

Hill-Rom Holdings, Inc.
Form 10-Q
February 01, 2016

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, 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.)

Two Prudential Plaza, Suite 4100 60601
Chicago, IL (Address of principal executive offices) (Zip Code)

(312) 819-7200
(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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required

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to submit and post such files).

Yes

No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes

No

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

Common Stock, without par value – 65,316,490 shares as of January 25, 2016.

HILL-ROM HOLDINGS, INC.

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PART I – FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

Hill-Rom Holdings, Inc. and Subsidiaries
Condensed Consolidated Statements of Income (Unaudited)
(In millions, except per share data)

	Quarter Ended December 31	
	2015	2014
Net Revenue		
Capital sales	\$ 565.1	\$ 373.4
Rental revenue	96.1	91.6
Total revenue	661.2	465.0
Cost of Revenue		
Cost of goods sold	323.1	220.5
Rental expenses	47.4	44.6
Total cost of revenue	370.5	265.1
Gross Profit	290.7	199.9
Research and development expenses	33.6	21.8
Selling and administrative expenses	221.2	155.1
Special charges (Note 8)	7.1	3.7
Operating Profit	28.8	19.3
Interest expense	(22.5)	(3.2)
Investment income and other, net	(0.5)	0.9
Income Before Income Taxes	5.8	17.0
Income tax expense (Note 9)	1.5	4.9
Net Income	4.3	12.1
Less: Net loss attributable to noncontrolling interests	(0.5)	-
Net Income Attributable to Common Shareholders	\$ 4.8	\$ 12.1
Net Income Attributable to Common Shareholders per Common Share - Basic	\$ 0.07	\$ 0.21
Net Income Attributable to Common Shareholders per Common Share - Diluted	\$ 0.07	\$ 0.21
Dividends per Common Share	\$ 0.1600	\$ 0.1525

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Average Common Shares Outstanding - Basic (thousands) (Note 10)	65,217	57,137
Average Common Shares Outstanding - Diluted (thousands) (Note 10)	66,274	58,154

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	
	2015	2014
Net Income	\$ 4.3	\$ 12.1
Other Comprehensive Income (Loss), net of tax (Note 7):		
Available-for-sale securities and currency hedges	0.1	(0.4)
Foreign currency translation adjustment	(10.2)	(22.6)
Change in pension and postretirement defined benefit plans	0.7	0.9
Total Other Comprehensive Income (Loss), net of tax	(9.4)	(22.1)
Total Comprehensive Income (Loss)	(5.1)	(10.0)
Less: Comprehensive loss attributable to noncontrolling interests	(0.5)	-
Total Comprehensive Income (Loss) Attributable to Common Shareholders	\$ (4.6)	\$ (10.0)

See Notes to Condensed Consolidated Financial Statements

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

	December 31, 2015	September 30, 2015
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 174.4	\$ 192.8
Trade accounts receivable, net of allowances (Note 2)	460.6	494.7
Inventories (Note 2)	248.9	267.4
Deferred income taxes (Notes 1 and 9)	-	77.0
Other current assets	105.4	109.1
Total current assets	989.3	1,141.0
Property, plant and equipment, net (Note 2)	375.3	378.4
Goodwill (Note 4)	1,607.8	1,610.5
Software and other intangible assets, net (Note 2)	1,221.6	1,247.7
Deferred income taxes (Notes 1 and 9)	26.1	21.6
Other assets	51.5	58.4
Total Assets	\$ 4,271.6	\$ 4,457.6
LIABILITIES		
Current Liabilities		
Trade accounts payable	\$ 114.7	\$ 136.3
Short-term borrowings (Note 5)	64.4	58.0
Accrued compensation	99.5	171.8
Accrued product warranties (Note 12)	32.7	32.1
Accrued rebates	39.6	33.7
Other current liabilities	142.5	146.9
Total current liabilities	493.4	578.8
Long-term debt (Note 5)	2,136.2	2,175.2
Accrued pension and postretirement benefits (Note 6)	118.6	118.8
Deferred income taxes (Notes 1 and 9)	332.6	380.6
Other long-term liabilities	44.6	47.3
Total Liabilities	3,125.4	3,300.7
Commitments and Contingencies (Note 14)		
SHAREHOLDERS' EQUITY		
Common Stock (Note 2)	4.4	4.4
Additional paid-in-capital	563.3	562.0
Retained earnings	1,504.2	1,509.9
Accumulated other comprehensive loss (Note 7)	(150.2)	(140.8)
Treasury stock, at cost (Note 2)	(785.0)	(788.6)
Total Shareholders' Equity Attributable to Common Shareholders	1,136.7	1,146.9
Noncontrolling interests	9.5	10.0
Total Shareholders' Equity	1,146.2	1,156.9
Total Liabilities and Shareholders' Equity	\$ 4,271.6	\$ 4,457.6

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)

	Quarter Ended December 31	
	2015	2014
Operating Activities		
Net income	\$ 4.3	\$ 12.1
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	23.6	17.3
Amortization	4.3	2.9
Acquisition-related intangible asset amortization	24.2	8.1
Provision for deferred income taxes	22.3	0.3
Loss (gain) on disposal of property, equipment leased to others, intangible assets, and impairments	0.7	(0.3)
Stock compensation	5.0	4.7
Excess tax benefits from employee stock plans	(1.0)	(1.0)
Change in working capital excluding cash, current debt, acquisitions and dispositions:		
Trade accounts receivable	31.6	36.1
Inventories	17.4	4.3
Other current assets	3.5	(3.2)
Trade accounts payable	(23.8)	(16.0)
Accrued expenses and other liabilities	(66.1)	(30.6)
Other, net	0.2	(3.7)
Net cash provided by operating activities	46.2	31.0
Investing Activities		
Capital expenditures and purchases of intangible assets	(17.7)	(44.9)
Proceeds on sale of property and equipment leased to others	0.3	0.5
Net cash used in investing activities	(17.4)	(44.4)
Financing Activities		
Net change in short-term debt	-	(0.7)
Borrowings on revolving credit facility	-	95.0
Payment of long-term debt	(34.5)	(3.8)
Purchase of noncontrolling interest of former joint venture	(0.4)	(1.0)
Payment of cash dividends	(10.4)	(8.6)
Proceeds on exercise of stock options	0.7	4.7
Proceeds from stock issuance	0.8	0.7
Excess tax benefits from employee stock plans	1.0	1.0
Treasury stock acquired	(2.8)	(56.9)
Net cash provided by (used in) financing activities	(45.6)	30.4
Effect of exchange rate changes on cash	(1.6)	(2.6)
Net Cash Flows	(18.4)	14.4

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Cash and Cash Equivalents:

At beginning of period	192.8	99.3
At end of period	\$ 174.4	\$ 113.7

See Notes to Condensed Consolidated Financial Statements

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

1. Summary of Significant Accounting Policies

Basis of Presentation and Principles of Consolidation

Unless the context otherwise requires, the terms “Hill-Rom,” “the Company,” “we,” “our,” and “us” refer to Hill-Rom Holdings, Inc. and its 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 Hill-Rom’s latest Annual Report on Form 10-K for the fiscal year ended September 30, 2015 (“2015 Form 10-K”) as filed with the United States (“U.S.”) Securities and Exchange Commission. The September 30, 2015 Condensed Consolidated Balance Sheet was derived from audited Consolidated Financial Statements, but does not include all disclosures required by accounting principles generally accepted in the U.S. In the opinion of management, the Condensed Consolidated Financial Statements herein include all adjustments, consisting only of normal recurring adjustments, necessary to state fairly the financial position, results of operations and cash flows for the interim periods presented. Quarterly results are not necessarily indicative of annual results.

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

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the U.S. requires the Company’s 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 income taxes (Notes 1 and 9), accounts receivable reserves (Note 2), accrued warranties (Note 12), the impairment of intangibles and goodwill (Note 4), use of the spot yield curve approach for pension expense (Note 6), 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

Hill-Rom and its 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, 2015, we had \$40.3 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. In August 2015, the FASB issued ASU 2015-14 which delayed the effective date of the new revenue guidance by one year. As a result, the provisions of ASU 2014-09 will be effective for us in the first quarter of fiscal 2019, ending December 31, 2018. Early adoption is permitted as of the original effective date, but not earlier. We are currently in the process of evaluating the impact of adoption of this ASU on our Consolidated Financial Statements.

In November 2015, the FASB issued ASU 2015-17, Income Taxes (Topic 740), “Balance Sheet Classification of Deferred Taxes.” The amendments in this update simplify the presentation of deferred income taxes by requiring deferred tax assets and liabilities to be classified as noncurrent in a classified balance sheet. As permitted, the Company elected to early-adopt this standard in the first quarter of fiscal 2016 on a prospective basis. Prior period amounts were not retrospectively adjusted for the impacts of this ASU.

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 Fiscal 2015 Form 10-K.

2. Supplementary Balance Sheet Information

	December 31, 2015	September 30, 2015
Allowance for possible losses and discounts on trade receivables	\$ 26.5	\$ 26.0
Inventories:		
Finished products	\$ 119.9	\$ 133.2
Raw materials and work in process	129.0	134.2
Total inventory	\$ 248.9	\$ 267.4
Accumulated depreciation of property, plant and equipment	\$ 610.9	\$ 598.0
Accumulated amortization of software and other intangible assets	\$ 324.3	\$ 304.4
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	88,457,634	88,457,634
Shares outstanding	65,299,252	65,165,896
Treasury shares	23,158,382	23,291,738

3. Acquisitions

Welch Allyn

On September 8, 2015, we completed the acquisition of Welch Allyn Holdings, Inc. and its subsidiaries (collectively, "Welch Allyn") for a consideration of \$1,687.3 million in cash (\$1,633.6 million, net of cash acquired) and 8,133,722 shares of Hill-Rom common stock for a total combined purchase price of approximately \$2.1 billion. Welch Allyn is a leading manufacturer of medical diagnostic equipment and offers a diversified portfolio of devices that assess, diagnose, treat, and manage a wide variety of illnesses and diseases.

The cash portion of the consideration is preliminary and subject to adjustment for various true-up provisions as described in the terms of the merger agreement. The transaction was funded with new borrowings, including \$1.8 billion in term loans and \$425.0 million of senior notes issued in a private placement debt offering. Funds from this new financing were also used to retire pre-existing debt. Refer to Note 5 for additional information regarding our debt obligations.

The following summarizes the fair value of assets acquired and liabilities assumed at the date of the acquisition. During the first quarter of 2016, we made certain adjustments to the opening balance sheet as of the acquisition date which were insignificant. These results are preliminary and subject to normal true-up provisions in the purchase agreement and other fair value adjustments.

	Amount
Trade receivables	\$ 63.2
Inventory	110.5
Other current assets	52.7
Current deferred income taxes	27.3
Property, plant, and equipment	93.2
Goodwill	1,203.5
Trade name (indefinite life)	434.0
Customer relationships (12-year useful life)	516.8
Developed technology (7-year weighted average useful life)	54.0
Other intangibles	19.9
Other noncurrent assets	30.3
Current liabilities	(161.5)
Noncurrent deferred income taxes	(368.9)
Other noncurrent liabilities	(25.1)
Total purchase price, net of cash acquired	\$ 2,049.9
Fair value of common stock issued	\$ 416.3
Cash payment, net of cash acquired	1,633.6
Total consideration	\$ 2,049.9

Goodwill from the Welch Allyn acquisition, which is not deductible for tax purposes, is primarily due to enhanced customer relevance and a stronger competitive position resulting from the business combination, including a complementary commercial position, product portfolio, and enhanced synergies. Welch Allyn is reported as its own reportable segment for the quarter ended December 31, 2015.

Our total revenue on an unaudited pro forma basis, as if the Welch Allyn acquisition had been consummated at the beginning of our 2014 fiscal year, would have been higher by approximately \$190 million for the quarter ended December 31, 2014. On the same unaudited pro forma basis, our net income would have been lower by approximately \$8 million for the quarter ended December 31, 2014. Pro forma net income is adversely impacted by significant costs related to the transaction including financing costs and purchase price accounting, including the effects of amortization of acquisition-related intangibles. These results are not indicative of expected future performance.

The unaudited pro forma results are based on the Company's historical financial statements and those of the Welch Allyn 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	Welch Allyn	Total
Balances at September 30, 2015:					
Goodwill	\$ 390.6	\$ 343.8	\$ 145.4	\$ 1,203.5	\$2,083.3
Accumulated impairment losses	(358.1)	-	(114.7)	-	