

Hill-Rom Holdings, Inc.
Form 10-Q
May 05, 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 March 31, 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 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 – 56,660,230 shares as of April 27, 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 (Loss) (Unaudited)

(In millions, except per share data)

	Quarter Ended March 31		Year to Date Ended March 31	
	2015	2014	2015	2014
Net Revenue				
Capital sales	\$375.7	\$313.6	\$ 749.1	\$ 609.1
Rental revenue	99.1	101.7	190.7	199.6
Total revenue	474.8	415.3	939.8	808.7
Cost of Revenue				
Cost of goods sold	213.9	169.5	434.4	340.7
Rental expenses	46.7	43.1	91.3	88.5
Total cost of revenue	260.6	212.6	525.7	429.2
Gross Profit	214.2	202.7	414.1	379.5
Research and development expenses	22.2	16.4	44.0	32.8
Selling and administrative expenses	149.9	130.1	305.0	268.1
Special charges (Note 8)	3.8	28.4	7.5	29.4
Operating Profit	38.3	27.8	57.6	49.2
Interest expense	(3.0)	(2.3)	(6.2)	(4.3)
Investment income and other, net	1.3	(0.2)	2.2	(0.2)
Income Before Income Taxes	36.6	25.3	53.6	44.7
Income tax expense (Note 9)	10.5	28.6	15.4	34.8
Net Income (Loss)	\$26.1	\$(3.3)	\$ 38.2	\$ 9.9
Net Income (Loss) per Common Share - Basic	\$0.46	\$(0.06)	\$ 0.67	\$ 0.17
Net Income (Loss) per Common Share - Diluted	\$0.45	\$(0.06)	\$ 0.66	\$ 0.17
Dividends per Common Share	\$0.1600	\$0.1525	\$ 0.3125	\$ 0.2900
Average Common Shares Outstanding - Basic (thousands) (Note 10)	56,544	57,303	56,841	57,781
Average Common Shares Outstanding - Diluted (thousands) (Note 10)	57,610	57,303	57,894	58,612

See Notes to Condensed Consolidated Financial Statements

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Hill-Rom Holdings, Inc. and Subsidiaries

Condensed Consolidated Statements of Comprehensive Income (Loss) (Unaudited)

(In millions)

	Quarter Ended March 31		Year to Date Ended March 31	
	2015	2014	2015	2014
Net Income (Loss)	\$26.1	\$(3.3)	\$ 38.2	\$ 9.9
Other Comprehensive Income (Loss), net of tax (Note 7):				
Available-for-sale securities and currency hedges	(0.2)	0.1	(0.6)	0.2
Foreign currency translation adjustment	(48.0)	(0.2)	(70.6)	5.6
Change in pension and postretirement defined benefit plans	0.9	0.5	1.8	1.1
Total Other Comprehensive Income (Loss), net of tax	(47.3)	0.4	(69.4)	6.9
Total Comprehensive Income (Loss)	\$(21.2)	\$(2.9)	\$ (31.2)	\$ 16.8

See Notes to Condensed Consolidated Financial Statements

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

	March 31, 2015	September 30, 2014
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 114.5	\$ 99.3
Trade accounts receivable, net of allowances (Note 2)	368.0	411.0
Inventories (Note 2)	168.7	176.2
Deferred income taxes (Notes 1 and 9)	41.9	40.9
Other current assets	51.5	51.9
Total current assets	744.6	779.3
Property, plant and equipment, net (Note 2)	286.0	261.5
Goodwill (Note 4)	387.3	399.8
Software and other intangible assets, net (Note 2)	236.9	261.1
Deferred income taxes (Notes 1 and 9)	21.5	23.0
Other assets	29.9	27.4
Total Assets	\$ 1,706.2	\$ 1,752.1
LIABILITIES		
Current Liabilities		
Trade accounts payable	\$ 87.7	\$ 112.7
Short-term borrowings (Note 5)	128.7	126.9
Accrued compensation	76.1	89.2
Accrued product warranties (Note 12)	27.2	28.4
Other current liabilities	82.0	85.1
Total current liabilities	401.7	442.3
Long-term debt (Note 5)	449.8	364.9
Accrued pension and postretirement benefits (Note 6)	74.4	76.9
Deferred income taxes (Notes 1 and 9)	27.8	31.0
Other long-term liabilities	30.2	30.5
Total Liabilities	983.9	945.6
Commitments and Contingencies (Note 14)		
SHAREHOLDERS' EQUITY		
Common stock (Note 2)	4.4	4.4
Additional paid-in-capital	140.4	134.1
Retained earnings	1,520.2	1,499.8
Accumulated other comprehensive loss (Note 7)	(143.5)	(74.1)
Treasury stock, at cost (Note 2)	(799.2)	(757.7)
Total Shareholders' Equity	722.3	806.5
Total Liabilities and Shareholders' Equity	\$ 1,706.2	\$ 1,752.1

See Notes to Condensed Consolidated Financial Statements

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

	Year to Date Ended March 31	
	2015	2014
Operating Activities		
Net income	\$ 38.2	\$ 9.9
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	34.9	33.6
Amortization	5.5	7.0
Acquisition-related intangible asset amortization	15.7	13.8
Provision for deferred income taxes	(6.2)	6.5
(Gain) loss on disposal of property, equipment leased to others, intangible assets and impairments	(0.2)	7.8
Stock compensation	9.9	9.0
Excess tax benefits from employee stock plans	(1.4)	0.6
Change in working capital excluding cash, current debt, acquisitions and dispositions:		
Trade accounts receivable	22.6	15.8
Inventories	(3.9)	0.9
Other current assets	(2.8)	(1.3)
Trade accounts payable	(16.6)	(14.5)
Accrued expenses and other liabilities	(9.4)	(14.6)
Other, net	0.8	3.4
Net cash provided by operating activities	87.1	77.9
Investing Activities		
Capital expenditures and purchases of intangible assets	(80.3)	(31.4)
Proceeds on sale of property and equipment leased to others	0.9	1.3
Payment for acquisition of businesses, net of cash acquired	(2.7)	(14.3)
Refund on acquisition of businesses	-	4.6
Other	(4.8)	-
Net cash used in investing activities	(86.9)	(39.8)
Financing Activities		
Net change in short-term debt	(0.7)	(0.2)
Borrowings on revolving credit facility	95.0	41.0
Proceeds from long-term debt	-	0.6
Payment of long-term debt	(7.6)	(5.0)
Purchase of noncontrolling interest	(1.3)	(1.0)
Payment of cash dividends	(17.7)	(16.7)
Proceeds on exercise of stock options	9.1	7.4
Proceeds from stock issuance	1.3	1.3
Excess tax benefits from employee stock plans	1.4	(0.6)
Treasury stock acquired	(57.1)	(71.6)
Net cash provided by (used in) financing activities	22.4	(44.8)

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Effect of exchange rate changes on cash	(7.4)	(0.4)
Net Cash Flows	15.2	(7.1)
Cash and Cash Equivalents:		
At beginning of period	99.3	127.4
At end of period	\$ 114.5	\$ 120.3

See Notes to Condensed Consolidated Financial Statements

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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.

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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.

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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 March 31, 2015, we had \$23.2 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 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. At present time, this guidance will be effective for us in the first quarter of fiscal 2018, ending December 31, 2017. Early adoption is not permitted.

In April 2015, the FASB proposed deferring the effective date by one year to annual reporting periods beginning after December 15, 2017. The FASB also proposed permitting early adoption of the standard, but not before the original effective date. We are currently in the process of evaluating the impact of adoption of this ASU on 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.

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2. Supplementary Balance Sheet Information

	March 31, 2015	September 30, 2014
Allowance for possible losses and discounts on trade receivables	\$ 27.9	\$ 31.4
Inventories:		
Finished products	\$ 89.1	\$ 93.5
Raw materials and work in process	79.6	82.7
Total inventory	\$ 168.7	\$ 176.2
Accumulated depreciation of property, plant and equipment	\$ 592.6	\$ 588.1
Accumulated amortization of software and other intangible assets	\$ 296.5	\$ 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	56,654,412	57,439,911
Treasury shares	23,669,500	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 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 \$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. During the first and second quarters of 2015, we made certain adjustments to the opening balance sheet as of the acquisition date to reflect certain fair value adjustments and recorded a \$3.0 million liability to reflect the settlement of certain purchase agreement provisions with the seller. These results are preliminary and subject to other fair value adjustments.

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	Amount
Trade receivables	\$ 65.6
Inventory	63.6
Other current assets	24.2
Property, plant, and equipment	42.1
Goodwill	62.8
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	15.2
Current liabilities	(72.3)
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 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 \$63 million and \$123 million for the quarter and year to date periods ended March 31, 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.

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	-	5.5	-	5.5
Currency translation effect	-	(13.8)	(4.2)	(18.0)
Balances at March 31, 2015:				
Goodwill	390.6	325.2	144.3	860.1
Accumulated impairment losses	(358.1)	-	(114.7)	(472.8)
Goodwill, net at March 31, 2015	\$ 32.5	\$ 325.2	\$ 29.6	\$387.3

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

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5. Financing Agreements

Total debt consists of the following:

	March 31, 2015	September 30, 2014
Revolving credit facility	\$ 360.0	\$ 265.0
Term loan current portion	18.7	16.2
Term loan long-term portion	150.0	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	578.5	491.8
Less current portion of debt	128.7	126.9
Total long-term debt	\$ 449.8	\$ 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 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 March 31, 2015, we had outstanding borrowings of \$360.0 million and undrawn letters of credit of \$5.1 million under the revolving credit facility, leaving \$134.9 million of borrowing capacity available. We are in compliance with all of our debt covenants as of March 31, 2015.

On May 1, 2015, we entered into an Amended and Restated Credit Agreement (the “New 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 New 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 \$168.8 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 New Credit Facility, leaving \$534.9 million of available borrowing capacity. The New Credit Facility is to be used for general corporate purposes, including financing permitted acquisitions.

All revolving loans under the New Credit Facility mature May 1, 2020. The term loans will continue to amortize so that \$43.8 million of the remaining principal will be repaid through August 24, 2017, with the balance due at such date.

Borrowings under the New 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. The New Credit Facility is guaranteed by several fully owned subsidiaries of the Company. The New 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.

Unsecured debentures outstanding at March 31, 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 March 31, 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 and \$42.4 million of outstanding standby letters of credit as of March 31, 2015 and September 30, 2014, respectively.

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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 March 31, 2015, we had one interest rate swap agreement with a notional amount of \$118.8 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 \$0.5 million liability as of March 31, 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 \$58.2 million at March 31, 2015 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 \$168.0 million and \$175.2 million based on quoted prices for similar liabilities at March 31, 2015 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 March 31		Year to Date Ended March 31	
	2015	2014	2015	2014
Service cost	\$1.3	\$1.3	\$ 2.7	\$ 2.5
Interest cost	3.7	3.6	7.4	7.2
Expected return on plan assets	(4.2)	(4.2)	(8.5)	(8.4)
Amortization of unrecognized prior service cost, net	0.2	0.1	0.3	0.3
Amortization of net loss	1.3	0.8	2.7	1.6
Net pension expense	2.3	1.6	4.6	3.2
Special termination benefits	-	2.4	-	2.4
Net pension expense	\$2.3	\$4.0	\$ 4.6	\$ 5.6

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.

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 \$3.8 million and \$3.6 million in each of the quarterly periods ended March 31, 2015 and 2014; and \$8.0 million and \$7.3 million in the year to date periods ended March 31, 2015 and 2014.

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7. Other Comprehensive Income

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

Quarter Ended March 31, 2015

	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	\$(0.4)	\$ -	\$(0.4)	\$0.2	\$(0.2)	\$(0.4)	\$(0.2)	\$(0.6)
Foreign currency translation adjustment	(48.0)	-	(48.0)	-	(48.0)	(56.8)	(48.0)	(104.8)
Change in pension and postretirement defined benefit plans	-	1.4	1.4	(0.5)	0.9	(39.0)	0.9	(38.1)
Total	\$(48.4)	\$ 1.4	\$(47.0)	\$(0.3)	\$(47.3)	\$(96.2)	\$(47.3)	\$(143.5)

Quarter Ended March 31, 2014

	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	\$-	\$ 0.1	\$0.1	\$-	\$0.1	\$(0.2)	\$0.1	\$(0.1)
Foreign currency translation adjustment	(0.2)	-	(0.2)	-	(0.2)	1.2	(0.2)	1.0
Change in pension and postretirement defined benefit plans	-	0.9	0.9	(0.4)	0.5	(30.2)	0.5	(29.7)
Total	\$(0.2)	\$ 1.0	\$0.8	\$(0.4)	\$0.4	\$(29.2)	\$0.4	\$(28.8)

Year to Date Ended March 31, 2015

	Other comprehensive income				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	\$(1.0)	\$ -	\$(1.0)	\$0.4	\$(0.6)	\$-	\$(0.6)	\$(0.6)
Foreign currency translation adjustment	(70.6)	-	(70.6)	-	(70.6)	(34.2)	(70.6)	(104.8)
Change in pension and postretirement defined benefit plans	0.1	2.7	2.8	(1.0)	1.8	(39.9)	1.8	(38.1)
Total	\$(71.5)	\$ 2.7	\$(68.8)	\$(0.6)	\$(69.4)	\$(74.1)	\$(69.4)	\$(143.5)

Year to Date Ended March 31, 2014

	Other comprehensive income				Accumulated other comprehensive loss		
	Prior reclassification	Reclassification from	Pre-tax	Tax effect	Net of tax	Beginning balance	Net activity

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Available-for-sale securities and currency hedges	\$0.1	\$ 0.1	\$0.2	\$-	\$0.2	\$(0.3)	\$ 0.2	\$(0.1)
Foreign currency translation adjustment	5.6	-	5.6	-	5.6	(4.6)	5.6	1.0
Change in pension and postretirement defined benefit plans	0.2	1.7	1.9	(0.8)	1.1	(30.8)	1.1	(29.7)
Total	\$5.9	\$ 1.8	\$7.7	\$(0.8)	\$6.9	\$(35.7)	\$ 6.9	\$(28.8)

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

	Quarter Ended March 31					
	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	\$(0.5)	\$0.9	\$0.9	\$(0.4)	\$0.5
Available-for-sale securities and currency hedges (b)	-	-	-	0.1	-	0.1
	Year to Date Ended March 31					
	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)	\$ 2.7	\$ (1.0)	\$ 1.7	\$ 1.7	\$ (0.7)	\$ 1.0
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

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 has resulted in severance and benefit charges of \$2.3 million and \$4.6 million for the quarter and year to date ended March 31, 2015, as well as other costs of \$2.0 and \$3.4 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 March 31, 2015, we have recognized aggregate special charges of \$32.4 million, which are recorded in both fiscal 2014 and 2015. Charges of \$16.9 million were recorded in the quarter ended March 31, 2014. We expect to incur \$10 million to \$15 million of additional European restructuring costs through the completion of the program.

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. We intend to continue renting these products to facilities and customers who are billed directly for the product. 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 \$1.8 million in other related costs. This action is substantially complete.

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.

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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	4.6
Cash Payments	(7.2)
Reversals	(0.5)
Balance at March 31, 2015	\$8.6

9. Income Taxes

The effective tax rate was 28.7 percent for both the quarterly and year to date periods ended March 31, 2015 compared to 113.0 and 77.9 percent for the comparable prior year periods.

The effective rates for both the three- and six-month periods ended March 31, 2015 are lower than the comparable periods in fiscal 2014 due primarily to \$19.6 million of tax expense realized in the prior year to establish a valuation allowance in France reflecting cumulative and expected future losses associated with the expenses of our global restructuring program. The three- and six-month periods ended March 31, 2015 are also favorably impacted by a \$1.9 million tax benefit due to the reversal of previously recorded valuation allowances in Australia. Additionally, the reinstatement of the research and development tax credit favorably impacted the effective rate for the three- and six-month periods ended March 31, 2015.

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.

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):

	Quarter Ended		Year to Date	
	March 31 2015	March 31 2014	Ended March 31 2015	Ended March 31 2014
Net income (loss)	\$26.1	\$(3.3)	\$38.2	\$9.9
Average shares outstanding - Basic	56,544	57,303	56,841	57,781

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Add potential effect of exercise of stock options and other unvested equity awards	1,066	-	1,053	831
Average shares outstanding - Diluted	57,610	57,303	57,894	58,612
Net income (loss) per common share - Basic	\$0.46	\$(0.06)	\$0.67	\$0.17
Net income (loss) per common share - Diluted	\$0.45	\$(0.06)	\$0.66	\$0.17
Shares with anti-dilutive effect excluded from the computation of Diluted EPS	541	1,812	516	504

11. Common Stock

The stock-based compensation cost that was charged against income, net of tax, for all plans was \$3.4 million and \$6.4 million for the quarterly and year to date periods ended March 31, 2015 and \$3.4 million and \$5.7 million for the comparable prior year periods.

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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 March 31		Year to Date Ended March 31	
	2015	2014	2015	2014
Balance at beginning of period	\$28.0	\$37.3	\$ 28.4	\$ 38.1
Provision for warranties during the period	3.6	2.6	6.5	7.2
Warranty reserves acquired	-	-	1.1	-
Warranty claims during the period	(4.4)	(5.8)	(8.8)	(11.2)
Balance at end of period	\$27.2	\$34.1	\$ 27.2	\$ 34.1

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.

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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 March 31		Year to Date Ended March 31	
	2015	2014	2015	2014
Revenue:				
North America	\$246.9	\$224.5	\$ 472.1	\$ 430.0
Surgical and Respiratory Care	120.0	65.6	246.3	128.9
International	107.9	125.2	221.4	249.8
Total revenue	\$474.8	\$415.3	\$ 939.8	\$ 808.7
Divisional income:				
North America	\$52.3	\$47.5	\$ 90.8	\$ 75.5
Surgical and Respiratory Care	18.3	15.7	37.7	30.3
International	4.4	5.2	7.2	10.7
Other operating costs:				
Non-allocated operating and administrative costs	32.9	12.2	70.6	37.9
Special charges	3.8	28.4	7.5	29.4
Operating profit	38.3	27.8	57.6	49.2
Interest expense	(3.0)	(2.3)	(6.2)	(4.3)
Investment income and other, net	1.3	(0.2)	2.2	(0.2)
Income before income taxes	\$36.6	\$25.3	\$ 53.6	\$ 44.7

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.

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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.

15. Subsequent Events

On April 22, 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 offer will extend for a period of several months with payments likely to occur in September 2015. Based on the voluntary elections of participants we may incur a settlement charge in the second half of fiscal 2015 with respect to this action. We cannot reasonably estimate the financial impact of any potential settlement charge at this time.

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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 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.

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Net Revenue

	Quarter Ended March 31		Percentage Change Constant	
	2015	2014	As	
			Reported	Currency
Revenue:				
Capital sales	\$375.7	\$313.6	19.8	28.3
Rental revenue	99.1	101.7	(2.6)	(0.3)
Total Revenue	\$474.8	\$415.3	14.3	21.3

	Year to Date Ended March 31		Percentage Change Constant	
	2015	2014	As	
			Reported	Currency
Revenue:				
Capital sales	\$749.1	\$609.1	23.0	29.3
Rental revenue	190.7	199.6	(4.5)	(2.8)
Total Revenue	\$939.8	\$808.7	16.2	21.4

Capital sales increased for the three- and six-month periods ended March 31, 2015 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 2.4 and 4.3 percent on a reported basis, or 7.9 and 8.4 percent on a constant currency basis, for the quarterly and year to date periods. The three- and six-month organic growth is primarily driven by our North America segment. Additionally, higher organic sales in our Surgical and Respiratory segment favorably impacted the six-month period. Our International segment sales declined for the three- and six month periods primarily due to unfavorable exchange rate movements, in addition to lower sales in the Middle East and Latin America, partially offset by higher sales in Asia.

Rental revenue decreased for the three- and six-month periods ended March 31, 2015 due to lower revenue in the North America and International segments, partially offset by an increase in the Surgical and Respiratory segment. Excluding the effects of our discontinuance of third-party payer therapy product rentals, rental revenue increased 2.4 and 1.0 percent for the three- and six-month periods ended March 31, 2015. The North America decrease for both periods 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 decreased 14.0 percent on a reported basis for the three-month period, but increased 1.5 percent on a constant currency basis. For the six-month period, International rental revenue declined 12.9 percent on a reported basis, or 2.2 percent on a constant currency basis, due to ongoing volume and pricing pressures. In Surgical and Respiratory Care, revenue increased for both periods on higher respiratory care volumes and organic growth from recent product introductions.

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Gross Profit

	Quarter Ended March 31		Percentage Change
	2015	2014	
Gross Profit			
Capital	\$161.8	\$144.1	12.3
Percent of Related Revenue	43.1	% 46.0	%
Rental	\$52.4	\$58.6	(10.6)
Percent of Related Revenue	52.9	% 57.6	%
Total Gross Profit	\$214.2	\$202.7	5.7
Percent of Total Revenue	45.1	% 48.8	%
	Year to Date Ended		Percentage Change
	March 31		
	2015	2014	
Gross Profit			
Capital	\$314.7	\$268.4	17.3
Percent of Related Revenue	42.0	% 44.1	%
Rental	\$99.4	\$111.1	(10.5)
Percent of Related Revenue	52.1	% 55.7	%
Total Gross Profit	\$414.1	\$379.5	9.1
Percent of Total Revenue	44.1	% 46.9	%

Capital gross profit increased 12.3 percent for the quarter and 17.3 percent the year, while gross margin decreased 290 basis points and 210 basis points for the three- and six-month periods ended March 31, 2015. The margin rate decrease for the three- and six-month periods is primarily driven by the impact of dilutive Trumpf margins, incremental field corrective action charges of \$3.1 million and \$3.0 million for the three- and six-months ended March 31, 2015, respectively, and the prior year recognition of a \$2.5 million benefit from a change in our employee benefits program. The six-month period ended March 31, 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 margins are essentially flat for the three-months ended March 31, 2015 and increased by approximately 90 basis points due to portfolio mix for the six-months ended March 31, 2015.

Rental gross profit decreased 10.6 and 10.5 percent and gross margin decreased 470 basis points and 360 basis points for the three- and six-month periods ended March 31, 2015. This margin decline is partially driven by the prior year recognition of a \$2.6 million benefit from the employee benefit program change referenced earlier. Additional margin decreases are 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. Foreign currency rate changes did not meaningfully impact our margins as a percent of revenue for the three- or six-month periods ended March 31, 2015.

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Other

	Quarter Ended March 31		Year to Date Ended March 31	
	2015	2014	2015	2014
Research and development expenses	\$22.2	\$16.4	\$44.0	\$32.8
Percent of Total Revenue	4.7	% 3.9	% 4.7	% 4.1
Selling and administrative expenses	\$149.9	\$130.1	\$305.0	\$268.1
Percent of Total Revenue	31.6	% 31.3	% 32.5	% 33.2
Special charges	\$3.8	\$28.4	\$7.5	\$29.4
Interest expense	\$(3.0)	\$(2.3)	\$(6.2)	\$(4.3)
Investment income and other, net	\$1.3	\$(0.2)	\$2.2	\$(0.2)

Research and development expenses increased 35.4 and 34.1 percent for the three- and six-month periods ended March 31, 2015 primarily due to the addition of Trumpf spending and additional investment in organic product development initiatives. Excluding a benefit of \$1.1 million associated with the prior year employee benefit program change referenced earlier, research and development expenses increased 26.9 and 29.8 percent for the three- and six-month periods ended March 31, 2015, respectively. As a percentage of total revenue, selling and administrative expenses increased by 30 basis points for the three-month period primarily due to higher acquisition and integration costs, and decreased by 70 basis points for the six-month period due to higher revenue and ongoing cost control initiatives. The three- and six-month periods ended March 31, 2015 include year over year increases of \$3.2 million and \$6.2 million, respectively, relating to acquisition and integration costs, acquisition-related intangible asset amortization, and FDA remediation costs, partially offset by a \$0.9 litigation credit in the three-month period ended March 31, 2015. Excluding these incremental costs, the litigation credit, and a \$6.0 million employee benefit change recorded in the prior year three- and six-month periods, selling and administrative expenses decreased 140 and 160 basis points as a percentage of revenue for the three- and six-month periods ended March 31, 2015, respectively. Foreign currency rate changes did not meaningfully impact our comparative selling and administrative costs as a percentage of revenue for the three- or six-month periods ended March 31, 2015.

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 has resulted in severance and benefit charges of \$2.3 million and \$4.6 million for the quarter and year to date ended March 31, 2015, as well as other costs of \$2.0 and \$3.4 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 March 31, 2015, we have recognized aggregate special charges of \$32.4 million, which are recorded in both fiscal 2014 and 2015. Charges of \$16.9 million were recorded in the quarter ended March 31, 2014. We expect to incur \$10 million to \$15 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.

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. We intend to continue renting these products to facilities and customers who are billed directly for the product. 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 \$1.8 million in other related costs. This action is substantially complete.

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.

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Reported and Adjusted Earnings

	Quarter Ended March 31, 2015			Quarter Ended March 31, 2014		
	Income Before Income Taxes	Income Tax Expense	Diluted EPS*	Income Before Income Taxes	Income Tax Expense	Diluted EPS*
GAAP Earnings	\$36.6	\$10.5	\$0.45	\$25.3	\$28.6	\$(0.06)
Adjustments:						
Acquisition and integration costs	3.8	1.2	0.05	1.7	0.6	0.02
Acquisition-related intangible asset amortization	7.6	2.2	0.10	6.9	2.0	0.09
Employee benefits change	-	-	-	(12.2)	(4.7)	(0.13)
FDA remediation expenses	1.2	0.4	0.01	0.8	0.2	0.01
Field corrective actions	1.2	0.2	0.02	(1.9)	(1.2)	(0.01)
Litigation credit	(0.9)	(0.3)	(0.01)	-	-	-
Special charges	3.8	0.1	0.06	28.4	9.9	0.32
Foreign valuation allowance	-	1.9	(0.03)	-	(19.6)	0.34