1999 Financial Highlights

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Management's Discussion and Analysis of Results of Operations and Financial Condition

Results of Operations › Net sales for fiscal year 1999 were $357,571,000, representing a 2% increase in net sales over the $351,576,000 recorded in fiscal year 1998. Fiscal year 1998 net sales represented a 12% increase over the $314,542,000 recorded in fiscal year 1997. The fiscal year 1998 to fiscal year 1999 increase was due primarily to increases in unit and dollar sales of the Company's obstructive sleep apnea therapy products, non-invasive ventilatory support products for hospital use, and oxygen concentrator products, offset by decreases in unit and dollar sales of the Company's non-invasive ventilatory support products for home use. The fiscal year 1997 to fiscal year 1998 increase was due to increases in unit and dollar sales for all of the Company's major product lines and, to a lesser extent, to sales generated by two companies acquired during fiscal year 1997 (see Note K to the Consolidated Financial Statements for additional information regarding these acquisitions).

Sales for the second half of fiscal year 1998 and all of fiscal year 1999 were adversely impacted by decreases in sales of the Company's non-invasive ventilatory support products for use in the home compared to prior year levels. These sales decreases were caused by uncertainty in the market concerning government insurance coverage guidelines for the home use of these products in the United States and the corresponding reduction in purchases of these units by the Company's dealer customers pending resolution of the coverage guidelines. Government policymakers issued a draft coverage policy in July 1998 that was more restrictive than had been expected. The Company, along with trade and medical associations, other device manufacturers, and home care dealers, filed formal comments as permitted with the policy makers indicating disagreement with the draft coverage policy. In May 1999, a revised set of coverage guidelines were issued for implementation on October 1, 1999. While several restrictive provisions of the July 1998 draft guidelines were removed and potential changes in reimbursement categories have been delayed, the Company believes that this latest set of guidelines is still overly restrictive relative to patient qualification and administratively burdensome for clinicians and healthcare providers. As a result, the Company plans to continue to work with the government policy makers and Congress to resolve the remaining issues. The Company believes that until final guidelines are issued, sales of its non-invasive ventilatory support units for home use in the United States will continue to be negatively impacted as compared with periods prior to the issuance of the guidelines. If the final guidelines issued are either as restrictive as, or more restrictive than, the currently drafted guidelines, or if significant changes in reimbursement categories are ultimately made, the Company's sales of its non-invasive ventilatory support units for home use in the United States will continue to be negatively impacted and could be further depressed. In addition, the Company is also experiencing more general challenges in its marketplace due to the January 1998 reductions in Medicare reimbursement for oxygen therapy, which adversely affected many of the Company's dealer customers.

The Company's gross profit was 48% of net sales for fiscal year 1999 as compared to 49% of net sales for fiscal years 1998 and 1997. The decrease in the gross margin percentage for fiscal year 1999 was due primarily to reductions in gross margin in the fourth quarter of that year caused by a change in distribution method for sales in Germany (see below), increased manufacturing overhead expenses, and sales mix. The constant gross margin percentage for fiscal years 1999 (other than the fourth quarter items noted above), 1998 and 1997 reflects the fact that decreases in average selling prices for the Company's major products (which had been expected over the period) were offset by manufacturing support costs increasing at rates less than the rate of sales increase, lower product costs and sales mix.

General and administrative expenses, including additions to the allowance for uncollectible accounts receivable, were $48,522,000 (14% of net sales) for fiscal year 1999 compared to $37,200,000 (11% of net sales) for fiscal year 1998 and $30,103,000 (10% of net sales) for fiscal year 1997. The fiscal year 1999 total shown above includes a special addition of $5,000,000 (1% of net sales) to the Company's allowance for uncollectible accounts receivable. This special addition was made primarily to address accounts receivable remaining uncollected

that were generated by Healthdyne Technologies, Inc. ("Healthdyne") prior to its merger with the Company in February 1998. This addition was made in the fourth quarter of fiscal year 1999 as a change in previous estimates resulting from slow collections, aging deterioration, and issues affecting customers related to accounts that management expected to collect during fiscal year 1999. The remaining increases in expenses for the periods presented were due primarily to increased information systems costs, legal fees, allowances for doubtful accounts other than the special addition described above, and other administrative expenses. The increase from fiscal year 1997 to fiscal year 1998 was also due to costs incurred by the Company's Respironics Colorado, Inc. ("Respironics Colorado") and Stimotron Medizinische Gerate GmbH ("Stimotron") subsidiaries, since their acquisitions in October 1996 and February 1997, respectively. Finally, amortization of the goodwill generated by those acquisitions is included in general and administrative expenses starting at the date of acquisitions. Increased expenses for fiscal years 1998 and 1999 were partially offset by cost reductions that the Company obtained since the February 1998 merger with Healthdyne.

Sales, marketing and commission expenses were $60,899,000 (17% of net sales) for fiscal year 1999 as compared to $65,560,000 (19% of net sales) for fiscal year 1998 and $58,391,000 (19% of net sales) for fiscal year 1997. The decrease in these expenses from fiscal year 1998 to fiscal year 1999 was due primarily to the cost reductions that the Company achieved since the February 1998 merger with Healthdyne. The increase in absolute dollars in these expenses from fiscal year 1997 to fiscal year 1998 was due primarily to increased costs for advertising, trade shows and related marketing communication activities, international sales and marketing activities and sales and marketing management. The increases were also due to costs incurred by the Company's Respironics Colorado and Stimotron subsidiaries since their acquisition.

Research and development expenses were $16,714,000 (5% of net sales) for fiscal year 1999 as compared to $20,225,000 (6% of net sales) for fiscal year 1998 and $17,836,000 (6% of net sales) for fiscal year 1997. The decrease in these expenses from fiscal year 1998 to fiscal year 1999 was due primarily to the elimination of duplicate product development efforts following the merger with Healthdyne in February 1998. The increase in these expenses from fiscal year 1997 to fiscal year 1998 was due to continuing development work by both Respironics and Healthdyne on a variety of new products in each major product line. Significant product development efforts are ongoing, and new product launches in all of the Company's major product lines took place in fiscal year 1999 with additional new product launches scheduled for fiscal year 2000. Additional development work and clinical trials are being conducted in certain product areas outside the Company's current core products.

During fiscal year 1999, the Company incurred $2,415,000 in costs related to its May 1999 decision to enter into a new distribution arrangement for sales of its products in Germany. Under the new arrangement, the Company's products will be distributed by an independent dealer in Germany, and the Company's direct sales efforts in that country will be significantly reduced. Accordingly, costs were incurred to reduce the Company's German workforce and facilities and such costs are included in the charge. As a result of this change in distribution, the Company's sales and gross margins in Germany were reduced starting in May 1999 because of the foregone dealer margin; however selling, administrative and distribution costs have been, and will continue to be, reduced as well. The Company expects that the change in distribution will be accretive to earnings in fiscal year 2000.

In July 1999, the Company announced a major restructuring of its U.S. operations. The major components of the restructuring include the closing of the Westminster, Colorado manufacturing facility, the closing of the 19 customer satisfaction centers throughout the United States, the downsizing of the Marietta, Georgia manufacturing facilities, the opening of the Youngwood, Pennsylvania distribution and repair facility, the realignment of the Company into four divisions with a corresponding management realignment, and a workforce reduction

Management's Discussion and Analysis *(continued)*

associated with the facility changes and the realignment. The majority of the facility changes are expected to be completed during the second quarter of fiscal year 2000, and the divisional realignment is currently in place.

The total charges associated with the change in German distribution and the restructuring described above are expected to be approximately $25,000,000. As noted above, $2,415,000 of the charges were recorded in fiscal year 1999 with the remainder expected to be recorded in fiscal year 2000. See Note M to the Consolidated Financial Statements for additional information regarding the restructuring.

During fiscal year 1998, the Company incurred $40,751,000 in costs related to the merger with Healthdyne. The primary components of these costs were direct expenses of the transaction such as legal and investment banking fees ($9,500,000), severance and other employment related costs ($9,500,000) and asset write-downs to reflect decisions made regarding product and operational standardization (inventory; $11,000,000, other assets, $8,000,000). See Note N to the Consolidated Financial Statements for additional information regarding merger costs. During fiscal years 1998 and 1997, the Company also incurred a total of $2,800,000 in costs associated with an unsolicited offer by a third party to acquire Healthdyne.

The Company's effective income tax rate from operations (i.e. excluding the impact of the merger costs described above) was 40% for fiscal years 1999, 1998 and 1997. The Company's effective income tax rate for fiscal year 1998 including the impact of the merger charges was 147% because certain of the direct expenses of the merger transaction, such as investment banking and legal fees, were assumed to be non-deductible for income tax purposes.

As a result of the factors described above, the Company's net income (loss) was $23,061,000 (6% of net sales) or $0.72 per diluted share for fiscal year 1999 as compared to $(1,825,000) (1% of net sales) or $(.06) per diluted share for fiscal year 1998 and $26,425,000 (8% of net sales) or $0.82 per diluted share for fiscal year 1997.

Excluding the impact of the special addition to the allowance for uncollectible accounts receivable, restructuring costs, merger costs and the costs associated with the unsolicited offer to acquire Healthdyne, the Company's net income was $27,522,000 (8% of net sales) or $0.86 per diluted share for fiscal year 1999 as compared to $27,270,000 (8% of net sales) or $0.82 per diluted share for fiscal year 1998 and $27,714,000 (9% of net sales) or $0.86 per diluted share for fiscal year 1997.

Financial Condition, Liquidity and Capital Resources ›

The Company had working capital of $155,336,000 and $137,550,000 at June 30, 1999 and 1998, respectively. Net cash provided by operating activities was $34,158,000 for fiscal year 1999, as compared to net cash used by operating activities of $13,042,000 for fiscal year 1998 and net cash provided by operating activities of $19,904,000 for fiscal year 1997. The improvement in cash flow from operating activities from fiscal year 1998 to fiscal year 1999 was due primarily to higher earnings in fiscal year 1999, including the impact of merger costs incurred in fiscal year 1998. The deterioration in cash flow from operating activities from fiscal year 1997 to fiscal year 1998 was due primarily to lower earnings in fiscal year 1998 (including the impact of merger costs incurred in fiscal year 1998), increases in inventory and accounts receivable and decreases in accounts payable and accrued expenses.

Net cash used by investing activities was $23,005,000, $20,013,000 and $69,717,000 for fiscal years 1999, 1998 and 1997, respectively. Net cash used by investing activities for fiscal year 1997 included $49,865,000 relating to the October 1996 acquisition of LIFECARE International, Inc. and $9,000,000 relating to the February 1997 acquisition of Stimotron. The majority of the remaining cash used by investing activities for all periods represented capital expenditures, including the purchase of production equipment, software, computer and telecommunications equipment, and office

equipment. Funding for the LIFECARE acquisition was provided by the proceeds from a public offering completed in April 1996. Funding for the Stimotron acquisition was provided by a $9,000,000 loan received from a commercial bank in February 1997 under the terms of a credit agreement. The funding for the remainder of the investment activities in all periods was provided by positive cash flows from financing activities, accumulated cash and short-term investment balances, and for fiscal years 1999 and 1997, positive cash flows from operating activities. See Note K to the Consolidated Financial Statements for additional information regarding these acquisitions. See Notes D and K to the Consolidated Financial Statements for additional information about long-term obligations and acquisition financing.

Net cash provided by financing activities includes borrowings and repayments under the Company's various long-term obligations, proceeds from the issuance of common stock under the Company's stock option plans, and the acquisition of treasury stock.

In August 1998, the Company's Board of Directors authorized a stock buy back of up to 1,000,000 shares of the Company's outstanding common stock. In October 1998, the Board of Directors increased the authorization to a total of up to 2,000,000 shares and in March 1999 increased the authorization to a total of up to 3,000,000 shares. In September 1999, the Board of Directors increased the authorization to a total of up to 4,000,000 shares. During fiscal year 1999, the Company repurchased a total of 2,640,000 shares in open market transactions resulting in a use of cash of $33,055,000. Shares that are repurchased are added to treasury shares pending future use and reduce the number of shares outstanding used in calculating earnings per share.

In May 1998, the Company finalized a $100,000,000 revolving credit facility with a group of commercial banks. This credit facility was initially used to refinance approximately $55,000,000 of the Company's existing long-term debt with the remaining balance of the facility available for future borrowing and has also been used for general corporate purposes, including the stock buy back described above. The revolving credit facility permits borrowings and repayments until its maturity in May 2003. In December 1998, the amount of the revolving credit facility was increased to $125,000,000. The revolving credit facility is unsecured and contains certain financial covenants with which the Company must comply. The Company is currently in compliance with these covenants. The interest rate on the revolving credit facility is based on a spread over the London Interbank Borrowing Rate ("LIBOR"). As of June 30, 1999, the resulting interest rate on amounts outstanding under the revolving credit facility was approximately 5.81%. See Note D to the Consolidated Financial Statements for additional information about the credit facility.

The Company has not provided a valuation allowance for deferred income tax assets because it has determined that it is more likely than not that such assets can be realized, at a minimum, through carrybacks to prior years in which taxable income was generated.

The Company believes that positive cash flow from operating and financing activities, the availability of additional funds under its revolving credit facility, and its accumulated cash and short-term investments will be sufficient to meet its current and presently anticipated future needs for fiscal year 2000 for operating activities, investing activities, and financing activities (primarily consisting of payments on long-term debt).

Year 2000 ›

Year 2000 State of Readiness › The Company began its Year 2000 readiness plan in 1998 and is currently working towards completion. The Company has a program in place to systematically review and evaluate its systems, products and processes for Year 2000 compliance. The Company's Year 2000 readiness plan covers business management, financial and accounting systems and processes, suppliers, vendors and procurement processes, products and services, including the customer satisfaction processes, and production, material movement and distribution systems and processes. A full time Program

Management's Discussion and Analysis *(continued)*

Management Office ("PMO") team is responsible for the project management and coordination of the Company's Year 2000 efforts, with assistance as needed by the services of a Year 2000 consulting firm and with oversight by an Executive Steering Committee.

Year 2000 readiness reviews of the Company's core information technology systems are being addressed. Year 2000 compliance of the Company's core business information systems and technology have been largely addressed with the implementation of Year 2000 compliant enterprise-wide resource planning ("ERP") software at each of the Company's major locations. The Company's telecommunication systems have been inventoried, tested and determined to meet Year 2000 readiness certification. In addition, other network and desktop systems are presently being tested and remediated according to plan, with critical systems targeted for November 1999 completion/certification.

A technical review of the Company's current and discontinued product lines addressing Year 2000 issues has been completed. Three products were identified as having minor compliance anomalies and solutions in the form of upgrades and users manual inserts are available to customers. A strategy has been implemented for systematically responding to customer inquiries about the Company's product compliance status. The Year 2000 product review also covers products that are currently in research and development or are near launch. Based on this review, no additional issues were noted, and the Company's investments in research and development (including acquired technology rights) do not appear to be affected.

The Company's infrastructure, facilities and embedded systems have been inventoried and compliance status evaluation of critical items is nearing completion. Vendors of embedded software products have been contacted with the compliance status of their specific products identified and, where applicable, remediation or contingency plans are being put into place. No non-compliance issues have been identified related to these items, and, where applicable and cost-beneficial, contingency plans will include compliant upgrades. The Company's suppliers, service providers and dealer customers have been contacted and queried about their Year 2000 readiness. Readiness status of critical suppliers and service providers is nearing completion.

Year 2000 Costs › Total costs for the Company's Year 2000 compliance efforts are currently estimated to be approximately $11,000,000. The majority of these costs relate to the ERP system installations and upgrades and have been, and will be, capitalized and charged to expense over the estimated useful life of the associated software and hardware. The remaining costs have been, and will continue to be, charged directly to expense. Additional costs could be incurred if significant remediation activities are required with third party suppliers (see below). Costs associated with Year 2000 compliance are funded through the Company's operating cash flows.

Risks and Contingency Plans › Based on the Year 2000 compliance work conducted to date and described above, the Company's most significant risk, and its reasonably likely worst case scenario relative to Year 2000 compliance, appears to be that upon completion of its review of its third party product and service providers' Year 2000 compliance, it determines that certain of its third party product and service suppliers may not be Year 2000 compliant. If such product and service suppliers in fact do not become Year 2000 compliant in a timely manner and these suppliers cannot provide the Company with products and services in a timely and cost effective manner, future operating results could be adversely affected. The Company believes that the vendor management process that is currently in place will identify these potential risks.

Efforts to formalize contingency plans across the company are underway. The contingency planning scope of work will focus on third party products and service providers. In addition, contingency plans will be developed as needed in the event that risks arise other than those related to third party product and service providers.

For products and services where the Company's needs are not unique or where a long-term

relationship with a supplier does not exist, a search for alternative suppliers who are Year 2000 compliant would be conducted and suppliers changed as needed prior to January 1, 2000. While the Company believes that raw materials and components for its products are readily available from a number of suppliers and believes that its service needs are not significantly unique from other companies, it is possible that for some of its suppliers who are identified as being non-compliant, certain remediation strategies with the supplier may be employed, at least initially, as an alternative to switching suppliers because of the operational difficulties that switching suppliers could cause. These remediation strategies include, but are not limited to, increasing purchases from the suppliers in question prior to January 1, 2000 to provide a safety stock if the supplier experiences difficulty and providing the Company's Year 2000 compliance resources to assist the supplier in becoming compliant.

Quantitative and Qualitative Disclosures About Market Risk › The Company is exposed to market risk from changes in interest rates and foreign exchange rates.

Interest Rates › The Company's primary interest rate risk relates to its long-term debt obligations. At June 30, 1999, the Company had total long-term obligations, including the current portion of those obligations, of $100,342,000. Of that amount, $3,282,000 was in fixed rate obligations and $97,060,000 was in variable rate obligations. Assuming a 10% increase in interest rates on the Company's variable rate obligations (i.e., an increase from the June 30, 1999 weighted average interest rate of 5.76% to a weighted average interest rate of 6.34%), annual interest expense would be approximately $559,000 higher based on the June 30, 1999 outstanding balance of variable rate obligations. The Company has no interest rate swap or exchange agreements.

Foreign Exchange Rates › A substantial majority of the Company's sales, expenses and cash flows are transacted in U.S. dollars. For the year ended June 30, 1999, sales denominated in currencies other than the U.S. dollar (primarily the German mark, and to a lesser extent the French franc and the Chinese yuan) totaled $23,325,000, or approximately 7% of total sales. For the year ended June 30, 1999, pre-tax income (loss) denominated in currencies other than the U.S. dollar (primarily the Hong Kong dollar and the German mark) totaled $(772,000), or approximately (2%) of total pre-tax income. An adverse change of 10% in exchange rates would have resulted in a decrease in sales of $2,333,000 and an increase in net income of $77,000 for the year ended June 30, 1999. The Company's entities that operate in Germany, France, Hong Kong and China have certain accounts receivable and accounts payable denominated in U.S. dollars in addition to receivable and payable accounts in their home currencies which can act to further mitigate the impact of foreign exchange rate changes. The Company has no significant foreign currency exchange contracts that expose it to market risk.

Inflation › Inflation has not had a significant effect on the Company's business during the periods discussed.

Recent Accounting Pronouncements › In June 1998, the Financial Accounting Standards Board (FASB) issued Statement No. 133 "Accounting for Derivative Instruments and Hedging Activities." As amended by FASB Statement No. 137, "Accounting for Derivative Instruments and Hedging Activities—Deferral of the Effective Date of FASB Statement No. 133," FASB No. 133 will be required to be adopted as of the first quarter of fiscal year 2001. The Company intends to adopt FASB No. 133 by the effective date although earlier adoption is permitted. The statement requires the foreign currency contracts used by the Company to manage the risks associated with foreign currency exchange volatility to be recorded at fair market value, with changes in fair value reflected in earnings to the extent the foreign currency contracts do not qualify as hedges in accordance with the statement. The Company has evaluated its existing foreign currency contracts and management does not believe the statement will have a material effect on earnings for existing contracts.

Consolidated Balance Sheets

June 30	1999	1998
Assets		
Current Assets		
Cash and short-term investments	$ 23,651,401	$ 14,874,753
Trade accounts receivable, less allowance for doubtful accounts of $13,919,000 and $8,246,000	99,253,207	90,985,120
Inventories	61,212,368	58,897,764
Prepaid expenses and other	6,328,742	5,195,638
Deferred income tax benefits	11,407,404	14,948,226
Total Current Assets	201,853,121	184,901,501
Property, Plant and Equipment		
Land	3,342,017	3,360,885
Building	12,687,961	13,564,623
Machinery and equipment	64,603,276	54,087,893
Furniture, office and computer equipment	37,719,450	27,170,001
Leasehold improvements	1,249,044	1,148,251
	119,601,748	99,331,653
Less allowances for depreciation and amortization	58,371,315	50,408,095
	61,230,433	48,923,558
Funds held in trust for construction of new facility	852,631	817,820
Other Assets	11,822,484	14,774,380
Goodwill	65,420,031	68,902,667
	$341,178,701	$318,319,926
Liabilities and Shareholders' Equity		
Current Liabilities		
Accounts payable	$ 26,787,172	$ 20,966,011
Accrued expenses and other	18,762,481	23,226,112
Current portion of long-term obligations	967,387	3,119,617
Total Current Liabilities	46,517,040	47,351,740
Long-Term Obligations	99,374,180	69,316,177
Minority Interest	766,035	812,116
Commitments	—	—
Shareholders' Equity		
Common Stock, $.01 par value; authorized 100,000,000 shares; issued and outstanding 32,999,283 shares at June 30, 1999 and 32,678,632 shares at June 30, 1998	329,993	326,786
Additional capital	108,863,191	105,376,608
Accumulated other comprehensive loss	(1,231,013)	(1,416,465)
Retained earnings	120,709,953	97,648,469
Treasury stock	(34,150,678)	(1,095,505)
Total Shareholders' Equity	194,521,446	200,839,893
	$341,178,701	$318,319,926

See notes to consolidated financial statements.

Consolidated Statements of Operations

Year Ended June 30	1999	1998	1997
Net sales	$357,570,743	$351,576,443	$314,541,736
Cost of goods sold	186,486,458	180,650,363	161,283,031
	171,084,285	170,926,080	153,258,705
General and administrative expenses	41,921,573	34,362,146	27,764,668
General and administrative expenses—increase to allowance for bad debts	6,600,000	2,838,000	2,338,000
Sales, marketing and commission expenses	60,899,432	65,560,336	58,391,202
Research and development expenses	16,713,796	20,224,584	17,835,838
Merger related costs	–0–	40,751,079	–0–
Restructuring charges	2,414,844	–0–	–0–
Costs related to unsolicited offer to acquired Healthdyne	–0–	650,000	2,150,000
Interest expense	5,206,767	4,188,740	3,173,497
Other income	(1,127,847)	(1,513,291)	(2,378,746)
	132,628,565	167,061,594	109,274,459
Income Before Income Taxes	38,455,720	3,864,486	43,984,246
Income taxes	15,394,236	5,689,220	17,559,494
Net income (loss)	$ 23,061,484	$ (1,824,734)	$ 26,424,752
Basic earnings (loss) per share	$ 0.73	$ (0.06)	$ 0.84
Basic shares outstanding	31,521,296	32,097,955	31,292,658
Diluted earnings (loss) per share	$ 0.72	$ (0.06)	$ 0.82
Diluted shares outstanding	31,956,088	32,097,955	32,352,208

See notes to consolidated financial statements.

Consolidated Statements of Shareholders' Equity

	Common Stock		Additional	Accumulated Other Comprehensive	Retained	Treasury Stock		
	Shares	Amount	Capital	Income (Loss)	Earnings	Shares	Amount	Total
Balance at June 30, 1996	30,929,982	$309,300	$ 89,327,044	$ 0	$ 73,046,379	1,819	$ (38,888)	$162,643,835
Shares sold pursuant to stock option plans	726,918	7,269	3,124,787	0	0	0	0	3,132,056
Acquisition of treasury stock	0	0	0	0	0	46,000	(843,560)	(843,560)
Income tax benefit from exercise of stock options	0	0	386,374	0	0	0	0	386,374
Comprehensive income:								
Net income for the year ended June 30, 1997	0	0	0	0	26,426,824	0	0	26,424,752
Other comprehensive loss	0	0	0	(689,813)	0	0	0	(689,813)
Total comprehensive income (loss)	0	0	0	(689,813)	26,424,752	0	0	25,734,939
Balance at June 30, 1997	31,656,900	316,569	92,838,205	(689,813)	99,473,203	47,819	(882,448)	191,055,716
Shares sold pursuant to stock option plans	1,021,732	10,217	8,368,232	0	0	0	0	8,378,449
Acquisition of treasury stock	0	0	0	0	0	2,208	(213,057)	(213,057)
Income tax benefit from exercise of stock options	0	0	4,170,171	0	0	0	0	4,170,171
Comprehensive income:								
Net loss for the year ended June 30, 1998	0	0	0	0	(1,824,734)	0	0	(1,824,734)
Other comprehensive loss	0	0	0	(726,652)	0	0	0	(726,652)
Total comprehensive loss	0	0	0	(726,652)	(1,824,734)	0	0	(2,551,386)
Balance at June 30, 1998	32,678,632	326,786	105,376,608	(1,416,465)	97,648,469	50,027	(1,095,505)	200,839,893
Shares sold pursuant to stock option plans	320,700	3,207	2,850,897	0	0	0	0	2,854,104
Acquisition of treasury stock	0	0	0	0	0	2,639,656	(33,055,173)	(33,055,173)
Income tax benefit from exercise of stock options	0	0	635,686	0	0	0	0	635,686
Comprehensive income:								
Net income for the year ended June 30, 1999	0	0	0	0	23,061,484	0	0	23,061,484
Other comprehensive income	0	0	0	185,452	0	0	0	185,452
Total comprehensive income	0	0	0	185,452	23,061,484	0	0	23,246,936
Balance at June 30, 1999	32,999,332	$329,993	$108,863,191	$(1,231,013)	$120,709,953	2,689,683	$(34,150,678)	$194,521,446

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Year Ended June 30	1999	1998	1997
Operating Activities			
Net income (loss)	$23,061,484	$(1,824,734)	$26,424,752
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	11,554,345	10,586,890	7,420,375
Amortization	4,546,355	3,428,791	2,773,294
Provision for asset write-offs	–0–	18,134,483	–0–
Provision for bad debts	6,600,000	2,838,000	2,335,000
Provision for deferred income taxes	3,540,822	(8,152,329)	(803,924)
Changes in operating assets and liabilities:			
Increase in accounts receivable	(14,868,087)	(11,834,737)	(9,403,845)
Increase in inventories and other current assets	(3,447,708)	(10,499,884)	(5,850,801)
Decrease (increase) in other assets	1,853,366	(1,902,889)	(4,705,223)
Increase (decrease) in accounts payable and accrued expenses	1,317,530	(13,815,149)	1,714,683
Net Cash Provided (Used) by Operating Activities	34,158,107	(13,041,558)	19,904,311
Investing Activities			
Purchase of property, plant and equipment	(23,005,235)	(20,012,780)	(11,186,005)
Acquisition of businesses, net of cash acquired	–0–	–0–	(58,531,208)
Net Cash Used by Investing Activities	(23,005,235)	(20,012,780)	(69,717,213)
Financing Activities			
Proceeds from long-term obligations	28,500,000	68,500,000	21,750,000
Reduction in long-term obligations	(1,450,212)	(46,850,350)	(22,168,575)
Issuance of common stock	3,489,790	8,378,449	3,132,056
Acquisition of treasury stock	(33,055,173)	(213,057)	(843,560)
(Decrease) increase in minority interest	(46,081)	210,044	(283,248)
Net Cash (Used) Provided by Financing Activities	(2,561,676)	30,025,086	1,586,673
Effect of Exchange Rate Changes on Cash	185,452	(726,652)	(689,813)
Increase (Decrease) in Cash and Short-Term Investments	8,776,648	(3,755,904)	(48,916,042)
Cash and short-term investments at beginning of period	14,874,753	18,630,657	67,546,699
Cash and Short-Term Investments at End of Period	$23,651,401	$14,874,753	$18,630,657

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

Note A — Significant Accounting Policies

Principles of Consolidation › The consolidated financial statements include the accounts of Respironics, Inc. (the "Company"), its wholly owned subsidiaries, and a foreign joint venture in which it holds a 51% ownership interest. The joint venture partner's 49% equity interest is included in the Company's financial statements as minority interest. All significant intercompany accounts and transactions have been eliminated in consolidation.

Revenue Recognition › Revenue is recognized from sales when a product is shipped to a customer location.

Inventories › Inventories are valued at the lower of cost (first-in, first-out) or market.

Property, Plant and Equipment › Property, plant and equipment is recorded on the basis of cost. Depreciation is computed using the straight-line method based upon the estimated useful lives of the respective assets, which range from five to 30 years. Amortization of assets under capital leases is included in depreciation expense.

Income Taxes › Provisions for income taxes include deferred taxes resulting from temporary differences in income for financial and tax purposes using the liability method. Such temporary differences result primarily from differences in the carrying value of assets and liabilities.

The Company does not provide for federal income taxes on the undistributed earnings of its foreign subsidiaries (other than deemed dividends which are taxed currently) because such earnings are reinvested and, in the opinion of management, will continue to be reinvested indefinitely.

Foreign Currency Translation › The Company follows Statement of Financial Accounting Standards No. 52 for the translation of the accounts of its foreign subsidiaries and its joint venture. Foreign currency assets and liabilities are translated into U.S. dollars at the rate of exchange existing at the statement date or historical rates depending upon the nature of the account. Income and expense amounts are translated at the average of the monthly exchange rates. Adjustments resulting from these translations are credited or charged directly to accumulated other comprehensive income (loss). Gains and losses resulting from foreign currency transactions are credited or charged directly to income.

Stock Options › Stock options are granted to certain employees and certain members of the Company's Board of Directors at fair market value on the date of the grant. Proceeds from the exercise of common stock options are credited to shareholders' equity at the date the options are exercised. There are no charges or credits to income with respect to these options. The Company follows the requirements of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" in accounting for stock based compensation.

Earnings per Share › Basic earnings per share are based on the weighted average number of shares actually outstanding. Diluted earnings per share are based on the weighted average number of shares actually outstanding and dilutive potential shares, such as dilutive stock options which are determined using the treasury stock method.

Cash and Short-Term Investments › The Company considers all highly liquid investments with a maturity of 90 days or less when purchased to be cash and short-term investments.

Capitalized Software Costs › Software development costs have been capitalized and are being amortized to the cost of product revenues over the estimated economic lives (generally three to five years) of the products that include such software. Total net capitalized software costs were $1,096,000 and $1,978,000 at June 30, 1999 and 1998, respectively.

Advertising Costs › Advertising is charged to expenses during the period in which it is incurred. Total advertising expenses for the fiscal years ended June 30, 1999, 1998 and 1997 were $975,000, $1,138,000 and $1,006,000, respectively.

Goodwill and Other Long Lived Assets › Goodwill is the cost in excess of the fair value of net assets of businesses acquired and is amortized on the straight-line method over periods from 15 to 40 years. Accumulated amortization was $11,664,000 and $8,117,000 at June 30, 1999 and 1998, respectively. The Company evaluates the carrying value of goodwill and other long lived assets for potential impairment on an ongoing basis. Such evaluation considers projected future operating results, trends and other circumstances. If factors indicated that goodwill or other long lived assets could be impaired, the Company would use an estimate of the related undiscounted future cash flows over the remaining life of the goodwill or other long lived asset in measuring whether the goodwill or other long lived asset is recoverable. If such an analysis indicated that impairment had occurred, the Company would adjust the book value of the goodwill or other long lived asset to fair value.

Accrued Expenses and Other › Accrued expense and other includes accrued compensation of $6,532,000 and $6,062,000 at June 30, 1999 and 1998, respectively.

Comprehensive Income › The Company adopted Statement of Financial Accounting Standard No. 130, "Reporting Comprehensive Income," during the fiscal year ended June 30, 1999. This statement establishes standards for the reporting and display of "comprehensive income" and its components, in addition to net income, in the financial statements. Comprehensive income consists of net income and foreign currency translation adjustments and is presented in the Consolidated Statement of Shareholders' Equity. The adoption of Statement No. 130 had no impact on total shareholders' equity. Prior year financial statements have been reclassified to conform to the Statement No. 130 requirements.

Use of Estimates › The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Changes in Presentation of Comparative Financial Statements › Certain amounts in the June 30, 1998 and 1997 financial statements were reclassified to conform with the presentation in the current period.

Note B — Short-Term Investments

Short-term investments consist primarily of money market accounts and certificates of deposit issued by large commercial banks located in the United States and Hong Kong. These investments are readily convertible to cash and are stated at cost which approximates market.

Note C — Inventories

Inventories consisted of the following:

June 30	1999	1998
Raw materials	$23,633,517	$18,540,521
Work-in-process	7,036,132	7,570,524
Finished goods	30,542,719	32,786,719
	$61,212,368	$58,897,764

Notes to Consolidated Financial Statements *(continued)*

Note D — Long-Term Obligations

Long-term obligations consisted of the following:

June 30	1999	1998
1989 Economic Development Revenue Bonds, variable interest rate (effective rate of 4.63%, including letter of credit and remarketing fees, at June 30, 1999), principal payable in annual installments of $200,000 through 2004	$ 1,200,000	$ 1,400,000
Industrial Development Authority Loan, payable in monthly installments of $13,777, including interest at 3%, through June 2005	885,249	1,021,786
Redevelopment Authority Loan, payable in quarterly installments of $14,533, including interest at 5%, through June 2005	331,289	371,589
Redevelopment Authority Loan, payable in monthly installments of $6,296, including interest at 2%, through July 2009	684,253	746,275
Industrial Development Authority Loan, payable in monthly installments of $7,289, including interest at 2%, through March 2010	854,713	926,144
Industrial Development Revenue Bond, payable in quarterly installments of $40,000 plus interest at a floating rate (effective rate of 4.96% including letter of credit fees at June 30, 1999) through November 2009	4,360,000	4,520,000
Commercial Bank Credit Agreement, payable in one lump sum in May 2003 including interest at a floating rate (5.81% at June 30, 1999)	91,500,000	63,000,000
Other	526,063	450,000
	$100,341,567	$72,435,794
Less current portion	967,387	3,119,617
	$ 99,374,180	$69,316,177

The Economic Development Revenue Bonds, the Industrial Development Authority Loans, and the Redevelopment Authority Loans are secured by mortgages on the Company's manufacturing facility in Murrysville, Pennsylvania. The Revenue Bond is secured by a mortgage on the Company's facility in Westminster, Colorado. Proceeds from the bonds and the loans were used to finance the construction and expansion of the facilities. The Commercial Bank Credit Agreement, under which a total of $125,000,000 is available, is unsecured. The Company is required to meet certain financial covenants in connection with these obligations, including those relating to current ratio, ratio of total liabilities to tangible net worth, minimum tangible net worth, leverage, and interest coverage. At June 30, 1999 the Company was in compliance with these covenants. The Commercial Bank Revolving Credit Agreement includes a commitment fee, currently equal to 0.15%, on the unused portion of the facility.

Scheduled maturities of long-term obligations for the next five years are as follows:

	Maturities of Long-Term Debt
2000	$ 967,387
2001	924,815
2002	696,941
2003	92,207,480
2004	716,735
Thereafter	4,828,209
Total	$100,341,567

Interest paid was $5,228,000, $3,790,000 and $2,962,000 for the years ended June 30, 1999, 1998 and 1997, respectively.

Note E—Operating Leases

The Company leases its corporate headquarters, its customer satisfaction centers and certain of its offices, warehouses and manufacturing facilities in the United States and also leases its offices, warehouses and manufacturing facilities in the Far East and in Europe.

The minimum rentals due under noncancelable leases with recurring terms of one year or more as of June 30, 1999 are as follows:

Year Ending June 30	Amount
2000	$3,346,000
2001	2,212,000
2002	1,732,000
2003	1,534,000
2004	1,315,000
Thereafter	164,000

Total rent expense for the years ended June 30, 1999, 1998 and 1997 was $3,900,000, $3,318,000 and $2,533,000, respectively.

Note F—Fair Value of Financial Instruments

The following methods and assumptions were used to estimate the fair value of financial instruments:

Cash and Short-Term Investments › The carrying amount approximates fair value because of the short maturity of those investments.

Long-Term Obligations › The fair values of long-term debt obligations are established from the market values of similar issues.

The carrying amounts of the Company's cash and short-term investments and long-term obligations approximate their fair values at June 30, 1999 and 1998.

Note G—Income Taxes

Income (loss) before income taxes consisted of the following:

Year Ended June 30	1999	1998	1997
United States	$39,228,046	$ 253,254	$40,455,546
Foreign	(772,236)	3,611,232	3,528,700
Total	$38,455,720	$3,864,486	$43,984,246

Year Ended June 30	1999	1998	1997
Income taxes consisted of:			
Current:			
Federal	$10,725,807	$11,046,816	$14,578,734
Foreign	(849,893)	648,804	1,485,216
State	1,977,500	2,145,929	2,299,468
Tax benefit from exercise of stock options	(635,686)	(4,170,171)	(386,374)
	11,217,728	9,671,378	17,977,044
Deferred:			
Federal	2,994,679	(7,017,573)	(796,731)
State	546,143	(1,134,756)	(7,193)
	3,540,822	(8,152,329)	(803,924)
Credit to additional paid in capital for tax benefit from stock option exercises	635,686	4,170,171	386,374
Total Income Taxes	$15,394,236	$ 5,689,220	$17,559,494

The difference between the statutory U.S. federal income tax rate and the Company's effective income tax rate is explained below:

Year Ended June 30	1999	1998	1997
Statutory federal income tax rate	35%	35%	35%
Increases (decreases):			
State taxes	4	17	3
Foreign taxes	(2)	(13)	–0–
Tax credits	(2)	(29)	–0–
Non-deductible expenses (primarily goodwill amortization and certain merger related costs)	5	137	–0–
Other items, net	–0–	–0–	2
Effective Income Tax Rate	40%	147%	40%

Notes to Consolidated Financial Statements *(continued)*

Deferred income tax assets consisted of the following:

June 30	1999	1998
Allowance for bad debts	$ 4,196,645	$ 2,527,747
Depreciation	(14,895)	1,709,546
Accruals and reserves (including inventories) not deducted for tax purposes	7,225,654	10,710,933
Total	$11,407,404	$14,948,226

Undistributed earnings of the foreign subsidiaries on which no U.S. income tax has been provided amounted to $7,587,000 at June 30, 1999.

Income taxes paid were $9,352,998, $18,473,851 and $17,674,183 for the years ended June 30, 1999, 1998 and 1997, respectively.

Note H — Stock Option and Purchase Plans

The Company has in place the 1984 Incentive Stock Option Plan (the "1984 Plan") and the 1992 Stock Incentive Plan (the "1992 Plan") which provide options to eligible employees to purchase common stock over five or ten years at option prices not less than fair market value at the time of the grant. Options become exercisable no sooner than six months from the date of the grant at rates that vary depending on the plan and are subject to possible acceleration in certain circumstances. Under the 1992 Plan, options may include cash payment rights and eligible employees may receive awards of restricted shares of the Company's common stock. The 1984 Plan, which terminated as to new grants in 1993, had 3,400,000 options approved for issuance. The 1992 Plan has a total of 3,000,000 options and restricted shares approved for issuance, including 1,000,000 options that were approved by the Company's shareholders when the 1992 Plan was adopted and an additional 2,000,000 options that were approved by the Company's shareholders in November 1998.

The Company also has in place the 1991 Non-Employee Directors' Stock Option Plan (the "Directors' Plan"). All options under the Directors' Plan are granted to members of the Company's Board of Directors who are not employees of the Company. Each non-employee director receives an option to purchase 5,100 shares on the third business day following the Company's annual meeting of shareholders. These grants will continue until options for all the shares available under the Directors' Plan have been granted. Such options are granted at fair market value on the date of grant. For options granted under the Directors' Plan, 25% of the shares are exercisable one year after the date of the grant, 25% are exercisable two years after the date of grant, and the remaining 50% are exercisable three years after the date of grant. All options granted under the Directors' Plan expire ten years after the date of grant. The Directors' Plan has 300,000 options approved for issuance.

Healthdyne had in place, prior to its merger with the Company, four stock option plans: the 1993 Stock Option Plan; the 1993 Nonemployee Director Stock Option Plan; the 1995 Stock Option Plan II; and 1996 Stock Option Plan. At the date of the merger, the outstanding Healthdyne options were converted into a total of 1,360,061 options to purchase Respironics common stock. Under the terms of the Healthdyne plans, all such options became immediately exercisable at the date of the merger and the plans terminated as to new grants. All future stock option grants will be made from Respironics stock option plans.

Pertinent information regarding options under all Plans is as follows:

	Option Shares		
Year Ended June 30	**1999**	1998	1997
Outstanding at beginning of period	1,843,278	2,696,987	3,122,661
Granted:			
Price range ($12.00–$19.13)	498,906		
Price range ($18.56–$26.84)		248,500	
Price range ($ 9.70–$23.25)			429,274
Exercised:			
Price range ($ 1.38–$24.63)	(320,683)		
Price range ($ 1.00–$22.75)		(1,017,589)	
Price range ($ 1.00–$16.25)			(684,111)
Canceled	(70,640)	(84,350)	(170,837)
Outstanding at end of period (weighted average price $12.74)	1,950,861	1,843,278	2,696,987
Exercisable at end of period	1,187,288	1,458,557	2,345,365
Shares available for future grant	2,149,111	577,377	741,527

The per share weighted-average fair value of stock options granted during 1999, 1998 and 1997 was $6.04, $12.09 and $7.86, respectively, on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

	1999	1998	1997
Expected volatility	52.7%	43.1%	39.8%
Expected dividend yield	none	none	none
Risk-free interest rate	6.0%	5.7%	6.1%
Expected life of stock options	5	5	5

The Company applies APB Opinion No. 25 in accounting for its stock option plans and accordingly, no compensation cost has been recognized for its stock options in the financial statements. Had the Company determined compensation cost based on the fair value at the grant date for its stock options under SFAS 123, the Company's net earnings and related per share amounts would have been reduced to the pro forma amounts indicated below:

	1999	1998	1997
Net earnings (loss):			
As reported	$23,061,484	$(1,824,734)	$26,424,752
Pro forma	21,391,820	(3,243,498)	25,462,011
Diluted earnings (loss) per share:			
As reported	0.72	(0.06)	0.82
Pro forma	0.67	(0.10)	0.79

In March 1997, the Company adopted an Employee Stock Purchase Plan ("Plan") under which employees can purchase common stock of the Company through payroll deductions. The purchase price under the Plan is the lesser of 85% of the market value of the Company's common stock on either the first or last day of the Plan year. The maximum amount each employee can purchase is equal to 20% of annual compensation. There are no charges or credits to income in connection with the Plan. Shares are purchased with the funds set aside through payroll deductions at the end of each Plan year.

In June 1996, the Company adopted a shareholders' rights plan under which existing and future shareholders received a right for each share outstanding entitling such shareholders to purchase shares of the Company's common stock at a specified exercise price. The right to purchase such shares is not currently exercisable, but would become exercisable in the future if certain events occurred relating to a person or group (the "acquiror") acquiring or attempting to acquire 20% or more of the Company's outstanding shares of common stock. In the event the rights become exercisable, each right would entitle the holder (other than the acquiror) to purchase shares of the Company's common stock having a value equal to two times the specified exercise price.

Notes to Consolidated Financial Statements *(continued)*

Note I—Industry Segment, Financial Information by Geographic Areas and Major Customers

The Company conducts its operations in one reportable industry segment; the design, development, manufacture and sale of medical devices. Financial information about the Company by geographic area is presented below.

Year Ended June 30	1999	1998	1997
Net Sales			
United States:			
Unaffiliated customers	$324,070,103	$317,032,121	$290,988,977
Interarea transfers	100,953,047	25,318,249	16,030,250
	425,023,150	342,350,370	307,019,227
Europe:			
Unaffiliated customers	23,324,507	24,094,532	14,348,947
Far East:			
Unaffiliated customers	10,176,133	10,449,790	9,203,812
Interarea transfers	6,505,547	4,713,133	4,883,257
	16,681,680	15,162,923	14,087,069
Elimination—Transfers	107,458,594	30,031,382	20,913,507
Net Sales	$357,570,743	$351,576,443	$314,541,736
Operating Profit			
United States	$ 54,013,927	$ 52,861,539	$ 50,800,333
Europe	(1,173,304)	1,037,896	2,138,534
Far East	3,640,863	4,172,253	3,453,349
Operating Profit	56,481,486	58,071,688	56,392,216
Corporate expense	12,818,999	50,018,462	9,234,473
Interest expense	5,206,767	4,188,740	3,173,497
Income Before Income Taxes	$ 38,455,720	$ 3,864,486	$ 43,984,246

Interarea transfers are accounted for at prices comparable to unaffiliated customer sales reduced by an approximation of costs not incurred on internal sales.

Additional information regarding assets and liabilities by geographic area follows:

June 30	1999	1998
Identifiable Assets		
United States	$275,915,304	$257,892,111
Europe	20,687,292	20,032,689
Far East	9,517,300	10,572,147
	306,119,896	288,496,947
Corporate assets (primarily cash and short-term investments and deferred income taxes)	35,058,805	29,822,979
Total Assets	$341,178,701	$318,319,926
Total Assets		
United States	$304,873,461	$280,174,789
Europe	21,772,570	20,718,545
Far East	14,532,670	17,426,592
	$341,178,701	$318,319,926
Total Liabilities		
United States	$138,300,426	$109,122,934
Europe	4,022,739	4,844,086
Far East	4,334,090	3,513,013
	$146,657,255	$117,480,033

The Company develops, manufactures and markets medical devices for the treatment of patients suffering from respiratory disorders. Its products are used primarily in the home and in hospitals, as well as emergency medical settings and alternative care facilities. The Company sells and rents primarily to distributors in the healthcare industry and closely monitors the extension of credit to both domestic and foreign customers, including obtaining and analyzing credit applications for all new accounts and maintaining an active program to contact customers promptly when invoices become past due. No single customer accounted for 10% or more of net sales for the years ended June 30, 1999, 1998 or 1997.

Note J—Retirement Plans

The Company has a Retirement Savings Plan which is available to all U.S. employees. Employees may contribute up to 15% (to a defined maximum) of their compensation. The Company matches employee contributions (up to 3% of each employee's compensation) at a 100% rate and may make discretionary contributions. Total Company contributions to these plans was $1,270,000, $877,000 and $759,000 for the years ended June 30, 1999, 1998 and 1997, respectively. The Company's current benefit program does not provide postretirement benefits to employees.

Note K—Significant Acquisitions

In February 1998, the Company merged a wholly owned subsidiary with Healthdyne Technologies, Inc. ("Healthdyne") in a stock for stock merger by issuing approximately 12,000,000 shares of the Company's common stock in exchange for the outstanding shares of Healthdyne. The merger was accounted for as a pooling of interests. Accordingly, the consolidated financial statements include, for all periods presented, the combined financial results and financial position of the Company and Healthdyne.

In February 1997, the Company acquired the capital stock of Stimotron Medizinische Gerate GmbH ("Stimotron"). Stimotron was based in Wendelstein, Germany and was the exclusive distributor for the Company's products in that country. The initial consideration paid was $9,000,000 in cash, with the terms of the transaction providing for additional consideration of up to $5,000,000 in cash over the next four years based upon the achievement of certain financial results in Germany. Financing for the initial consideration was obtained from a commercial bank, and financing for the additional consideration, if needed, is expected to come from the Company's Commercial Bank Credit Agreement. The acquisition was treated as a purchase for financial reporting purposes, and accordingly the Company's results of operations include the results of operations of Stimotron since the acquisition date. Goodwill generated by the acquisition is being amortized over 20 years on a straight-line basis.

In October 1996, the Company acquired the capital stock of LIFECARE International, Inc. ("LIFE-CARE"), a developer, manufacturer and marketer of respiratory therapy products, with its primary focus on portable home ventilation therapy, based in Westminster, Colorado. Consideration paid was $50,000,000 in cash. Financing for the acquisition came primarily from the proceeds of a public offering completed by the Company in April 1996. The acquisition was treated as a purchase for financial accounting purposes, and accordingly the Company's results of operations include the results of operations of LIFECARE since the acquisition date. Goodwill generated by the acquisition is being amortized over 20 years on a straight-line basis.

Note L—Contingencies

The Company is a party to actions filed in a federal District Court in January 1995 and June 1996 in which a competitor alleges that the Company's sale in the United States of certain products infringes a total of four of the competitor's patents. In its response to these actions, the Company has denied the allegations and has separately sought judgment that the claims under the patents are invalid and that the Company does not infringe upon the patents. The January 1995 and June 1996 actions have been consolidated, and discovery is currently underway. The Court has granted the Company's motions for summary judgment that the Company does not infringe two of the competitor's patents. The Company believes that none of its products infringe any of the patents in question in the event that any one or more of such patents should be held to be valid and it intends to vigorously defend this position.

Notes to Consolidated Financial Statements *(continued)*

In connection with customer leasing programs with independent leasing companies, the Company is contingently liable, in the event of a customer default, to the leasing companies within certain limits for unpaid installment receivables transferred to the leasing companies. The total exposure for unpaid installment receivables was approximately $16,320,000 and $13,721,000 at June 30, 1999 and 1998, respectively.

Note M — Restructuring

During fiscal year 1999, the Company incurred $2,415,000 in costs related to its decision to enter into a new distribution arrangement for sales of its products in Germany. Under the new arrangement, the Company's products will be distributed by an independent dealer in Germany, and the Company's direct sales efforts in that country will be significantly reduced. Accordingly, costs were incurred to reduce the Company's German workforce and facilities as follows: employment related costs ($1,400,000), asset write-offs ($200,000), and lease buyouts and other direct expenses ($815,000).

In July 1999, the Company announced a major restructuring of its U.S. operations. The major components of the restructuring include the closing of the Westminster, Colorado manufacturing facility, the closing of the 19 customer satisfaction centers throughout the United States, the downsizing of the Marietta, Georgia manufacturing facilities, the opening of a centralized distribution and repair center in Youngwood, Pennsylvania, the realignment of the Company into four divisions with a corresponding management realignment, and a workforce reduction associated with the facility changes and the realignment. The majority of the facility changes are expected to be completed during the second quarter of fiscal year 2000, and the divisional realignment is currently in place.

The total charges associated with the change in German distribution and the restructuring described above are expected to be approximately $25,000,000. The primary components of these charges are employment related costs ($11,000,000), asset write-offs ($7,000,000), lease buyouts and other direct restructuring expenses ($7,000,000). As noted above, $2,415,000 of the charges were recorded in fiscal year 1999 with the remainder expected to be recorded in fiscal year 2000.

Note N — Merger Costs

During the year ended June 30, 1998, the Company incurred approximately $41,000,000 in costs related to the merger with Healthdyne. The primary components of these costs were direct expenses of the transaction ($9,500,000), employment related costs ($9,500,000), asset write-downs to reflect decisions made regarding product and operational standardization (inventory; $11,000,000, other assets; $8,000,000), and other merger related costs ($3,000,000). Transaction and employment costs incurred but not yet paid have been credited to accrued expense and asset write-downs have been credited against the applicable asset accounts. Included in asset write-downs is $1,000,000 resulting from Healthdyne and Respironics conforming accounting practices as they relate to the recording of the allowance for doubtful accounts. Approximately $1,100,000 of merger related costs remain unpaid at June 30, 1999.

Note O — Stock Repurchase

In August 1998, the Company's Board of Directors authorized a stock buy back of up to 1,000,000 shares of the Company's outstanding common stock. In October 1998, the Board of Directors increased the authorization to a total of up to 2,000,000 shares and in March 1999 increased the authorization to a total of up to 3,000,000 shares. During fiscal year 1999, the Company repurchased a total of 2,640,000 shares in open market transactions resulting in a use of cash of $33,055,000. Shares that are repurchased are added to treasury shares pending future use and reduce the number of shares outstanding used in calculating earnings per share.

Note P—Earnings per Share

The following table sets forth the computation of basic and diluted earnings per share:

Year Ended June 30	1999	1998	1997
Numerator:			
Net Income (loss)	$23,061,484	$ (1,824,734)	$26,424,752
Denominator:			
Denominator for basic earnings per share—weighted average shares	31,521,296	32,097,955	31,292,658
Effect of Dilutive Securities Stock Options	434,792	–0–	1,059,550
Denominator for diluted earnings per share—adjusted weighted average shares and assumed conversions	31,956,088	32,097,955	32,352,208
Basic Earnings (Loss) Per Share	$ 0.73	$ (0.06)	$ 0.84
Diluted Earnings (Loss) Per Share	$ 0.72	$ (0.06)	$ 0.82

Note Q—Quarterly Results of Operations (Unaudited)

Following are the unaudited quarterly results of operations for the fiscal years ended June 30, 1999 and 1998:

1999 Three Months Ended	September 30	December 31	March 31	June 30
Net Sales	$86,412,000	$90,197,000	$90,882,000	$90,080,000
Gross Profit	41,646,000	43,348,000	44,304,000	41,786,000
Special Addition to Allowance For Uncollectible Receivables	—	—	—	5,000,000
Restructuring Costs	—	—	—	2,415,000
Net Income	6,309,000	7,359,000	8,621,000	1,132,000
Basic Earnings Per Share	.19	.23	.26	.04
Diluted Earnings Per Share	.19	.23	.26	.04

1998 Three Months Ended	September 30	December 31	March 31	June 30
Net Sales	$90,750,000	$95,472,000	$80,128,000	$85,227,000
Gross Profit	45,022,000	47,093,000	38,228,000	40,583,000
Merger Related Costs	—	—	37,503,000	3,248,000
Costs Associated with Unsolicited Offer to Acquire Healthdyne	650,000	—	—	—
Net Income (Loss)	7,853,851	8,953,000	(22,250,000)	3,618,000
Basic Earnings (Loss) Per Share	.25	.28	(.69)	.11
Diluted Earnings (Loss) Per Share	.24	.27	(.69)	.11

Report of Independent Auditors

Board of Directors
Respironics, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of Respironics, Inc. and subsidiaries as of June 30, 1999 and 1998, and the related consolidated statements of operations, shareholders' equity and cash flows for each of the three years in the period ended June 30, 1999. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Respironics, Inc. and subsidiaries at June 30, 1999 and 1998, and the consolidated results of their operations and their cash flows for each of the three years in the period ended June 30, 1999, in conformity with generally accepted accounting principles.

Ernst & Young LLP

Pittsburgh, Pennsylvania
July 23, 1999

Five-Year Summary *(amounts in thousands except ratios and per share data)*

Year Ended June 30	1999	1998	1997	1996	1995
Per Share Data					
Net income	$ 0.72[1]	$ (0.06)[3]	$ 0.82[3]	$ 0.71	$ 0.58
Book value at year end	5.89	6.14	6.03	5.37	3.14
Results of Operations					
Net sales	$357,571	$351,576	$314,542	$236,471	$203,704
Cost of goods sold	186,487	180,650	161,283	120,597	108,794
Income before income taxes	38,456[1]	3,864[3]	43,984[3]	35,328	27,244
Net income	23,061[1]	(1,825)[3]	26,425[3]	21,486	16,921
Financial Position at Year End					
Working capital	$155,336	$137,550	$110,566	$135,564	$ 71,292
Property, plant and equipment (net)	61,230	48,924	42,094	30,120	26,319
Total assets	341,178	318,320	294,769	232,924	154,088
Long-term obligations	99,374	69,316	48,985	33,035	30,113
Shareholders' equity	194,521	200,840	191,056	162,644	91,185
Other Data					
Capital expenditures	$ 23,005	$ 20,013	$ 11,186	$ 10,066	$ 11,151
Depreciation and amortization	16,101	14,016	10,194	7,021	7,027
Number of employees at year end	1,988	2,045	2,094	1,772	1,720
Weighted average shares outstanding	31,956	33,122	32,352	30,285	29,008
Selected Financial Ratios					
Gross profit as a percent of sales	48%	49%	49%	49%	47%
Income before income taxes as a percent of sales	13%[2]	13%[4]	15%[4]	15%	13%
Effective income tax rate	40%[2]	40%[4]	40%[4]	39%	38%
Net income as a percent of sales	8%[2]	8%[4]	9%[4]	9%	8%
Return on average equity	14%[2]	14%[4]	16%[4]	17%	21%
Debt to equity ratio	51%	35%	26%	20%	33%
Current ratio	4.34x	3.90x	2.90x	4.73x	3.22x

(1) Includes the impact of a special addition to the allowance for doubtful accounts and restructuring charges. These costs reduced net income by $4,449,000 ($0.14 per share) in fiscal year 1999.

(2) Excludes the impact of a special addition to the allowance for doubtful accounts and restructuring charges.

(3) Includes the impact of merger costs and cost associated with an unsolicited offer to acquire Healthdyne. These costs reduced net income by $29,095,000 ($0.88 per share) in fiscal year 1998 and $1,289,000 ($0.04 per share) in fiscal year 1997.

(4) Excludes the impact of merger costs and cost associated with an unsolicited offer to acquire Healthdyne.

Shareholder Information

Corporate Headquarters › 1501 Ardmore Boulevard
Pittsburgh, PA 15221-4401
(412) 731-2100

Annual Meeting of Shareholders › The annual meeting of the shareholders will be held at the Union Trust Building, 501 Grant Street, Pittsburgh, Pennsylvania on November 18, 1999 at 1:00 p.m.

Market for the Company's Common Stock and Related Shareholder Matters › The company's shares are traded on the over-the-counter market and are reported on the NASDAQ National Market System under the symbol RESP. The company began trading on the national over-the-counter market on May 12, 1988. As of October 11, 1999, there were 2,275 shareholders of record of the company's common stock.

The company has never paid a cash dividend with respect to its common stock and does not intend to pay cash dividends in the foreseeable future.

High and low price information for the company's common stock for the applicable quarter is shown below:

Fiscal Year Ended June 30, 1999

	First	Second	Third	Fourth
High	$19.88	$20.75	$21.38	$16.12
Low	$11.25	$9.88	$10.81	$12.38

Fiscal Year Ended June 30, 1998

	First	Second	Third	Fourth
High	$28.13	$30.38	$29.63	$29.13
Low	$21.00	$21.50	$20.63	$14.50

Form 10-K › Copies of the Respironics, Inc. annual report on Form 10-K as filed with the Securities and Exchange Commission will be sent without charge upon written request. Address requests to Dorita Pishko, Corporate Secretary, Respironics, Inc., 1501 Ardmore Boulevard, Pittsburgh, PA 15221-4401.

Shareholder Inquiries / Financial Data › Shareholders, analysts or others seeking information about the company are encouraged to contact Daniel Bevevino, Vice President and Chief Financial Officer, or James Woll, Vice President–Corporate Controller, Respironics, Inc., 1501 Ardmore Boulevard, Pittsburgh, PA 15221-4401.

Market Makers ›

Archipelago, LLC
B-Trade Services LLC
CIBC World Markets Corp.
Deutsche Bank Securities Inc.
Herzog, Heine, Geduld, Inc.
ING Barings Furman Selz, LLC
Instinet Corporation
Island System Corporation
Jefferies & Company, Inc.
Knight Securities LP
Legg Mason Wood Walker Inc.
Mayer & Schweitzer Inc.
McDonald & Company Sec., Inc.
Parker/Hunter Inc.
Prudential Securities Inc.
Robert W. Baird & Co., Inc.
SG Cowen Securities
Sherwood Securities Corp.
Spear, Leeds & Kellogg
Strike Technologies LLC

Research Coverage ›

BT Alex.Brown Inc.
Robert W. Baird
ING Barings
Lynch Jones & Ryan
McDonald Investments Inc.
Midwest Research
Parker/Hunter Inc.
Prudential Vector Healthcare

Transfer Agent and Registrar › Chase Mellon Shareholder Services, Four Station Square, Third Floor, Pittsburgh, PA 15219

General Counsel › Steven P. Fulton

Auditors › Ernst & Young LLP, Pittsburgh, PA 15219