

BOSTON SCIENTIFIC CORP  
Form 10-Q  
November 07, 2007

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

**FORM 10-Q**

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES ACT OF 1934

For the quarterly period ended: September 30, 2007

Commission file number: 1-11083

**BOSTON SCIENTIFIC CORPORATION**  
(Exact name of registrant as specified in its charter)

**DELAWARE**  
(State or other jurisdiction  
of incorporation or organization)

**04-2695240**  
(I.R.S. Employer  
Identification No.)

**One Boston Scientific Place, Natick,**  
**Massachusetts**  
(Address of principal executive offices)

**01760-1537**  
(Zip Code)

Registrant's telephone number, including area code: **(508) 650-8000**

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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 is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

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

<u>Class</u>	<u>Shares Outstanding as of October 31, 2007</u>
Common Stock, \$.01 Par Value	1,490,785,766

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**PART I**  
**FINANCIAL INFORMATION**

**ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

BOSTON SCIENTIFIC CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

<i>(in millions, except per share data)</i>	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Net sales	\$ 2,048	\$ 2,026	\$ 6,204	\$ 5,756
Cost of products sold	575	630	1,706	1,681
Gross profit	1,473	1,396	4,498	4,075
Operating expenses				
Selling, general and administrative expenses	719	719	2,205	1,917
Research and development expenses	271	272	835	741
Royalty expense	48	57	151	177
Amortization expense	155	153	467	356
Purchased research and development	75		72	4,117
Loss on assets held for sale	352		352	
	1,620	1,201	4,082	7,308
Operating (loss) income	(147)	195	416	(3,233)
Other income (expense):				
Interest expense	(147)	(143)	(433)	(291)
Fair-value adjustment for the sharing of proceeds feature of the Abbott Laboratories stock purchase		(13)	(8)	(100)
Other, net	35	12	52	(80)
(Loss) income before income taxes	(259)	51	27	(3,704)
Income tax expense (benefit)	13	(25)	64	150
<b>Net (loss) income</b>	<b>\$ (272)</b>	<b>\$ 76</b>	<b>\$ (37)</b>	<b>\$ (3,854)</b>
<b>Net (loss) income per common share — basic</b>	<b>\$ (0.18)</b>	<b>\$ 0.05</b>	<b>\$ (0.02)</b>	<b>\$ (3.19)</b>
<b>Net (loss) income per common share — assuming dilution</b>	<b>\$ (0.18)</b>	<b>\$ 0.05</b>	<b>\$ (0.02)</b>	<b>\$ (3.19)</b>
<b><u>Weighted-average shares outstanding:</u></b>				
Basic	1,489.8	1,472.8	1,485.5	1,207.0
Assuming dilution	1,489.8	1,486.7	1,485.5	1,207.0

See notes to the unaudited condensed consolidated financial statements.



BOSTON SCIENTIFIC CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

<i>(in millions, except share data)</i>	<b>September 30, 2007</b>	<b>December 31, 2006</b>
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 1,237	\$ 1,668
Trade accounts receivable, net	1,487	1,398
Inventories	814	733
Deferred income taxes	637	583
Assets held for sale <i>(see Note C)</i>	196	333
Prepaid expenses and other current assets	316	475
Total current assets	\$ 4,687	\$ 5,190
Property, plant and equipment, net	1,764	1,715
Investments	435	596
Intangible assets, net	24,272	23,360
Other assets	176	235
<b>Total assets</b>	<b>\$ 31,334</b>	<b>\$ 31,096</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities		
Current debt obligations	\$ 254	\$ 7
Accounts payable and accrued expenses	2,620	2,056
Liabilities associated with assets held for sale <i>(see Note C)</i>	56	68
Other current liabilities	446	540
Total current liabilities	\$ 3,376	\$ 2,671
Long-term debt	7,903	8,895
Deferred income taxes	2,424	2,743
Other long-term liabilities	2,114	1,489
Commitments and contingencies		
Stockholders' equity		
Preferred stock, \$ .01 par value - authorized 50,000,000 shares, none issued and outstanding		
Common stock, \$ .01 par value - authorized 2,000,000,000 shares, 1,490,192,338 shares issued at September 30, 2007 and 1,486,403,445 shares issued at December 31, 2006	15	15
Treasury stock, at cost - 11,728,643 shares at December 31, 2006		(334)
Additional paid-in capital	15,730	15,734
Retained deficit	(239)	(174)
Other stockholders' equity	11	57
	15,517	15,298
<b>Total liabilities and stockholders' equity</b>	<b>\$ 31,334</b>	<b>\$ 31,096</b>

See notes to the unaudited condensed consolidated financial statements.



BOSTON SCIENTIFIC CORPORATION AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

<i>(in millions)</i>	Nine Months Ended September 30,	
	2007	2006
<b>Cash provided by operating activities</b>	<b>\$ 626</b>	<b>\$ 1,480</b>
<u>Investing activities:</u>		
Net purchases of property, plant and equipment	(245)	(213)
Proceeds from maturities of marketable securities		159
<u>Acquisitions</u>		
Payments for the Guidant acquisition		(15,394)
Cash acquired from the Guidant acquisition, including proceeds from Guidant's sale of its vascular intervention and endovascular solutions businesses		6,730
Payments for acquisitions of other businesses, net of cash acquired	(80)	
Payments relating to prior period acquisitions	(213)	(282)
<u>Other investing activity</u>		
Proceeds from sales of investments in and collections of notes receivable from portfolio companies	149	20
Payments for investments in and acquisitions of certain technologies	(47)	(77)
<b>Cash used for investing activities</b>	<b>(436)</b>	<b>(9,057)</b>
<u>Financing activities:</u>		
<u>Debt</u>		
Net payments on commercial paper		(149)
Net (payments on) proceeds from revolving borrowings, notes payable, capital leases and long-term borrowings	(754)	7,037
<u>Equity</u>		
Proceeds from issuances of shares of common stock to Abbott Laboratories		1,400
Proceeds from issuances of shares of common stock to employees	130	137
<b>Cash (used for) provided by financing activities</b>	<b>(624)</b>	<b>8,425</b>
Effect of foreign exchange rates on cash	3	4
Net (decrease) increase in cash and cash equivalents	(431)	852
Cash and cash equivalents at beginning of period	1,668	689
<b>Cash and cash equivalents at end of period</b>	<b>\$ 1,237</b>	<b>\$ 1,541</b>
<b>Supplemental Information:</b>		
Stock and stock equivalents issued for acquisitions	\$ 91	\$ 12,964

See notes to the unaudited condensed consolidated financial statements.



**NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

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**NOTE A – BASIS OF PRESENTATION**

The accompanying unaudited condensed consolidated financial statements of Boston Scientific Corporation have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for fair presentation have been included. Operating results for the three and nine months ended September 30, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. For further information, refer to the consolidated financial statements and footnotes thereto incorporated by reference in our Annual Report on Form 10-K for the year ended December 31, 2006.

On April 21, 2006, we consummated our acquisition of Guidant Corporation. Prior to our acquisition of Guidant, Abbott Laboratories acquired Guidant's vascular intervention and endovascular solutions businesses and agreed to share the drug-eluting technology it acquired from Guidant with us. Refer to our 2006 Annual Report filed on Form 10-K for further details regarding these transactions.

Certain prior year amounts have been reclassified to conform to the current year presentation. See *Note C – Advanced Bionics Transactions*, *Note H – Supplemental Balance Sheet Information*, and *Note L - Segment Reporting* for further details.

**NOTE B – ACQUISITIONS**

In August 2007, we completed our acquisition of 100 percent of the fully diluted equity of Remon Medical Technologies, Inc. Remon is a development-stage company focused on creating communication technology for medical device applications. We paid approximately \$70 million in cash, net of cash acquired, to acquire Remon, in addition to our previous investments of \$3 million. We may also be required to make future payments contingent upon Remon achieving certain performance milestones. The acquisition was intended to expand our sensor and wireless communication technology portfolio, which will complement our existing Cardiac Rhythm Management (CRM) product line. In connection with our acquisition of Remon, we acquired an in-process pressure-sensing system development project, which will be combined with our existing CRM devices, and recorded associated in-process research and development of approximately \$75 million in the third quarter of 2007. We expect to launch devices using pressure-sensing technology in 2013 in Europe and certain other international countries, subject to regulatory approval. As of September 30, 2007, we estimate that the total cost to complete the development project is between \$75 million and \$80 million. We believe that the estimated purchased research and development amount so determined represents the fair value at the date of acquisition and does not exceed the amount a third party would pay for the project.

In January 2007, we acquired 100 percent of the fully diluted equity of EndoTex Interventional Systems, Inc., a developer of stents used in the treatment of stenotic lesions in the carotid arteries. In conjunction with the acquisition of EndoTex, we paid \$102 million, which included five million shares of our common stock valued at \$91 million and cash of \$11 million, in addition to our previous investments and notes issued of approximately \$40 million, plus future consideration that is contingent upon EndoTex achieving certain performance-related milestones. The acquisition is intended to expand our carotid artery disease technology portfolio.

In addition, during the first nine months of 2007, we paid \$213 million of contingent consideration, representing primarily payments to the former shareholders of Advanced Bionics Corporation, which we



had accrued for at December 31, 2006. Certain of our business combinations involve the payment of contingent consideration, some of which are based on the acquired company's revenue during the earn-out period. Consequently, we cannot currently determine the total payments; however, we have developed an estimate of the maximum potential contingent consideration for each of our acquisitions with an outstanding earn-out obligation. On August 9, 2007, we entered an agreement to amend our 2004 merger agreement with Advanced Bionics. Previously, we were obligated to pay future consideration contingent primarily on the achievement of future performance milestones, with certain milestones tied to profitability. We estimated that these payments could amount to as much as \$2.0 billion through 2013. The amended agreement provides a new schedule of consolidated, fixed earnout payments that we are required to make, consisting of \$650 million payable upon closing, expected in January 2008, and \$500 million payable in March 2009. These payments will be the final earnout payments made to Advanced Bionics. See *Note C – Advanced Bionics Transactions* for further discussion of the amendment. The estimated maximum potential amount of future contingent consideration (undiscounted) that we could be required to make associated with our other business combinations, some of which may be payable in common stock, is approximately \$1.0 billion. The milestones associated with the contingent consideration must be reached in certain future periods ranging from 2007 through 2022. The estimated cumulative specified revenue level associated with these maximum future contingent payments is approximately \$3.0 billion.

During 2006, we paid \$28.4 billion to acquire Guidant through a combination of cash, common stock, and fully vested stock options. The purchase price was based upon estimates of the fair value of assets acquired and liabilities assumed.

The following summarizes the Guidant purchase price allocation (in millions):

Cash	\$ 6,708
Intangible assets subject to amortization	7,719
Goodwill	12,572
Other assets	2,271
Purchased research and development	4,169
Current liabilities	(2,014)
Net deferred income taxes	(2,475)
Other long-term liabilities	(592)
	<b>\$ 28,358</b>

Adjustments to the purchase price allocation in 2007 consisted primarily of changes in our estimates for the costs associated with product liability claims and litigation; adjustments in taxes payable and deferred income taxes, including changes in the liability for unrecognized tax benefits resulting from the adoption of Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*; as well as changes in our estimate for Guidant-related exit costs, as described below.

### **Costs Associated with Exit Activities**

Included in the Guidant purchase price allocation at September 30, 2007 is an accrual for \$60 million associated with acquisition-related costs that includes approximately \$46 million for involuntary terminations, change-in-control payments, relocation and related costs, and approximately \$14 million of estimated costs to cancel contractual commitments.

As of the acquisition date, management began to assess and formulate plans to exit certain Guidant activities. As a result of these exit plans, we continue to make severance, relocation and change-in-control payments. The majority of the exit cost accrual relates to our first quarter 2007 reduction of the acquired CRM workforce by approximately 400 employees. The affected workforce included primarily research and development employees, although employees within sales and marketing and certain other



functions were also impacted. We also made smaller workforce reductions internationally across multiple functions in order to eliminate duplicate facilities and rationalize our distribution network in certain countries. During 2007, in connection with finalizing the purchase price allocation, we reduced our estimate for Guidant-related exit costs and recorded an adjustment to goodwill to reflect the change in estimate. We expect that substantially all of the amounts accrued at September 30, 2007 will be paid prior to December 31, 2008.

The components of our accrual for Guidant-related exit and other costs are as follows:

<i>(in millions)</i>	<b>Balance at December 31, 2006</b>	<b>Purchase Price Adjustments</b>	<b>Charges Utilized</b>	<b>Balance at September 30, 2007</b>
Workforce reductions	\$ 163	\$ (46)	\$ (75)	\$ 42
Relocation costs	10		(6)	4
Contractual commitments	25	(6)	(5)	14
	<b>\$ 198</b>	<b>\$ (52)</b>	<b>\$ (86)</b>	<b>\$ 60</b>

### Pro Forma Results of Operations

The following unaudited pro forma information presents a summary of consolidated results of our operations and Guidant, as if the acquisition, the Abbott transaction and the financing for the acquisition had occurred at the beginning of the period. We have adjusted the historical consolidated financial information to give effect to pro forma events that are (i) directly attributable to the acquisition and (ii) factually supportable. We present the pro forma unaudited condensed consolidated financial information for informational purposes only. The pro forma information is not necessarily indicative of what the financial position or results of operations actually would have been had the acquisition, the sale of the Guidant vascular intervention and endovascular solutions businesses to Abbott and the financing transactions with Abbott and other lenders been completed at January 1, 2006. Pro forma adjustments are tax-effected at our effective tax rate.

	<b>Nine Months Ended September 30, 2006</b>
<i>in millions, except per share data</i>	
Net sales	\$ 6,468
Net loss	(4,185)
Net loss per share - basic	\$ (2.84)
Net loss per share - assuming dilution	\$ (2.84)

The unaudited pro forma net loss includes \$360 million for the amortization of purchased intangible assets, as well as the following charges: in-process research and development of \$4.169 billion obtained as part of the Guidant acquisition; expense associated with the step-up value of acquired inventory sold; a tax charge for the drug-eluting stent license right obtained from Abbott; and a fair value adjustment related to the sharing of proceeds feature of the Abbott stock purchase.

**NOTE C – ADVANCED BIONICS TRANSACTIONS**

In August 2007, we entered an agreement to amend our merger agreement with Advanced Bionics. The acquisition of Advanced Bionics in 2004 included potential earnout payments that were contingent primarily on the achievement of future performance milestones, with certain milestones tied to profitability. The amended agreement provides for a new schedule of consolidated, fixed earnout payments by Boston Scientific to former Advanced Bionics Shareholders, consisting of \$650 million payable upon closing, expected in January 2008, and \$500 million payable in March 2009. These payments will be the final earnout payments made to Advanced Bionics. The former shareholders of Advanced Bionics approved the amended merger agreement in September 2007. Following the approval by the former shareholders of Advanced Bionics, we accrued the fair value of these payments in accordance with FASB Statement No. 141, *Business Combinations*, as the payment of this consideration was determinable beyond a reasonable doubt. The fair value of these payments, determined to be \$1.150 billion, was recorded as an increase to goodwill.

In conjunction with the amended merger agreement, we entered a definitive agreement to sell a controlling interest in our auditory business and drug pump development program, acquired with Advanced Bionics, to entities affiliated with the principal former shareholders of Advanced Bionics for an aggregate purchase price of \$150 million. The sale is expected to close in January 2008 and is subject to customary closing conditions, including regulatory approvals. The former shareholders of Advanced Bionics approved the sale in September 2007. The sale will help allow us to better focus on our core businesses and priorities, including the retained pain management business and emerging indications program acquired with Advanced Bionics. We determined that, pursuant to FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, the asset held for sale criteria were met during the third quarter of 2007. As a result, we adjusted the carrying value of the disposal group to its fair value less cost to sell and recorded a loss of approximately \$352 million, representing primarily a writedown of goodwill, which we recorded in the third quarter of 2007. Under the terms of the agreement, we will retain a 12 percent interest in the limited liability companies formed for purposes of operating the auditory business and drug pump program. In accordance with Emerging Issues Task Force (EITF) Issue No. 03-16, *Accounting for Investments in Limited Liability Companies*, we will account for this investment using the equity method of accounting. The assets held for sale and liabilities associated with the assets held for sale included in the accompanying unaudited condensed consolidated balance sheets consist of the following:

<i>(in millions)</i>	<b>September 30, 2007</b>	<b>December 31, 2006</b>
Trade accounts receivable, net	\$ 24	\$ 26
Inventories	22	16
Prepaid expenses and other current assets	1	2
Property, plant and equipment, net	11	11
Goodwill and intangible assets, net	137	276
Other long-term assets	1	2
<b>Assets held for sale</b>	<b>\$ 196</b>	<b>\$ 333</b>
Accounts payable and accrued expenses	\$ 4	\$ 11
Other current liabilities	13	16
Non-current deferred tax liabilities	39	41
<b>Liabilities associated with assets held for sale</b>	<b>\$ 56</b>	<b>\$ 68</b>

The assets and liabilities presented in the table above are primarily U.S. assets and liabilities and are included in our United States reportable segment. The December 31, 2006 balances presented are for comparative purposes and were not classified as held for sale at that date.



The following are the net sales and operating results of the businesses to be sold for the three and nine months ended September 30, 2007 and 2006:

(in millions)	Three Months Ended September 30,				Nine Months Ended September 30,			
	2007		2006		2007		2006	
Net sales	\$	29	\$	22	\$	80	\$	64
Operating loss	\$	(5)	\$	(8)	\$	(23)	\$	(30)

#### NOTE D – INVESTMENTS

We account for our publicly traded investments as available-for-sale securities and record unrealized gains and losses as a separate component of stockholders' equity. During the second quarter of 2007, we announced our decision to monetize the majority of our investment portfolio in order to eliminate investments determined to be non-strategic. According to FASB Staff Position Nos. FAS 115-1 and FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, once the decision is made to sell an available-for-sale security whose fair value is less than its cost basis and the fair value of the security is not expected to recover prior to the expected time of sale, the value of the investment must be written down to its fair value. This reduced value becomes the new cost basis for the investment and any unrealized gains are not recognized in earnings until realized. We recognized losses of \$14 million for the third quarter of 2007 and \$41 million for the first nine months of 2007 associated with our publicly held investments, primarily as a result of the application of these Staff Positions. Certain other publicly held investments had unrealized gains totaling \$12 million at September 30, 2007.

In the third quarter of 2007, we sold publicly held and privately held investments having an aggregate carrying value of \$53 million and recognized associated gains of \$20 million. For the first nine months of 2007, we sold investments having an aggregate carrying value of \$86 million and recognized associated net gains of \$32 million. In addition, in the third quarter of 2007, we recognized a gain of \$14 million associated with the collection of a note receivable from one of our privately held investees, which had been written down in a prior year.

In addition, we recorded losses of \$6 million in the third quarter of 2007 and \$13 million in the first nine months of 2007 due to other-than-temporary impairments associated with our privately held investments and adjustments related to investments accounted for under the equity method. We recorded no other-than-temporary impairments for the third quarter of 2006 and \$105 million for the first nine months of 2006 related to technological delays and financial deterioration of certain of our investments in vascular sealing and gene therapy companies.

#### NOTE E – COMPREHENSIVE (LOSS) INCOME

The following table provides a summary of our comprehensive (loss) income:

<i>(in millions)</i>	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Net (loss) income	\$ (272)	\$ 76	\$ (37)	\$ (3,854)
Foreign currency translation adjustment	11	5	36	51
Net change in derivative financial instruments	(69)	(4)	(74)	(24)
Net change in equity investments	(18)	(3)	(9)	(23)
<b>Comprehensive (loss) income</b>	<b>\$ (348)</b>	<b>\$ 74</b>	<b>\$ (84)</b>	<b>\$ (3,850)</b>

**NOTE F – WEIGHTED-AVERAGE SHARES OUTSTANDING**

The following is a reconciliation of weighted-average shares outstanding for basic and diluted (loss) income per share computations:

<i>(in millions)</i>	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2007</b>	<b>2006</b>	<b>2007</b>	<b>2006</b>
Weighted-average shares outstanding - basic	1,489.8	1,472.8	1,485.5	1,207.0
Net effect of common stock equivalents		13.9		
Weighted-average shares outstanding - assuming dilution	1,489.8	1,486.7	1,485.5	1,207.0

Weighted-average shares outstanding, assuming dilution, excludes the impact of 12.5 million common stock equivalents for the third quarter of 2007, 14.5 million for the first nine months of 2007, and 14.2 million for the first nine months of 2006 due to our net loss position in those periods.

Additionally, weighted-average shares outstanding, assuming dilution, excludes the impact of 45.6 million stock options for the third quarter of 2007, 39.0 million for the third quarter of 2006, 41.3 million for the first nine months of 2007, and 27.1 million for the first nine months of 2006 due to the exercise prices of these stock options being greater than the average market price of our common stock during those periods.

During the nine months ended September 30, 2007, we issued 10.5 million shares of common stock following the exercise or vesting of the underlying stock option or deferred stock unit, or purchase under our employee stock purchase plan.

**NOTE G – STOCK-BASED COMPENSATION**

The following presents the impact of stock-based compensation expense on our unaudited condensed consolidated statements of operations:

(in millions)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Cost of products sold	\$ 6	\$ 4	\$ 14	\$ 12
Selling, general and administrative expenses	16	16	60	59
Research and development expenses	7	6	21	18
	<b>29</b>	<b>26</b>	<b>95</b>	<b>89</b>
Income tax benefit	9	6	28	24
	<b>\$ 20</b>	<b>\$ 20</b>	<b>\$ 67</b>	<b>\$ 65</b>

On May 22, 2007, we extended an offer to our non-director and non-executive employees to exchange certain outstanding stock options for deferred stock units (DSUs). Stock options previously granted under our stock plans with an exercise price of \$25 or more per share were exchangeable for a smaller number of DSUs, based on exchange ratios derived from the exercise prices of the surrendered options. On June 20, 2007, following the expiration of the offer, our employees exchanged approximately 6.6 million options for approximately 1.1 million DSUs, which were subject to additional vesting restrictions. We did not record incremental stock compensation expense as a result of these exchanges because the fair values of the options exchanged equaled the fair values of the DSUs issued.

#### NOTE H – SUPPLEMENTAL BALANCE SHEET INFORMATION

The following are the components of various balance sheet items at September 30, 2007 and December 31, 2006, excluding those assets and associated liabilities classified as held for sale. See *Note C - Advanced Bionics Transactions* for further information.

##### Inventories

(in millions)	September 30, 2007	December 31, 2006
Finished goods	\$ 495	\$ 443
Work-in-process	161	141
Raw materials	158	149
	<b>\$ 814</b>	<b>\$ 733</b>

##### Property, plant and equipment, net

(in millions)	September 30, 2007	December 31, 2006
Property, plant and equipment	\$ 2,940	\$ 2,678
Less: accumulated depreciation	1,176	963
	<b>\$ 1,764</b>	<b>\$ 1,715</b>

Intangible assets, net

(in millions)	September 30, 2007	December 31, 2006
Goodwill	\$ 15,680	\$ 14,480
Technology - core	7,219	7,134
Other intangible assets	2,930	2,878
	<b>25,829</b>	<b>24,492</b>
Less: accumulated amortization	1,557	1,132
	<b>\$ 24,272</b>	<b>\$ 23,360</b>

The increase in our goodwill balance relates primarily to the Advanced Bionics transactions. See *Note B – Business Combinations* and *Note C – Advanced Bionics Transactions* for further discussion.

Our accrual for warranty liabilities was \$63 million at September 30, 2007 and \$53 million at December 31, 2006.

**NOTE I – BORROWINGS AND CREDIT ARRANGEMENTS**

We had outstanding borrowings of \$8.157 billion at September 30, 2007 at a weighted average interest rate of 6.34 percent, as compared to outstanding borrowings of \$8.902 billion at December 31, 2006 at a weighted average interest rate of 6.03 percent. Our borrowings at September 30, 2007 consisted of unsecured subsidiary indebtedness of \$4.0 billion under our senior term loan and our subordinated \$900 million loan from Abbott, unsecured senior corporate notes of \$3.050 billion, and \$250 million in borrowings against our credit and security facility secured by our U.S. trade receivables. Our borrowings as of December 31, 2006 consisted of unsecured subsidiary indebtedness of \$5.0 billion under our senior term loan and our subordinated \$900 million loan from Abbott, and unsecured corporate notes of \$3.050 billion. In the third quarter of 2007, we made a prepayment of \$1.0 billion against the outstanding principal under our five-year term loan. The prepayment satisfied our first scheduled principal repayment of \$650 million in April 2008 and reduced our April 2009 obligation by \$350 million. As a result, the next maturity under our term loan will be in April 2009 for \$300 million.

At September 30, 2007 and December 31, 2006, borrowings available under our revolving credit facility totaled \$2.0 billion. There were no amounts outstanding under this facility as of September 30, 2007 and December 31, 2006. In addition, we maintain a \$350 million credit and security facility secured by our U.S. trade receivables. During the third quarter of 2007, we extended the maturity of this facility to August 2008 and, in connection with the prepayment of our term loan in the third quarter of 2007, borrowed \$250 million against the facility.

Our revolving credit facility and term loan agreement requires that we maintain certain financial covenants. In the third quarter of 2007, we amended this agreement. Among other items, the amendment extends a step-down in the maximum permitted ratio of debt to consolidated EBITDA, as defined by the agreement, as follows:

**From:**

4.5 times to 3.5 times on March 31, 2008

**To:**

4.5 times to 4.0 times on March 31, 2009, and

4.0 times to 3.5 times on September 30, 2009



The amendment also provides for an exclusion from the calculation of consolidated EBITDA, as defined by the agreement, of up to \$300 million of restructuring charges incurred through June 30, 2009 and up to \$500 million of litigation and settlement expenses incurred (net of any litigation or settlement income received) in any period of four fiscal quarters through June 30, 2009, not to exceed \$1.0 billion in the aggregate. There was no change in our minimum required ratio of consolidated EBITDA, as defined by the agreement, to interest expense of greater than or equal to 3.0 to 1.0. As of September 30, 2007, we were in compliance with the required covenants. Exiting the quarter, our ratio of debt to consolidated EBITDA was approximately 3.6 to 1.0 and our ratio of consolidated EBITDA to interest expense was approximately 3.9 to 1.0. Our inability to maintain these covenants could require us to seek to further renegotiate the terms of our credit facilities or seek waivers from compliance with these covenants, both of which could result in additional borrowing costs.

During the third quarter of 2007, our credit ratings from Standard & Poor's Rating Services (S&P) and Fitch Ratings were downgraded to BB+, and our credit rating from Moody's Investor Service was downgraded to Ba1. All of these are non-investment grade ratings and the ratings outlook by all three agencies is currently negative. Credit rating changes may impact our borrowing cost, but do not require the repayment of borrowings. These credit rating changes have not materially increased the cost of our existing borrowings.

#### **NOTE J – COMMITMENTS AND CONTINGENCIES**

The medical device market in which we primarily participate is largely technology driven. Physician customers, particularly in interventional cardiology, have historically moved quickly to new products and new technologies. As a result, intellectual property rights, particularly patents and trade secrets, play a significant role in product development and differentiation. However, intellectual property litigation to defend or create market advantage is inherently complex and unpredictable. Furthermore, appellate courts frequently overturn lower court patent decisions.

In addition, competing parties frequently file multiple suits to leverage patent portfolios across product lines, technologies and geographies and to balance risk and exposure between the parties. In some cases, several competitors are parties in the same proceeding, or in a series of related proceedings, or litigate multiple features of a single class of devices. These forces frequently drive settlement not only of individual cases, but also of a series of pending and potentially related and unrelated cases. In addition, although monetary and injunctive relief is typically sought, remedies and restitution are generally not determined until the conclusion of the proceedings and are frequently modified on appeal. Accordingly, the outcomes of individual cases are difficult to time, predict or quantify and are often dependent upon the outcomes of other cases in other geographies.

Several third parties have asserted that our current and former stent systems infringe patents owned or licensed by them. We have similarly asserted that stent systems or other products sold by these companies infringe patents owned or licensed by us. Adverse outcomes in one or more of the proceedings against us could limit our ability to sell certain stent products in certain jurisdictions, or reduce our operating margin on the sale of these products and could have a material adverse effect on our financial position, results of operations or liquidity.

We are substantially self-insured with respect to general, product liability and securities claims. In the normal course of business, product liability and securities claims are asserted against us. Product liability and securities claims against us may be asserted in the future related to events not known to management at the present time. The absence of significant third-party insurance coverage increases our potential exposure to unanticipated claims or adverse decisions. Product liability claims, product recalls, securities litigation and other litigation in the future, regardless of their outcome, could have a material adverse effect on our financial position, results of operations or liquidity.

We accrue anticipated costs of settlement and damages and, under certain conditions, costs of defense, based on historical experience or to the extent specific losses are probable and estimable. We record losses for claims in excess of the limits of purchased insurance in earnings at the time and to the extent they are probable and estimable. If the estimate of a probable loss is a range and no amount within the range is more likely, we accrue the minimum amount of the range.

In connection with our acquisition of Guidant, the number of legal claims against us, including product liability, private securities and shareholder derivative claims, significantly increased. Our accrual for legal matters that are probable and estimable was \$680 million at September 30, 2007 and \$485 million at December 31, 2006, and includes costs of settlement, damages and defense. The amounts accrued relate primarily to Guidant litigation and claims recorded as part of the purchase price. We continue to assess certain litigation and claims to determine the amounts that management believes will be paid as a result of such claims and litigation and, therefore, additional losses may be accrued in the future, which could adversely impact our operating results, cash flows and our ability to comply with our debt covenants.

In management's opinion, we are not currently involved in any legal proceedings other than those specifically identified below, which, individually or in the aggregate, could have a material effect on our financial condition, operations and/or cash flows. Unless included in our legal accrual or otherwise indicated below, a range of loss associated with any individual material legal proceeding can not be estimated.

Except as disclosed below, there have been no material developments with regards to any matters of litigation or other proceedings disclosed in our 2006 Annual Report on Form 10-K.

#### ***Litigation with Johnson & Johnson***

On October 22, 1997, Cordis Corporation, a subsidiary of Johnson & Johnson, filed a suit for patent infringement against us and SCIMED Life Systems, Inc., our wholly owned subsidiary, alleging that the importation and use of the NIR® stent infringes two patents owned by Cordis. On April 13, 1998, Cordis filed a suit for patent infringement against us and SCIMED alleging that our NIR® stent infringes two additional patents owned by Cordis. The suits were filed in the U.S. District Court for the District of Delaware seeking monetary damages, injunctive relief and that the patents be adjudged valid, enforceable and infringed. A trial on both actions was held in late 2000. A jury found that the NIR® stent does not infringe three Cordis patents, but does infringe one claim of one Cordis patent and awarded damages of approximately \$324 million to Cordis. On March 28, 2002, the Court set aside the damage award, but upheld the remainder of the verdict, and held that two of the four patents had been obtained through inequitable conduct in the U.S. Patent and Trademark Office. On May 27, 2005, Cordis filed an appeal on those two patents and an appeal hearing was held on May 3, 2006. The Court of Appeals remanded the case back to the trial court for further briefing and fact-finding by the Court. On May 16, 2002, the Court also set aside the verdict of infringement, requiring a new trial. On March 24, 2005, in a second trial, a jury found that a single claim of the Cordis patent was valid and infringed. The jury determined liability only; any monetary damages will be determined at a later trial. On March 27, 2006, the judge entered judgment in favor of Cordis, and on April 26, 2006, we filed an appeal. A hearing on the appeal was held on October 3, 2007, and a decision has not yet been rendered. Even though it is reasonably possible that we may incur a liability associated with this case, we do not believe that a loss is probable or estimable. Therefore, we have not accrued for any losses associated with this case.

On April 2, 1997, Ethicon and other Johnson & Johnson subsidiaries filed a cross-border proceeding in The Netherlands alleging that the NIR® stent infringes a European patent licensed to Ethicon. In this action, the Johnson & Johnson entities requested relief, including provisional relief (a preliminary injunction). In October 1997, Johnson & Johnson's request for provisional cross-border relief on the patent was denied by



the Dutch Court, on the ground that it is “very likely” that the NIR® stent will be found not to infringe the patent. Johnson & Johnson’s appeal of this decision was denied. In January 1999, Johnson & Johnson amended the claims of the patent and changed the action from a cross-border case to a Dutch national action. On June 23, 1999, the Dutch Court affirmed that there were no remaining infringement claims with respect to the patent and also asked the Dutch Patent Office for technical advice about the validity of the amended patent. In late 1999, Johnson & Johnson appealed this decision. On March 11, 2004, the Court of Appeals nullified the Dutch Court’s June 23, 1999 decision and the proceedings have been returned to the Dutch Court. In accordance with its 1999 decision, the Dutch Court asked the Dutch Patent Office for technical advice on the validity of the amended patent. On August 31, 2005, the Dutch Patent Office issued its technical advice that the amended patent was valid but left certain legal issues for the Dutch Court to resolve. A hearing has been scheduled for December 21, 2007.

On August 22, 1997, Johnson & Johnson filed a suit for patent infringement against us alleging that the sale of the NIR® stent infringes certain Canadian patents owned by Johnson & Johnson. Suit was filed in the federal court of Canada seeking a declaration of infringement, monetary damages and injunctive relief. On December 2, 2004, the Court dismissed the case, finding all patents to be invalid. On December 6, 2004, Johnson & Johnson appealed the Court’s decision, and in May 2006, the Court reinstated the patent. In August 2006, we appealed the Court’s decision to the Supreme Court. On January 18, 2007, the Supreme Court denied review. A trial has been scheduled for January 21, 2008.

On February 14, 2002, we, and certain of our subsidiaries, filed suit for patent infringement against Johnson & Johnson and Cordis alleging that certain balloon catheters and stent delivery systems sold by Johnson & Johnson and Cordis infringe five U.S. patents owned by Boston Scientific. The complaint was filed in the U.S. District Court for the Northern District of California seeking monetary and injunctive relief. On October 15, 2002, Cordis filed a counterclaim alleging that certain balloon catheters and stent delivery systems sold by Boston Scientific infringe three U.S. patents owned by Cordis and seeking monetary and injunctive relief. On December 6, 2002, we filed an amended complaint alleging that two additional patents owned by us are infringed by the Cordis products. A bench trial on interfering patent issues was held December 5, 2005 and on September 19, 2006, the Court found there to be no interference. Trial began on October 9, 2007 and, on October 31, 2007, the jury found that we infringe a patent of Cordis. No damages were determined because the judge found that Cordis failed to submit evidence sufficient to enable a jury to make a damage assessment. We intend to request the judge to overturn the verdict. The jury also found invalid four of our patents, which were infringed by Cordis.

On March 26, 2002, we and Target Therapeutics, Inc., our wholly owned subsidiary, filed suit for patent infringement against Cordis alleging that certain detachable coil delivery systems and/or pushable coil vascular occlusion systems (coil delivery systems) infringe three U.S. patents, owned by or exclusively licensed to Target. The complaint was filed in the U.S. District Court for the Northern District of California seeking monetary and injunctive relief. In 2004, the Court granted summary judgment in our favor finding infringement of one of the patents. On November 14, 2005, the Court denied Cordis’ summary judgment motions with respect to the validity of the patent. Cordis filed a motion for reconsideration and a hearing was held on October 26, 2006. The Court ruled on Cordis’ motion for reconsideration by modifying its claim construction order. On February 9, 2007, Cordis filed a motion for summary judgment of non-infringement with respect to one of the patents. On July 27, 2007, the Court denied Cordis’ motion. The Court also modified its claim construction and vacated its earlier summary judgment order finding infringement of the Cordis device. Summary judgment motions were renewed by both parties and a hearing on these renewed motions is scheduled for December 3, 2007.

On January 13, 2003, Cordis filed suit for patent infringement against us and SCIMED alleging that our Express<sup>2TM</sup> coronary stent infringes a U.S. patent owned by Cordis. The suit was filed in the U.S. District Court for the District of Delaware seeking monetary and injunctive relief. We answered the complaint, denying the allegations and filed a counterclaim alleging that certain Cordis products infringe a patent



owned by us. On August 4, 2004, the Court granted a Cordis motion to add our Liberté™ coronary stent and two additional patents to the complaint. On June 21, 2005, a jury found that our TAXUS® Express 2™, Express Express™ Biliary, and Liberté stents infringe a Johnson & Johnson patent and that the Liberté stent infringes a second Johnson & Johnson patent. The juries only determined liability; monetary damages will be determined at a later trial. We filed a motion to set aside the verdict and enter judgment in our favor as a matter of law. On May 11, 2006, our motion was denied. With respect to our counterclaim, a jury found on July 1, 2005 that Johnson & Johnson's Cypher®, Bx Velocity®, Bx Sonic™ and Genesis™ stents infringe our patent. Johnson & Johnson filed a motion to set aside the verdict and enter judgment in its favor as a matter of law. On May 11, 2006, the Court denied Johnson & Johnson's motion. Johnson & Johnson filed a motion for reconsideration which was denied on March 27, 2007. On April 17, 2007, Johnson & Johnson filed a second motion to set aside the verdict and enter judgment in its favor as a matter of law or, in the alternative, request a new trial on infringement. That motion was denied and judgment was entered on September 24, 2007. Both parties have filed an appeal. Even though it is reasonably possible that we will incur a liability associated with this case, we do not believe that a loss is probable or estimable. Therefore, we have not accrued for any losses associated with this case.

On March 13, 2003, we and Boston Scientific Scimed, Inc., filed suit for patent infringement against Johnson & Johnson and Cordis, alleging that its Cypher drug-eluting stent infringes one of our patents. The suit was filed in the U.S. District Court for the District of Delaware seeking monetary and injunctive relief. Cordis answered the complaint, denying the allegations, and filed a counterclaim against us alleging that the patent is not valid and is unenforceable. We subsequently filed amended and new complaints in the U.S. District Court for the District of Delaware alleging that the Cypher drug-eluting stent infringes four of our additional patents (Additional Patents). Following the announcement on February 23, 2004 by Guidant Corporation of an agreement with Johnson & Johnson and Cordis to sell the Cypher drug-eluting stent, we amended our complaint to include Guidant and certain of its subsidiaries as co-defendants as to certain patents in suit. We may replace Abbott Laboratories for Guidant as a party in the suit as a result of Abbott's purchase of Guidant's vascular intervention and endovascular solutions businesses. In March 2005, we filed a stipulated dismissal as to three of the four Additional Patents. On July 1, 2005, a jury found that Johnson & Johnson's Cypher drug-eluting stent infringes one of our patents and upheld the validity of the patent. The jury determined liability only; any monetary damages will be determined at a later trial. Johnson & Johnson filed a motion to set aside the verdict and enter judgment in its favor as a matter of law. On June 15, 2006, the Court denied Johnson & Johnson's motion. Johnson & Johnson moved for reconsideration of the Court's decision. A summary judgment hearing as to the remaining patent was held on June 14, 2006. On April 4, 2007, the Court granted summary judgment of non-infringement of the remaining patent and the parties entered a stipulated dismissal as to the claim of that patent on May 11, 2007. A hearing on the reconsideration motion was held on August 10, 2007. On September 24, 2007, the Court denied Cordis' motion for reconsideration. The Court entered judgment and Cordis has appealed.

On December 24, 2003, we (through our subsidiary Schneider Europe GmbH) filed suit against the Belgian subsidiaries of Johnson & Johnson, Cordis and Janssen Pharmaceutica alleging that Cordis' Bx Velocity stent, Bx Sonic stent, Cypher stent, Cypher Select stent, Aqua T3™ balloon and U-Pass balloon infringe one of our European patents. The suit was filed in the District Court of Brussels, Belgium seeking preliminary cross-border, injunctive and monetary relief and sought an expedited review of the claims by the Court. A separate suit was filed in the District Court of Brussels, Belgium against nine additional Johnson & Johnson subsidiaries. The Belgium Court linked all Johnson & Johnson entities into a single action but dismissed the case for failure to satisfy the requirements for expedited review without commenting on the merits of the claims. On August 5, 2004, we refiled the suit on the merits against the same Johnson & Johnson subsidiaries in the District Court of Brussels, Belgium seeking injunctive and monetary relief for infringement of the same European patent. A hearing was held on September 20 and 21, 2007, and a decision has not yet been rendered. In December 2005, the Johnson & Johnson subsidiaries filed a nullity action in France and, in January 2006, the same Johnson & Johnson subsidiaries filed nullity actions in Italy.

and Germany. We have filed a counterclaim infringement action in Italy and an infringement action in Germany.

On May 12, 2004, we filed suit against two of Johnson & Johnson's Dutch subsidiaries, alleging that Cordis' Bx Velocity stent, Bx Sonic stent, Cypher stent, Cypher Select stent, and Aqua T3 balloon delivery systems for those stents, and U-Pass angioplasty balloon catheters infringe one of our European patents. The suit was filed in the District Court of The Hague in The Netherlands seeking injunctive and monetary relief. On June 8, 2005, the Court found the Johnson & Johnson products infringe our patent and granted injunctive relief. On June 23, 2005, the District Court in Assen, The Netherlands stayed enforcement of the injunction. On October 12, 2005, a Dutch Court of Appeals overturned the Assen court's ruling and reinstated the injunction against the manufacture, use and sale of the Cordis products in The Netherlands. Damages for Cordis' infringing acts in The Netherlands will be determined at a later date. Cordis appealed the validity and infringement ruling by The Hague Court. A hearing on this appeal was held on November 2, 2006 and a decision was received on March 15, 2007 finding the patent valid but not infringed. We appealed the Court's decision. A hearing on the appeal is expected during the fourth quarter of 2008.

On September 27, 2004, our wholly owned subsidiary, Boston Scientific Scimed, Inc., filed suit against a German subsidiary of Johnson & Johnson alleging the Cypher drug-eluting stent infringes one of our European patents. The suit was filed in Mannheim, Germany seeking monetary and injunctive relief. A hearing was held on April 1, 2005 and on July 15, 2005, the Court indicated that it would appoint a technical expert. The expert's opinion was submitted to the Court on September 19, 2006. A hearing was held on September 21, 2007 in Mannheim, Germany, and a decision has not yet been rendered.

On October 15, 2004, our wholly owned subsidiary, Boston Scientific Scimed, Inc., filed suit against a German subsidiary of Johnson & Johnson alleging the Cypher drug-eluting stent infringes one of our German utility models. The suit was filed in Mannheim, Germany seeking monetary and injunctive relief. A hearing was held on April 1, 2005 and on July 15, 2005, the Court indicated that it would appoint a technical expert. The expert's opinion was submitted to the Court on September 19, 2006. A hearing was held on September 21, 2007 in Mannheim, Germany, and a decision has not yet been rendered.

On September 25, 2006, Johnson & Johnson filed a lawsuit against us, Guidant and Abbott in the U.S. District Court for the Southern District of New York. The complaint alleges that Guidant breached certain provisions of the amended merger agreement between Johnson & Johnson and Guidant (Merger Agreement) as well as the implied duty of good faith and fair dealing. The complaint further alleges that we and Abbott tortiously interfered with the Merger Agreement by inducing Guidant's breach. The complaint seeks certain factual findings, damages in an amount no less than \$5.5 billion and attorneys' fees and costs. We and Guidant filed a motion to dismiss the complaint on November 15, 2006. Johnson & Johnson filed its opposition to the motion on January 9, 2007, and defendants filed their reply on January 31, 2007. A hearing on the motion to dismiss was held on February 28, 2007. On August 29, 2007, the judge dismissed the tortious interference claims against us and Abbott and the implied duty of good faith and fair dealing claim against Guidant. On October 10, 2007, the Court denied Johnson & Johnson's motion to reconsider the dismissal of the tortious interference claim against us and Abbott. A trial date has not yet been scheduled.

On February 1, 2005, we and Angiotech Pharmaceuticals, Inc. filed suit against Conor Medsystems, Inc., a subsidiary of Johnson and Johnson, in The Hague, The Netherlands seeking a declaration that Conor's drug-eluting stent products infringe patents owned by Angiotech and licensed to us. A hearing was held on October 27, 2006, and a decision was rendered on January 17, 2007 in favor of Angiotech and us. The Court granted an injunction against Conor, prohibiting it from selling its paclitaxel-eluting stent in The Netherlands, and also ordered Conor to pay damages. On April 17, 2007, Conor appealed this decision and on July 19, 2007, we filed our defense to Conor's appeal. On September 5, 2007, the case was dismissed pursuant to a settlement agreement between the parties.

On November 8, 2005, we and Scimed filed suit against Conor alleging that certain of Conor's stent and drug-coated stent products infringe a patent owned by us. The complaint was filed in the U.S. District Court for the District of Delaware seeking monetary and injunctive relief. On December 30, 2005, Conor answered the complaint, denying the allegations. A joint stipulation to dismiss without prejudice was filed on June 7, 2007.

On May 25, 2007, we and Boston Scientific Scimed, Inc. filed suit against Johnson & Johnson and Cordis in the U.S. District Court for the District of Delaware seeking a declaratory judgment of invalidity of a U.S. patent owned by them and of non-infringement by our PROMUS<sup>TM</sup> coronary stent system of the patent.

On June 1, 2007, we and Boston Scientific Scimed, Inc. filed a suit against Johnson & Johnson and Cordis in the U.S. District Court for the District of Delaware seeking a declaratory judgment of invalidity of a U.S. patent owned by them and of non-infringement by our PROMUS coronary stent system of the patent.

On June 22, 2007, we and Boston Scientific Scimed, Inc. filed a suit against Johnson & Johnson and Cordis in the U.S. District Court for the District of Delaware seeking a declaratory judgment of invalidity of a U.S. patent owned by them and of non-infringement by our PROMUS coronary stent system of the patent. A trial is scheduled to begin on August 3, 2009.

***Litigation with Medtronic, Inc.***

On July 25, 2007, the U.S. District Court for the Northern District of California granted our motion to intervene in an action filed February 15, 2006 by Medtronic Vascular, Inc. and certain of its affiliates against Advanced Cardiovascular Systems, Inc. and Abbott Laboratories. As a counterclaim plaintiff in this litigation, we are seeking a declaratory judgment of patent invalidity and of non-infringement by the PROMUS coronary stent system relating to two U.S. patents owned by Medtronic.

***Litigation Relating to St. Jude Medical, Inc.***

On February 2, 2004, Guidant, Guidant Sales Corp. (GSC), Cardiac Pacemakers, Inc. (CPI) and Mirowski Family Ventures LLC filed a declaratory judgment action in the District Court for Delaware against St. Jude Medical and Pacesetter Inc., a subsidiary of St. Jude Medical, alleging that their Epic HF, Atlas HF and Frontier 3x2 devices infringe a patent exclusively licensed to Guidant. Pursuant to a Settlement Agreement dated July 29, 2006 between us and St. Jude Medical, the parties have agreed to limit the scope and available remedies of this case. On June 26, 2007, the parties reached an agreement to settle this litigation and the case has been dismissed.

Guidant Sales Corp., Cardiac Pacemakers, Inc. (CPI) and Mirowski Family Ventures LLC are plaintiffs in a patent infringement suit originally filed against St. Jude Medical and its affiliates in November 1996 in the District Court in Indianapolis. In July 2001, a jury found that a patent licensed to CPI and expired in December 2003, was valid but not infringed by certain of St. Jude Medical's defibrillator products. In February 2002, the District Court reversed the jury's finding of validity. In August 2004, the Federal Circuit Court of Appeals, among other things, reinstated the jury verdict of validity and remanded the matter for a new trial on infringement and damages. The case was sent back to the District Court for further proceedings. Pursuant to a Settlement Agreement dated July 29, 2006 between us and St. Jude Medical, the parties agreed to limit the scope and available remedies of this case. On March 26, 2007, the District Court issued a ruling invalidating the patent. On April 23, 2007, we appealed the Court's ruling.

***Litigation with Medinol Ltd.***

On February 20, 2006, Medinol submitted a request for arbitration against us, and our wholly owned subsidiaries Boston Scientific Ltd. and Boston Scientific Scimed, Inc., under the Arbitration Rules of the World Intellectual Property Organization pursuant to a settlement agreement between Medinol and us dated September 21, 2005. The request for arbitration alleges that the Company's Liberté coronary stent system infringes two U.S. patents and one European patent owned by Medinol. Medinol is seeking to have the patents declared valid and enforceable and a reasonable royalty. The September 2005 settlement agreement provides, among other things, that Medinol may only seek reasonable royalties and is specifically precluded from seeking injunctive relief. As a result, we do not expect the outcome of this proceeding to have a material impact on the continued sale of the Liberté™ stent system internationally or in the United States, the continued sale of the TAXUS® Liberté™ stent system internationally or the launch of the TAXUS® Liberté™ stent system in the United States. We plan to defend against Medinol's claims vigorously. The arbitration hearing was held on September 17 through September 21, 2007, and decision is expected during the first quarter of 2008.

On September 25, 2002, we filed suit against Medinol alleging Medinol's NIRFlex™ and NIRFlex™ Royal products infringe a patent owned by us. The suit was filed in the District Court of The Hague, The Netherlands seeking cross-border, monetary and injunctive relief. On September 10, 2003, the Dutch Court ruled that the patent was invalid. We appealed the Court's decision in December 2003. A hearing on the appeal was held on August 17, 2006. On December 14, 2006, a decision was rendered upholding the trial court ruling. We appealed the Court's decision on March 14, 2007. On May 25, 2007, Medinol moved to dismiss our appeal.

On January 26, 2007, Medinol filed a Vindication Action against us in the German District Court of Munich, Germany. The complaint alleges, and seeks a ruling, that Medinol be deemed the owner of one of our European patents covering coronary stent designs. On May 31, 2007, we responded to the action, denying Medinol's allegations that it is owner of the patent. On September 12, 2007, Medinol withdrew its complaint.

On August 3, 2007, Medinol submitted a request for arbitration against us, and our wholly owned subsidiaries Boston Scientific Ltd. and Boston Scientific Scimed, Inc., under the Arbitration Rules of the World Intellectual Property Organization pursuant to a settlement agreement between Medinol and us dated September 21, 2005. The request for arbitration alleges that our PROMUS coronary stent system infringes five U.S. patents, three European patents and two German Patents owned by Medinol. Medinol is seeking to have the patents declared valid and enforceable and a reasonable royalty. The September 2005 settlement agreement provides, among other things, that Medinol may only seek reasonable royalties and is specifically precluded from seeking injunctive relief. As a result, we do not expect the outcome of this proceeding to have a material impact on the continued sale of the PROMUS stent system internationally or the launch of the PROMUS stent system in the United States. We plan to defend against Medinol's claims vigorously.

***Other Patent Litigation***

On July 28, 2000, Dr. Tassilo Bonzel filed a complaint naming certain of our Schneider Worldwide subsidiaries and Pfizer Inc. and certain of its affiliates as defendants, alleging that Pfizer failed to pay Dr. Bonzel amounts owed under a license agreement involving Dr. Bonzel's patented Monorail® balloon catheter technology. The suit was filed in the U.S. District Court for the District of Minnesota seeking monetary relief. On September 26, 2001, we reached a contingent settlement with Dr. Bonzel involving all but one claim asserted in the complaint. The contingency was satisfied and the settlement is final. On December 17, 2001, the remaining claim was dismissed without prejudice with leave to refile the suit in Germany. Dr. Bonzel filed an appeal of the dismissal of the remaining claim. On July 29, 2003, the Appellate Court affirmed the lower court's dismissal, and on October 24, 2003, the Minnesota Supreme Court denied Dr. Bonzel's petition for further review. On March 26, 2004, Dr. Bonzel filed a similar complaint against us, certain of our subsidiaries and Pfizer in the Federal District Court for the District of Minnesota. We answered, denying the allegations of the complaint. We filed a motion to dismiss the case, and the

case was dismissed with prejudice on November 2, 2004. On February 7, 2005, Dr. Bonzel appealed the Court's decision. On March 2, 2006, the Federal District Court dismissed the appeal and affirmed the lower court's decision. On April 24,

2007, we received a letter from Dr. Bonzel's counsel alleging that the 1995 license agreement with Dr. Bonzel may have been invalid under German law. On May 11, 2007, we responded to Dr. Bonzel's counsel's letter asserting the validity of the 1995 license agreement. On October 5, 2007, Dr. Bonzel filed a complaint against us in Kassel, Germany alleging the 1995 license agreement is invalid under German law and seeking monetary damages. We have not yet answered the complaint, but intend to vigorously defend against its allegations.

On September 12, 2002, ev3 Inc. filed suit against The Regents of the University of California and a subsidiary of ours in the District Court of The Hague, The Netherlands, seeking a declaration that ev3's EDC II and VDS embolic coil products do not infringe three patents licensed to us from The Regents. On October 22, 2003, the Court ruled that the ev3 products infringe three patents licensed to us. On December 18, 2003, ev3 appealed the Court's ruling. A hearing on the appeal has not yet been scheduled. A damages hearing originally scheduled for June 15, 2007 has been postponed and not yet rescheduled. On October 30, 2007, we reached an agreement in principle with ev3 to resolve this matter. The case will be dismissed upon completion of a definitive settlement agreement.

On December 16, 2003, The Regents of the University of California filed suit against Micro Therapeutics, Inc., a subsidiary of ev3, and Dendron GmbH alleging that Micro Therapeutics' Sapphire™ detachable coil delivery systems infringe twelve patents licensed to us and owned by The Regents. The complaint was filed in the U.S. District Court for the Northern District of California seeking monetary and injunctive relief. On January 8, 2004, Micro Therapeutics and Dendron filed a third-party complaint to include us and Target as third-party defendants seeking a declaratory judgment of invalidity and noninfringement with respect to the patents and antitrust violations. On February 17, 2004, we, as a third-party defendant, filed a motion to dismiss us from the case. On July 9, 2004, the Court granted our motion in part and dismissed us and Target from the claims relating only to patent infringement, while denying dismissal of an antitrust claim. On April 7, 2006, the Court denied Micro Therapeutics' motion seeking unenforceability of The Regents' patent and denied The Regents' cross-motion for summary judgment of unenforceability. A summary judgment hearing was held on July 31, 2007 relating to the antitrust claim, and on August 22, 2007, the Court granted summary judgment in our favor and dismissed us from the case. On October 30, 2007, we reached an agreement in principle with ev3 to resolve this matter. The case will be dismissed upon completion of a definitive settlement agreement.

On March 29, 2005, we and our wholly owned subsidiary, Boston Scientific Scimed, Inc., filed suit against ev3 for patent infringement, alleging that ev3's SpideRX™ embolic protection device infringes four U.S. patents owned by us. The complaint was filed in the U.S. District Court for the District of Minnesota seeking monetary and injunctive relief. On May 9, 2005, ev3 answered the complaint, denying the allegations, and filed a counterclaim seeking a declaratory judgment of invalidity and unenforceability, and noninfringement of our patents in the suit. On October 28, 2005, ev3 filed its first amended answer and counterclaim alleging that certain of our embolic protection devices infringe a patent owned by ev3. On June 20, 2006, we filed an amended complaint adding a claim of trade secret misappropriation and claiming infringement of two additional U.S. patents owned by us. On June 30, 2006, ev3 filed an amended answer and counterclaim alleging infringement of two additional U.S. patents owned by ev3. A trial has not yet been scheduled. On October 30, 2007, we reached an agreement in principle with ev3 to resolve this matter. The case will be dismissed upon completion of a definitive settlement agreement.

On May 19, 2005, G. David Jang, M.D. filed suit against us alleging breach of contract relating to certain patent rights covering stent technology. The suit was filed in the U.S. District Court, Central District of California seeking monetary damages and rescission of the contract. On June 24, 2005, we answered,

denying the allegations, and filed a counterclaim. After a Markman ruling relating to the Jang patent rights, Dr. Jang stipulated to the dismissal of certain claims alleged in the complaint with a right to appeal. In February 2007, the parties agreed to settle the other claims of the case. On May 23, 2007, Jang filed an appeal with respect to the remaining patent claims.

On April 4, 2007, SciCo Tec GmbH filed suit against us alleging certain of our balloon catheters infringe a U.S. patent owned by SciCo Tec GmbH. The suit was filed in the U. S. District Court for the Eastern District of Texas seeking monetary and injunctive relief. On May 10, 2007, SciCo Tec filed an amended complaint based on similar allegations as those pled in the original complaint and alleging certain additional balloon catheters and stent delivery systems infringe the same patent. On May 14, 2007 we answered, denying the allegations of the first complaint. On May 29, 2007, we responded to the amended complaint and filed a counterclaim seeking declaratory judgment of invalidity and non-infringement with respect to the patent at issue. A trial has been scheduled for November 10, 2008.

On April 19, 2007, SciCo Tec GmbH, filed suit against us and our subsidiary, Boston Scientific Nedizintechnik GmbH, alleging certain of our balloon catheters infringe a German patent owned by SciCo Tec GmbH. The suit was filed in Mannheim, Germany. We answered the complaint, denying the allegations and filed a nullity action against SciCo Tec relating to one of its German patents. A hearing on the merits in the infringement action is scheduled for February 12, 2008.

In February 2003, Boston Scientific completed its acquisition of Inflow Dynamics, Inc. pursuant to an Agreement and Plan of Merger dated December 2, 2002, among Boston Scientific, Inflow Dynamics, the stockholders of Inflow Dynamics and Eckard Alt, Donald Green and Jerry Griffin, acting in each case solely as members of the Stockholder Representative Committee (the "Merger Agreement"). On September 21, 2006, the Stockholder Representative Committee made a demand for arbitration pursuant to the terms of the Merger Agreement seeking contingent payments with respect to the sales of our Liberté™ stent system and TAXUS Liberté stent system. A hearing was held July 11 and 12, 2007. On September 28, 2007, the arbitration panel found that sales of our Liberté stent system and TAXUS Liberté stent system were not subject to contingent payments under the Merger Agreement, and ordered Inflow Dynamics to reimburse our expenses associated with the arbitration.

### ***Other Proceedings***

On January 10, 2002 and January 15, 2002, Alan Schuster and Antoinette Loeffler, respectively, putatively initiated shareholder derivative lawsuits for and on our behalf in the U.S. District Court for the Southern District of New York against our then current directors and us as nominal defendant. Both complaints allege, among other things, that with regard to our relationship with Medinol, the defendants breached their fiduciary duties to us and our shareholders in our management and affairs, and in the use and preservation of our assets. The suits seek a declaration of the directors' alleged breach, damages sustained by us as a result of the alleged breach and monetary and injunctive relief. On October 18, 2002, the plaintiffs filed a consolidated amended complaint naming two senior officials as defendants and us as nominal defendant. The action was stayed in February 2003 pending resolution of a separate lawsuit brought by Medinol against us. After the resolution of the Medinol lawsuit, plaintiffs, on May 1, 2006, were permitted to file an amended complaint to supplement the allegations in the prior consolidated amended complaint based mainly on events that occurred subsequent to the parties' agreement to stay the action. The defendants filed a motion to dismiss the amended complaint on or about June 30, 2006. The motion was denied without prejudice on October 18, 2006, and the Court ordered that the amended complaint be deemed a demand for our Board of Directors to consider taking action in connection with the allegations of the amended complaint. On February 20, 2007, the Board of Directors responded, rejecting plaintiffs' demand. Defendants filed a renewed motion to dismiss the amended complaint on March 13, 2007. The Court granted Defendants' renewed motion and dismissed the amended complaint on June 13, 2007.

On September 8, 2005, the Laborers Local 100 and 397 Pension Fund initiated a putative shareholder derivative lawsuit on our behalf in the Commonwealth of Massachusetts Superior Court Department for Middlesex County against our directors, certain of our current and former officers, and us as nominal defendant. The complaint alleged, among other things, that with regard to certain matters of regulatory compliance, the defendants breached their fiduciary duties to us and our shareholders in the management and affairs of our business and in the use and preservation of our assets. The complaint also alleged that as a result of the alleged misconduct and the purported failure to publicly disclose material information, certain directors and officers sold our stock at inflated prices in violation of their fiduciary duties and were unjustly enriched. The suits sought a declaration of the directors' and officers' alleged breaches, unspecified damages sustained by us as a result of the alleged breaches and other unspecified equitable and injunctive relief. On September 15, 2005, Benjamin Roussey also initiated a putative shareholder derivative lawsuit in the same Court alleging similar misconduct and seeking similar relief. Following consolidation of the cases, the defendants filed a motion to dismiss the consolidated derivative complaint. Our motion to dismiss was granted without leave to amend on September 11, 2006. On September 21, 2006, plaintiff Laborers Local 100 and 397 Pension Fund filed a motion to alter or amend judgment and for leave to file an amended complaint which was denied on October 19, 2006. The Board of Directors thereafter received two letters from the Laborers Local 100 and 397 Pension Fund dated February 21, 2007. One letter demanded that the Board of Directors investigate and commence action against the defendants named in the original complaint in connection with the matters alleged in the original complaint. The second letter (as well as subsequent letters from the Pension Fund) made a demand for an inspection of certain books and records for the purpose of, among other things, the investigation of possible breaches of fiduciary duty, misappropriation of information, abuse of control, gross mismanagement, waste of corporate assets and unjust enrichment. On March 21, 2007, we rejected the request to inspect books and records on the ground that Laborers Local 100 and 397 Pension Fund had not established a proper purpose for the request.

On September 23, 2005, Srinivasan Shankar, on behalf of himself and all others similarly situated, filed a purported securities class action suit in the U.S. District Court for the District of Massachusetts on behalf of those who purchased or otherwise acquired our securities during the period March 31, 2003 through August 23, 2005, alleging that we and certain of our officers violated certain sections of the Securities Exchange Act of 1934. On September 28, 2005, October 27, 2005, November 2, 2005 and November 3, 2005, Jack Yopp, Robert L. Garber, Betty C. Meyer and John Ryan, respectively, on behalf of themselves and all others similarly situated, filed additional purported securities class action suits in the same Court on behalf of the same purported class. On February 15, 2006, the Court ordered that the five class actions be consolidated and appointed the Mississippi Public Employee Retirement System Group as lead plaintiff. A consolidated amended complaint was filed on April 17, 2006. The consolidated amended complaint alleges that we made material misstatements and omissions by failing to disclose the supposed merit of the Medinol litigation and DOJ investigation relating to the 1998 NIR ON® Ranger with Sox stent recall, problems with the TAXUS® drug-eluting coronary stent systems that led to product recalls, and our ability to satisfy FDA regulations concerning medical device quality. The consolidated amended complaint seeks unspecified damages, interest, and attorneys' fees. The defendants filed a motion to dismiss the consolidated amended complaint on June 8, 2006 which was granted by the Court on March 30, 2007. On April 27, 2007, Mississippi Public Employee Retirement System Group appealed the Court's decision.

On January 19, 2006, George Larson, on behalf of himself and all others similarly situated, filed a purported class action complaint in the U.S. District Court for the District of Massachusetts on behalf of participants and beneficiaries of our 401(k) Retirement Savings Plan (401(k) Plan) and GESOP (together the Plans) alleging that we and certain of our officers and employees violated certain provisions under the Employee Retirement Income Security Act of 1974, as amended (ERISA) and Department of Labor Regulations. On January 26, 2006, February 8, 2006, February 14, 2006, February 23, 2006 and March 3, 2006, Robert Hochstadt, Jeff Klunke, Kirk Harvey, Michael Lowe and Douglas Fletcher, respectively, on behalf of themselves and others similarly situated, filed purported class action complaints in the same Court on behalf of the participants and beneficiaries in our Plans alleging similar misconduct and seeking similar



relief as in the Larson lawsuit. On April 3, 2006, the Court issued an order consolidating the actions and appointing Jeffrey Klunke and Michael Lowe as interim lead plaintiffs. On August 23, 2006, plaintiffs filed a consolidated complaint that purports to bring a class action on behalf of all participants and beneficiaries of our 401(k) Plan during the period May 7, 2004 through January 26, 2006 alleging that we, our 401(k) Administrative and Investment Committee (the Committee), members of the Committee, and certain directors violated certain provisions of ERISA. The complaint alleges, among other things, that the defendants breached their fiduciary duties to the 401(k) Plan's participants. The complaint seeks equitable and monetary relief. Defendants filed a motion to dismiss on October 10, 2006 which was denied by the Court on August 27, 2007. A trial has yet been scheduled.

We have been a defendant in two lawsuits involving the TAXUS Express<sup>2</sup> paclitaxel-eluting coronary stent system in which the plaintiffs are seeking class certification. On November 16, 2006, Michael Seaburn and Beatriz Seaburn filed suit in the U.S. District Court for the Southern District of Florida on behalf of themselves and a purported class of plaintiffs resident in the United States. This suit was voluntarily dismissed by Plaintiffs on June 6, 2007. On January 23, 2007, Ronald E. and Tammy Coterill filed suit in the U.S. District Court for the District of Idaho on behalf of themselves and a purported class of plaintiffs resident in the state of Idaho or any contiguous state. The complaint seeks certification of class status and also compensatory damages for personal injury, restitution of the purchase price, disgorgement of our profits associated with the sale of TAXUS stent systems, and injunctive relief in the form of medical monitoring. The suit was voluntarily dismissed by Plaintiffs on August 17, 2007.

On June 12, 2003, Guidant announced that its subsidiary, EndoVascular Technologies, Inc. (EVT), had entered into a plea agreement with the U.S. Department of Justice relating to a previously disclosed investigation regarding the ANCURE ENDOGRAFT System for the treatment of abdominal aortic aneurysms. At the time of the EVT plea, Guidant had outstanding fourteen suits alleging product liability related causes of action relating to the ANCURE System. Subsequent to the EVT plea, Guidant was notified of additional claims and served with additional complaints. From time to time, Guidant has settled certain of the individual claims and suits for amounts that were not material to Guidant. Currently, Guidant has approximately 16 suits outstanding, and more suits may be filed. Additionally, Guidant has been notified of over 135 unfiled claims that are pending. The cases generally allege the plaintiffs suffered injuries, and in certain cases died, as a result of purported defects in the device or the accompanying warnings and labeling. The complaints seek damages, including punitive damages.

Although insurance may reduce Guidant's exposure with respect to ANCURE System claims, one of Guidant's carriers, Allianz Insurance Company (Allianz), filed suit in the Circuit Court, State of Illinois, County of DuPage, seeking to rescind or otherwise deny coverage and alleging fraud. Additional carriers have intervened in the case and Guidant affiliates, including EVT, are also named as defendants. Guidant and its affiliates also initiated suit against certain of their insurers, including Allianz, in the Superior Court, State of Indiana, County of Marion, in order to preserve Guidant's rights to coverage. The lawsuits are virtually identical and proceeding in both state courts. A trial has not yet been scheduled in either case. On March 23, 2007, the Court in the Indiana lawsuit granted Guidant and its affiliates' motion for partial summary judgment regarding Allianz's duty to defend, finding that Allianz breached its duty to defend 41 ANCURE lawsuits. On April 19, 2007, Allianz filed a notice of appeal of that ruling. On July 11, 2007, the Illinois court entered a final partial summary judgment ruling in favor of Allianz. Guidant appealed the Court's ruling on August 9, 2007.

Shareholder derivative suits relating to the ANCURE System are currently pending in the Southern District of Indiana and in the Superior Court of the State of Indiana, County of Marion. The suits, purportedly filed on behalf of Guidant, initially alleged that Guidant's directors breached their fiduciary duties by taking improper steps or failing to take steps to prevent the ANCURE and EVT related matters described above. The complaints seek damages and other equitable relief. The state court derivative suits have been stayed in favor of the federal derivative action. On March 9, 2007, the Superior Court granted the parties' joint motion

to dismiss the complaint with prejudice for lack of standing in one of the pending state derivative actions. The plaintiff in the federal derivative case filed an amended complaint in December 2005, adding allegations regarding defibrillator and pacemaker products and Guidant's proposed merger with Johnson & Johnson. On January 23, 2006, Guidant and its directors moved to dismiss the amended complaint. On March 17, 2006, a second amended complaint in the federal derivative case was filed. On May 1, 2006, the defendants moved to dismiss the second amended complaint. This motion remains pending.

In July 2005, a purported class action complaint was filed on behalf of participants in Guidant's employee pension benefit plans. This action was filed in the U.S. District Court for the Southern District of Indiana against Guidant and its directors. The complaint alleges breaches of fiduciary duty under the Employee Retirement Income Security Act (ERISA), 29 U.S.C. § 1132. Specifically, the complaint alleges that Guidant fiduciaries concealed adverse information about Guidant's defibrillators and imprudently made contributions to Guidant's 401(k) plan and employee stock ownership plan in the form of Guidant stock. The complaint seeks class certification, declaratory and injunctive relief, monetary damages, the imposition of a constructive trust, and costs and attorneys' fees. A second, similar complaint was filed and consolidated with the initial complaint. A consolidated, amended complaint was filed on February 8, 2006. The defendants moved to dismiss the consolidated complaint, and on September 15, 2006, the Court dismissed the complaint for lack of jurisdiction. In October 2006, the Plaintiffs appealed the Court's decision to the United States Court of Appeals for the Seventh Circuit. A hearing was held on April 10, 2007. In June 2007, the Seventh Circuit vacated the dismissal and remanded the case to the District Court. The Seventh Circuit specifically instructed the District Court to consider potential problems with the Plaintiffs' ability to prove damages or a breach of fiduciary duty. In September 2007, we filed a renewed motion to dismiss the complaint for failure to state a claim. A hearing has not yet been scheduled.

Approximately 75 product liability class action lawsuits and more than 2,200 individual lawsuits involving approximately 5,450 individual plaintiffs are pending in various state and federal jurisdictions against Guidant alleging personal injuries associated with defibrillators or pacemakers involved in the 2005 and 2006 product communications. The majority of the cases in the United States are pending in federal court but 219 cases are currently pending in state courts. On November 7, 2005, the Judicial Panel on Multi-District Litigation established MDL-1708 (MDL) in the United States District Court for the District of Minnesota and appointed a single judge to preside over all the cases in the MDL. In April 2006, the personal injury plaintiffs and certain third-party payors served a Master Complaint in the MDL asserting claims for class action certification, alleging claims of strict liability, negligence, fraud, breach of warranty and other common law and/or statutory claims and seeking punitive damages. The majority of claimants allege no physical injury, but are suing for medical monitoring and anxiety. On July 13, 2007, we reached an agreement to settle certain claims associated with the 2005 and 2006 product communications. Subject to certain conditions, we will pay a total of \$195 million. The agreement includes approximately 4,900 claims of individuals that have been consolidated in the MDL, as well as an undetermined number, but not all, of additional similar claims throughout the country. To date, Guidant has also been informed of over 3,900 other claims of individuals that may or may not mature into filed suits.

An additional sixteen lawsuits are pending internationally. Nine suits are pending in Canada, six of which are putative class actions and three are individual lawsuits. On June 13, 2006, the Minnesota Supreme Court appointed a single judge to preside over all Minnesota state court lawsuits involving cases arising from the recent product communications. The first state court trial has been scheduled in Minnesota for January 28, 2008.

In 2005, Guidant received requests for information in the form of Civil Investigative Demands (CID) from the attorneys general of Arizona, California, Oregon, Illinois, Vermont and Louisiana. These attorneys general advise that approximately twenty-nine other states and the District of Columbia are cooperating in these CID demands. The CIDs pertain to whether Guidant violated any applicable state laws, primarily state



consumer protection laws, in connection with the sale and promotion of certain of its implantable defibrillators. On August 30, 2007, we announced settlement of the CIDs of 35 states and the District of Columbia related to certain of our products. Under the terms of the settlement, our subsidiaries will pay a total of \$16.75 million and admit no liability. We also agreed under the terms of the settlement to extend the supplemental warranty program for the devices subject to the investigations for an additional six months and reaffirmed our commitment to implement changes recommended by the Independent Panel commissioned by Guidant in 2005 such as appointing a Patient Safety Officer, implementing a Patient Safety Advisory Board and enhancing product performance communication to customers and patients.

On November 2, 2005, the Attorney General of the State of New York filed a civil complaint against Guidant pursuant to the New York's Consumer Protection Law (N.Y. Executive Law § 63(12)). In the complaint, the Attorney General alleges that Guidant concealed from physicians and patients a design flaw in its PRIZM 1861 defibrillator from approximately February of 2002 until May 23, 2005. The complaint further alleges that due to Guidant's concealment of this information, Guidant has engaged in repeated and persistent fraudulent conduct in violation of N.Y. Executive Law § 63(12). The Attorney General is seeking permanent injunctive relief, restitution for patients in whom a PRIZM 1861 defibrillator manufactured before April 2002 was implanted, disgorgement of profits, and all other proper relief. This case is currently pending in the MDL in the United States District Court for the District of Minnesota.

Sixty-nine former employees filed charges against Guidant with the U.S. Equal Employment Opportunity Commission (EEOC) alleging that Guidant discriminated against the former employees on the basis of their age when Guidant terminated their employment in the fall of 2004 as part of a reduction in force. In September 2006, the EEOC found probable cause to support the allegations in the charges pending before it. Separately, in April 2006, sixty-one of these former employees also sued Guidant in federal district court for the District of Minnesota, again alleging that Guidant discriminated against the former employees on the basis of their age when it terminated their employment in the Fall of 2004 as part of a reduction in force. All but one of the plaintiffs in the federal court action signed a full and complete release of claims that included any claim based on age discrimination, shortly after their employments ended in 2004. The parties conducted discovery in the Fall of 2006 regarding the issue of the validity of those releases and have since filed cross motions for summary judgment on this issue. A hearing on the summary judgment motions was held on February 21, 2007, and on April 4, 2007, the Court issued a decision in which it held that the releases did not bar the plaintiffs from pursuing their claims of age discrimination against Guidant. On April 30, 2007, Guidant moved the District Court for permission to appeal this decision to the United States Court of Appeals for the Eighth Circuit but on July 18, 2007, the Eighth Circuit Court of Appeals declined to accept our appeal. Counsel for the plaintiffs voluntarily dismissed two of their clients from the case, leaving a total of fifty-nine individual plaintiffs, and have moved the District Court for preliminary certification of the matter as a class action. On September 28, 2007, the Court granted plaintiffs' motion for preliminary certification of their proposed class. Discovery is on-going and the deadline for any additional motions for summary judgment is May 1, 2009. The case is to be ready for trial on August 1, 2009.

Guidant is a defendant in two separate complaints in which plaintiffs allege a right of recovery under the Medicare secondary payer (or MSP) private right of action, as well as related claims. Plaintiffs claim as damages double the amount paid by Medicare in connection with devices that were the subject of recent voluntary field actions. Both of these cases were pending in the MDL in the United States District Court for the District of Minnesota. We moved to dismiss one of the suits and the plaintiff filed an opposition to this motion. The Court held a hearing on the motion to dismiss the MSP claim on March 6, 2007 which was granted on April 16, 2007. Plaintiffs appealed this dismissal to the Eighth Circuit Court of Appeals. Guidant moved to dismiss the appeal for lack of appellate jurisdiction. The Eighth Circuit granted Guidant's motion, and dismissed the MSP appeal, which the MSP plaintiffs now seek to have certified by the District Court for interlocutory appeal. The District Court, however, has stayed this motion and others like it due to the recent announcement of the MDL settlement. Guidant expects to oppose plaintiffs' motion for interlocutory certification if, and when, the court lifts the stay. Guidant expects to file



a motion to dismiss the second MSP claim based on the Court's recent ruling relating to the first MSP claim once the District Court indicates a willingness to hear these motions.

Guidant or its affiliates are defendants in four separate actions brought by private third-party providers of health benefits or health insurance (TPPs). In these cases, plaintiffs allege various theories of recovery, including derivative tort claims, subrogation, violation of consumer protection statutes and unjust enrichment, for the cost of healthcare benefits they allegedly paid for in connection with the devices that have been the subject of Guidant's voluntary field actions. Two of these actions were pending in the multi-district litigation in the federal district court in Minnesota (MDL) as part of a single 'master complaint,' filed on April 24, 2006, which also includes other types of claims by other plaintiffs. The two named TPP plaintiffs in the master complaint claim to represent a putative nationwide class of TPPs. These two TPP plaintiffs had previously filed separate complaints against Guidant. Guidant moved to dismiss the MDL TPP claims in the master complaint for lack of standing and for failure to state a claim. A hearing was held on March 6, 2007, and on April 16, 2007, the MDL Court granted Guidant's motion to dismiss, dismissing the claims of both TPP plaintiffs in the MDL. While most of the claims were dismissed with prejudice, the subrogation claims brought by the TPP plaintiffs were dismissed without prejudice and may later be reasserted. The TPP plaintiffs have filed an appeal of that ruling in the Eighth Circuit which was dismissed for lack of jurisdiction. Plaintiffs have subsequently filed a motion in the District Court for certification of the Eight Circuit's dismissal. We have opposed the Plaintiffs motion for certification.

The other two TPP actions are pending in state court in Minnesota, and are part of the coordinated state court proceeding ordered by the Minnesota Supreme Court. The plaintiffs in one of these cases are a number of Blue Cross & Blue Shield plans, while the plaintiffs in the other case are a national health insurer and its affiliates. The complaints in these cases were served on Guidant on May 18 and June 25, 2006, respectively. Guidant has moved to dismiss both cases. A hearing was held on June 18, 2007, and a decision has not yet been rendered.

In January 2006, Guidant was served with a civil False Claims Act qui tam lawsuit filed in the U.S. District Court for the Middle District of Tennessee in September 2003 by Robert Fry, a former employee alleged to have worked for Guidant from 1981 to 1997. The lawsuit claims that Guidant violated federal law and the laws of the States of Tennessee, Florida and California, by allegedly concealing limited warranty and other credits for upgraded or replacement medical devices, thereby allegedly causing hospitals to file reimbursement claims with federal and state healthcare programs for amounts that did not reflect the providers' true costs for the devices. On April 25, 2006, the Court denied Guidant's motion to dismiss the complaint, but ordered the relator to file a second amended complaint. On May 4, 2006, the relator filed a second amended complaint. On May 24, 2006, Guidant moved to dismiss that complaint, which motion was denied by the Court on September 13, 2006. On October 16, 2006, the United States filed a motion to intervene in this action, which was approved by the Court on November 2, 2006. To date, no state has intervened in this case.

In 2005, the Securities and Exchange Commission began a formal inquiry into issues related to certain of Guidant's product disclosures and trading in Guidant stock. Guidant has cooperated with the inquiry.

On November 3, 2005, a securities class action complaint was filed on behalf of purchasers of Guidant stock between December 1, 2004 and October 18, 2005 in the U.S. District Court for the Southern District of Indiana, against Guidant and several of its officers and directors. The complaint alleges that the defendants concealed adverse information about Guidant's defibrillators and pacemakers and sold stock in violation of federal securities laws. The complaint seeks a declaration that the lawsuit can be maintained as a class action, monetary damages, and injunctive relief. Several additional, related securities class actions were filed in November 2005 and January 2006, and were consolidated with the initial complaint filed on November 3, 2005. The Court issued an order consolidating the complaints and appointed the Iron Workers

of Western Pennsylvania Pension Plan and David Fannon as lead plaintiffs. Lead plaintiffs filed a consolidated amended complaint. In August 2006, the defendants moved to dismiss the complaint. That motion remains pending.

In October 2005, Guidant received administrative subpoenas from the U.S. Department of Justice U.S. Attorney's offices in Boston and Minneapolis, issued under the Health Insurance Portability & Accountability Act of 1996. The subpoena from the U.S. Attorney's office in Boston requests documents concerning marketing practices for pacemakers, implantable cardioverter defibrillators, leads and related products. The subpoena from the U.S. Attorney's office in Minneapolis requests documents relating to Guidant's VENTAK PRIZM 2 and CONTAK RENEWAL and CONTAK RENEWAL 2 devices. Guidant is cooperating in these matters.

On May 3, 2006, Emergency Care Research Institute (ECRI) filed a complaint against Guidant in the U.S. District Court for the Eastern District of Pennsylvania generally seeking a declaration that ECRI may publish confidential pricing information about Guidant's medical devices. The complaint seeks, on constitutional and other grounds, a declaration that confidentiality clauses contained in contracts between Guidant and its customers are not binding and that ECRI does not tortiously interfere with Guidant's contractual relations by obtaining and publishing Guidant pricing information. Guidant's motion to transfer the matter to Minnesota was denied and discovery is proceeding in the Eastern District of Pennsylvania. A trial is expected to be scheduled in late 2007 or early 2008.

On July 17, 2006, Carla Woods and Jeffrey Goldberg, as Trustees of the Bionics Trust and Stockholders' Representative, filed a lawsuit against us in the U.S. District Court for the Southern District of New York. The complaint alleges that we breached the Agreement and Plan of Merger among us, Advanced Bionics Corporation, the Bionics Trust, Alfred E. Mann, Jeffrey H. Greiner, and David MacCallum, collectively in their capacity as Stockholders' Representative, and others dated May 28, 2004 (the Merger Agreement) or, alternatively, the covenant of good faith and fair dealing. The complaint seeks injunctive and other relief. On February 20, 2007, the district court entered a preliminary injunction prohibiting us from taking certain actions until we complete specific actions described in the Merger Agreement. We appealed the preliminary injunction order on March 16, 2007. On April 17, 2007, the District Court issued a permanent injunction. On May 7, 2007, we appealed the permanent injunction order. A hearing on the appeal was held on July 13, 2007. On August 24, 2007, the U.S. Court of Appeals for the Second Circuit affirmed the order of the District Court in part and vacated the order in part. In connection with an amendment to the Merger Agreement and the execution of related agreements in August 2007, the parties agreed to a resolution to this litigation contingent upon the closing of the Amendment and related agreements.

On January 16, 2007, the French Conseil de la Concurrence (one of the bodies responsible for the enforcement of antitrust/competition law in France) issued a Statement of Objections alleging that Guidant had agreed with the four other main suppliers of ICDs in France to collectively refrain from responding to a 2001 tender for ICDs conducted by a group of seventeen University Hospital Centers in France. This alleged collusion is said to be contrary to the French Commercial Code and Article 81 of the European Community Treaty. Guidant France filed a response to the Statement of Objections on March 29, 2007. On June 25, 2007, a further report was issued addressing the defendants' response and recommending that the Conseil pursue the alleged violation of competition law. Guidant France filed its full defense with the Conseil in August, 2007. A hearing before the Conseil was held on October 11, 2007. A decision is expected in late November 2007.

On February 28, 2007, we received a letter from the Congressional Committee on Oversight and Government Reform requesting information relating to our TAXUS stent systems. The Committee's request expressly related to concerns about the safety and off-label use of drug-eluting stents raised by a recent FDA panel. We are one of two device companies asked to provide information about research and

marketing activities relating to drug-eluting stents. We are cooperating with the Committee regarding its request.

### ***FDA Warning Letters***

On December 23, 2005, Guidant received an FDA warning letter citing certain deficiencies with respect to its manufacturing quality systems and record-keeping procedures in its CRM facility in St. Paul, Minnesota. In 2007, following FDA reinspections of our CRM facilities, we resolved the warning letter and all associated restrictions were removed.

On January 26, 2006, legacy Boston Scientific received a corporate warning letter from the FDA, notifying us of serious regulatory problems at three facilities and advising us that our corrective action plan relating to three site-specific warning letters issued to us in 2005 was inadequate. As stated in this FDA warning letter, the FDA may not grant our requests for exportation certificates to foreign governments or approve pre-market approval applications for class III devices to which the quality control or current good manufacturing practices deficiencies described in the letter are reasonably related until the deficiencies have been corrected.

In August 2007, we received a warning letter from the FDA regarding the conduct of clinical investigations associated with our abdominal aortic aneurysm (AAA) stent-graft program acquired from TriVascular, Inc. We are taking corrective action and are cooperating with the FDA's request for documentation on two U.S. clinical trials related to the AAA device dating back to 2004. We terminated the TriVascular AAA program in 2006 and do not believe the recent warning letter will have an impact on the timing of the resolution of our corporate warning letter.

## **NOTE K – INCOME TAXES**

### ***Tax Rate***

The following table provides a summary of our reported tax rate:

	<b>Three Months Ended September 30, 2007</b>		<b>Percentage Point Increase (Decrease)</b>
	<b>2007</b>	<b>2006</b>	
Reported tax rate	(5)%	(49)%	44%
Impact of certain charges*	(18)%	(72)%	54%

	<b>Nine Months Ended September 30, 2007</b>		<b>Percentage Point Increase (Decrease)</b>
	<b>2007</b>	<b>2006</b>	
Reported tax rate	237%	(4)%	241%
Impact of certain charges*	219%	(27)%	246%

\*These charges are taxed at different rates than our effective tax rate.

The differences in our reported tax rate for the third quarter of 2007 and the first nine months of 2007 as compared to the same periods in the prior year related primarily to the impact of certain charges that are taxed at different rates than our effective tax rate. In 2007, these charges included purchased in-process research and development and goodwill writedowns not deductible for tax purposes, as well as discrete items associated with resolution of various

tax matters and changes in estimates for tax benefits claimed

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related to prior periods. In 2006, these charges included in-process research and development associated with the acquisition of Guidant; a charge to step-up the value of acquired inventory sold during the quarter; a tax charge for the drug-eluting stent license right obtained from Abbott; the fair value adjustment related to the sharing of proceeds feature of the Abbott stock purchase; and the net reserve increase resulting from tax audit settlements and new tax reserve items that originated in the quarter. In addition, our projected annual effective tax rate for 2007 decreased by approximately five percentage points as compared to the prior year, due primarily to our decision at the end of 2006 to indefinitely reinvest earnings in foreign operations in order to repay debt obligations associated with the Guidant acquisition, additional foreign tax credits, and changes in the geographic mix of our revenues.

Effective January 1, 2007, we adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*. As a result of the implementation of Interpretation No. 48, we recognized an approximately \$128 million increase in our liability for unrecognized tax benefits. Approximately \$28 million of this increase was reflected as a reduction to the January 1, 2007 balance of retained earnings. Substantially all of the remaining increase related to pre-acquisition uncertain tax liabilities related to Guidant which we recorded as an increase to goodwill in accordance with EITF Issue No. 93-7, *Uncertainties Related to Income Taxes in a Purchase Business Combination*. At the adoption date of January 1, 2007, we had \$1.155 billion of gross unrecognized tax benefits, \$360 million of which, if recognized, would affect our effective tax rate. At September 30, 2007, we had \$1.114 billion of gross unrecognized tax benefits, \$358 million of which, if recognized, would affect our effective tax rate.

We are subject to U.S. federal income tax as well as income tax of multiple state and foreign jurisdictions. We have concluded all U.S. federal income tax matters through 1997. Substantially all material state, local, and foreign income tax matters have been concluded for all years through 2001.

During the first nine months of 2007, we settled several audits, obtained an Advance Pricing Agreement between the U.S. and Japan, and received a favorable appellate court decision on a previously outstanding Japan matter with respect to the 1995 to 1998 tax periods. As a result of the settlement of these matters, we decreased our reserve for uncertain tax positions, net of payments, by \$67 million, inclusive of \$16 million of interest and penalties. Of this amount, we treated \$53 million as a reduction in goodwill in accordance with Issue No. 93-7, and we recorded the remaining \$14 million to earnings. It is reasonably possible that within the next twelve months we will resolve multiple issues with taxing authorities, including matters presently under consideration at IRS Appeals related to Guidant's acquisition of Intermedics, Inc., in which case we could record a reduction in our balance of unrecognized tax benefits of up to approximately \$105 million.

Our historical practice was and continues to be to recognize interest and penalties related to income tax matters in income tax expense. We had \$221 million accrued for interest and penalties at adoption of Interpretation No. 48 and \$258 million at September 30, 2007. The total amount of interest and penalties recognized in the unaudited condensed consolidated statements of operations was \$21 million for the third quarter of 2007 and \$53 million for the first nine months of 2007.

#### **NOTE L – SEGMENT REPORTING**

We have four reportable operating segments based on geographic regions: the United States, Europe, Asia Pacific and Inter-Continental. In the third quarter of 2007, we revised our reportable segments to reflect the way we currently manage and view our business. We combined certain countries that were previously part of our Inter-Continental region with Japan to form a new Asia Pacific region. There were no material changes to the composition of our Europe or United States segments. Each of our reportable segments generates revenues from the sale of medical devices. The reportable segments represent an aggregate of all operating divisions within each segment. We measure and evaluate our reportable segments based on

segment income. This segment income excludes certain corporate and manufacturing expenses associated with divisions that do not meet the definition of a segment, as defined by FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*. In addition, acquisition- and divestiture-related and restructuring charges, as well as amortization expense, are excluded from segment income. Although we exclude these amounts from segment income, they are included in reported consolidated net (loss) income and are included in the reconciliation below.

Sales and operating results of reportable segments are based on internally derived standard foreign exchange rates, which may differ from year to year and do not include intersegment profits. We have restated the segment information for 2006 net sales and operating results based on our standard foreign exchange rates used for 2007. In addition, we have reclassified previously reported 2006 segment results to be consistent with the 2007 presentation. Because of the interdependence of the reportable segments, the operating profit as presented may not be representative of the geographic distribution that would occur if the segments were not interdependent. We base enterprise-wide information on actual foreign exchange rates used in our unaudited condensed consolidated financial statements. A reconciliation of the totals reported for the reportable segments to the applicable line items in our unaudited condensed consolidated financial statements is as follows:

(in millions)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
<b>Net sales</b>				
United States	\$ 1,207	\$ 1,273	\$ 3,697	\$ 3,579
Europe	373	385	1,212	1,131
Asia Pacific	312	243	862	696
Inter-Continental	103	111	311	332
Net sales allocated to reportable segments	\$ 1,995	\$ 2,012	\$ 6,082	\$ 5,738
Foreign exchange	53	14	122	18
	\$ 2,048	\$ 2,026	\$ 6,204	\$ 5,756
<b>(Loss) income before income taxes</b>				
United States	\$ 315	\$ 394	\$ 1,016	\$ 1,301
Europe	185	190	601	582
Asia Pacific	186	124	492	362
Inter-Continental	47	52	140	161
Operating income allocated to reportable segments	\$ 733	\$ 760	\$ 2,249	\$ 2,406
Manufacturing operations	(159)	(157)	(477)	(397)
Corporate expenses and foreign exchange	(129)	(121)	(431)	(386)
Acquisition- and divestiture-related charges	(437)	(134)	(458)	(4,500)
Amortization expense	(155)	(153)	(467)	(356)
	(147)	195	416	(3,233)
Other expense	(112)	(144)	(389)	(471)
	\$ (259)	\$ 51	\$ 27	\$ (3,704)



## NOTE M – NEW ACCOUNTING PRONOUNCEMENTS

### *Statement No. 159*

In February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115*, which allows an entity to elect to record financial assets and liabilities at fair value upon their initial recognition on a contract-by-contract basis. Subsequent changes in fair value would be recognized in earnings as the changes occur. Statement No. 159 also establishes additional disclosure requirements for these items stated at fair value. Statement No. 159 is effective for our 2008 fiscal year, with early adoption permitted, provided that we also adopt Statement No. 157, *Fair Value Measurements*. We are in the process of determining the effect of adoption of Statement No. 159, but we do not believe such adoption will materially impact our future results of operations or financial position.

### *Statement No. 157*

In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements*. Statement No. 157 defines fair value, establishes a framework for measuring fair value in accordance with U.S. GAAP, and expands disclosures about fair value measurements. Statement No. 157 does not require any new fair value measurements; rather, it applies to other accounting pronouncements that require or permit fair value measurements. We are required to apply the provisions of Statement No. 157 prospectively as of January 1, 2008, and recognize any transition adjustment as a cumulative-effect adjustment to the opening balance of retained earnings. We are in the process of determining the effect of adoption of Statement No. 157, but we do not believe such adoption will materially impact our future results of operations or financial position.

### *Issue No. 06-3*

In June 2006, the FASB ratified EITF Issue No. 06–3, *How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation)*. The scope of this consensus includes any taxes assessed by a governmental authority that are directly imposed on a revenue producing transaction between a seller and a customer and may include, but are not limited to: sales, use, value-added, and some excise taxes. Per the consensus, the presentation of these taxes on either a gross (included in revenues and costs) or a net (excluded from revenues) basis is an accounting policy decision that should be disclosed. We present sales net of sales taxes in our unaudited condensed consolidated statements of operations. Issue No. 06–3 is effective for interim and annual reporting periods beginning after December 15, 2006. No change of presentation has resulted from our adoption of Issue No. 06–3.

## NOTE N – SUBSEQUENT EVENTS

In August 2007, we announced our intent to explore the joint sale of our Cardiac Surgery and Vascular Surgery businesses. In November 2007, we entered a definitive agreement to sell these businesses for a cash price of approximately \$750 million. We expect the transaction to close late in the fourth quarter of 2007 or in the first quarter of 2008, subject to regulatory approvals and customary conditions. We acquired the Cardiac Surgery business in April 2006 as part of the Guidant transaction, and acquired the Vascular Surgery business in 1995. The net assets of the Cardiac Surgery and Vascular Surgery businesses were approximately \$750 million as of September 30, 2007, and are comprised primarily of intangible assets.

In October 2007, our Board of Directors approved, and we committed to, an expense and workforce reduction plan, which will result in the elimination of approximately 2,300 positions worldwide. We will provide affected employees with severance packages, outplacement services and other appropriate assistance and support. The plan is intended to bring expenses in line with revenues as part of our initiatives to enhance short- and long-term shareholder value. Activities under the plan will be initiated in the fourth quarter of 2007 and are expected to be substantially completed

worldwide by the end of 2008. The plan includes the restructuring of several business units and product franchises in order to leverage

resources, strengthen competitive positions, and create a more simplified and efficient business model. We expect that the plan will result in total pre-tax expenses of approximately \$450 million to \$475 million, of which \$275 million to \$300 million will be recorded in the fourth quarter of 2007 and the remainder recorded throughout 2008 and into 2009. The fourth quarter expenses relate primarily to termination benefits recorded pursuant to FASB Statement No. 112, *Employer's Accounting for Postemployment Benefits* and asset write-offs. We estimate asset write-offs in the fourth quarter will be approximately \$40 million. These write-offs relate primarily to intangible assets and fixed assets that are not recoverable following our decision in October 2007 to (i) commit to the expense and workforce reduction plan, including the elimination, suspension or reduction of spending on certain R&D projects, and (ii) restructure several businesses. We expect approximately \$400 million to \$425 million of these expenses to result in cash outlays, with the remainder being non-cash expenses. We will record these expenses primarily as restructuring charges with a portion recorded through other lines within our consolidated statements of operations.

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

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### Overview

Boston Scientific Corporation is a worldwide developer, manufacturer and marketer of medical devices that are used in a broad range of interventional medical specialties. Our mission is to improve the quality of patient care and the productivity of healthcare delivery through the development and advocacy of less-invasive medical devices and procedures. We accomplish this mission through the continuing refinement of existing products and procedures and the investigation and development of new technologies that can reduce risk, trauma, cost, procedure time and the need for aftercare. Our approach to innovation combines internally developed products and technologies with those we obtain externally through our strategic acquisitions and alliances. The growth and success of our organization is dependent upon the shared values of our people. Our quality policy, applicable to all employees, is "I improve the quality of patient care and all things Boston Scientific." This personal commitment connects our people with the vision and mission of Boston Scientific.

Our operating results for the nine months ended September 30, 2007 include the full nine-month results of our Cardiac Rhythm Management (CRM) and Cardiac Surgery businesses that we acquired as part of Guidant Corporation on April 21, 2006. Our operating results for the nine months ended September 30, 2006 include the results of CRM and Cardiac Surgery beginning on the date of acquisition.

### Financial Summary

#### *Three Months Ended September 30, 2007 and 2006*

Our net sales for the third quarter of 2007 increased to \$2.048 billion from \$2.026 billion for the third quarter of 2006, an increase of one percent. Our reported net loss for the third quarter of 2007 was \$272 million, or \$0.18 per diluted share, as compared to net income of \$76 million, or \$0.05 per diluted share, for the third quarter of 2006.

Our reported results for the third quarter of 2007 included acquisition- and divestiture-related charges (after-tax) of \$435 million, or \$0.29 per share, consisting primarily of a loss of approximately \$352 million attributable principally to the writedown of goodwill in connection with the anticipated sale of our auditory and drug pump businesses, expected to close in January 2008; \$75 million of in-process research and development acquired from Remon Medical Technologies, Inc. during the quarter; and \$8 million of Guidant integration costs.

Our reported results for the third quarter of 2006 included acquisition-related charges (after-tax) of \$77 million, or \$0.05 per share, consisting of \$59 million associated with the step-up value of acquired Guidant inventory sold during the quarter, and \$18 million in other Guidant acquisition-related costs, including a CRM technology offering charge, a fair value adjustment to the sharing of proceeds feature of the Abbott Laboratories stock purchase and integration costs.

#### *Nine Months Ended September 30, 2007 and 2006*

Our net sales for the first nine months of 2007 increased to \$6.204 billion from \$5.756 billion for the first nine months of 2006, an increase of eight percent. The increase in net sales is attributable primarily to the inclusion of net sales from our CRM and Cardiac Surgery divisions for nine months in 2007, whereas the results for these divisions were included only following the April 21, 2006 acquisition date in 2006. Our



reported net loss for the first nine months of 2007 was \$37 million, or \$0.02 per diluted share, as compared to \$3.854 billion, or \$3.19 per diluted share, for the first nine months of 2006.

Our reported results for the first nine months of 2007 included acquisition- and divestiture-related charges (after-tax) of \$456 million, or \$0.30 per share, consisting primarily of: a loss of approximately \$352 million attributable principally to the writedown of goodwill in connection with the anticipated sale of our auditory and drug pump businesses, \$71 million of in-process research and development, and \$33 million in other Guidant acquisition-related costs including integration costs and a fair value adjustment to the sharing of proceeds feature of the Abbott Laboratories stock purchase.

Our reported results for the first nine months of 2006 included acquisition-related charges (after-tax) of \$4.566 billion, or \$3.77 per share, consisting primarily of: \$4.483 billion in expenses resulting from purchase accounting associated principally with in-process research and development obtained as part of the Guidant acquisition and the step-up value of acquired inventory sold; \$114 million in other Guidant acquisition-related costs, including a fair value adjustment related to the sharing of proceeds feature of the Abbott stock purchase, a CRM technology offering charge and integration costs; and a \$31 million credit resulting primarily from the reversal of acquisition-related obligations following the cancellation of the abdominal aortic aneurysm (AAA) stent-graft program that we obtained as part of our 2005 acquisition of TriVascular, Inc.

## Outlook

### *Coronary Stent Business*

Coronary stent revenue represented approximately 25 percent of our consolidated net sales during the third quarter of 2007. We estimate that the worldwide coronary stent market will approximate \$5.0 billion in 2007, as compared to approximately \$6.0 billion in 2006, and estimate that drug-eluting stents will represent approximately 80 percent of the dollar value of worldwide coronary stent market sales in 2007, as compared to 90 percent for 2006. Market size is driven primarily by the number of percutaneous coronary intervention (PCI) procedures performed; the number of devices used per procedure; average drug-eluting stent selling prices; and the drug-eluting stent penetration rate, or a measure of the mix between bare metal and drug-eluting stents used across procedures. Uncertainty regarding the efficacy of drug-eluting stents, as well as the increased perceived risk of late stent thrombosis following the use of drug-eluting stents has contributed to a decline in the worldwide coronary stent market size. However, recent data addressing this risk and supporting the safety of drug-eluting stent systems could positively affect the number of PCI procedures performed and penetration rates, as referring cardiologists regain confidence in this technology. Late stent thrombosis is the formation of a clot, or thrombus, within the stented area one year or more after implantation of the stent.

The following are the components of our worldwide coronary stent system sales:

(in millions)	Three Months Ended September 30, 2007			Three Months Ended September 30, 2006		
	U.S.	International	Total	U.S.	International	Total
Drug-eluting	\$ 240	\$ 208	\$ 448	\$ 384	\$ 188	\$ 572
Bare metal	28	31	59	13	22	35
	<b>\$ 268</b>	<b>\$ 239</b>	<b>\$ 507</b>	<b>\$ 397</b>	<b>\$ 210</b>	<b>\$ 607</b>

The decline in U.S. sales of our drug-eluting stent systems for the third quarter of 2007, as compared to the same period in the prior year, was due to a decline in market size. For the third quarter of 2007, the percentage of drug-eluting stents used in U.S. interventional procedures was approximately 63 percent, as compared to approximately 85 percent for the third quarter of 2006. In addition, decreases in general PCI procedural volume, following the release of certain clinical data, contributed to an overall reduction in the U.S. coronary stent market size. We estimate that the number of PCI procedures performed in the U.S. in the third quarter of 2007 decreased 11 percent, as compared to the same period in the prior year. Despite the decrease in the size of the U.S. drug-eluting stent market, we remain the market leader with 56 percent market share for the third quarter of 2007, a sequential increase of two percentage points over the second quarter of 2007. However, until the U.S. drug-eluting stent market stabilizes, we expect that there will be continued pressure on our sales. In addition, our TAXUS® Express<sup>2</sup> paclitaxel-eluting coronary stent system is currently one of only two drug-eluting systems available for sale in the U.S. market. We expect that our share of the drug-eluting stent market, as well as unit prices, will be adversely impacted as additional competitors enter this market, which could occur as early as the fourth quarter of 2007.

The increase in sales of drug-eluting stent systems in our International markets was due primarily to the successful launch of our TAXUS Express<sup>2</sup> drug-eluting stent system in Japan in May 2007, following the receipt of regulatory and reimbursement approval. We estimate the Japan market size for drug-eluting stents will approximate \$500 million in 2007. For the third quarter of 2007, we generated \$67 million of TAXUS stent system sales in Japan and achieved average market share of approximately 62 percent for the quarter, and approximately 59 percent for the month of September. We believe that our market share could continue to settle in Japan during the fourth quarter of 2007, which may negatively impact our revenues and market share. The increase of sales in Japan was offset partially by declines in sales of drug-eluting stent systems in our other International markets, due to a reduction in average selling prices and our market share as a result of having numerous competitors in these markets. We believe that this competitive pressure will persist, which may continue to negatively impact our revenues and market share in these geographies. In addition, net sales in these regions were negatively impacted by declines in market size as a result of decreases in drug-eluting stent penetration rates and decreased PCI procedural volume, as compared to the same period in the prior year, driven primarily by continuing uncertainty regarding the perceived risk of late stent thrombosis following the use of drug-eluting stents. We expect that penetration rates in these markets will remain relatively stable during the remainder of 2007.

The worldwide coronary stent market has historically been dynamic and highly competitive with significant market share volatility. In addition, in the ordinary course of our business, we conduct and participate in numerous clinical trials with a variety of study designs, patient populations and trial endpoints. Unfavorable or inconsistent clinical data, from existing or future clinical trials conducted by us, by our competitors or by third parties, or the market's perception of this clinical data may adversely impact our position in and share of the drug-eluting stent market and may contribute to increased volatility in the market. However, we believe that we can maintain a leadership position within the worldwide drug-eluting stent market for a variety of reasons, including:

- the broad and consistent long-term results of our TAXUS clinical trials, including up to five years of clinical follow up;
- the performance benefits of our current technology;
- the strength of our pipeline of drug-eluting stent products, including opportunities to expand indications for use through FDA review of existing and additional randomized trial data in extended use subsets;
- our overall position in the worldwide interventional medicine market and our experienced interventional cardiology sales force;

- our sales, clinical, marketing and manufacturing capabilities; and
- our second drug-eluting stent platform (the PROMUS™ everolimus-eluting coronary stent system) obtained as a result of the Guidant acquisition.

However, a further decline in revenues from our drug-eluting stent systems could continue to have a significant adverse impact on our operating results and operating cash flows. The most significant variables that may impact the size of the drug-eluting coronary stent market and our position within this market include:

- the entry of additional competitors into the market;
- physician and patient confidence in our technology and attitudes toward drug-eluting stents, including expected abatement of prior concerns regarding the risk of late stent thrombosis;
- drug-eluting stent penetration rates, the average number of stents used per procedure, the overall number of PCI procedures performed, and declines in average selling prices of drug-eluting stent systems;
  - variations in clinical results or perceived product performance of our or our competitors' products;
  - delayed or limited regulatory approvals and unfavorable reimbursement policies;
  - the outcomes of intellectual property litigation;
- our ability to launch next-generation products and technology features, including our TAXUS Liberté™ paclitaxel-eluting coronary stent system and our PROMUS drug-eluting stent system, in the U.S. market;
  - our ability to retain key members of our sales force; and
  - changes in FDA clinical trial data and post-market surveillance requirements and the associated impact on new product launch schedules and the cost of compliance.

Prior to our acquisition of Guidant, Abbott acquired Guidant's vascular intervention and endovascular solutions businesses and agreed to share the drug-eluting technology it acquired from Guidant with us, including the XIENCE™ V everolimus-eluting coronary stent system. In October 2006, we received CE mark approval to begin marketing the PROMUS everolimus-eluting coronary stent system, which is a private-labeled XIENCE V drug-eluting stent system supplied to us by Abbott. During the fourth quarter of 2006, we initiated a limited launch of the PROMUS stent system in certain European countries and, during the first nine months of 2007, expanded our launch in Europe, as well as key countries in other regions. In those markets, our strategy is to maximize aggregate share and minimize TAXUS stent system erosion with our dual drug platform. In June, Abbott submitted the final module of a pre-market approval (PMA) application to the FDA seeking approval in the U.S. for both XIENCE and PROMUS stent systems. An FDA advisory panel meeting is scheduled for November 29, 2007 to review Abbott's PMA submission. Upon approval, which Abbott is expecting in the first half of 2008, we plan to launch the PROMUS stent system in the U.S., simultaneously with Abbott's launch of XIENCE. Under the terms of our supply arrangement with Abbott, the profit margin of a PROMUS stent system is significantly lower than that of our TAXUS stent system. Therefore, an increase in PROMUS stent system revenue relative to our total drug-eluting stent

revenue could have a negative impact on our profit margins. In addition, we will incur incremental costs and expend incremental resources in order to develop and commercialize additional products utilizing the Guidant drug-eluting stent system technology and to support the launch of our internally developed and manufactured everolimus-eluting stent system in the future. We expect that our internally developed everolimus-eluting stent system will have profit margins more comparable to our TAXUS stent system. See the *Purchased Research and Development* section below for further discussion of our product pipeline.

### **CRM Business**

CRM revenue represented approximately 25 percent of our consolidated net sales for the third quarter of 2007. We estimate that the worldwide CRM market will approximate \$10.0 billion in 2007, as compared to approximately \$9.5 billion in 2006, and estimate that U.S. implantable cardioverter defibrillator (ICD) sales will represent approximately 40 percent of the worldwide CRM market in 2007, as it did in 2006.

The following are the components of our worldwide CRM sales:

(in millions)	Three Months Ended September 30, 2007			Three Months Ended September 30, 2006		
	U.S.	International	Total	U.S.	International	Total
ICDs	\$ 261	\$ 111	\$ 372	\$ 221	\$ 94	\$ 315
Pacemakers	82	63	145	75	56	131
	<b>\$ 343</b>	<b>\$ 174</b>	<b>\$ 517</b>	<b>\$ 296</b>	<b>\$ 150</b>	<b>\$ 446</b>

Our worldwide CRM sales increased by 16 percent for the third quarter of 2007, as compared to the third quarter of 2006, due primarily to increased ICD sales. Our third quarter U.S. sales of ICDs increased 18 percent, as compared to the same period in the prior year, due primarily to an increase in our market share. Our third quarter international sales of ICDs also increased 18 percent, as compared to the same period in the prior year, due primarily to an increase in the size of the market. However, our net sales and market share in Japan were negatively impacted by the recent decision made by our CRM distributor in that country to no longer distribute our CRM products. As a result, we intend to move to a direct sales model in Japan and, until we fully implement this model, our net sales and market share in Japan may continue to be negatively impacted. In addition, a recent field action initiated by one of our competitors may have an adverse impact on the overall size of the worldwide CRM market and our CRM sales, which may be partially offset by increased market share.

We expect that growth rates in the worldwide CRM market will improve over time; however, there can be no assurance that these markets will return to their historical growth rates or that we will be able to increase net sales in a timely manner, if at all. The most significant variables that may impact the size of the CRM market and our position within that market include:

- future product field actions or new physician advisories by us or our competitors;
- our ability to re-establish the trust and confidence of the implanting community, the referring community and prospective patients in our technology;
- variations in clinical results, reliability or product performance of our and our competitors' products;
- our ability to retain key members of our sales force;



- delayed or limited regulatory approvals and unfavorable reimbursement policies;
- our ability to launch next-generation products and technology features in a timely manner;
- new competitive launches;
- declines in average selling prices and the overall number of procedures performed; and
- the outcome of legal proceedings related to our CRM business.

In April 2007, following FDA reinspections of our CRM facilities, we resolved the warning letter issued to Guidant in December 2005 and all associated restrictions were removed. The reinspections included an assessment of our implementation of quality system improvements and the FDA inspectors noted no additional observations during their reinspections. We believe the FDA's decision represents a major milestone in the ongoing recovery of our CRM business, and is a crucial element in our ongoing efforts to rebuild trust and restore confidence in our CRM product offerings, and has allowed us to resume our new product cadence. Following the resolution of the warning letter, we received various FDA approvals that had been pending and have since launched several products using Guidant technology.

### ***Regulatory Compliance***

In January 2006, legacy Boston Scientific received a corporate warning letter from the FDA notifying us of serious regulatory problems at three of our facilities and advising us that our corporate-wide corrective action plan relating to three site-specific warning letters issued to us in 2005 was inadequate. During 2005, in order to strengthen our corporate-wide quality controls, we launched Project Horizon, which has resulted in significant incremental spending on and the reallocation of internal employee and management resources to quality initiatives. It also has resulted in adjustments to the launch schedules of certain products and the decision to discontinue certain other product lines over time.

We believe we have identified solutions to the quality system issues cited by the FDA and continue to make progress in transitioning our organization to implement those solutions. We communicate frequently and meet regularly with the FDA to apprise them of our progress. We engaged a third party to audit our enhanced quality systems in order to assess our corporate-wide compliance prior to reinspection by the FDA. We completed substantially all of these third-party audits in the third quarter of 2007 and provided results to the FDA. We are planning to meet with the FDA during the fourth quarter to discuss our readiness and a plan for the reinspection of our facilities.

In August 2007, we received a warning letter from the FDA regarding the conduct of clinical investigations associated with our TriVascular AAA program. We are taking corrective action and are cooperating with the FDA's request for documentation on two U.S. clinical trials related to the AAA device dating back to 2004. We terminated the TriVascular AAA program in 2006 and do not believe the recent warning letter will have an impact on the timing of the resolution of our corporate warning letter.

There can be no assurances regarding the length of time or cost it will take us to resolve these quality issues to our satisfaction and to the satisfaction of the FDA. Our inability to resolve these quality issues in a timely manner may further delay product launch schedules, including the U.S. launch of our TAXUS Liberté stent system, which may weaken our competitive position in the market. If our remedial actions are not satisfactory to the FDA, we may have to devote additional financial and human resources to our efforts, and the FDA may take further regulatory actions against us, including, but not limited to: seizing our



product inventory, obtaining a court injunction against further marketing of our products, issuing a consent decree or assessing civil monetary penalties.

In addition, the FDA has informed manufacturers of new requirements for clinical trial data for PMA applications and post-market surveillance studies for drug-eluting stent products, which could affect our new product launch schedules and increase the cost of compliance.

### ***Strategic Initiatives***

In October 2007, we announced several new initiatives designed to enhance short- and long-term shareholder value, including the restructuring of several of our businesses, the potential sale of several business units, as well as substantial expense and head count reductions. Our goal is to better align expenses with revenues, while preserving our ability to make needed investments in quality, research and development projects, capital and our people that are essential to our long-term success. We expect these initiatives to help provide better focus on our core businesses and priorities, which will strengthen Boston Scientific for the future and position us for increased, sustainable and profitable sales growth. Our plan is to reduce research and development (R&D) and selling, general, and administrative (SG&A) expenses by \$475 million to \$525 million, including expense reductions associated with potential divestitures. This range represents the annualized run rate amount of reductions we expect to achieve as we exit 2008, as the implementation of these initiatives will take place throughout the year; however, we expect to realize the majority of these savings in 2008. In addition, we expect to reduce our R&D and SG&A expenses by an additional \$25 million to \$50 million in 2009. Our estimate of our 2007 net sales associated with potential divestitures is approximately \$550 million, including revenues from our auditory business expected to be sold in January 2008.

### **Restructuring**

In October 2007, our Board of Directors approved, and we committed to, an expense and workforce reduction plan, which is expected to result in the elimination of approximately 2,300 positions worldwide. We will provide affected employees with severance packages, outplacement services and other appropriate assistance and support. The plan is intended to bring expenses in line with revenues as a part of our initiatives to enhance short- and long-term shareholder value. Activities under the plan will be initiated in the fourth quarter of 2007 and are expected to be substantially completed worldwide by the end of 2008. The plan includes the restructuring of several business units and product franchises in order to leverage resources, strengthen competitive positions, and create a more simplified and efficient business model. We expect that the plan will result in total pre-tax expenses of approximately \$450 million to \$475 million, of which \$275 million to \$300 million will be recorded in the fourth quarter of 2007 and the remainder recorded throughout 2008 and into 2009. We expect approximately \$400 million to \$425 million of these expenses to result in future cash outlays, with the remainder being non-cash expenses. We will record these expenses primarily as restructuring charges, with a portion recorded through other lines within our consolidated statements of operations. Refer to *Note N – Subsequent Events* to our unaudited condensed, consolidated financial statements contained in this Quarterly Report for more information on our restructuring plan.

### **Divestitures**

In August 2007, we entered a definitive agreement to sell a controlling interest in our auditory business and drug pump development program, acquired from our 2004 acquisition of Advanced Bionics Corporation, to entities affiliated with the principal former shareholders of Advanced Bionics for an aggregate payment of \$150 million. The sale is expected to close in January 2008, and is subject to customary closing conditions, including regulatory approvals. The former shareholders of Advanced Bionics approved the sale in September 2007. In the third quarter of 2007, we recorded a loss of approximately \$352 million, attributable primarily to the writedown of goodwill associated with the anticipated sale. Refer to *Note C –*



*Advanced Bionics Transactions* to our unaudited condensed consolidated financial statements contained in this Quarterly Report for more information on the transaction.

In August 2007, we announced our intent to explore the joint sale of our Cardiac Surgery and Vascular Surgery businesses. In November 2007, we entered a definitive agreement to sell these businesses for a cash price of approximately \$750 million. We expect the transaction to close late in the fourth quarter of 2007 or in the first quarter of 2008, subject to regulatory approvals and customary conditions. Refer to *Note N – Subsequent Events* to our unaudited condensed consolidated financial statements contained in this Quarterly Report for more information regarding the sale.

In July 2007, we announced our intent to explore the sale of our fluid management business, formerly North American Medical Instruments Corporation. Our Venous Access franchise, which is currently part of our Oncology business, will be combined with the fluid management business and will be included as a part of the explored sale. We are in the early stages of discussions with several potential acquirers for these divestitures and expect the exploration process to take a number of months.

On March 12, 2007, we announced our intent to explore the benefits that could be gained from operating our Endosurgery group as a separately traded public company that would become a majority-owned subsidiary of Boston Scientific. In July 2007, we completed our exploration of an IPO of a minority interest in our Endosurgery group and determined that the group will remain wholly owned by Boston Scientific.

#### Monetizing of Investments

During the second quarter of 2007, we announced our decision to monetize the majority of our investment portfolio in order to eliminate investments determined to be non-strategic. During the third quarter of 2007, we monetized several of our investments in, and notes receivable from, certain public and private companies, and received gross proceeds of approximately \$100 million. We plan to monetize the majority of our remaining investments over the next several quarters. Refer to *Note D – Investments* to our unaudited condensed consolidated financial statements contained in this Quarterly Report for more information on our investment portfolio activity. We believe that the fair value of our individual investments equals or exceeds their carrying values as of September 30, 2007; however, we could recognize losses as we monetize these investments depending on the market conditions for these investments at the time of sale and ultimate proceeds we may receive.

#### **Quarterly Results**

##### *Net Sales*

The following table provides our net sales by region and the relative change on an as reported and constant currency basis. In the third quarter of 2007, we revised our reportable segments to reflect the way we currently manage and view our business. We combined certain countries previously part of our Inter-Continental region with Japan to form a new Asia Pacific region. There were no material changes to the composition of our Europe or United States regions. We have reclassified previously reported 2006 segment results to be consistent with the 2007 presentation.

	Three Months Ended		Change	
	September 30,		As Reported	Constant
(in millions)	2007	2006	Currency Basis	Currency Basis
<b>United States</b>	\$ 1,207	\$ 1,273	(5%)	(5%)
Europe	418	400	4%	(3%)
Asia Pacific	311	239	30%	29%
Inter-Continental	112	114	(1%)	(7%)
<b>International</b>	<b>841</b>	<b>753</b>	<b>12%</b>	<b>7%</b>
	\$ 2,048	\$ 2,026	1%	(1%)

	Nine Months Ended		Change	
	September 30,		As Reported	Constant
(in millions)	2007	2006	Currency Basis	Currency Basis
<b>United States</b>	\$ 3,697	\$ 3,579	3%	3%
Europe	1,327	1,150	15%	7%
Asia Pacific	850	686	24%	24%
Inter-Continental	330	341	(3%)	(6%)
<b>International</b>	<b>2,507</b>	<b>2,177</b>	<b>15%</b>	<b>10%</b>
	\$ 6,204	\$ 5,756	8%	6%

The following tables provide our worldwide net sales by division and the relative change on an as reported and constant currency basis:

(in millions)	Three Months Ended September 30,		Change	
	2007	2006	As Reported Currency Basis	Constant Currency Basis
Interventional Cardiology	\$ 762	\$ 868	(12%)	(13%)
Peripheral Interventions/ Vascular				
Surgery	154	154	0%	3%
Electrophysiology	36	32	10%	9%
Neurovascular	81	81	1%	(2%)
Cardiac Surgery	47	45	2%	2%
Cardiac Rhythm Management	517	446	16%	13%
<b>Cardiovascular</b>	<b>1,597</b>	<b>1,626</b>	<b>(2%)</b>	<b>4%</b>
Oncology	58	60	(2%)	(4%)
Endoscopy	212	187	13%	9%
Urology	100	93	8%	6%
<b>Endosurgery</b>	<b>370</b>	<b>340</b>	<b>9%</b>	<b>6%</b>
<b>Neuromodulation</b>	<b>81</b>	<b>60</b>	<b>36%</b>	<b>34%</b>
	<b>\$ 2,048</b>	<b>\$ 2,026</b>	<b>1%</b>	<b>(1%)</b>

(in millions)	Nine Months Ended September 30,		Change	
	2007	2006	As Reported Currency Basis	Constant Currency Basis
Interventional Cardiology	\$ 2,332	\$ 2,781	(16%)	(17%)
Peripheral Interventions/ Vascular				
Surgery	468	506	(8%)	(10%)
Electrophysiology	109	99	9%	8%
Neurovascular	260	243	7%	5%
Cardiac Surgery	144	83	72%	72%
Cardiac Rhythm Management	1,580	882	79%	76%
<b>Cardiovascular</b>	<b>4,893</b>	<b>4,594</b>	<b>6%</b>	<b>5%</b>
Oncology	173	166	4%	3%
Endoscopy	620	556	11%	9%
Urology	295	273	8%	7%
<b>Endosurgery</b>	<b>1,088</b>	<b>995</b>	<b>9%</b>	<b>7%</b>
<b>Neuromodulation</b>	<b>223</b>	<b>167</b>	<b>34%</b>	<b>32%</b>
	<b>\$ 6,204</b>	<b>\$ 5,756</b>	<b>8%</b>	<b>6%</b>

We manage our international operating regions and divisions on a constant currency basis, while we manage market risk from currency exchange rate changes at the corporate level. To calculate regional and divisional revenue growth rates that exclude the impact of currency exchange, we convert actual current-period net sales from local currency to U.S. dollars using constant currency exchange rates. Growth rates in the tables above are based on actual,

non-rounded amounts and, therefore, may not recalculate precisely.

*U.S. Net Sales*

During the third quarter of 2007, our U.S. net sales decreased by \$66 million, or five percent, as compared to the third quarter of 2006. The decrease related primarily to the decline in U.S. net sales of our drug-eluting coronary stent systems by \$144 million for the third quarter of 2007, as compared to the same period in the

prior year, principally as a result of an overall decrease in the U.S. drug-eluting stent market size. See the *Outlook* section above for a more detailed discussion of the drug-eluting stent market and our position within that market. Offsetting this decrease was sales growth of \$47 million from our CRM division, \$13 million from our Endosurgery divisions and \$17 million from our Neuromodulation division.

During the first nine months of 2007, our U.S. net sales increased by \$118 million, or three percent, as compared to the same period in the prior year. The increase related primarily to increases in U.S. CRM and Cardiac Surgery division sales of \$493 million due to the inclusion of a full period of operations in our consolidated results in 2007, as well as year-over-year sales growth of \$45 million each from our Endosurgery and Neuromodulation divisions. Offsetting these increases were declines in U.S. net sales of our drug-eluting coronary stent systems by \$450 million for the first nine months of 2007, as compared to the same period in the prior year, due primarily to declines in U.S. market size.

### *International Net Sales*

During the third quarter of 2007, our international net sales increased by \$88 million, or 12 percent, as compared to the third quarter of 2006. The increase was due primarily to an increase in net sales in our Asia Pacific region of \$72 million, resulting principally from the May 2007 launch of our TAXUS Express<sup>2</sup> coronary stent system in Japan. See the *Outlook* section above for a more detailed discussion of the international drug-eluting stent markets and our position within those markets. In addition, the favorable impact of foreign currency fluctuations contributed \$39 million to our sales growth for the third quarter of 2007, as compared to the third quarter of 2006.

During the first nine months of 2007, our international net sales increased by \$330 million, or 15 percent, as compared to the same period in the prior year. The increase related primarily to the increase in net sales from our CRM and Cardiac Surgery divisions by \$266 million, as compared to the first nine months of 2006, due to the inclusion of a full period of operations in our consolidated results in 2007. In addition, net sales of our drug-eluting stent systems in our Asia Pacific region increased \$79 million as compared to the same period in the prior year, due primarily to the May 2007 launch of our TAXUS Express<sup>2</sup> coronary stent system in Japan. Further, international sales from our Endosurgery divisions increased \$48 million, as compared to the same period in the prior year. Offsetting these increases were declines in net sales of our drug-eluting stent systems in our Europe and Inter-Continental markets by \$126 million for the first nine months of 2007, as compared to the same period in the prior year, due primarily to market share declines in these regions associated with several new competitors having launched drug-eluting stent products in these markets, as well as an overall decline in the size of the drug-eluting stent market. In addition, the favorable impact of foreign currency fluctuations contributed \$104 million to our sales growth for the first nine months of 2007, as compared to the same period in the prior year.

### *Gross Profit*

For the third quarter of 2007, our gross profit was \$1.473 billion, as compared to \$1.396 billion for the same period in the prior year. As a percentage of net sales, our gross profit increased to 71.9 percent, as compared to 68.9 percent for the third quarter of 2006. For the first nine months of 2007, our gross profit was \$4.498 billion, as compared to \$4.075 billion for the same period in the prior year. As a percentage of net sales, our gross profit increased to 72.5 percent, as compared to 70.8 percent for the first nine months of 2006. The following is a reconciliation of our gross profit and a description of the drivers of the change from period to period:

	Three Months	Nine Months
<b>Gross profit - period ended September 30, 2006</b>	<b>68.9%</b>	<b>70.8%</b>
Inventory step-up charge in 2006	4.6%	4.8%
CRM offering charge in 2006	1.5%	0.5%
Impact of lower production volumes	-1.5%	-0.9%
Shifts in product mix	-1.4%	-1.2%
Impact of foreign currency rates	-0.3%	-0.2%
Impact of period expenses	0.1%	-1.3%
<b>Gross profit - period ended September 30, 2007</b>	<b>71.9%</b>	<b>72.5%</b>

Included in cost of products sold for 2006 is an adjustment representing the step-up value of acquired Guidant inventory sold during the period of \$94 million for the third quarter and \$279 million for the first nine months. As of September 30, 2007, we had no step-up value remaining in inventory. In addition, cost of products sold includes \$31 million for the three and nine months ended September 30, 2006 representing a CRM technology offering charge associated with making our LATITUDE® Patient Management System available to most of our existing CRM patients without additional charge. Factors contributing to a shift in product mix towards lower margin products include a decrease in sales of our higher margin TAXUS drug-eluting stent system and an increase in sales of CRM products, which generally have lower gross profit margins. In addition, we have manufactured lower volumes of certain of our products, including our CRM and drug-eluting stent devices, which has resulted in higher unit costs during the three and nine months ended September 30, 2007.

### *Operating Expenses*

In October 2007, we announced several new initiatives designed to enhance short- and long-term shareholder value, including the restructuring of several of our business units, the potential sale of several business units, as well as substantial expense and head count reductions. Refer to the *Outlook* section above for more on our cost improvement initiatives, including the anticipated cost reductions and expenses associated with these initiatives.

The following table provides a summary of certain of our operating expenses:

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2007	2006	% of Net Sales	% of Net Sales	2007	2006	% of Net Sales	% of Net Sales
	\$	\$			\$	\$		
Selling, general and administrative expenses	719	719	35.1	35.5	2,205	1,917	35.5	33.3
Research and development expenses	271	272	13.2	13.4	835	741	13.5	12.9
Royalty expense	48	57	2.3	2.8	151	177	2.4	3.1
Amortization expense	155	153	7.6	7.6	467	356	7.5	6.2

### *Selling, General and Administrative (SG&A) Expenses*

During the third quarter of 2007, our SG&A expenses remained flat and decreased slightly as a percentage of net sales as compared to the third quarter of 2006. During the first nine months of 2007, our SG&A

expenses increased by \$288 million, or 15 percent, as compared to the same period in the prior year. As a percentage of our net sales, SG&A expenses increased to 35.5 percent for the first nine months of 2007 from 33.3 percent for the same period in the prior year. The increase in our SG&A expenses related primarily to incremental expenditures associated with our CRM and Cardiac Surgery divisions of approximately \$259 million due to the inclusion of a full period of operations in our consolidated results in 2007. Additionally, foreign currency fluctuations negatively impacted our SG&A expenses by \$28 million during the first nine months of 2007.

#### *Research and Development (R&D) Expenses*

Our investment in R&D reflects spending on regulatory compliance and clinical research as well as new product development programs. Our R&D spending for the third quarter of 2007 was consistent with that for the third quarter of 2006 and decreased slightly as a percentage of our net sales. For the first nine months of 2007, our R&D expenses increased by \$94 million, or 13 percent, as compared to the same period in the prior year. As a percentage of our net sales, R&D expenses increased to 13.5 percent for the first nine months of 2007 from 12.9 percent for the same period in the prior year. This increase related primarily to the inclusion of \$130 million in additional expenditures related to our CRM and Cardiac Surgery divisions due to a full period of operations, partially offset by lower spending of approximately \$25 million associated with the cancellation of our Endovations<sup>TM</sup> single-use endoscopy system. During the second quarter of 2007, we determined that our Endovations system would not be a commercially viable product; therefore, we terminated the program. We continue to invest in our paclitaxel drug-eluting stent program, along with our next-generation internally developed and manufactured everolimus-eluting stent program, in order to sustain our leadership position in the worldwide drug-eluting stent market.

#### *Royalty Expense*

For the third quarter of 2007, our royalty expense decreased by \$9 million, or 16 percent, as compared to the third quarter of 2006, due primarily to lower sales of our TAXUS stent system. As a percentage of our net sales, royalty expense decreased to 2.3 percent for the third quarter of 2007 from 2.8 percent for the same period in the prior year. Royalty expense attributable to sales of our TAXUS stent system decreased by \$12 million to \$25 million for the third quarter of 2007, as compared to the same period in the prior year.

For the first nine months of 2007, our royalty expense decreased by \$26 million, or 15 percent, as compared to the same period in the prior year, due primarily to lower sales of our TAXUS stent system. As a percentage of our net sales, royalty expense decreased to 2.4 percent for the first nine months of 2007 from 3.1 percent for the same period in the prior year. Royalty expense attributable to sales of our TAXUS stent system decreased by \$41 million to \$80 million for the first nine months of 2007, as compared to the same period in the prior year.

#### *Amortization Expense*

Amortization expense for the third quarter of 2007 was consistent with that for the third quarter of 2006. For the first nine months of 2007, our amortization expense increased by \$111 million, or 31 percent, as compared to the first nine months of 2006. As a percentage of our net sales, amortization expense increased to 7.5 percent for the first nine months of 2007, as compared to 6.2 percent for the same period in the prior year. The increase in our amortization expense was due to incremental amortization associated with Guidant-related intangible assets of \$146 million, offset by the inclusion in the first nine months of 2006 of amortization expense of \$23 million for the write-off of intangible assets due to the cancellation of our TriVascular AAA program and \$12 million for the write-off of intangible assets associated with our Real-Time Position Management System (RPM) technology.

### ***Purchased Research and Development***

During the first nine months of 2007, we recorded \$72 million of purchased research and development. This amount consisted primarily of \$75 million relating to the acquisition of Remon Medical Technologies, Inc. Further, our policy is to record certain costs associated with our strategic alliances as purchased research and development. In accordance with this policy, we recorded \$12 million of in-process research and development in conjunction with payments made for certain early-stage CRM technology. Additionally, in June 2007, we terminated our Product Development Agreement with Aspect Medical Systems relating to brain monitoring technology that Aspect had been developing to aid the diagnosis and treatment of depression, Alzheimer's disease and other neurological conditions. As a result, we recognized a credit to purchased research and development of approximately \$15 million during the second quarter of 2007, representing future payments that we would have been obligated to make prior to the termination of the agreement.

In connection with our acquisition of Remon, we acquired an in-process pressure-sensing system development project that will be combined with our existing CRM devices. We expect to launch devices using pressure-sensing technology in Europe and certain other international countries in 2013, subject to regulatory approval. As of September 30, 2007, we estimate that the total cost to complete the development project is between \$75 million and \$80 million. We expect material net cash inflows from such products to commence in 2016, following the launch of this technology in the U.S. We believe that the estimated in-process research and development amount so determined represents the fair value at the date of acquisition and does not exceed the amount a third party would pay for the project.

During the first nine months of 2006, we recorded \$4.117 billion of purchased research and development. This amount included a charge of approximately \$4.169 billion associated with the in-process research and development obtained in conjunction with the Guidant acquisition, a credit of approximately \$67 million related to the cancellation of our TriVascular AAA program, and an expense of approximately \$15 million resulting from the application of equity method accounting for our investment in EndoTex Interventional Systems, Inc.

In connection with our 2004 acquisition of Advanced Bionics Corporation, we acquired an in-process drug delivery pump development program. In August 2007, we entered an agreement to amend our merger agreement with Advanced Bionics. Under the terms of the agreement, we will sell this development program back to principal former shareholders of Advanced Bionics. Refer to *Note C – Advanced Bionics Transactions* to our unaudited condensed consolidated financial statements contained in this Quarterly Report for more information regarding the transaction.

In connection with our 2005 acquisition of Advanced Stent Technologies (AST), we acquired the in-process Petal™ bifurcation stent project. The AST Petal bifurcation stent is designed to expand into the side vessel where a single vessel branches into two vessels, permitting blood to flow into both branches of the bifurcation and providing support at the junction. In connection with our expense and head count reduction plan, during the fourth quarter of 2007 we decided to suspend funding further research and development associated with this project and may or may not decide to pursue its completion.

In connection with our 2006 acquisition of Guidant, we acquired rights to Guidant's everolimus-based drug-eluting stent technology, which we share with Abbott. We are currently developing an internally manufactured next-generation everolimus-based stent using this technology. Due to recent changes in FDA clinical trial data requirements for PMA applications and post-market surveillance studies for drug-eluting stent products, we have modified our expectations regarding the timing of commercial availability of this product. We currently expect to launch an internally developed and manufactured next-generation everolimus-based stent in Europe in late 2009 or early 2010 and in the U.S. in late 2012 or early 2013. We expect that material net cash inflows from our internally manufactured everolimus-based drug-eluting



stent will commence in 2010, following its approval in Europe. Our estimate for the remaining cost to complete the project is between \$200 million and \$250 million.

Our other research and development projects acquired in connection with our prior business combinations and alliances are generally progressing in line with the estimates set forth in our 2006 Annual Report on Form 10-K. We expect to continue to pursue these research and development efforts and believe we have a reasonable chance of completing the projects.

### ***Loss on Assets Held for Sale***

In the third quarter of 2007, we recorded a \$352 million loss attributable primarily to the writedown of goodwill associated with the sale of our auditory and drug pump businesses to principal former shareholders of Advanced Bionics. Refer to *Note C – Advanced Bionics Transactions* to our unaudited condensed consolidated financial statements contained in this Quarterly Report for more information on the transaction.

### ***Interest Expense***

Interest expense for the third quarter of 2007 was \$147 million, as compared to \$143 million for the third quarter of 2006. For the first nine months of 2007, our interest expense increased to \$433 million, as compared to \$291 million for the same period in the prior year. This increase related primarily to an increase in our average debt levels used to finance the Guidant acquisition, as well as an increase in our weighted-average borrowing cost. Our average debt levels for the first nine months of 2007 increased to \$8.756 billion, as compared to \$6.720 billion for the first nine months of 2006. Our weighted-average borrowing cost for the first nine months of 2007 increased to 6.25 percent from 5.75 percent for the same period in the prior year.

### ***Fair-Value Adjustment***

In the third quarter of 2006, we recorded a loss of \$13 million to reflect a reduction in fair value of the sharing of proceeds feature of the Abbott stock purchase, compared to no loss or gain for the third quarter of 2007. In the first nine months of 2007, we recorded a net loss of \$8 million to reflect the fair-value adjustment on this feature, as compared to a loss of \$100 million for the first nine months of 2006. As of September 30, 2007, there was no remaining value associated with this feature.

### ***Other, net***

For the third quarter of 2007, our other, net reflected income of \$35 million, as compared to income of \$12 million for the third quarter of 2006. Other, net included income of \$14 million for the third quarter of 2007 associated with net gains attributable to our investment portfolio. Refer to *Note D – Investments* to our unaudited condensed consolidated financial statements contained in this Quarterly Report for information regarding our investment portfolio. Other, net included interest income of \$19 million for the third quarters of 2007 and 2006.

For the first nine months of 2007, our other, net reflected income of \$52 million, as compared to expense of \$80 million for the same period in the prior year. Other, net included interest income of \$61 million for the first nine months of 2007, as compared to \$44 million for the same period in the prior year. The increase in interest income is due primarily to increases in our average cash and cash equivalents balances. In addition, other, net included expense of \$8 million for the first nine months of 2007 and \$105 million for the first nine months of 2006 associated with net writedowns attributable to our investment portfolio.

**Tax Rate**

The following table provides a summary of our reported tax rate:

	<b>Three Months Ended September 30,</b>		<b>Percentage Point Increase (Decrease)</b>
	<b>2007</b>	<b>2006</b>	
Reported tax rate	(5)%	(49)%	44%
Impact of certain charges*	(18)%	(72)%	54%

	<b>Nine Months Ended September 30,</b>		<b>Percentage Point Increase (Decrease)</b>
	<b>2007</b>	<b>2006</b>	
Reported tax rate	237%	(4)%	241%
Impact of certain charges*	219%	(27)%	246%

\*These charges are taxed at different rates than our effective tax rate.

The differences in our reported tax rate for the third quarter of 2007 and the first nine months of 2007, as compared to the same periods in the prior year, related primarily to the impact of certain charges that are taxed at different rates than our effective tax rate. In 2007, these charges included purchased in-process research and development and goodwill writedowns not deductible for tax purposes, as well as discrete items associated with resolution of various tax matters and changes in estimates for tax benefits claimed related to prior periods. In 2006, these charges included in-process research and development associated with the acquisition of Guidant; a charge to step-up the value of acquired inventory sold during the quarter; a tax charge for the drug-eluting stent license right obtained from Abbott; the fair value adjustment related to the sharing of proceeds feature of the Abbott stock purchase; and the net reserve increase resulting from tax audit settlements and new tax reserve items that originated in the quarter. In addition, our projected annual effective tax rate for 2007 decreased by approximately five percentage points, as compared to the prior year, due primarily to our decision at the end of 2006 to indefinitely reinvest earnings in foreign operations in order to repay debt obligations associated with the Guidant acquisition, additional foreign tax credits, and changes in the geographic mix of our revenues.

Effective January 1, 2007, we adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*. As a result of the implementation of Interpretation No. 48, we recognized an approximately \$128 million increase in our liability for unrecognized tax benefits. Approximately \$28 million of this increase was reflected as a reduction to our January 1, 2007 balance of retained earnings. Substantially all of the remaining increase related to pre-acquisition uncertain tax liabilities related to Guidant, which we recorded as an increase to goodwill in accordance with EITF Issue No. 93-7, *Uncertainties Related to Income Taxes in a Purchase Business Combination*. At the adoption date of January 1, 2007, we had \$1.155 billion of gross unrecognized tax benefits, \$360 million of which, if recognized, would affect our effective tax rate. At September 30, 2007, we had \$1.114 billion of gross unrecognized tax benefits, \$358 million of which, if recognized, would affect our effective tax rate.

We are subject to U.S. federal income tax as well as income tax of multiple state and foreign jurisdictions. We have concluded all U.S. federal income tax matters through 1997. Substantially all material state, local, and foreign income tax matters have been concluded for all years through 2001.

During the first nine months of 2007, we settled several audits, obtained an Advance Pricing Agreement between the U.S. and Japan, and received a favorable appellate court decision on a previously outstanding Japan matter with

respect to the 1995 to 1998 tax periods. As a result of the settlement of these matters, we

decreased our reserve for uncertain tax positions, net of payments, by \$67 million, inclusive of \$16 million of interest and penalties. Of this amount, we treated \$53 million as a reduction in goodwill in accordance with Issue No. 93-7, and we recorded the remaining \$14 million to earnings. It is reasonably possible that within the next twelve months we will resolve multiple issues with taxing authorities, including matters presently under consideration at IRS Appeals related to Guidant's acquisition of Intermedics, Inc., in which case we could record a reduction in our balance of unrecognized tax benefits of up to approximately \$105 million.

Our historical practice was and continues to be to recognize interest and penalties related to income tax matters in income tax expense. We had \$221 million accrued for interest and penalties at the time of adoption of Interpretation No. 48 and \$258 million at September 30, 2007. The total amount of interest and penalties we recognized in our unaudited condensed consolidated statements of operations was \$21 million for the third quarter of 2007 and \$53 million for the first nine months of 2007.

### ***Critical Accounting Policies***

Our financial results are affected by the selection and application of accounting policies and methods. On January 1, 2007, we adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*. See *Tax Rate* discussion above for further details of our adoption of Interpretation No. 48.

There were no other material changes in the nine-month period ended September 30, 2007 to the application of critical accounting policies as described in our Annual Report on Form 10-K for the year ended December 31, 2006.

### **Liquidity and Capital Resources**

The following provides a summary of key performance indicators that we use to assess our liquidity and operating performance.

#### Net Debt<sup>1</sup>

<i>(in millions)</i>	<b>September 30, 2007</b>	<b>December 31, 2006</b>
Short-term debt	\$ 254	\$ 7
Long-term debt	7,903	8,895
<b>Gross debt</b>	<b>8,157</b>	<b>8,902</b>
Less: cash and cash equivalents	1,237	1,668
<b>Net debt</b>	<b>\$ 6,920</b>	<b>\$ 7,234</b>

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<sup>1</sup>Management uses net debt to monitor and evaluate cash and debt levels and believes it is a measure that provides valuable information regarding our net financial position and interest rate exposure. Users of our financial statements should consider this non-GAAP financial information in addition to, not as a substitute for, nor as superior to, financial information prepared in accordance with GAAP.

EBITDA<sup>2</sup>

	Nine Months Ended September 30,	
(in millions)	2007	2006
Net loss	\$ (37)	\$ (3,854)
Interest income	(61)	(44)
Interest expense	433	291
Income taxes	64	150
Depreciation and amortization	683	533
<b>EBITDA</b>	<b>\$ 1,082</b>	<b>\$ (2,924)</b>

Cash Flow Measures

	Nine Months Ended September 30,	
(in millions)	2007	2006
Cash provided by operating activities	\$ 626	\$ 1,480
Cash used for investing activities	(436)	(9,057)
Cash (used for) provided by financing activities	(624)	8,425

***Operating Activities***

The decrease in operating cash flow for the first nine months of 2007, as compared to the first nine months of 2006, is attributable primarily to: approximately \$400 million in tax payments made in the first quarter of 2007 associated principally with the gain on Guidant's sale of its vascular intervention and endovascular solutions businesses to Abbott; an increase in interest payments of \$156 million, related primarily to the increase in our average debt levels used to finance the Guidant acquisition; an increase in estimated income tax payments, net of tax refunds, of \$87 million; and an \$80 million increase in our incentive program that is paid annually in the first quarter, due primarily to the inclusion of legacy Guidant employees. The decline in cash flow from operations for the first nine months of 2007 is also due to a decline in operating profit, excluding non-cash items, as compared to the same period in the prior year.

***Investing Activities***

The consummation of our acquisition of Guidant Corporation in April 2006 is the primary driver for the decrease in cash used for investing activities during the nine months ended September 30, 2007, as compared to the same period in the prior year. Cash paid to acquire Guidant, our only acquisition in the first nine months of 2006, net of cash acquired, totaled \$8.664 billion, as compared to \$80 million paid for acquisitions in the first nine months of 2007.

Certain of our business combinations involve the payment of contingent consideration. Our investing activities during the first nine months of 2007 included \$213 million of contingent payments, representing primarily payments to the former shareholders of Advanced Bionics, due principally to the achievement of certain revenue growth objectives. During the first nine months of 2006, we made approximately \$282 million of contingent payments to the former shareholders of Advanced Bionics and CryoVascular Systems,

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<sup>2</sup>Management uses EBITDA to assess operating performance and believes that it may assist users of our financial statements in analyzing the underlying trends in our business over time. In addition, management considers EBITDA as a component of the financial covenants included in our credit agreements. Users of our financial statements should consider this non-GAAP financial information in addition to, not as a substitute for, nor as superior to, financial information prepared in accordance with GAAP. Our EBITDA included acquisition and divestiture-related charges

(pre-tax) of \$466 million for the first nine months of 2007 and \$4.628 billion for the first nine months of 2006.

Inc. See *Note B - Business Combinations* to our unaudited condensed consolidated financial statements contained in this Quarterly Report for the estimated maximum potential amount of future contingent consideration we could be required to pay associated with our business combinations.

We made capital expenditures of \$273 million in the first nine months of 2007, as compared to \$231 million during the first nine months of 2006. The increase was primarily a result of capital expenditures associated with our CRM division. In addition, during the third quarter of 2007, we received cash proceeds of \$28 million for the sale of one of our manufacturing facilities, as compared to proceeds of \$18 million for the first nine months of 2006. We expect to incur capital expenditures of approximately \$125 million for the remainder of 2007, including capital expenditures to continue to upgrade our quality systems, to continue to enhance our manufacturing capabilities in order to support our second drug-eluting stent platform, and to support future growth in our core business units.

We received cash proceeds of \$149 million during the first nine months of 2007 and \$20 million during the first nine months of 2006 from sales of equity investments in and collections of notes receivable from certain of our portfolio companies. In addition, our 2006 cash flows from investing activities included \$159 million of net proceeds from maturities of marketable securities.

### ***Financing Activities***

Our cash flows from financing activities reflect issuances and repayments of debt and proceeds from stock issuances related to our equity incentive programs.

### **Debt**

We had outstanding borrowings of \$8.157 billion at September 30, 2007 at a weighted average interest rate of 6.34 percent, as compared to outstanding borrowings of \$8.902 billion at December 31, 2006 at a weighted average interest rate of 6.03 percent. Our borrowings at September 30, 2007 consisted of unsecured subsidiary indebtedness including \$4.0 billion under our senior term loan, \$900 million in our subordinated loan from Abbott, unsecured senior corporate notes of \$3.050 billion and \$250 million in borrowings against our credit and security facility secured by our U.S. trade receivables. Our borrowings as of December 31, 2006 consisted of unsecured subsidiary indebtedness including \$5.0 billion under our senior term loan, \$900 million in our subordinated loan from Abbott and unsecured corporate notes of \$3.050 billion. There were no amounts outstanding under our \$2.0 billion revolving credit facility as of September 30, 2007 and December 31, 2006.

Our revolving credit facility and term loan agreement requires that we maintain certain financial covenants. In the third quarter of 2007, we amended our \$2.0 billion revolving line of credit and \$5.0 billion term loan agreements. Among other items, the amendment extends a step-down in the maximum permitted ratio of debt to consolidated EBITDA, as defined by the agreement, as follows:

#### **From:**

4.5 times to 3.5 times on March 31, 2008

#### **To:**

4.5 times to 4.0 times on March 31, 2009, and

4.0 times to 3.5 times on September 30, 2009

The amendment also provides for an exclusion from the calculation of consolidated EBITDA, as defined by the agreement, of up to \$300 million of restructuring charges incurred through June 30, 2009 and up to \$500 million of litigation and settlement expenses incurred (net of any litigation or settlement income received) in any period of four fiscal quarters through June 30, 2009, not to exceed \$1 billion in the aggregate. There



was no change in our minimum required ratio of consolidated EBITDA, as defined by the agreement, to interest expense of greater than or equal to 3.0 to 1.0. In connection with the amended agreement, we prepaid \$1.0 billion against the outstanding principal under the term loan, using \$750 million of cash on hand and \$250 million in borrowings against our credit and security facility secured by our U.S. trade receivables. The amendment changes the application of any term loan prepayments from pro-rata across maturities to the chronological order of maturities. Accordingly, the prepayment satisfied the first scheduled repayment under our term loan of \$650 million in April 2008 and reduces our April 2009 obligation by \$350 million. As a result, the next maturity under our term loan will be in April 2009 for \$300 million.

As of September 30, 2007, we were in compliance with the required financial covenants. Exiting the quarter, our ratio of debt to consolidated EBITDA was approximately 3.6 to 1.0 and our ratio of consolidated EBITDA to interest expense was approximately 3.9 to 1.0. Any inability to maintain compliance with these covenants would require us to either amend the terms of our credit facilities or obtain waivers from our lenders, and there can be no assurance that our lenders would renegotiate the terms or grant such waivers. Our inability to obtain any necessary waivers, or to obtain them on reasonable terms, could have a material adverse impact on our operations.

During the third quarter of 2007, our credit ratings from Standard & Poor's Rating Services (S&P) and Fitch Ratings were downgraded to BB+, and our credit rating from Moody's Investor Service was downgraded to Ba1. All of these are non-investment grade ratings and the ratings outlook by all three agencies is currently negative. Credit rating changes may impact our borrowing cost, but do not require the repayment of any borrowings. These credit rating changes have not materially increased the cost of our existing borrowings.

#### Equity

During the first nine months of 2007, we received \$130 million in proceeds from stock issuances related to our stock option and employee stock purchase plans, as compared to \$137 million for the same period in the prior year.

On May 22, 2007, we extended an offer to our non-director and non-executive employees to exchange certain outstanding stock options for deferred stock units (DSUs). Stock options previously granted under our stock plans with an exercise price of \$25 or more per share were exchangeable for a smaller number of DSUs, based on exchange ratios derived from the exercise prices of the surrendered options. On June 20, 2007, following the expiration of the offer, our employees exchanged approximately 6.6 million options for approximately 1.1 million DSUs, which were subject to additional vesting restrictions. We did not record incremental stock compensation expense as a result of these exchanges because the fair values of the options exchanged equaled the fair values of the DSUs issued.

#### ***Contractual Obligations and Commitments***

Certain of our business combinations involve the payment of contingent consideration. Prior to the amendment of our merger agreement with Advanced Bionics, we were obligated to pay future consideration contingent primarily on the achievement of future performance milestones, with certain milestone payments tied to profitability. We estimated that these payments could amount to as much as \$2.0 billion through 2013. The amended agreement provides a new schedule of consolidated, fixed earnout payments that we are required to make, consisting of \$650 million payable upon closing, expected in January 2008, and \$500 million payable in March 2009. These payments will be the final earnout payments made to Advanced Bionics. See *Note B – Business Combinations* to our unaudited condensed consolidated financial statements contained in this Quarterly Report for the estimated potential amount of future contingent consideration we could be required to pay associated with our other business combinations.

Refer also to the *Tax Rate* discussion above for changes to our contractual obligations and commitments that resulted from the adoption of Interpretation No. 48. There have been no other material changes to our contractual obligations and commitments as reported in our 2006 Annual Report on Form 10-K.

In connection with our acquisition of Guidant and concurrent transaction with Abbott Laboratories, Abbott purchased from us approximately 65 million shares of our common stock for \$1.4 billion, or \$21.66 per share. We agreed to issue Abbott additional shares of our common stock having an aggregate value of up to \$60 million eighteen months following the Abbott transaction closing to reimburse Abbott for a portion of its cost of borrowing \$1.4 billion to purchase the shares of our common stock. We recorded the \$60 million as a liability assumed in connection with the sale of Guidant's vascular intervention and endovascular solutions businesses to Abbott. In October 2007, we modified our agreement with Abbott, and paid this obligation in cash, rather than in shares of our common stock.

## Legal Matters

The medical device market in which we primarily participate is largely technology driven. Physician customers, particularly in interventional cardiology, have historically moved quickly to new products and new technologies. As a result, intellectual property rights, particularly patents and trade secrets, play a significant role in product development and differentiation. However, intellectual property litigation to defend or create market advantage is inherently complex and unpredictable. Furthermore, appellate courts frequently overturn lower court patent decisions.

In addition, competing parties frequently file multiple suits to leverage patent portfolios across product lines, technologies and geographies and to balance risk and exposure between the parties. In some cases, several competitors are parties in the same proceeding, or in a series of related proceedings, or litigate multiple features of a single class of devices. These forces frequently drive settlement not only of individual cases, but also of a series of pending and potentially related and unrelated cases. In addition, although monetary and injunctive relief is typically sought, remedies and restitution are generally not determined until the conclusion of the proceedings and are frequently modified on appeal. Accordingly, the outcomes of individual cases are difficult to time, predict or quantify and are often dependent upon the outcomes of other cases in other geographies.

Several third parties have asserted that our current and former stent systems infringe patents owned or licensed by them. We have similarly asserted that stent systems or other products sold by these companies infringe patents owned or licensed by us. Adverse outcomes in one or more of these proceedings could limit our ability to sell certain stent products in certain jurisdictions, or reduce our operating margin on the sale of these products and could have a material adverse effect on our financial position, results of operations or liquidity.

We are substantially self-insured with respect to general, product liability and securities litigation claims. In the normal course of business, product liability and securities litigation claims are asserted against us. Product liability and securities litigation claims against us may be asserted in the future related to events not known to management at the present time. The absence of significant third-party insurance coverage increases our potential exposure to unanticipated claims or adverse decisions. Product liability claims, product recalls, securities litigation and other litigation in the future, regardless of their outcome, could have a material adverse effect on our financial position, results of operations or liquidity.

We accrue anticipated costs of settlement and damages and, under certain conditions, costs of defense, based on historical experience or to the extent specific losses are probable and estimable. We record losses for claims in excess of the limits of purchased insurance in earnings at the time and to the extent they are

probable and estimable. If the estimate of a probable loss is a range and no amount within the range is more likely, we accrue the minimum amount of the range.

In connection with our acquisition of Guidant, the number of legal claims against us, including product liability, private securities and shareholder derivative claims, significantly increased. Our accrual for legal matters that are probable and estimable was \$680 million at September 30, 2007 and \$485 million at December 31, 2006, and includes costs of settlement, damages and defense. The amounts accrued relate primarily to Guidant litigation and claims recorded as part of the purchase price. We continue to assess certain litigation and claims to determine the amounts that management believes will be paid as a result of such claims and litigation and, therefore, additional losses may be accrued in the future, which could adversely impact our operating results, cash flows and our ability to comply with our debt covenants.

In July 2007, we reached an agreement to settle certain claims related to CRM product liability claims. Under the terms of the settlement, we agreed to pay a total of \$195 million to resolve approximately 4,900 claims of individuals that have been consolidated in the U.S. District Court for the District of Minnesota in a Multi-District Litigation. In addition, the agreement includes an undetermined number, but not all, of additional similar claims throughout the country. To date, Guidant has also been informed of over 3,900 other claims of individuals that may or may not mature into filed suits. Refer to *Note J - Commitments and Contingencies* to our unaudited condensed consolidated financial statements contained in this Quarterly Report which identifies all material developments with regard to any matters of litigation disclosed in our 2006 Annual Report on Form 10-K or instituted since December 31, 2006.

### **Recent Accounting Pronouncements**

#### *Statement No. 159*

In February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115*, which allows an entity to elect to record financial assets and liabilities at fair value upon their initial recognition on a contract-by-contract basis. Subsequent changes in fair value would be recognized in earnings as the changes occur. Statement No. 159 also establishes additional disclosure requirements for these items stated at fair value. Statement No. 159 is effective for our 2008 fiscal year, with early adoption permitted, provided that we also adopt Statement No. 157, *Fair Value Measurements*. We are currently evaluating the impact that the adoption of Statement No. 159 will have on our consolidated financial statements.

#### *Statement No. 157*

In September 2006, the FASB issued Statement No. 157, *Fair Value Measurements*. Statement No. 157 defines fair value, establishes a framework for measuring fair value in accordance with U.S. GAAP, and expands disclosures about fair value measurements. Statement No. 157 does not require any new fair value measurements; rather, it applies to other accounting pronouncements that require or permit fair value measurements. We are required to apply the provisions of Statement No. 157 prospectively as of January 1, 2008, and recognize any transition adjustment as a cumulative-effect adjustment to the opening balance of retained earnings. We are in the process of determining the effect of adoption of Statement No. 157, but we do not believe such adoption will materially impact our future results of operations or financial position.

#### *Issue No. 06-3*

In June 2006, the FASB ratified EITF Issue No. 06-3, *How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation)*. The scope of this consensus includes any taxes assessed by a governmental authority that are directly imposed on a revenue producing transaction between a seller and a customer and may include, but are not



limited to, sales, use, value-added, and some excise taxes. Per the consensus, the presentation of these taxes on either a gross (included in revenues and costs) or a net (excluded from revenues) basis is an accounting policy decision that should be disclosed. We present sales net of sales taxes in our unaudited condensed consolidated statements of operations. Issue No. 06-3 is effective for interim and annual reporting periods beginning after December 15, 2006. No change of presentation has resulted from our adoption of Issue No. 06-3.

### **Cautionary Statement Regarding Forward Looking Statements**

Certain statements that we may make from time to time, including statements contained in this report and information incorporated by reference into this report, constitute “forward-looking statements” within the meaning of Section 27E of the Securities Exchange Act of 1934. Forward-looking statements may be identified by words like “anticipate,” “expect,” “project,” “believe,” “plan,” “estimate,” “intend” and similar words and include, among other things, statements regarding our financial performance, our growth strategy, timing of regulatory approvals and our regulatory and quality compliance, expected research and development efforts, product development and new product launches, our market position and competitive changes in the marketplace for our products, the effect of new accounting pronouncements, the outcome of matters before taxing authorities, intellectual property and litigation matters, our capital needs and expenditures, our ability to meet the financial covenants required by our credit facilities or to renegotiate the terms of our credit facilities or obtain waivers for compliance with those covenants, and potential acquisitions and divestitures. These forward-looking statements are based on our beliefs, assumptions and estimates using information available to us at the time and are not intended to be guarantees of future events or performance. If our underlying assumptions turn out to be incorrect, or if certain risks or uncertainties materialize, actual results could vary materially from the expectations and projections expressed or implied by our forward-looking statements. As a result, investors are cautioned not to place undue reliance on any of our forward-looking statements.

We do not intend to update the forward-looking statements below even if new information becomes available or other events occur in the future. We have identified these forward-looking statements below in order to take advantage of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Certain factors that could cause actual results to differ materially from those expressed in forward-looking statements are contained below.

#### ***Coronary Stent Business***

- Volatility in the coronary stent market, competitive offerings and the timing of receipt of regulatory approvals to market existing and anticipated drug-eluting stent technology and other stent platforms;
- Our ability to launch our next-generation drug-eluting stent system, the TAXUS® Liberté coronary stent system, in the U.S., subject to regulatory approval, and to maintain or expand our worldwide market positions through reinvestment in our drug-eluting stent program;
- Our share of the worldwide drug-eluting stent market, the impact of concerns relating to late stent thrombosis on the size of the coronary stent market, the distribution of share within the coronary stent market in the U.S. and around the world, the average number of stents used per procedure and average selling prices;
- The overall performance of, and continued physician confidence in, our and other drug-eluting stents, our ability to adequately address concerns regarding the risk of late stent thrombosis, and the results of drug-eluting stent clinical trials undertaken by us, our competitors or other third parties;

- The penetration rate of drug-eluting stent technology in the U.S. and our International markets;
- Our ability to leverage our position as one of two early entrants in the U.S. drug-eluting stent market, to anticipate competitor products as they enter the market and to respond to the challenges presented as additional competitors enter the U.S. drug-eluting stent market;
- Changes in FDA clinical trial and post-market surveillance requirements and the associated impact on new product launch schedules and the cost of compliance;
- Our ability to manage inventory levels, accounts receivable, gross margins and operating expenses and to react effectively to worldwide economic and political conditions;
- Our ability to retain key members of our cardiology sales force; and
- Our ability to manage the mix of our PROMUS stent system revenue relative to our total drug-eluting stent revenue and maintain our overall profitability as a percentage of revenue.

### ***CRM Business***

- Our estimate for the worldwide CRM market, the recovery of the CRM market to historical growth rates and our ability to increase CRM net sales;
- The overall performance of, and referring physician, implanting physician and patient confidence in, our and our competitors' CRM products and technologies, including our LATITUDE® Patient Management System and next-generation pulse generator platform;
  - Our continued ability to minimize or eliminate future field actions relating to our CRM technology;
    - The results of CRM clinical trials undertaken by us, our competitors or other third parties;
- Our continued ability to launch various products utilizing our next-generation CRM pulse generator platform in the U.S. over the next 27 months and to expand our CRM market position through reinvestment in our CRM products and technologies;
  - Our ability to retain key members of our CRM sales force;
    - Competitive offerings in the CRM market and the timing of receipt of regulatory approvals to market existing and anticipated CRM products and technologies;
- Our ability to move quickly and effectively implement a direct sales model for our CRM products in Japan; and
- Our ability to avoid disruption in the supply of certain components or materials or to quickly secure additional or replacement components or materials on a timely basis.

***Litigation and Regulatory Compliance***

- Any conditions imposed in resolving, or any inability to resolve, our corporate warning letter or other FDA matters, as well as risks generally associated with our regulatory compliance and quality systems;
- The effect of our litigation, risk management practices, including self-insurance, and compliance activities on our loss contingency, legal provision and cash flow;
- The impact of our stockholder derivative and class action, patent, product liability, contract and other litigation and legal proceedings;
- The ongoing, inherent risk of potential physician communications or field actions related to medical devices;
  - Costs associated with our incremental compliance and quality initiatives, including Project Horizon; and
  - The availability and rate of third-party reimbursement for our products and procedures.

***Innovation***

- Our ability to complete planned clinical trials successfully, to obtain regulatory approvals and to develop and launch products on a timely basis within cost estimates, including the successful completion of in-process projects from purchased research and development;
- Our ability to manage research and development and other operating expenses consistent with our expected revenue growth;
- Our ability to develop products and technologies successfully in addition to our drug-eluting stent and CRM technologies;
- Our ability to fund and achieve benefits from our focus on internal research and development and external alliances as well as our ability to capitalize on opportunities across our businesses;
- Our ability to develop next-generation products and technologies within our drug-eluting stent and CRM business;
  - Our failure to succeed at, or our decision to discontinue, any of our growth initiatives;
- Our ability to integrate the acquisitions and other strategic alliances we have consummated, including Guidant;
- Our decision to exercise, or not to exercise, options to purchase certain companies party to our strategic alliances and our ability to fund with cash or common stock these and other acquisitions, or to fund contingent payments associated with these alliances;
- The timing, size and nature of strategic initiatives, market opportunities and research and development platforms available to us and the ultimate cost and success of these initiatives; and
- Our ability to successfully identify, develop and market new products or the ability of others to develop products or technologies that render our products or technologies noncompetitive or obsolete.

### ***International Markets***

- Dependency on international net sales to achieve growth;
- Risks associated with international operations, including compliance with local legal and regulatory requirements as well as reimbursement practices and policies; and
- The potential effect of foreign currency fluctuations and interest rate fluctuations on our net sales, expenses and resulting margins.

### ***Liquidity***

- Our ability to generate sufficient cash flow to fund operations, capital expenditures, and strategic investments, as well as debt reduction over the next twelve months and beyond;
  - Our ability to maintain positive operating cash flow for the remainder of 2007;
  - Our ability to recover substantially all of our deferred tax assets;
- Our ability to access the public and private capital markets and to issue debt or equity securities on terms reasonably acceptable to us;
- Our ability to regain investment-grade credit ratings and to remain in compliance with our financial covenants;
- Our ability to generate sufficient cash flow to effectively manage our debt levels and minimize the impact of interest rate fluctuations on our earnings and cash flows; and
  - Our ability to implement, fund, and achieve sustainable cost improvement measures, including expense and head count reduction initiatives and potential divestitures of non-strategic assets, that will better align operating expenses with expected revenue levels and reallocate resources to better support growth initiatives.

### ***Other***

- Risks associated with significant changes made or to be made to our organizational structure, or to the membership of our executive committee;
- Risks associated with our acquisition of Guidant, including, among other things, the indebtedness we have incurred and the integration costs and challenges we will continue to face;
- Our ability to retain our key employees and avoid business disruption and employee distraction as we execute our expense and head count reduction initiatives; and
- Our ability to maintain management focus on core business activities while also concentrating on resolving the corporate warning letter and implementing strategic initiatives, including expense and head count reduction initiatives and potential divestitures of non-strategic assets, in order to streamline our operations and reduce our debt obligations.



Several important factors, in addition to the specific factors discussed in connection with each forward-looking statement individually could affect our future results and growth rates and could cause those results and rates to differ materially from those expressed in the forward-looking statements and the risk factors contained in this report. These additional factors include, among other things, future economic, competitive, reimbursement and regulatory conditions, new product introductions, demographic trends, intellectual property, financial market conditions and future business decisions made by us and our competitors, all of which are difficult or impossible to predict accurately and many of which are beyond our control. We discuss those and other important risks and uncertainties that may affect our future operations in Part I, Item 1A- *Risk Factors* in our most recent Annual Report on Form 10-K and may update that discussion in Part II, Item 1A – *Risk Factors* in this or another Quarterly Report on Form 10-Q we file hereafter. Therefore, we wish to caution each reader of this report to consider carefully these factors as well as the specific factors discussed with each forward-looking statement and risk factor in this report and as disclosed in our filings with the SEC. These factors, in some cases, have affected and in the future (together with other factors) could affect our ability to implement our business strategy and may cause actual results to differ materially from those contemplated by the statements expressed in this report.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

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We develop, manufacture and sell medical devices globally and our earnings and cash flows are exposed to market risk from changes in currency exchange rates and interest rates. We address these risks through a risk management program that includes the use of derivative financial instruments. We operate the program pursuant to documented corporate risk management policies. We do not enter derivative transactions for speculative purposes. Gains and losses on derivative financial instruments substantially offset losses and gains on underlying hedged exposures. Furthermore, we manage our exposure to counterparty risk on derivative instruments by entering into contracts with a diversified group of major financial institutions and by monitoring outstanding positions.

Our currency risk consists primarily of foreign currency denominated firm commitments, forecasted foreign currency denominated intercompany and third party transactions and net investments in certain subsidiaries. We use both nonderivative (primarily European manufacturing operations) and derivative instruments to manage our earnings and cash flow exposure to changes in currency exchange rates. We had currency derivative instruments outstanding in the contract amount of \$4.409 billion at September 30, 2007 and \$3.413 billion at December 31, 2006. We recorded \$20 million of other assets and \$110 million of other liabilities to recognize the fair value of these derivative instruments at September 30, 2007 as compared to \$71 million of other assets and \$27 million of other liabilities recorded at December 31, 2006. A ten percent appreciation in the U.S. dollar's value relative to the hedged currencies would increase the derivative instruments' fair value by \$285 million at September 30, 2007 and \$112 million at December 31, 2006. A ten percent depreciation in the U.S. dollar's value relative to the hedged currencies would decrease the derivative instruments' fair value by \$346 million at September 30, 2007 and \$134 million at December 31, 2006. Any increase or decrease in the fair value of our currency exchange rate sensitive derivative instruments would be substantially offset by a corresponding decrease or increase in the fair value of the hedged underlying asset, liability or forecasted transaction.

Our interest rate risk relates primarily to U.S. dollar borrowings partially offset by U.S. dollar cash investments. We use interest rate derivative instruments to manage the risk of interest rate changes either by converting floating-rate borrowings into fixed-rate borrowings or fixed-rate borrowings into floating-rate borrowings. We had interest rate derivative instruments outstanding in the notional amount of \$1.750 billion at September 30, 2007 and \$2.0 billion at December 31, 2006. The fair value of our interest rate derivative instruments was a liability of \$12 million at September 30, 2007 and \$11 million at December 31, 2006. A one percentage point increase in interest rates would increase the derivative instruments' fair value by \$13 million at September 30, 2007 and \$26 million at December 31, 2006. A one percentage point decrease in interest rates would decrease the derivative instruments' fair value by \$13 million at September 30, 2007 and \$26 million at December 31, 2006. Any increase or decrease in the fair value of our interest rate derivative instruments would be substantially offset by a corresponding decrease or increase in the fair value of the hedged interest payments related to the hedged term loan. As of September 30, 2007, \$5.646 billion of our outstanding debt obligations was at fixed interest rates, representing 69 percent of our total debt or 82 percent of our net debt balance.

**ITEM 4.**

**CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of our President and Chief Executive Officer and Chief Financial Officer and Executive Vice President - Finance and Information Systems, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2007 pursuant to Rule 13a-15(b) of the Securities Exchange Act. Disclosure controls and procedures are designed to ensure that material information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and ensure that such material information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. Based on their evaluation, our Chief Executive Officer and Chief Financial Officer concluded that as of September 30, 2007, our disclosure controls and procedures were effective.

**Changes in Internal Controls over Financial Reporting**

During the quarter ended September 30, 2007, there were no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## LEGAL PROCEEDINGS

**ITEM 1A.**

## RISK FACTORS



**ITEM 6.**

**EXHIBITS**

- 31.1 Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, President and Chief Executive Officer
- 32.2 Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, Executive Vice President and Chief Financial Officer

**SIGNATURE**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized on November 7, 2007.

**BOSTON SCIENTIFIC CORPORATION**

By: /s/ Sam R. Leno  
Name: Sam R. Leno  
Title: Chief Financial Officer and Executive Vice  
President - Finance and Information Systems