each as defined in the credit agreement) of not more than 3.5:1.0 and a ratio of consolidated EBITDA to interest expense of not less than 3.5:1.0. As of December 31, 2014, we had outstanding borrowings of \$360.0 million and undrawn letters of credit of \$5.3 million under the revolving credit facility, leaving \$134.7 million of borrowing capacity available. We are in compliance with all of our debt covenants as of December 31, 2014.

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 \$40.9 million and \$42.4 million of outstanding standby letters of credit as of December 31, 2014 and September 30, 2014. As of December 31, 2014, \$38.3 million relates to one standby letter of credit issued in connection with the Trumpf acquisition to guarantee Trumpf's outstanding debt, which we paid off during the fourth quarter of fiscal 2014. The expiration date for this letter of credit is January 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 December 31, 2014, we had one interest rate swap agreement with a notional amount of \$122.5 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 \$0.1 million liability as of December 31, 2014 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 December 31, 2014, 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.

We intend to continue to pursue selective acquisition candidates 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. We expect to fund future acquisitions primarily with cash on hand, cash flow from operations and borrowings.

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. Repurchases may be made on the open market or via private transactions, and are used for general business purposes.

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. However, disruption and volatility in the credit markets could impede our access to capital. Our \$500.0 million revolving credit facility is with a syndicate of banks. The syndication group consists of 11 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.

As of December 31, 2014, \$65.5 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.

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 December 31, 2014, the notional amount of open foreign exchange contracts was \$8.4 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 December 31, 2014, we had one interest rate swap agreement with a notional amount of \$122.5 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 \$0.1 million liability as of December 31, 2014 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

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 of December 31, 2014. 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 December 31, 2014.

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. In connection with this transition, the affected Völker transactions are now subject to the internal controls applicable to our primary ERP system. We are in the process of migrating additional Völker transaction processes to our primary ERP system, which is expected to be completed in our third fiscal quarter.

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. There have been no material changes to the risk factors described in that report.

Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

| Period | Total Number of Shares Purchased (1) | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (2) | Approximate Dollar Value of Shares That May Yet Be Purchased Under the Programs (2) |
|--------------------------------------|--|------------------------------------|--|--|
| October 1, 2014 - October 31, 2014 | 2,489 | \$41.92 | - | \$ 119.5 |
| November 1, 2014 - November 30, 2014 | 643,440 | \$45.00 | 600,000 | \$ 92.4 |
| December 1, 2014 - December 31, 2014 | 603,636 | \$46.17 | 600,000 | \$ 64.7 |
| Total | 1,249,565 | \$45.56 | 1,200,000 | \$ 64.7 |

(1) Shares purchased during the quarter ended December 31, 2014 were in connection with the share repurchase program discussed below as well as employee payroll tax withholding for restricted and deferred stock distributions.

(2) In September 2013, the Board approved an expansion of its previously announced share repurchase authorization to a total of \$190.0 million. As of December 31, 2014, a cumulative total of \$125.3 million has been used under this existing authorization. The plan does not have an expiration date and currently there are no plans to terminate this program in the future.

Item 6. EXHIBITS

A. Exhibits

- | | |
|---------|---|
| 10.1 | Employment Agreement between Hill-Rom Holdings, Inc. and Carlyn Solomon (Incorporated by reference to Exhibit 10.1 filed with the Company's Form 8-K on October 9, 2014). |
| 10.2 | Employment Agreement between Hill-Rom Holdings, Inc. and Steven J. Strobel (Incorporated by reference to Exhibit 10.1 filed with the Company's Form 8-K on October 27, 2014). |
| 10.3 | Employment Agreement between Hill-Rom Holdings, Inc. and Michiel de Zwaan, dated August 4, 2014 |
| 31.1 | Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2 | Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32.1 | Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2 | Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Taxonomy Extension Schema Document |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.LAB | XBRL Extension Labels Linkbase Document |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document |

SIGNATURES

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

HILL-ROM HOLDINGS, INC.
(Registrant)

DATE: February 3, 2015

By: /s/ Steven J. Strobel
Name: Steven J. Strobel
Title: Senior Vice President and Chief Financial Officer
(duly authorized officer and principal financial officer)