

STRYKER CORP
Form 10-Q
August 09, 2007

**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 EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2007

Commission file number: 0-9165

STRYKER CORPORATION

(Exact name of registrant as specified in its charter)

Michigan

(State or other jurisdiction of
incorporation or organization)

38-1239739

(I.R.S. Employer Identification No.)

2825 Airview Boulevard, Kalamazoo, Michigan

(Address of principal executive offices)

49002

(Zip Code)

(269) 385-2600

(Registrant's telephone number, including area code)

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 and 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.

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YES NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

YES NO

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

409,927,028 shares of Common Stock, \$.10 par value, as of July 31, 2007.

PART I. - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)

Stryker Corporation and Subsidiaries

(in millions, except per share amounts)

| | June 30 2007 | December 31 2006 |
|--|-----------------|---------------------|
| ASSETS | | |
| <i>Current Assets</i> | | |
| Cash and cash equivalents | \$170.0 | \$416.6 |
| Marketable securities | 1,610.2 | 998.2 |
| Accounts receivable, less allowance of \$42.0 (\$41.8 in 2006) | 940.5 | 867.2 |
| Inventories | 733.4 | 677.6 |
| Deferred income taxes | 476.0 | 417.2 |
| Prepaid expenses and other current assets | 132.2 | 113.3 |
| Current assets of discontinued operations | -- | 44.2 |
| Total current assets | 4,062.3 | 3,534.3 |
| <i>Property, Plant and Equipment, less allowance for depreciation of \$721.6 (\$659.7 in 2006)</i> | 932.7 | 914.9 |
| <i>Other Assets</i> | | |
| Goodwill | 513.0 | 511.0 |
| Other intangibles, less accumulated amortization of \$239.3 (\$221.1 in 2006) | 392.3 | 403.8 |
| Loaner instrumentation, less accumulated amortization of \$623.2 (\$564.6 in 2006) | 299.7 | 287.7 |
| Deferred income taxes | 165.2 | 118.6 |
| Other | 54.7 | 44.5 |
| Noncurrent assets of discontinued operations | -- | 59.0 |
| | 1,424.9 | 1,424.6 |
| | \$6,419.9 | \$5,873.8 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| <i>Current Liabilities</i> | | |
| Accounts payable | \$231.2 | \$247.9 |
| Accrued compensation | 218.1 | 272.0 |
| Income taxes | 69.3 | 208.2 |
| Dividend payable | -- | 89.7 |
| Accrued expenses and other liabilities | 503.9 | 496.4 |
| Current maturities of long-term debt | 17.4 | 14.8 |
| Current liabilities of discontinued operations | -- | 22.5 |
| Total current liabilities | 1,039.9 | 1,351.5 |
| <i>Other Liabilities</i> | 578.6 | 325.7 |
| <i>Other Liabilities of Discontinued Operations</i> | -- | 5.6 |
| <i>Shareholders' Equity</i> | | |
| Common stock, \$.10 par value: | | |
| Authorized - 1,000.0 shares | | |
| Outstanding - 409.7 shares (407.9 in 2006) | 41.0 | 40.8 |
| Additional paid-in capital | 651.3 | 569.1 |
| Retained earnings | 3,995.5 | 3,490.5 |
| Accumulated other comprehensive gain | 113.6 | 90.6 |

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Total shareholders' equity

| | |
|-----------|-----------|
| 4,801.4 | 4,191.0 |
| \$6,419.9 | \$5,873.8 |

See accompanying notes to condensed consolidated financial statements.

- 2 -

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS (Unaudited)

Stryker Corporation and Subsidiaries

(in millions, except per share amounts)

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|-----------|------------------|-----------|
| | June 30 | | June 30 | |
| | 2007 | 2006 | 2007 | 2006 |
| Net sales | \$1,463.7 | \$1,261.8 | \$2,889.2 | \$2,515.7 |
| Cost of sales | 444.3 | 393.9 | 883.7 | 787.3 |
| Gross profit | 1,019.4 | 867.9 | 2,005.5 | 1,728.4 |
| Research, development and engineering expenses | 92.1 | 75.9 | 176.7 | 153.0 |
| Selling, general and administrative expenses | 581.6 | 493.0 | 1,149.7 | 994.7 |
| Intangibles amortization | 11.0 | 10.1 | 22.2 | 20.3 |
| Intangible asset impairment | 19.8 | -- | 19.8 | -- |
| Purchased in-process research and development | -- | -- | -- | 52.7 |
| | 704.5 | 579.0 | 1,368.4 | 1,220.7 |
| Operating income | 314.9 | 288.9 | 637.1 | 507.7 |
| Other income (expense) | 16.9 | 4.9 | 31.1 | 10.3 |
| Earnings before income taxes | 331.8 | 293.8 | 668.2 | 518.0 |
| Income taxes | 91.7 | 81.7 | 186.3 | 160.3 |
| Net earnings from continuing operations | 240.1 | 212.1 | 481.9 | 357.7 |
| Net earnings from discontinued operations | 3.3 | 1.8 | 5.0 | 3.7 |
| Net gain on sale of discontinued operations | 25.7 | -- | 25.7 | -- |
| Net earnings | \$269.1 | \$213.9 | \$512.6 | \$361.4 |
| Basic net earnings per share: | | | | |
| Net earnings from continuing operations | \$0.59 | \$0.52 | \$1.18 | \$0.88 |
| Net earnings from discontinued operations | \$0.01 | -- | \$0.01 | \$0.01 |
| Net gain on sale of discontinued operations | \$0.06 | -- | \$0.06 | -- |
| Basic net earnings per share | \$0.66 | \$0.53 | \$1.25 | \$0.89 |
| Diluted net earnings per share: | | | | |
| Net earnings from continuing operations | \$0.58 | \$0.52 | \$1.16 | \$0.87 |
| Net earnings from discontinued operations | \$0.01 | -- | \$0.01 | \$0.01 |
| Net gain on sale of discontinued operations | \$0.06 | -- | \$0.06 | -- |
| Diluted net earnings per share | \$0.65 | \$0.52 | \$1.23 | \$0.88 |
| Weighted-average outstanding shares for the period: | | | | |
| Basic | 409.4 | 406.4 | 409.0 | 406.0 |
| Diluted | 416.9 | 410.7 | 416.5 | 411.0 |

See accompanying notes to condensed consolidated financial statements.

CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY (Unaudited)

Stryker Corporation and Subsidiaries

(in millions, except per share amounts)

| | Common Stock | Additional Paid-In Capital | Retained Earnings | Accumulated Other Comprehensive Gain (Loss) | Total |
|---|-----------------|----------------------------------|----------------------|--|-------------|
| Balances at January 1, 2007 | \$40.8 | \$569.1 | \$3,490.5 | \$90.6 | \$4,191.0 |
| Net earnings | | | 512.6 | | 512.6 |
| Unrealized losses on securities | | | | (0.9) | (0.9) |
| Unfunded pension losses | | | | (0.2) | (0.2) |
| Foreign currency translation adjustments | | | | 24.1 | <u>24.1</u> |
| Comprehensive earnings for the six months ended June 30, 2007 | | | | | 535.6 |
| Issuance of 1.8 shares of common stock under stock option and benefit plans, including \$22.8 excess income tax benefit | 0.2 | 49.8 | | | 50.0 |
| Share-based compensation | | 32.4 | | | 32.4 |
| Adjustment to adopt FASB Interpretation No. 48, net of \$4.2 income tax benefit | | | (7.6) | | (7.6) |
| Balances at June 30, 2007 | \$41.0 | \$651.3 | \$3,995.5 | \$113.6 | \$4,801.4 |

See accompanying notes to condensed consolidated financial statements.

In 2006, the Company declared a cash dividend of twenty-two cents per share to shareholders of record on December 29, 2006, payable on January 31, 2007. No cash dividends have been declared during 2007.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

Stryker Corporation and Subsidiaries

(in millions)

| | Three Months Ended June 30 | | Six Months Ended June 30 | |
|--|-------------------------------|-----------|-----------------------------|-----------|
| | 2007 | 2006 | 2007 | 2006 |
| <i>Operating Activities</i> | | | | |
| Net earnings from continuing operations | \$240.1 | \$212.1 | \$481.9 | \$357.7 |
| Adjustments to reconcile net earnings from continuing operations to net cash provided by operating activities: | | | | |
| Depreciation | 32.8 | 28.7 | 64.7 | 55.8 |
| Amortization | 57.5 | 51.1 | 112.7 | 99.9 |
| Intangible asset impairment | 19.8 | -- | 19.8 | -- |
| Share-based compensation | 15.4 | 14.3 | 31.3 | 29.3 |
| Income tax benefit from exercise of stock options | 10.2 | 4.7 | 27.4 | 16.6 |
| Excess income tax benefit from exercise of stock options | (8.1) | (3.8) | (22.8) | (13.7) |
| Purchased in-process research and development | -- | -- | -- | 52.7 |
| Gain on sale of discontinued operations | (40.7) | -- | (40.7) | -- |
| Other | 2.3 | 0.9 | 2.9 | 3.4 |
| Changes in operating assets and liabilities, net of effects of acquisitions: | | | | |
| Accounts receivable | (42.0) | 13.4 | (67.0) | (53.7) |
| Inventories | (19.6) | (37.4) | (49.4) | (68.1) |
| Loaner instrumentation | (50.1) | (58.7) | (101.4) | (116.8) |
| Accounts payable | 10.6 | (12.4) | (17.8) | (17.9) |
| Accrued expenses | 21.8 | 23.4 | (75.0) | (64.6) |
| Income taxes | (79.6) | (58.8) | (33.5) | (44.7) |
| Other | 10.9 | 11.5 | (0.3) | (24.9) |
| Net cash provided by discontinued operations | 29.6 | 6.8 | 30.8 | 5.5 |
| Net cash provided by operating activities | 210.9 | 195.8 | 363.6 | 216.5 |
| <i>Investing Activities</i> | | | | |
| Acquisitions, net of cash acquired | (31.9) | (31.7) | (37.6) | (76.2) |
| Proceeds from sale of discontinued operations, net of cash divested | 144.7 | -- | 144.7 | -- |
| Purchases of marketable securities | (3,425.2) | (3,257.5) | (5,225.4) | (3,673.7) |
| Proceeds from sales of marketable securities | 2,987.5 | 3,195.2 | 4,616.3 | 3,501.0 |
| Purchases of property, plant and equipment | (39.1) | (49.5) | (79.9) | (99.0) |
| Proceeds from sales of property, plant and equipment | 0.1 | 0.1 | 0.3 | 0.2 |
| Net cash used by discontinued operations | (0.4) | (3.0) | (1.6) | (8.3) |
| Net cash used in investing activities | (364.3) | (146.4) | (583.2) | (356.0) |
| <i>Financing Activities</i> | | | | |
| Proceeds from borrowings | 74.2 | 73.1 | 93.2 | 84.8 |
| Payments on borrowings | (72.3) | (201.8) | (90.9) | (311.6) |
| Dividends paid | -- | -- | (89.7) | (44.6) |
| Proceeds from exercise of stock options | 20.2 | 5.9 | 37.5 | 19.5 |
| Excess income tax benefit from exercise of stock options | 8.1 | 3.8 | 22.8 | 13.7 |
| Other | (2.5) | (1.6) | (4.0) | 13.1 |
| Net cash provided by (used in) financing activities | 27.7 | (120.6) | (31.1) | (225.1) |
| Effect of exchange rate changes on cash and cash equivalents | 1.4 | 2.5 | 4.1 | 3.1 |
| Decrease in cash and cash equivalents | (\$124.3) | (\$68.7) | (\$246.6) | (\$361.5) |

See accompanying notes to condensed consolidated financial statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Stryker Corporation and Subsidiaries

June 30, 2007

NOTE 1

BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles 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 United States generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The results of operations for the six-months ended June 30, 2007 are not necessarily indicative of the results that may be expected for the year ended December 31, 2007.

The balance sheet at December 31, 2006 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2006 (the "2006 Form 10-K").

The Company adopted the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, on January 1, 2007. This Interpretation clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the Company's consolidated financial statements. The Interpretation also provides guidance for the measurement and classification of tax positions, interest and penalties, and requires additional disclosure on an annual basis. Upon adoption, the Company recognized an increase in the interest accrual associated with unresolved income tax positions, which was accounted for by reducing the January 1, 2007 balance of retained earnings by \$7.6 million (net of income taxes). Subsequent to the adoption, interest and penalties incurred associated with unresolved income tax positions will continue to be included in other income (expense). In addition, the Company reclassified \$179.2 million from the current income taxes liability to noncurrent liabilities to match the anticipated timing of future income tax payments.

NOTE 2

COMPREHENSIVE EARNINGS

The Company follows FASB Statement No. 130, *Reporting Comprehensive Income*, in accounting for comprehensive earnings and its components. The comprehensive earnings for the six months ended June 30, 2007 and 2006 were \$535.6 million and \$409.4 million, respectively, and for the three months ended June 30, 2007 and 2006 were \$276.8 million and \$258.5 million, respectively.

- 6 -

NOTE 3

INVENTORIES

Inventories are as follows (in millions):

| | June 30 2007 | December 31 2006 |
|-------------------|-----------------|---------------------|
| Finished goods | \$554.8 | \$506.2 |
| Work-in-process | 80.9 | 76.0 |
| Raw material | 101.1 | 98.8 |
| FIFO Cost | 736.8 | 681.0 |
| Less LIFO reserve | (3.4) | (3.4) |
| | \$733.4 | \$677.6 |

NOTE 4

ACQUISITIONS

In the first quarter of 2006, the Company acquired all of the outstanding stock of Sightline Technologies Ltd. (Sightline), a private, development-stage company, for an upfront payment of \$50.0 million in cash plus certain transaction costs and the assumption of certain liabilities. The acquisition of Sightline, a developer of flexible endoscopes, is expected to enhance the Company's presence in the gastrointestinal and other markets within its MedSurg Equipment segment. Sightline's operating results are included in the Company's condensed consolidated financial statements from the date of the acquisition and did not materially impact the Company's operating results. Pro forma consolidated results of operations would not differ significantly as a result of the Sightline acquisition.

The purchase price was allocated to assets acquired, purchased in-process research and development and liabilities assumed based on their estimated fair value at the date of acquisition. The amount of the purchase price allocated to purchased in-process research and development resulted in a charge of \$52.7 million, or \$.13 per diluted

share, against the Company's first quarter 2006 operating results. At the date of the acquisition, the flexible endoscope technologies acquired had not yet reached technological feasibility. The amount written-off as purchased in-process research and development was not deductible for income tax purposes in the United States.

Terms of the transaction also include potential milestone payments of up to an additional \$90.0 million upon the achievement of certain operational and financial targets related to Sightline's products, the first of which is expected to occur in 2007. The potential milestone payments are expected to be capitalized at their fair values as intangible assets at the time of payment and will be amortized over their remaining useful lives.

The Company believes that the technologies acquired in the Sightline acquisition will result in the introduction of new products and additional future sales. However, factors including regulatory delays, safety concerns or patent disputes could delay the introduction or marketing of these potential new products. Additionally, unanticipated issues may arise that could delay or terminate a product's development prior to commercialization, which could have an unfavorable impact on the Company's operating results. As of June 30, 2007, the Company must validate certain key manufacturing processes in order to achieve its plan for initial commercialization of the flexible endoscope technologies in 2007.

- 7 -

NOTE 5

DISCONTINUED OPERATIONS

On June 4, 2007, the Company announced that it had completed the sale of its outpatient physical therapy business, Physiotherapy Associates, to Water Street Healthcare Partners (Water Street), for \$150.0 million in cash less certain indebtedness. The sale of Physiotherapy is expected to allow the Company to focus its efforts on the medical technology market. The sale of Physiotherapy resulted in a second quarter 2007 gain of \$25.7 million (net of income taxes), or \$.06 per diluted share. Net sales and net earnings from discontinued operations for the first half of 2007 were \$107.4 million and \$5.0 million, respectively, compared to net sales and net earnings from discontinued operations of \$133.1 million and \$3.7 million, respectively, for the first half of 2006. Net sales and net earnings from discontinued operations for the second quarter of 2007 were \$43.6 million and \$3.3 million, respectively, compared to net sales and net earnings from discontinued operations of \$66.1 million and \$1.8 million, respectively, for the second quarter of 2006.

Under the terms of the sale agreement, the Company retained responsibility for certain cash damages to be paid in connection with the investigation of Physiotherapy Associates' billing and coding practices by the United States Department of Justice announced in December 2003. The Company's liability for such damages was fixed under the sale agreement, with interest to be accrued through the date of payment, which occurred on July 31, 2007. Liabilities previously recorded by the Company were sufficient to cover these obligations.

The assets and liabilities classified as discontinued operations as of December 31, 2006 are as follows (in millions):

| | |
|--|--------|
| Accounts receivable, less allowance of \$8.3 | \$39.8 |
| Prepaid expenses and other current assets | 4.4 |
| Current assets of discontinued operations | \$44.2 |
| Property, plant and equipment, less allowance for depreciation of \$39.6 | \$36.8 |
| Goodwill | 20.3 |
| Other intangibles, less accumulated amortization of \$64.9 | 1.9 |
| Noncurrent assets of discontinued operations | \$59.0 |
| Accounts payable | \$4.3 |
| Accrued compensation | 13.9 |
| Accrued expenses and other liabilities | 4.3 |
| Current liabilities of discontinued operations | \$22.5 |
| Noncurrent liabilities - other liabilities of discontinued operations | \$5.6 |

NOTE 6

INTANGIBLE ASSET IMPAIRMENT

In the second quarter of 2007, the Company recorded a \$19.8 million charge (\$12.7 million net of income taxes) within its Orthopaedic Implants segment to write-off patents associated with intervertebral body fusion cage products. The impairment follows a United States Food and Drug Administration (FDA) decision to downgrade certain intervertebral body fusion products to class II devices, along with a weak market for sales of these specific products. As a result, the Company performed a discounted cash flow analysis over the remaining life of the patented technologies and determined the charge to recognize an intangible asset impairment was required.

- 8 -

NOTE 7

NET EARNINGS PER SHARE

The Company has key employee and director stock option plans under which options are granted at an exercise price not less than the fair market value of the underlying common stock at the date of grant. Options to purchase an

average of 1.7 million and 7.2 million shares of common stock during the six months ended June 30, 2007 and 2006, respectively, and 11.0 million shares of common stock during the three months ended June 30, 2006 were outstanding but were not included in the computation of diluted net earnings per share because the exercise prices of the options were greater than the average market price of common shares for those periods. During the three months ended June 30, 2007, all outstanding options to purchase shares of common stock were included in the computation of diluted net earnings per share.

NOTE 8

RETIREMENT PLANS

Certain of the Company's subsidiaries have both funded and unfunded defined benefit plans covering some or all of their employees. The components of net periodic benefit cost are as follows (in millions):

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|-------|------------------|-------|
| | June 30 | | June 30 | |
| | 2007 | 2006 | 2007 | 2006 |
| Service cost | \$3.0 | \$2.7 | \$6.0 | \$5.5 |
| Interest cost | 2.3 | 2.2 | 4.4 | 3.5 |
| Expected return on plan assets | (1.9) | (2.0) | (3.7) | (2.9) |
| Amortization of transition amounts and prior service cost | 0.1 | 0.1 | 0.3 | 0.2 |
| Recognized actuarial loss | 0.2 | 0.4 | 0.3 | 0.6 |
| Net periodic benefit cost | \$3.7 | \$3.4 | \$7.3 | \$6.9 |

The Company previously disclosed in its 2006 Form 10-K that it anticipated contributing approximately \$8.2 million to its defined benefit plans in 2007 to meet minimum funding requirements. As of June 30, 2007, \$4.6 million of contributions have been made.

NOTE 9

INCOME TAXES

The Company operates in multiple tax jurisdictions both inside and outside the United States and, accordingly, management must determine the appropriate allocation of income to each of these jurisdictions based on current interpretations of complex tax regulations. The Company files income tax returns in each of these countries based on its determination. At June 30, 2007, tax authorities in several tax jurisdictions both inside and outside the United States were conducting routine audits of the Company's income tax returns filed in prior years. These audits are generally designed to determine if individual tax authorities are in agreement with the Company's interpretations of complex income tax regulations regarding the allocation of income to the various tax jurisdictions. With few exceptions, the Company is no longer subject to audits by tax authorities for tax years prior to 2001. Tax years subsequent to 2000 are open to examination in many of the tax jurisdictions the Company operates in, including the United States, Japan and countries throughout Europe.

At January 1, 2007, the date of the adoption of FASB Interpretation No. 48, the Company's income tax accruals associated with unresolved income tax positions were \$185.1 million. The Company's income taxes could be reduced by \$168.8 million upon favorable resolution of these unresolved income tax positions. There were no material changes in the income tax accruals recorded during the first six months of 2007 resulting from income tax positions taken in the current or prior years, settlements with tax authorities or lapse of applicable statutes of limitations.

In addition, upon adoption of the Interpretation, the Company increased its accrual for interest associated with unresolved income tax positions by \$11.8 million (\$7.6 million net of income taxes) to \$21.7 million. There were no material changes in accrued interest recorded during the first six months of 2007.

- 10 -

NOTE 10

SEGMENT INFORMATION

The Company segregates its operations into two reportable business segments: Orthopaedic Implants and MedSurg Equipment. The Orthopaedic Implants segment sells orthopaedic reconstructive (hip, knee, and shoulder), trauma, spinal and craniomaxillofacial implant systems; bone cement; and the bone growth factor OP-1. The MedSurg Equipment segment sells surgical equipment; surgical navigation systems; endoscopic, communications, and digital imaging systems; as well as patient handling and emergency medical equipment. The Other category includes corporate administration, interest expense and interest and marketable securities income.

The Company's reportable segments are business units that offer different products and services and are managed separately because each business requires different manufacturing, technology and marketing strategies. The accounting policies of the segments are the same as those described in the summary of significant accounting policies found in Note 1 of the Company's 2006 Form 10-K. The Company measures the financial results of its reportable segments using an internal performance measure that excludes the intangible asset impairment charge

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recorded in the second quarter of 2007 and the purchased in-process research and development charge recognized for the Sightline acquisition in the first quarter of 2006 as well as the effect of share-based compensation, which includes compensation related to both employee and director stock option plans and restricted stock grants.

Sales and net earnings (loss) from continuing operations by business segment follow (in millions):

| | Orthopaedic Implants | MedSurg Equipment | Other | Total |
|---|-------------------------|----------------------|---------|-----------|
| Three Months Ended June 30, 2007 | | | | |
| Net sales | \$883.3 | \$580.4 | | \$1,463.7 |
| Segment net earnings (loss) | 175.3 | 89.2 | (\$1.6) | 262.9 |
| Less intangible asset impairment charge, net of income tax benefit | | | | 12.7 |
| Less share-based compensation, net of income tax benefit | | | | 10.1 |
| Net earnings from continuing operations | | | | \$240.1 |
| Three Months Ended June 30, 2006 | | | | |
| Net sales | \$771.1 | \$490.7 | | \$1,261.8 |
| Segment net earnings (loss) | 151.8 | 74.8 | (\$5.2) | 221.4 |
| Less share-based compensation, net of income tax benefit | | | | 9.3 |
| Net earnings from continuing operations | | | | \$212.1 |
| Six Months Ended June 30, 2007 | | | | |
| Net sales | \$1,743.3 | \$1,145.9 | | \$2,889.2 |
| Segment net earnings (loss) | 333.5 | 183.0 | (\$1.5) | 515.0 |
| Less intangible asset impairment charge, net of income tax benefit | | | | 12.7 |
| Less share-based compensation, net of income tax benefit | | | | 20.4 |
| Net earnings from continuing operations | | | | \$481.9 |
| Six Months Ended June 30, 2006 | | | | |
| Net sales | \$1,534.7 | \$981.0 | | \$2,515.7 |
| Segment net earnings (loss) | 290.0 | 149.3 | (\$9.9) | 429.4 |
| Less purchased in-process research and development | | | | 52.7 |
| Less share-based compensation, net of income tax benefit | | | | 19.0 |
| Net earnings from continuing operations | | | | \$357.7 |

NOTE 11
CONTINGENCIES

The Company is involved in various proceedings, legal actions and claims arising in the normal course of business, including proceedings related to product, labor, intellectual property and other matters. Such matters are subject to many uncertainties, and outcomes are not predictable with assurance. The Company records amounts for losses that are deemed to be probable and subject to reasonable estimate. However, the Company does not anticipate material losses as a result of these proceedings beyond amounts already provided in the accompanying condensed consolidated financial statements.

In March 2005, the Company announced that it received a subpoena from the United States Department of Justice requesting documents for the period January 2002 through the present relating to "any and all consulting contracts, professional service agreements, or remuneration agreements between Stryker Corporation and any orthopedic surgeon, orthopedic surgeon in training, or medical school graduate using or considering the surgical use of hip or knee joint replacement/reconstruction products manufactured or sold by Stryker Corporation." In June 2006, the Company announced that it received a subpoena from the United States Department of Justice, Antitrust Division requesting documents for the period January 2001 through the present regarding possible violations of federal criminal law, including possible violation of the antitrust laws, relating to the manufacture and sale of orthopaedic implant devices. The Company is fully cooperating with the Department of Justice regarding these matters.

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

Throughout this discussion, references are made to the following financial measures: "constant currency," "adjusted net earnings from continuing operations," "adjusted basic net earnings per share from continuing operations" and "adjusted diluted net earnings per share from continuing operations." These financial measures do not replace the presentation of Stryker Corporation's (the Company or Stryker) reported financial results under generally accepted accounting principles (GAAP). The Company has provided these supplemental non-GAAP financial measures because they provide meaningful information regarding the Company's results on a consistent and comparable basis for the periods presented. Management uses these non-GAAP financial measures for reviewing the operating results of its business segments, for analyzing potential future business trends in connection with its budget process and bases certain annual bonus plans on these non-GAAP financial measures. In order to measure the Company's sales performance on a constant currency basis, it is necessary to remove the impact of changes in foreign currency exchange rates which affects the comparability and trend of sales. In order to measure the Company's earnings performance on a consistent and comparable basis, it is necessary to exclude the intangible asset impairment charge recorded in the second quarter of 2007 and the purchased in-process research and development charge recorded in the first quarter of 2006, both of which affect the comparability of operating results and the trend of earnings. Additional details regarding the nature, determination and financial statement impact of these items are included in *Results of Operations*. Given the nature of these items, management believes that excluding them from certain financial metrics is more representative of the Company's past and potential future operational performance. In addition, the Company believes investors will utilize this information to evaluate period-to-period results on a comparable basis and to better understand potential future operating results. The Company encourages investors and other users of these financial

statements to review its consolidated financial statements and other publicly filed reports in their entirety and not to rely solely on any single financial measure.

Executive Level Overview

Stryker is one of the world's leading medical technology companies with the most broadly based range of products in orthopaedics and a significant presence in other medical specialties. Stryker works with respected medical professionals to help people lead more active and more satisfying lives. The Company's products include implants used in joint replacement, trauma, craniomaxillofacial and spinal surgeries; biologics; surgical, neurologic, ear, nose & throat and interventional pain equipment; endoscopic, surgical navigation, communications and digital imaging systems; as well as patient handling and emergency medical equipment.

- 12 -

Domestic sales accounted for 64% of total revenues in the first half of 2007 and 2006 and the second quarter of 2007 and 63% in the second quarter of 2006. Most of the Company's products are marketed directly to doctors, hospitals and other health-care facilities. Stryker primarily maintains separate and dedicated sales forces for each of its principal product lines to provide focus and a high level of expertise to each medical specialty served.

International sales accounted for 36% of total revenues in the first half of 2007 and 2006 and the second quarter of 2007 and 37% in the second quarter of 2006. The Company's products are sold in more than 100 countries through both Company-owned sales subsidiaries and branches as well as third-party dealers and distributors.

The Company's business is generally not seasonal in nature; however, the number of orthopaedic implant surgeries is lower during the summer months.

On June 4, 2007, the Company announced the completion of the sale of its outpatient physical therapy business, Physiotherapy Associates, to Water Street Healthcare Partners, for \$150.0 million in cash less certain indebtedness. Additional details, including the financial statement impact resulting from this divestiture, are included in *Results of Operations* and *Other Matters*.

The Company adopted the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, on January 1, 2007. This Interpretation clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the Company's consolidated financial statements. The Interpretation also provides guidance for the measurement and classification of tax positions, interest and penalties, and requires additional disclosure on an annual basis. Additional details, including the financial statement impact resulting from this adoption, are included in *Results of Operations*.

In the first quarter of 2006, the Company acquired all of the outstanding stock of Sightline Technologies Ltd. (Sightline), a private, development-stage company, for an upfront payment of \$50.0 million in cash plus certain transaction costs and the assumption of certain liabilities. Sightline is a developer of flexible endoscopes that should improve insertion and sterilization during colonoscopy procedures. Terms of the transaction also include milestone payments of up to an additional \$90.0 million upon the achievement of certain operational and financial targets related to Sightline's products, the first of which is expected to occur in 2007. This acquisition is expected to enhance the Company's presence in the gastrointestinal and other markets within its MedSurg Equipment segment.

Outlook

The Company's outlook for 2007 continues to be optimistic regarding underlying growth rates in orthopaedic procedures and sales growth rates in the Company's broadly based range of products in orthopaedics and other medical specialties, despite the potential for continued pricing pressure in certain markets. The Company projects that diluted net earnings per share from continuing operations for 2007 will approximate \$2.37, an increase of 27% over diluted net earnings per share from continuing operations for 2006 of \$1.87. Excluding the impacts of the charges to reflect the intangible asset impairment in the second quarter of 2007 and to write off purchased in-process research and development associated with the acquisition of Sightline in 2006, as more fully described in *Results of Operations*, the Company projects that adjusted diluted net earnings per share from continuing operations for 2007 will approximate \$2.40, an increase of 20% over adjusted diluted net earnings per share from continuing operations of \$2.00 in 2006.

The latest financial forecast for 2007 includes a constant currency net sales increase in the range of 12% to 13%, up from the previous forecast of 11% to 13% growth, as a result of growth in shipments of Orthopaedic Implants and MedSurg Equipment which is comparable to the 12% constant currency net sales increase in 2006. If foreign currency exchange rates hold near June 30, 2007 levels, the Company anticipates a favorable impact on net sales of approximately 1.0% to 1.5% in the third quarter of 2007 and a favorable impact on net sales of approximately 1.0% to 2.0% for the full year of 2007.

- 13 -

Results of Operations

The table below outlines the components of net earnings from continuing operations from the condensed consolidated statements of earnings as a percentage of net sales and the period-to-period percentage change in dollar amounts:

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Percentage of Net Sales

| | Six Months Ended | | Percentage Change |
|--|------------------|-------|----------------------|
| | June 30 | | |
| | 2007 | 2006 | 2007/2006 |
| Net sales | 100.0 | 100.0 | 15 |
| Cost of sales | 30.6 | 31.3 | 12 |
| Gross profit | 69.4 | 68.7 | 16 |
| Research, development and engineering expenses | 6.1 | 6.1 | 15 |
| Selling, general and administrative expenses | 39.8 | 39.5 | 16 |
| Intangibles amortization | 0.8 | 0.8 | 9 |
| Intangible asset impairment | 0.7 | -- | -- |
| Purchased in-process research and development | -- | 2.1 | (100) |
| Operating income | 22.1 | 20.2 | 25 |
| Other income (expense) | 1.1 | 0.4 | 202 |
| Earnings before income taxes | 23.1 | 20.6 | 29 |
| Income taxes | 6.4 | 6.4 | 16 |
| Net earnings from continuing operations | 16.7 | 14.2 | 35 |

Percentage of Net Sales

| | Three Months Ended | | Percentage Change |
|--|--------------------|-------|----------------------|
| | June 30 | | |
| | 2007 | 2006 | 2007/2006 |
| Net sales | 100.0 | 100.0 | 16 |
| Cost of sales | 30.4 | 31.2 | 13 |
| Gross profit | 69.6 | 68.8 | 17 |
| Research, development and engineering expenses | 6.3 | 6.0 | 21 |
| Selling, general and administrative expenses | 39.7 | 39.1 | 18 |
| Intangibles amortization | 0.8 | 0.8 | 9 |
| Intangible asset impairment | 1.4 | -- | -- |
| Operating income | 21.5 | 22.9 | 9 |
| Other income (expense) | 1.2 | 0.4 | 245 |
| Earnings before income taxes | 22.7 | 23.3 | 13 |
| Income taxes | 6.3 | 6.5 | 12 |
| Net earnings from continuing operations | 16.4 | 16.8 | 13 |

- 14 -

The table below sets forth domestic/international and product line sales information (in millions):

| | Six Months Ended | | Percentage Change | |
|--|------------------|------|-------------------|----------------------|
| | June 30 | | 2007/2006 | |
| | 2007 | 2006 | Reported | Constant Currency |

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| | | | | |
|-------------------------------|-----------|-----------|----|----|
| Domestic/international sales: | | | | |
| Domestic | \$1,849.7 | \$1,598.8 | 16 | 16 |
| International | 1,039.5 | 916.9 | 13 | 8 |
| Total net sales | \$2,889.2 | \$2,515.7 | 15 | 13 |
| Product line sales: | | | | |
| Orthopaedic Implants | \$1,743.3 | \$1,534.7 | 14 | 11 |
| MedSurg Equipment | 1,145.9 | 981.0 | 17 | 16 |
| Total net sales | \$2,889.2 | \$2,515.7 | 15 | 13 |

| | Three Months Ended | | Percentage Change | |
|-------------------------------|--------------------|-----------|-------------------|----------------------|
| | June 30 | | 2007/2006 | |
| | 2007 | 2006 | Reported | Constant Currency |
| Domestic/international sales: | | | | |
| Domestic | \$936.5 | \$797.9 | 17 | 17 |
| International | 527.2 | 463.9 | 14 | 9 |
| Total net sales | \$1,463.7 | \$1,261.8 | 16 | 14 |
| Product line sales: | | | | |
| Orthopaedic Implants | \$883.3 | \$771.1 | 15 | 12 |
| MedSurg Equipment | 580.4 | 490.7 | 18 | 17 |
| Total net sales | \$1,463.7 | \$1,261.8 | 16 | 14 |

- 15 -

The table below sets forth additional geographical sales growth information for significant products within the Company's Orthopaedic Implants and MedSurg Equipment segments on both a reported basis and a constant currency basis:

| | <u>Six Months Ended June 30 2007/2006</u> | | | | |
|---|---|----------------------|-----------------|------------------------------|-----------------|
| | <u>Domestic</u> | <u>International</u> | | <u>Total</u> | |
| | | <u>Reported</u> | <u>Reported</u> | <u>Constant Currency</u> | <u>Reported</u> |
| Worldwide Orthopaedic Implants sales: | | | | | |
| Hips | 5 | 10 | 4 | 7 | 5 |
| Knees | 17 | 14 | 8 | 16 | 13 |
| Trauma | 33 | 8 | 4 | 17 | 14 |
| Spine | 26 | 20 | 15 | 24 | 23 |
| Craniomaxillofacial | 25 | 9 | 5 | 19 | 17 |
| Total Orthopaedic Implants | 16 | 11 | 6 | 14 | 11 |
| Worldwide MedSurg Equipment sales: | | | | | |
| Surgical equipment and surgical navigation systems | 15 | 23 | 17 | 17 | 16 |

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| | | | | | |
|--|----|----|----|----|----|
| Endoscopic, communications and digital imaging systems | 17 | 24 | 18 | 19 | 18 |
| Patient handling and emergency medical equipment | 14 | 4 | 2 | 12 | 12 |
| Total MedSurg Equipment | 16 | 20 | 15 | 17 | 16 |

Three Months Ended June 30 2007/2006

Percentage Change

| | <u>Domestic</u> | <u>International</u> | | <u>Total</u> | |
|--|-----------------|----------------------|--------------------------|-----------------|--------------------------|
| | <u>Reported</u> | <u>Reported</u> | <u>Constant Currency</u> | <u>Reported</u> | <u>Constant Currency</u> |
| Worldwide Orthopaedic Implants sales: | | | | | |
| Hips | 6 | 10 | 5 | 8 | 6 |
| Knees | 16 | 14 | 9 | 15 | 13 |
| Trauma | 35 | 11 | 7 | 20 | 18 |
| Spine | 30 | 17 | 13 | 26 | 24 |
| Craniomaxillofacial | 27 | 8 | 4 | 20 | 18 |
| Total Orthopaedic Implants | 17 | 12 | 7 | 15 | 12 |
| Worldwide MedSurg Equipment sales: | | | | | |
| Surgical equipment and surgical navigation systems | 18 | 22 | 16 | 19 | 18 |
| Endoscopic, communications and digital imaging systems | 21 | 22 | 17 | 22 | 20 |
| Patient handling and emergency medical equipment | 13 | 3 | 0 | 11 | 11 |
| Total MedSurg Equipment | 18 | 19 | 14 | 18 | 17 |

- 16 -

Stryker Corporation's net sales increased 15% in the first half of 2007 to \$2,889.2 million from \$2,515.7 million in 2006. For the second quarter of 2007 net sales were \$1,463.7 million, representing a 16% increase over net sales of \$1,261.8 million in the second quarter of 2006. Net sales in the first half grew by 13% as a result of increased unit volume and changes in product mix and by 2% due to favorable changes in foreign currency exchange rates. Net sales in the second quarter grew by 14% as a result of increased unit volume and changes in product mix and by 2% due to favorable changes in foreign currency exchange rates.

The Company's domestic sales were \$1,849.7 million for the first half of 2007 and \$936.5 million for the second quarter of 2007, representing increases of 16% and 17%, respectively, as a result of higher shipments of Orthopaedic Implants and MedSurg Equipment. International sales were \$1,039.5 million for the first half of 2007 and \$527.2 million for the second quarter of 2007, representing increases of 13% and 14%, respectively, as a result of higher shipments of Orthopaedic Implants and MedSurg Equipment. The impact of foreign currency comparisons to the dollar value of international sales was favorable by \$46.8 million in the first half and by \$22.6 million in the second quarter. On a constant currency basis, international sales increased 8% in the first half of 2007 and 9% in the second quarter of 2007.

Worldwide sales of Orthopaedic Implants were \$1,743.3 million for the first half of 2007 and \$883.3 million for the second quarter of 2007, representing increases of 14% and 15%, respectively, as a result of higher shipments of reconstructive (hip, knee and shoulder), trauma, spinal and craniomaxillofacial implant systems; bone cement; and the bone growth factor OP-1. On a constant currency basis, sales of Orthopaedic Implants increased 11% in the first half of 2007 and 12% in the second quarter of 2007.

Hip Implant Systems: Sales of hip implant systems increased 7% in the first half of 2007 and 8% in the second quarter (5% and 6%, respectively, on a constant currency basis). In the United States, sales growth was driven by sales of X3 Polyethylene and sales growth in Accolade cementless hip products and Restoration Modular Hip System revision hip products partially offset by declines in other hip systems. Solid sales growth in the Exeter, Trident and Accolade Hip Systems in Europe, the Pacific region and Latin America also led to the Company's constant currency sales growth for the first half and second quarter of 2007.

Knee Implant Systems: Sales of knee implant systems increased 16% in the first half of 2007 and 15% in the second quarter (13% in both periods on a constant currency basis) due to strong growth in the Triathlon knee system in the United States, Europe and the Pacific region and solid growth in the Scorpio knee system in Europe and the Pacific region.

Trauma Implant Systems: Sales of trauma implant systems increased 17% in the first half of 2007 and 20% in the second quarter (14% and 18%, respectively, on a constant currency basis) as a result of strong sales growth in the Gamma 3 Hip Fracture System in the United States, Europe, Canada and the Pacific region as well as solid sales growth in the Company's T2 Nailing system in the United States and Europe partially offset by a sales decline in Japan as a result of government imposed price cuts.

Spinal Implant Systems: Sales of spinal implant systems increased 24% in the first half of 2007 and 26% in the second quarter (23% and 24%, respectively, on a constant currency basis) primarily due to strong worldwide sales growth of thoracolumbar implant systems, interbody devices and cervical implants.

Craniomaxillofacial Implant Systems: Sales of craniomaxillofacial implant systems increased 19% in the first half of 2007 and 20% in the second quarter (17% and 18%, respectively, on a constant currency basis) primarily due to strong domestic sales growth led by products for neurological indications.

Worldwide sales of MedSurg Equipment were \$1,145.9 million for the first half of 2007 and \$580.4 million for the second quarter of 2007, representing increases of 17% and 18%, respectively, as a result of higher shipments of surgical equipment; surgical navigation systems; endoscopic, communications and digital imaging systems; as well as patient handling and emergency medical equipment. On a constant currency basis, sales of MedSurg Equipment increased 16% and 17% for the first half and second quarter of 2007, respectively.

Surgical Equipment and Surgical Navigation Systems: Sales of surgical equipment and surgical navigation systems increased 17% in the first half of 2007 and 19% in the second quarter (16% and 18%, respectively, on a constant

currency basis) due to strong domestic sales growth in powered surgical and operating room equipment and interventional pain products. Strong sales growth in powered surgical instruments in Europe also led to the Company's constant currency sales growth.

Endoscopic, Communications and Digital Imaging Systems: Sales of endoscopic, communications and digital imaging systems increased 19% in the first half of 2007 and 22% in the second quarter (18% and 20%, respectively, on a constant currency basis) as a result of strong worldwide sales growth of medical video imaging equipment led by the recently launched 1188 HD Camera and complementary products such as the X8000 Lightsource and Vision Elect Monitor. Strong sales growth in arthroscopy products in Europe and solid domestic sales growth in communications products also led to the Company's constant currency sales growth.

Patient Handling and Emergency Medical Equipment: Sales of patient handling and emergency medical equipment increased 12% in the first half of 2007 and 11% in the second quarter on both a reported and constant currency basis due to strong sales growth in maternity beds in the United States, Canada, Europe and Latin America as well as strong sales growth of stretchers in the United States and Canada.

Cost of sales in the first half of 2007 represented 30.6% of sales compared to 31.3% in the same period of 2006. In the second quarter of 2007, the cost of sales percentages decreased to 30.4% from 31.2% in the second quarter of 2006. The decrease in the cost of sales percentage is primarily due to efficiencies gained within manufacturing plants and product distribution channels as well as lower royalty costs as a percent of sales.

Research, development and engineering expenses represented 6.1% of sales in both the first half of 2007 and 2006 and increased 15% to \$176.7 million. In the second quarter these costs increased 21% and represented 6.3% of sales in 2007 compared to 6.0% in 2006. The higher spending level is the result of the Company's continued focus on new product development for anticipated product launches throughout the remainder of the year and in future years.

Selling, general and administrative expenses increased 16% in the first half of 2007 and represented 39.8% of sales compared to 39.5% in the same period of 2006. In the second quarter, these expenses increased 18% and represented 39.7% of sales in 2007 compared to 39.1% in 2006. The increase in selling, general and administrative expenses as a percent of sales is primarily due to higher sales-related costs, including sales compensation, partially offset by decreases in insurance premiums.

In the second quarter of 2007, the Company recorded a \$19.8 million charge (\$12.7 million net of income taxes) within its Orthopaedic Implants segment to write-off patents associated with intervertebral body fusion cage products. The impairment follows a United States Food and Drug Administration (FDA) decision to downgrade certain intervertebral body fusion products to class II devices, along with a weak market for sales of these specific products. As a result, the Company performed a discounted cash flow analysis over the remaining life of the patented technologies and determined the charge to recognize an intangible asset impairment was required.

The purchased in-process research and development charge of \$52.7 million recorded in the first quarter of 2006 relates to the acquisition of Sightline. At the date of the acquisition, the flexible endoscope technologies acquired had not yet reached technological feasibility. The upfront payment of \$50.0 million, plus certain transaction costs and the assumption of certain liabilities, was allocated to assets acquired, purchased in-process research and development and liabilities assumed based on their estimated fair value at the date of acquisition.

Interest and marketable securities income, which is included in other income (expense), increased to \$36.1 million in the first half of 2007 from \$16.7 million in 2006 and increased to \$19.5 million in the second quarter of

2007 from \$8.3 million in 2006 as a result of increased cash and cash equivalents and marketable securities balances compared to the prior year period.

The Company's effective income tax rates on earnings from continuing operations for the first half and second quarter of 2007 were 27.9% and 27.6%, respectively, as compared to effective income tax rates for the year ended December 31, 2006 and the first half and second quarter of 2006 of 29.5%, 30.9% and 27.8%, respectively. The effective income tax rates for the first half and second quarter of 2007 reflect the impact of the intangible asset impairment charge of \$12.7 million (net of \$7.1 million income tax benefit). The effective income tax rates for the first half of 2006 and year

- 18 -

ended December 31, 2006 reflect the impact of the non-deductibility for income tax purposes of the purchased in-process research and development charge associated with the acquisition of Sightline.

Upon adoption of FASB Interpretation No. 48, the Company recognized an increase in the interest accrual associated with unresolved income tax positions, which was accounted for by reducing the January 1, 2007 balance of retained earnings by \$7.6 million (net of income taxes). In addition, the Company reclassified \$179.2 million from the current income taxes liability to noncurrent liabilities to match the anticipated timing of future income tax payments. Due to uncertainties regarding the ultimate resolution of income tax audits, the Company is not able to reasonably estimate the future periods in which income tax payments will be made to settle these unresolved tax positions.

Net earnings from continuing operations for the first half of 2007 were \$481.9 million, an increase of 35% compared to net earnings from continuing operations of \$357.7 million in the first half of 2006. Basic net earnings per share from continuing operations increased 34% in the first half of 2007 to \$1.18 from \$.88 in 2006, and diluted net earnings per share from continuing operations increased 33% in the first half of 2007 to \$1.16 from \$.87 in 2006. Net earnings from continuing operations for the second quarter of 2007 were \$240.1 million representing a 13% increase over net earnings from continuing operations of \$212.1 million in the second quarter of 2006. Basic net earnings per share from continuing operations increased 13% in the second quarter of 2007 to \$.59 from \$.52 in 2006, and diluted net earnings per share from continuing operations increased 12% in the second quarter of 2007 to \$.58 from \$.52 in 2006.

Excluding the impacts of the charges to reflect the intangible asset impairment in the second quarter of 2007 and to write off purchased in-process research and development recorded in the first quarter of 2006, adjusted net earnings from continuing operations for the first half of 2007 of \$494.6 million increased by 21% over adjusted net earnings of \$410.4 million for the first half of 2006. Adjusted basic net earnings per share from continuing operations increased 20% to \$1.21 for the first half of 2007 from \$1.01 for the first half of 2006, and adjusted diluted net earnings per share from continuing operations increased 19% to \$1.19 for the first half of 2007 from \$1.00 for the first half of

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2006. Excluding the impact of the charge to reflect the intangible asset impairment in the second quarter of 2007, adjusted net earnings from continuing operations for the second quarter of 2007 of \$252.8 million increased by 19% over net earnings from continuing operations of \$212.1 million for the second quarter of 2006. Adjusted basic net earnings per share from continuing operations of \$.62 increased by 19% over basic net earnings per share from continuing operations of \$.52 for the second quarter of 2006, and adjusted diluted net earnings per share from continuing operations of \$.61 increased by 17% over diluted net earnings per share from continuing operations of \$.52 for the second quarter of 2006.

- 19 -

The reconciliations of these non-GAAP financial measures are as follows (in millions, except per share amounts):

| | Three Months | | | Six Months | | |
|--|------------------|---------|------------|------------------|---------|------------|
| | Ended June 30 | | Percentage | Ended June 30 | | Percentage |
| | 2007 | 2006 | Change | 2007 | 2006 | Change |
| Reported net earnings from continuing operations | \$240.1 | \$212.1 | 13 | \$481.9 | \$357.7 | 35 |
| Intangible asset impairment | 12.7 | -- | -- | 12.7 | -- | -- |
| Purchased in-process research and development | -- | -- | -- | -- | 52.7 | (100) |
| Adjusted net earnings from continuing operations | \$252.8 | \$212.1 | 19 | \$494.6 | \$410.4 | 21 |
| Basic net earnings per share: | | | | | | |
| Reported basic net earnings per share from continuing operations | \$.59 | \$.52 | 13 | \$1.18 | \$.88 | 34 |
| Intangible asset impairment | \$.03 | \$ -- | -- | \$.03 | \$ -- | -- |
| Purchased in-process research and development | \$ -- | \$ -- | -- | \$ -- | \$.13 | (100) |
| Adjusted basic net earnings per share from continuing operations | \$.62 | \$.52 | 19 | \$1.21 | \$1.01 | 20 |
| Weighted-average basic shares outstanding | 409.4 | 406.4 | | 409.0 | 406.0 | |
| Diluted net earnings per share: | | | | | | |
| Reported diluted net earnings per share from continuing operations | \$.58 | \$.52 | 12 | \$1.16 | \$.87 | 33 |
| Intangible asset impairment | \$.03 | \$ -- | -- | \$.03 | \$ -- | -- |
| Purchased in-process research and development | \$ -- | \$ -- | -- | \$ -- | \$.13 | (100) |
| Adjusted diluted net earnings | | | | | | |

| | | | | | | |
|---|--------|--------|----|---------|---------|----|
| per share from continuing operations | \$.61 | \$.52 | 17 | \$ 1.19 | \$ 1.00 | 19 |
| Weighted-average diluted shares outstanding | 416.9 | 410.7 | | 416.5 | 411.0 | |

The weighted-average basic and diluted shares outstanding used in the calculation of these non-GAAP financial measures are the same as the weighted-average shares outstanding used in the calculation of the reported per share amounts.

- 20 -

The sale of Physiotherapy Associates resulted in a gain on the sale of discontinued operations of \$25.7 million (net of income taxes), or \$.06 per diluted share in the second quarter of 2007. Net earnings from discontinued operations for the first half of 2007 were \$5.0 million compared to net earnings from discontinued operations of \$3.7 million in the first half of 2006. Net earnings from discontinued operations for the second quarter of 2007 were \$3.3 million compared to net earnings from discontinued operations of \$1.8 million in the second quarter of 2006.

Net earnings for the first half of 2007 were \$512.6 million, an increase of 42% compared to net earnings of \$361.4 million for the first half of 2006. Basic net earnings per share increased 40% in the first half of 2007 to \$1.25 from \$.89 in 2006, and diluted net earnings per share increased 40% in the first half of 2007 to \$1.23 from \$.88 in 2006. Net earnings for the second quarter of 2007 were \$269.1 million representing a 26% increase over net earnings of \$213.9 million for the second quarter of 2006. Basic net earnings per share increased 25% in the second quarter of 2007 to \$.66 from \$.53 in 2006, and diluted net earnings per share increased 25% in the second quarter of 2007 to \$.65 from \$.52 in 2006.

Liquidity and Capital Resources

The Company's working capital at June 30, 2007, increased \$839.6 million to \$3,022.4 million from working capital \$2,182.8 million at December 31, 2006. The increase in working capital resulted from growth in the Company's overall business, the proceeds from the sale of Physiotherapy Associates and the use of cash earnings to fund increases in accounts receivable, inventories and prepaid expenses. Accounts receivable days sales outstanding increased 2 days to 58 days at June 30, 2007 from 56 days at December 31, 2006 and days sales in inventory increased 11 days to 149 days at June 30, 2007 from 138 days at December 31, 2006. The days sales outstanding at June 30, 2007 is consistent with historical levels. Days sales in inventory at June 30, 2007 is higher than the prior year period primarily due to higher levels of inventory in support of anticipated product launches and third quarter sales as well as managements efforts to run the manufacturing plants at a steady rate.

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The Company generated cash of \$363.6 million from operations in the first six months of 2007 compared to \$216.5 million in 2006. In the second quarter, the Company generated cash from operations of \$210.9 million compared to \$195.8 million in 2006. The increase in cash provided by operating activities in the first six months and second quarter of 2007 compared to 2006 is primarily due to increased earnings partially offset by changes in working capital accounts.

In the first half of 2007, the Company borrowed an additional \$93.2 million and used cash of \$90.9 million for payments on borrowings. The Company also used \$79.9 million for capital expenditures, \$37.6 million for acquisitions and \$89.7 million for the payment of dividends; it also purchased and sold marketable securities. These securities are classified as available-for-sale investments in accordance with the provisions of FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*.

The Company had \$170.0 million in cash and cash equivalents and \$1,610.2 million in marketable securities at June 30, 2007. The Company had outstanding borrowings totaling \$17.4 million at June 30, 2007. The Company believes its cash on hand and marketable securities, as well as anticipated future cash flows from operations, will be sufficient to fund future operating capital requirements; future manufacturing facility construction and other capital expenditures; future business and product line acquisitions to supplement its current product offerings; and loaner instrumentation for surgical implants in support of new product launches. Should additional funds be required, the Company had \$1,036.1 million of additional borrowing capacity available under all of its existing credit facilities, including the Company's \$1,000.0 million 5-year nonamortizing, revolving Unsecured Credit Facility that expires in November 2010. In addition, the Company had \$200.0 million of eligible accounts receivable that could be sold through its accounts receivable securitization facility at June 30, 2007.

- 21 -

As a result of the sale of Physiotherapy Associates, the Company's future contractual obligations under operating leases with initial terms greater than 1 year, as previously disclosed in its 2006 Form 10-K, were reduced as follows:

| | 2007 | 2008 | Payment Period | | 2011 | Thereafter |
|---|--------|--------|----------------|--------|--------|------------|
| | | | 2009 | 2010 | | |
| Operating leases as previously reported | \$62.1 | \$51.3 | \$38.5 | \$22.7 | \$13.3 | \$25.4 |
| Physiotherapy operating leases | (27.0) | (21.4) | (16.0) | (10.1) | (5.3) | (8.5) |
| Adjusted operating leases | \$35.1 | \$29.9 | \$22.5 | \$12.6 | \$8.0 | \$16.9 |

Other Matters

The Company has certain investments in net assets in international locations that are not hedged. These investments are subject to translation gains and losses due to changes in foreign currencies. For the first half of 2007, the strengthening of foreign currencies relative to the U.S. dollar increased the value of these investments in net assets,

and the related deferred gain in shareholders' equity, by \$24.1 million.

In December 2003, the Company announced that it received a subpoena from the United States Attorney's Office in Boston, Massachusetts, in connection with a Department of Justice investigation of Physiotherapy Associates' billing and coding practices. Under the terms of the Physiotherapy sale agreement, Stryker retained responsibility for certain cash damages to be paid in connection with this investigation. The Company's liability for such damages was fixed under the sale agreement, with interest to be accrued through the date of payment, which occurred on July 31, 2007. Liabilities previously recorded by the Company were sufficient to cover these obligations.

In March 2005, the Company announced that it received a subpoena from the United States Department of Justice requesting documents for the period January 2002 through the present relating to "any and all consulting contracts, professional service agreements, or remuneration agreements between Stryker Corporation and any orthopedic surgeon, orthopedic surgeon in training, or medical school graduate using or considering the surgical use of hip or knee joint replacement/reconstruction products manufactured or sold by Stryker Corporation." In June 2006, the Company announced that it received a subpoena from the United States Department of Justice, Antitrust Division requesting documents for the period January 2001 through the present regarding possible violations of federal criminal law, including possible violation of the antitrust laws, relating to the manufacture and sale of orthopaedic implant devices. The Company is fully cooperating with the Department of Justice regarding these matters.

Forward-Looking Statements

This report contains information that includes or is based on forward-looking statements within the meaning of the federal securities law that are subject to various risks and uncertainties that could cause the Company's actual results to differ materially from those expressed or implied in such statements. Such factors include, but are not limited to: pricing pressures generally, including cost-containment measures that could adversely affect the price of or demand for the Company's products; regulatory actions; unanticipated issues arising in connection with clinical studies and eventual United States FDA approval of additional OP-1 applications, the FlexiCore and CerviCore spinal implant products, the PlasmaSol sterilization products or other new product introductions; integration and other issues that could delay the introduction of the Sightline product line; changes in reimbursement levels from third-party payors; a significant increase in product liability claims; changes in economic conditions that adversely affect the level of demand for the Company's products; changes in foreign exchange markets; changes in financial markets; and changes in the competitive environment.

While the Company believes that the assumptions underlying such forward-looking statements are reasonable, there can be no assurance that future events or developments will not cause such statements to be inaccurate. All forward-looking statements contained in this report are qualified in their entirety by this cautionary statement.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes from the information provided in the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures - An evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of June 30, 2007 was carried out under the supervision and with the participation of the Company's management, including the President and Chief Executive Officer and the Vice President and Chief Financial Officer ("the Certifying Officers"). Based on that evaluation, the Certifying Officers concluded that the Company's disclosure controls and procedures are effective to bring to the attention of the Company's management the relevant information necessary to permit an assessment of the need to disclose material developments and risks pertaining to the Company's business in its periodic filings with the Securities and Exchange Commission. There was no change to the Company's internal control over financial reporting during the quarter ended June 30, 2007 that materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

Other Matters - The Company is in the process of implementing new Enterprise Resource Planning (ERP) systems at certain of its divisions. An ERP system is a fully-integrated set of programs and databases that incorporate order processing, production planning and scheduling, purchasing, accounts receivable and inventory management and accounting. The Company's European, Middle East, Africa division began the transition to its new ERP system in the third quarter of 2007. In connection with this ERP system implementation, the Company will update its internal controls over financial reporting, as necessary, to accommodate modifications to its business processes and accounting procedures. The Company does not believe that this ERP system implementation will have an adverse effect on the Company's internal control over financial reporting.

PART II - OTHER INFORMATION

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| ITEM 1. | LEGAL PROCEEDINGS |
|---------|-------------------|

There have been no material changes from the information provided in the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

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| ITEM 1A. | RISK FACTORS |
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There have been no material changes from the information provided in the Company's Annual Report on Form 10-K for the year ended December 31, 2006.

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| ITEM 2. | UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS |
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(c)The Company issued 1,665 shares of Common Stock in the second quarter of 2007 as performance incentive awards to certain employees. These shares were not registered under the Securities Act of 1933 based on the conclusion that the awards would not be events of sale within the meaning of Section 2(a)(3) of the Act.

- 23 -

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| ITEM 6. | EXHIBITS |
|---------|----------|

(a) Exhibits

- 31(i) Certification of Principal Executive Officer of Stryker Corporation pursuant to Rule 13a-14(a)
- 31(ii) Certification of Principal Financial Officer of Stryker Corporation pursuant to Rule 13a-14(a)
- 32(i) Certification by Chief Executive Officer of Stryker Corporation pursuant to 18 U.S.C. Section 1350
- 32(ii) Certification by Chief Financial Officer of Stryker Corporation pursuant to 18 U.S.C. Section 1350

SIGNATURES

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

| | |
|------------------------|--|
| August 9, 2007 Date | STRYKER CORPORATION (Registrant) /s/ STEPHEN P. MACMILLAN Stephen P. MacMillan, President and Chief Executive Officer (Principal Executive Officer) |
| August 9, 2007 Date | /s/ DEAN H. BERGY Dean H. Bergy, Vice President and Chief Financial Officer (Principal Financial Officer) |

EXHIBIT INDEX

Exhibit 31 -Rule 13a-14(a) Certifications

- (i) Certification of Principal Executive Officer of Stryker Corporation
- (ii) Certification of Principal Financial Officer of Stryker Corporation

Exhibit 32 -18 U.S.C. Section 1350 Certifications

- (i) Certification by Chief Executive Officer of Stryker Corporation
- (ii) Certification by Chief Financial Officer of Stryker Corporation