

CONMED CORP  
Form 10-Q  
November 05, 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  
September 30, 2007

Commission File Number 0-16093

**CONMED CORPORATION**

(Exact name of the registrant as specified in its charter)

**New York**

(State or other jurisdiction of  
incorporation or organization)

**16-0977505**

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

**525 French Road, Utica, New York**  
(Address of principal executive offices)

**13502**  
(Zip Code)

**(315) 797-8375**

(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 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 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

The number of shares outstanding of registrant's common stock, as of November 1, 2007 is 28,611,431 shares.

**CONMED CORPORATION**

**QUARTERLY REPORT ON FORM 10-Q  
FOR THE QUARTER ENDED SEPTEMBER 30, 2007**

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**PART I FINANCIAL INFORMATION**  
**Item 1.**

**CONMED CORPORATION**  
**CONSOLIDATED CONDENSED STATEMENTS OF INCOME**  
(Unaudited, in thousands except per share amounts)

	<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
	<u>September 30,</u>		<u>September 30,</u>	
	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>
Net sales	\$ 154,981	\$ 164,448	\$ 476,920	\$ 504,720
Cost of sales	80,250	82,090	246,515	251,277
Gross profit	74,731	82,358	230,405	253,443
Selling and administrative expense	56,219	57,506	172,716	175,518
Research and development expense	7,262	7,936	22,585	22,983
Other expense (income)	2,066	-	4,220	(4,102)
	65,547	65,442	199,521	194,399
Income from operations	9,184	16,916	30,884	59,044
Loss on early extinguishment of debt	-	-	678	-
Interest expense	4,962	3,861	14,503	12,706
Income before income taxes	4,222	13,055	15,703	46,338
Provision for income taxes	890	4,700	4,617	16,716
Net income	\$ 3,332	\$ 8,355	\$ 11,086	\$ 29,622
<b>Per share data:</b>				
Net income				
Basic	\$ .12	\$ .29	\$ .40	\$ 1.06
Diluted	.12	.29	.39	1.04
Weighted average common shares				
Basic	27,888	28,572	27,999	27,990
Diluted	28,134	29,101	28,241	28,580

**CONMED CORPORATION**  
**CONSOLIDATED CONDENSED BALANCE SHEETS**  
(Unaudited, in thousands except share and per share amounts)

	December 31, <u>2006</u>	September 30, <u>2007</u>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 3,831	\$ 5,411
Accounts receivable, net	75,120	81,765
Inventories	151,687	166,712
Income taxes receivable	747	2,919
Deferred income taxes	15,212	15,432
Prepaid expenses and other current assets	3,286	3,284
Total current assets	249,883	275,523
Property, plant and equipment, net	116,480	121,653
Goodwill	290,512	294,659
Other intangible assets, net	191,135	189,470
Other assets	13,561	10,767
Total assets	\$ 861,571	\$ 892,072
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
Current liabilities:		
Current portion of long-term debt	\$ 3,148	\$ 3,247
Accounts payable	41,823	34,769
Accrued compensation and benefits	17,712	18,452
Accrued interest	727	1,901
Other current liabilities	11,795	13,108
Total current liabilities	75,205	71,477
Long-term debt	264,676	239,647
Deferred income taxes	51,004	66,399
Other long-term liabilities	30,332	25,817
Total liabilities	421,217	403,340
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, par value \$.01 per share; authorized 500,000 shares; none outstanding	-	-
Common stock, par value \$.01 per share; 100,000,000 shares authorized; 31,304,203 and 31,299,203 shares issued in 2006 and 2007, respectively	313	313
Paid-in capital	284,858	287,180
Retained earnings	247,425	273,049
Accumulated other comprehensive income (loss)	(8,612)	(3,869)

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Less: 3,321,545 and 2,698,421 shares of common stock in treasury, at cost in 2006 and 2007, respectively	(83,630)	(67,941)
Total shareholders' equity	440,354	488,732
Total liabilities and shareholders' equity	\$ 861,571	\$ 892,072

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**CONMED CORPORATION**  
**CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS**  
(Unaudited, in thousands)

	<u>Nine months ended</u>	
	<u>September 30,</u>	
	<u>2006</u>	<u>2007</u>
Cash flows from operating activities:		
Net income	\$ 11,086	\$ 29,622
Adjustments to reconcile net income, to net cash provided by operating activities:		
Depreciation	8,591	9,498
Amortization	13,704	14,015
Stock-based compensation	2,599	2,932
Deferred income taxes	4,670	14,869
Loss on extinguishment of debt	203	-
Increase (decrease) in cash flows from changes in assets and liabilities:		
Sale of accounts receivable	(3,000)	(4,000)
Accounts receivable	3,320	(2,424)
Inventories	(9,975)	(21,826)
Accounts payable	4,065	(5,284)
Income taxes receivable	(1,979)	(1,904)
Accrued compensation and benefits	2,148	740
Accrued interest	844	1,174
Other assets	(1,083)	(298)
Other liabilities	5,604	(1,651)
	29,711	5,841
Net cash provided by operating activities	40,797	35,463
Cash flows from investing activities:		
Purchases of property, plant, and equipment	(16,738)	(15,964)
Proceeds from sale of equity investment	1,205	-
Payments related to business acquisitions	(2,463)	(5,837)
Net cash used in investing activities	(17,996)	(21,801)
Cash flows from financing activities:		
Net proceeds from common stock issued under employee plans	2,103	11,119
Excess tax benefits from stock-based compensation	102	-
Repurchase of common stock	(7,848)	-
Payments on senior credit agreement	(141,822)	(24,664)
Proceeds of senior credit agreement	135,000	-
Payments on mortgage notes	(223)	(266)
Payments related to issuance of long-term debt	(1,260)	-
Net change in cash overdrafts	(604)	(1,770)
Net cash used in financing activities	(14,552)	(15,581)
Effect of exchange rate changes on cash and cash equivalents	1,789	3,499

Net increase in cash and cash equivalents	10,038	1,580
Cash and cash equivalents at beginning of period	3,454	3,831
Cash and cash equivalents at end of period	\$ 13,492	\$ 5,411

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**CONMED CORPORATION**  
**NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS**  
(Unaudited, in thousands except per share amounts)

**Note 1 – Operations and Significant Accounting Policies****Organization and operations**

The accompanying consolidated condensed financial statements include the accounts of CONMED Corporation and its controlled subsidiaries (“CONMED”, the “Company”, “we” or “us”). All intercompany accounts and transactions have been eliminated. CONMED is a medical technology company with an emphasis on surgical devices and equipment for minimally invasive procedures and monitoring. The Company’s products serve the clinical areas of arthroscopy, powered surgical instruments, electrosurgery, cardiac monitoring disposables, endosurgery and endoscopic technologies. They are used by surgeons and physicians in a variety of specialties including orthopedics, general surgery, gynecology, neurosurgery, and gastroenterology.

**Note 2 - Interim financial information**

The accompanying unaudited consolidated condensed 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 generally accepted accounting principles for annual financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Results for the period ended September 30, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007.

The consolidated condensed financial statements and notes thereto should be read in conjunction with the financial statements and notes for the year-ended December 31, 2006 included in our Annual Report on Form 10-K.

**Note 3 – Other comprehensive income**

Comprehensive income consists of the following:

	<b><u>Three months ended</u></b>		<b><u>Nine months ended</u></b>	
	<b><u>September 30,</u></b>		<b><u>September 30,</u></b>	
	<b><u>2006</u></b>	<b><u>2007</u></b>	<b><u>2006</u></b>	<b><u>2007</u></b>
Net income	\$ 3,332	\$ 8,355	\$ 11,086	\$ 29,622
Other comprehensive income:				
Adjustment to net				
amortization and deferral of pension cost	-	145	-	434
Foreign currency				
translation adjustment	860	2,368	2,182	4,309
Comprehensive income	\$ 4,192	\$ 10,868	\$ 13,268	\$ 34,365





Accumulated other comprehensive income consists of the following:

	<b>Minimum Pension Liability</b>	<b>Cumulative Translation Adjustments</b>	<b>Accumulated Other Comprehensive Income (loss)</b>
Balance, December 31, 2006	\$ (12,386)	\$ 3,774	\$ (8,612)
Adjustment to net amortization and deferral of pension cost	434	-	434
Foreign currency translation adjustments	-	4,309	4,309
Balance, September 30, 2007	\$ (11,952)	\$ 8,083	\$ (3,869)

#### **Note 4 – Income Taxes**

The Company adopted Financial Accounting Standards Board (“FASB”) Interpretation No. 48, “Accounting for Uncertainty in Income Taxes” (“FIN 48”) on January 1, 2007. The impact of this pronouncement was not material to the Company’s consolidated financial statements. As of the date of adoption the Company’s unrecognized tax benefits totaled approximately \$1.4 million; \$1.3 million in taxes and \$0.1 million in interest. If recognized, the entire amount of unrecognized tax benefits would decrease the effective income tax rate.

The Internal Revenue Service (“IRS”) has completed examinations of our United States federal income tax returns through 2004. Tax years subsequent to 2004 are subject to future examination. Substantially all material state jurisdictions are closed for examination for tax years through 2002.

It is reasonably possible that the amount of unrecognized tax benefits could change in the next 12 months as a result of the anticipated completion of the 2005, 2006 and 2007 IRS examinations and expiration of statutes of limitations on prior tax returns. Unrecognized tax benefits for these years relate to permanent deductions and tax credits. A reasonable estimate of the range of change in unrecognized tax benefits cannot be made at this time.

The Company’s policy is to classify interest and penalties related to income tax matters as income tax expense.

#### **Note 5 - Inventories**

Inventories consist of the following:

	<b>December 31, 2006</b>	<b>September 30, 2007</b>
Raw materials	\$ 50,225	\$ 59,094
Work-in-process	17,815	22,488
Finished goods	83,647	85,130
Total	\$ 151,687	\$ 166,712



**Note 6 – Earnings per share**

Basic earnings per share (“EPS”) is computed by dividing net income by the weighted average number of common shares outstanding for the reporting period. Diluted earnings per share (“diluted EPS”) gives effect to all dilutive potential shares outstanding resulting from employee share-based awards during the period. The following table sets forth the computation of basic and diluted earnings per share for the three and nine month periods ended September 30, 2006 and 2007.

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2006</b>	<b>2007</b>	<b>2006</b>	<b>2007</b>
Net income	\$ 3,332	\$ 8,355	\$ 11,086	\$ 29,622
Basic – weighted average shares outstanding	27,888	28,572	27,999	27,990
Effect of dilutive potential securities	246	529	242	590
Diluted – weighted average shares outstanding	28,134	29,101	28,241	28,580
Basic EPS	\$ .12	\$ .29	\$ .40	\$ 1.06
Diluted EPS	.12	.29	.39	1.04

Stock based awards for both the three and nine months ended September 30, 2006 of approximately 1.7 million and for the three and nine months ended September 30, 2007 of 0.7 million and 0.6 million, respectively, were excluded from the computation of diluted earnings per share as the effect of exercise would be anti-dilutive. Upon conversion of our 2.50% convertible senior subordinated notes (the "Notes"), the holder of each Note will receive the conversion value of the Note payable in cash up to the principal amount of the Note and CONMED common stock for the Note's conversion value in excess of such principal amount. As of September 30, 2007, our share price has not exceeded the conversion price of the Notes, therefore the conversion value was less than the principal amount of the Notes. Under the net share settlement method and in accordance with Emerging Issues Task Force (“EITF”) Issue 04-8, “The Effect of Contingently Convertible Debt on Diluted Earnings per Share”, there were no potential shares issuable under the Notes to be used in the calculation of diluted EPS. The maximum number of shares we may issue with respect to the Notes is 5,750,000.

**Note 7 – Goodwill and other intangible assets**

The changes in the net carrying amount of goodwill for the nine months ended September 30, 2007 are as follows:

Balance as of January 1, 2007	\$ 290,512
Goodwill acquired	3,253
Adjustments to goodwill resulting from business acquisitions finalized	492

Foreign currency translation	402
Balance as of September 30, 2007	\$ 294,659

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Goodwill associated with each of our principal operating units is as follows:

	<b>December 31, <u>2006</u></b>	<b>September 30, <u>2007</u></b>
CONMED Electrosurgery	\$ 16,645	\$ 16,645
CONMED Endosurgery	42,419	42,430
CONMED Linvatec	173,007	173,409
CONMED Patient Care	58,441	62,175
	<b>\$ 290,512</b>	<b>\$ 294,659</b>

During the third quarter of 2007, we acquired a business in the amount of \$4.6 million of which \$3.3 million related to goodwill.

During our fourth quarter 2006 goodwill impairment testing, we determined that the goodwill of our Endoscopic Technologies operating unit was impaired and consequently we recorded a goodwill impairment charge of \$46.7 million in the year ended December 31, 2006.

Other intangible assets consist of the following:

	<b><u>December 31, 2006</u></b>		<b><u>September 30, 2007</u></b>	
	<b>Gross Carrying Amount</b>	<b>Accumulated Amortization</b>	<b>Gross Carrying Amount</b>	<b>Accumulated Amortization</b>
<b>Amortized intangible assets:</b>				
Customer relationships	\$ 113,376	\$ (24,498)	\$ 114,708	\$ (27,107)
Patents and other intangible assets	39,609	(24,696)	39,597	(26,072)
<b>Unamortized intangible assets:</b>				
Trademarks and tradenames	87,344	-	88,344	-
	<b>\$ 240,329</b>	<b>\$ (49,194)</b>	<b>\$ 242,649</b>	<b>\$ (53,179)</b>

Other intangible assets primarily represent allocations of purchase price to identifiable intangible assets of acquired businesses. The weighted average amortization period for intangible assets which are amortized is 24 years. Customer relationships are being amortized over a weighted average life of 36 years. Patents and other intangible assets are being amortized over a weighted average life of 11 years.

Amortization expense related to intangible assets which are subject to amortization totaled \$1,428 and \$3,985 in the three and nine months ended September 30, 2007, respectively, and \$1,289 and \$3,853 in the three and nine months ended September 30, 2006, respectively, and is included in selling and administrative expense on the consolidated condensed statement of income.



The estimated amortization expense for the year ending December 31, 2007, including the nine month period ended September 30, 2007 and for each of the five succeeding years is as follows:

2007	\$ 5,712
2008	5,718
2009	5,718
2010	5,119
2011	4,840
2012	4,788

### **Note 8 — Guarantees**

We provide warranties on certain of our products at the time of sale. The standard warranty period for our capital and reusable equipment is generally one year. Liability under service and warranty policies is based upon a review of historical warranty and service claim experience. Adjustments are made to accruals as claim data and historical experience warrant.

Changes in the carrying amount of service and product warranties for the nine months ended September 30, 2007 are as follows:

Balance as of January 1, 2007	\$ 3,617
Provision for warranties	2,575
Claims made	(2,684)
Balance as of September 30, 2007	\$ 3,508

### **Note 9 – Pension plan**

Net periodic pension costs consist of the following:

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b><u>September 30,</u></b>		<b><u>September 30,</u></b>	
	<b><u>2006</u></b>	<b><u>2007</u></b>	<b><u>2006</u></b>	<b><u>2007</u></b>
Service cost	\$ 1,391	\$ 1,602	\$ 4,175	\$ 4,312
Interest cost on projected benefit obligation	742	855	2,228	2,301
Expected return on plan assets	(687)	(793)	(2,066)	(2,134)



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Net amortization and deferral	312	229	937	687
Net periodic pension cost	\$ 1,758	\$ 1,893	\$ 5,274	\$ 5,166

We previously disclosed in our Annual Report on Form 10-K for the year-ended December 31, 2006 that we expect to make \$12.0 million in contributions to our pension plan in 2007. We made \$9.0 million in contributions for the nine months ended September 30, 2007.

**Note 10 – Other expense**

Other expense (income) consists of the following:

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2006</b>	<b>2007</b>	<b>2006</b>	<b>2007</b>
Acquisition-related costs	\$ 628	\$ -	\$ 2,104	\$ -
Termination of product offering	1,009	-	1,092	148
Write-off of inventory in settlement of a patent dispute	-	-	595	-
Facility closure costs	429	-	429	1,822
Litigation settlement	-	-	-	(6,072)
Other expense (income)	\$ 2,066	\$ -	\$ 4,220	\$ (4,102)

On September 30, 2004, we acquired the business operations of the Endoscopic Technologies Division of C.R. Bard, Inc. (the “Endoscopic Technologies acquisition”). As part of the acquisition, manufacturing of the acquired products was conducted in various C.R. Bard facilities under a transition agreement. During the three and nine months ended September 30, 2006, we incurred \$0.6 million and \$2.1 million of acquisition and transition-integration related charges associated with the Endoscopic Technologies acquisition which have been recorded in other expense (income). The Endoscopic Technologies acquisition transition was completed during 2006.

During 2004, we elected to terminate our surgical lights product line. We instituted a customer replacement program whereby all currently installed surgical lights were replaced by CONMED. During the three and nine months ended September 30, 2006 we incurred \$1.0 million and \$1.1 million, respectively, in costs related to the surgical lights customer replacement program. During the nine months ended September 30, 2007, we incurred an additional \$148 which was recorded in other expense (income). The surgical lights customer replacement program was completed during the second quarter of 2007.

During 2006, we were notified by Dolphin Medical, Inc. (“Dolphin”), that it would discontinue its Dolphin ONE® product line as a result of an agreement between Dolphin and Masimo Corporation in which Masimo agreed to release Dolphin and its affiliates from certain patent infringement claims. We have sold the Dolphin ONE® and certain other pulse oximetry products manufactured by Dolphin under a distribution agreement. As a result of the product line discontinuation, we recorded a \$0.6 million charge to other expense to write-off on-hand inventory of the discontinued product line.

During 2006, we elected to close our facility in Montreal, Canada which manufactured products for our CONMED Linvatec line of integrated operating room systems and equipment. The products which had been manufactured in the Montreal facility are now purchased from third party vendors. The closing of this facility was completed in the first quarter of 2007. We incurred a total of \$2.2 million in costs (including \$0.4 million in the third quarter of 2006) associated with this closure, of which \$1.3 million related to the write-off of inventory and was included in cost of goods sold during 2006. The remaining \$0.9 million (including \$0.3 million in the first quarter of 2007) primarily relates to severance expense and the disposal of fixed assets which we have recorded in other expense (income).

During 2007, we elected to close our CONMED Endoscopic Technologies sales office in France. During the nine months ended September 30, 2007, we incurred \$1.5 million in costs associated with this closure primarily related to severance expense. We did not incur any additional costs during the third quarter of 2007. We have recorded such costs in other expense (income); no further expenses are expected to be incurred.

In November 2003, we commenced litigation against Johnson & Johnson and several of its subsidiaries, including Ethicon, Inc. for violations of federal and state antitrust laws. In the lawsuit we claimed that Johnson & Johnson engaged in illegal and anticompetitive conduct with respect to sales of product used in endoscopic surgery, resulting in higher prices to consumers and the exclusion of competition. We sought relief including an injunction restraining Johnson & Johnson from continuing its anticompetitive practices as well as receiving the maximum amount of damages allowed by law. During the litigation, Johnson & Johnson represented that the marketing practices which gave rise to the litigation had been altered with respect to CONMED. On March 31, 2007, CONMED and Johnson & Johnson settled the litigation. Under the terms of the final settlement agreement, CONMED received a payment of \$11.0 million from Johnson & Johnson in return for which we terminated the lawsuit. After deducting legal and other related costs, we recorded a pre-tax gain of \$6.1 million related to the settlement which we have recorded in other expense (income).

#### **Note 11 — Business Segments and Geographic Areas**

CONMED conducts its business through five principal operating segments, CONMED Endoscopic Technologies, CONMED Endosurgery, CONMED Electrosurgery, CONMED Linvatec and CONMED Patient Care. We believe each of our segments are similar in the nature of products, production processes, customer base, distribution methods and regulatory environment. In accordance with Statement of Financial Accounting Standards No. 131 “Disclosures About Segments of an Enterprise and Related Information” (“SFAS 131”), our CONMED Endosurgery, CONMED Electrosurgery and CONMED Linvatec operating segments also have similar economic characteristics and therefore qualify for aggregation under SFAS 131. Our CONMED Patient Care and CONMED Endoscopic Technologies operating segments do not qualify for aggregation under SFAS 131 since their economic characteristics do not meet the criteria for aggregation as a result of the lower overall operating income (loss) in these segments.

CONMED Endosurgery, CONMED Electrosurgery and CONMED Linvatec consist of a single aggregated segment comprising a complete line of endo-mechanical instrumentation for minimally invasive laparoscopic procedures, electrosurgical generators and related surgical instruments, arthroscopic instrumentation for use in orthopedic surgery and small bone, large bone and specialty powered surgical instruments. CONMED Patient Care product offerings include a line of vital signs and cardiac monitoring products as well as suction instruments and tubing for use in the operating room. CONMED Endoscopic Technologies product offerings include a comprehensive line of minimally invasive endoscopic diagnostic and therapeutic instruments used in procedures in the digestive tract.

The following is net sales information by product line and reportable segment:

	Three months ended		Nine months ended	
	September 30,		September 30,	
	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>
Arthroscopy	\$ 54,773	\$ 58,825	\$ 168,387	\$ 186,017
Powered Surgical Instruments	33,184	36,314	100,598	109,857
CONMED Linvatec	87,957	95,139	268,985	295,874
Electrosurgery	23,388	22,948	70,991	69,097
Endosurgery	12,592	15,279	37,728	44,319
CONMED Linvatec, Endosurgery and Electrosurgery	123,937	133,366	377,704	409,290
CONMED Patient Care	18,345	18,546	57,065	56,222
CONMED Endoscopic Technologies	12,699	12,536	42,151	39,208
Total	\$ 154,981	\$ 164,448	\$ 476,920	\$ 504,720

Total assets, capital expenditures, depreciation and amortization information are not available by segment.

The following is a reconciliation between segment operating income and income before income taxes:

	Three months ended		Nine months ended	
	September 30,		September 30,	
	<u>2006</u>	<u>2007</u>	<u>2006</u>	<u>2007</u>
CONMED Linvatec, Endosurgery and Electrosurgery	\$ 14,551	\$ 18,229	\$ 50,523	\$ 61,938
CONMED Patient Care	339	1,110	(1,109)	872
CONMED Endoscopic Technologies	(4,439)	(1,449)	(10,830)	(5,092)
Corporate	(1,267)	(974)	(7,700)	1,326
Income from Operations	9,184	16,916	30,884	59,044
Loss on early extinguishment of debt	-	-	678	-
Interest expense	4,962	3,861	14,503	12,706
Total income before income taxes	\$ 4,222	\$ 13,055	\$ 15,703	\$ 46,338

## **Note 12 – Legal proceedings**

On April 7, 2006, CONMED received a copy of a complaint filed in the United States District for the Northern District of New York on behalf of a purported class of former CONMED Linvatec sales representatives. The complaint alleges that the former sales representatives were entitled to, but did not receive, severance in 2003 when CONMED Linvatec restructured its distribution channels. We believe that the exposure related to this complaint ranges from \$0 to \$3.0 million, not including any interest, fees or costs that might be awarded if the five named plaintiffs were to prevail on their own behalf as well as on behalf of the approximately 70 (or 90 as alleged by the plaintiffs) other members of the purported class. CONMED Linvatec did not generally pay severance during the 2003 restructuring because the former sales representatives were offered sales positions with CONMED Linvatec's new manufacturer's representatives. Other than three of the five named plaintiffs in the class action, nearly all of CONMED Linvatec's former sales representatives accepted such positions.



The Company's motions to dismiss and for summary judgment, which were heard at a hearing held on January 5, 2007, were denied by a Memorandum Decision and Order dated May 22, 2007. The District Court also granted the plaintiffs' motion to certify a class of former CONMED Linvatec sales representatives whose employment with CONMED Linvatec was involuntarily terminated in 2003 and who did not receive severance benefits. Although the Court's ruling on the motions to dismiss, for summary judgment and the motion to certify the class do not represent final rulings on the merits, the Company has filed a motion seeking reconsideration of the motions to dismiss and for summary judgment, and sought to appeal to the United State Court of Appeals for the Second Circuit from the class certification ruling. The Second Circuit declined to consider the appeal by Order dated August 28, 2007. There is no fixed time frame within the District Court must rule on the motions. The Company believes there is no merit to the claims asserted in the Complaint, and plans to vigorously defend the case. There can be no assurance, however, that the Company will prevail in the litigation.

The Company is defending a product liability claim asserted against it and several of the Company's subsidiaries in a case captioned *Wehner v. Linvatec Corp., et al.* The claim arises out of a June 2002 shoulder surgery involving a product manufactured and sold by Bionx Implants, Oy and Bionx Implants, Inc., respectively, prior to Conmed's acquisition of Bionx, now known as Linvatec Biomaterials, in March 2003. The Plaintiff's initial demand was for \$1.75 million, which demand the Company declined to accept. The Company plans to vigorously defend the claims, although there can be no assurance that the Company will prevail.

As the occurrence giving rise to the Wehner Case occurred in 2002 prior to Conmed's acquisition of the Bionx companies, the Wehner Case is not covered by the Company's current product liability insurance policy. The former product liability insurance carrier has denied coverage, and the Company commenced suit in the United States District Court for the Eastern District of Pennsylvania seeking a declaration that the underlying claim is covered by the policy. The Company plans to vigorously pursue its claims for insurance coverage, although there can be no assurance that the Company will prevail.

### **Note 13 – New accounting pronouncements**

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" ("SFAS 157") which is effective for fiscal years beginning after November 15, 2007 and for interim periods within those years. SFAS 157 defines fair value, establishes a framework for measuring fair value and expands the related disclosure requirements. We are currently evaluating the potential impact of this statement.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities-Including an amendment of FASB Statement No. 115" ("SFAS 159"). SFAS 159 expands the use of fair value accounting but does not affect existing standards which require assets and liabilities to be carried at fair value. Under SFAS 159, a company may elect to use fair value to measure accounts and loans receivable, available-for-sale and held-to-maturity securities, equity method investments, accounts payable, guarantees, issued debt and other eligible financial instruments. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The Company is currently assessing the impact of SFAS 159 on its consolidated financial statements.

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

### Forward-Looking Statements

In this Report on Form 10-Q, we make forward-looking statements about our financial condition, results of operations and business. Forward-looking statements are statements made by us concerning events that may or may not occur in the future. These statements may be made directly in this document or may be "incorporated by reference" from other documents. Such statements may be identified by the use of words such as "anticipates", "expects", "estimates", "intends" and "believes" and variations thereof and other terms of similar meaning.

### Forward-Looking Statements are not Guarantees of Future Performance

Forward-looking statements involve known and unknown risks, uncertainties and other factors, including those that may cause our actual results, performance or achievements, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. Such factors include those identified under "Risk Factors" in our Annual Report on Form 10-K for the year-ended December 31, 2006 and the following, among others:

- general economic and business conditions;
- cyclical customer purchasing patterns due to budgetary and other constraints;
  - changes in customer preferences;
  - competition;
  - changes in technology;
- the ability to evaluate, finance and integrate acquired businesses, products and companies;
  - the introduction and acceptance of new products;
  - changes in business strategy;
  - the availability and cost of materials;
- the possibility that United States or foreign regulatory and/or administrative agencies may initiate enforcement actions against us or our distributors;
  - future levels of indebtedness and capital spending;
  - changes in foreign exchange and interest rates;
- quality of our management and business abilities and the judgment of our personnel;

- the risk of litigation, especially patent litigation as well as the cost associated with patent and other litigation;
- changes in regulatory requirements; and
- the availability, terms and deployment of capital.

See “Management’s Discussion and Analysis of Financial Condition and Results of Operations” below and “Risk Factors” and “Business” in our Annual Report on Form 10-K for the year-ended December 31, 2006 for a further discussion of these factors. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. We do not undertake any obligation to publicly release any revisions to these forward-looking statements to reflect events or circumstances after the date of this Quarterly Report on Form 10-Q or to reflect the occurrence of unanticipated events.

### Overview:

CONMED Corporation (“CONMED”, the “Company”, “we” or “us”) is a medical technology company with six principal product lines. These product lines and the percentage of consolidated revenues associated with each, are as follows:

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>September 30,</b>		<b>September 30,</b>	
	<b>2006</b>	<b>2007</b>	<b>2006</b>	<b>2007</b>
Arthroscopy	35.4%	35.8%	35.3%	36.8%
Powered Surgical Instruments	21.4	22.1	21.1	21.8
Patient Care	11.8	11.3	12.0	11.1
Electrosurgery	15.1	14.0	14.9	13.7
Endosurgery	8.1	9.3	7.9	8.8
Endoscopic Technologies	8.2	7.5	8.8	7.8
Consolidated Net Sales	100.0%	100.0%	100.0%	100.0%

A significant amount of our products are used in surgical procedures with the majority of our revenues derived from the sale of disposable products. We manufacture substantially all of our products in facilities located in the United States, Mexico, and Finland. We market our products both domestically and internationally directly to customers and through distributors. International sales represent a significant portion of our business. During the three and nine months ended September 30, 2007, sales to purchasers outside of the United States accounted for 40.0% and 41.1%, respectively, of total net sales.

### Business Environment and Opportunities

The aging of the worldwide population along with lifestyle changes, continued cost containment pressures on healthcare systems and the desire of clinicians and administrators to use less invasive (or noninvasive) procedures are important trends which are driving the growth in our industry. We believe that with our broad product offering of high quality surgical and patient care products, we can capitalize on this growth for the benefit of the Company and our shareholders.

In order to further our growth prospects, we have historically used strategic business acquisitions and exclusive distribution relationships to continue to diversify our product offerings, increase our market share and realize economies of scale.





Continued innovation and commercialization of new proprietary products and processes are essential elements of our long-term growth strategy. In February 2007, we unveiled several new products at the American Academy of Orthopaedic Surgeons Annual Meeting which we believe further enhance our product offerings and reputation as an innovator as exemplified by the IM4000 High Definition Camera System, our first high definition camera system designed for use in both arthroscopic and multi-specialty endoscopy.

### **Business Challenges**

In September 2004, we acquired the business operations of the Endoscopic Technologies Division of C.R. Bard, Inc. (the "Endoscopic Technologies acquisition") for aggregate consideration of \$81.3 million in cash. The acquired business has enhanced our product offerings by adding a comprehensive line of single-use medical devices employed by gastro-intestinal and pulmonary physicians to diagnose and treat diseases of the digestive tract and lungs using minimally invasive endoscopic techniques. The transfer of the Endoscopic Technologies production lines from C.R. Bard facilities to CONMED facilities proved to be more time-consuming, costly and complex than was originally anticipated. Operational issues associated with the transfer of production lines resulted in backorders, which combined with increased competition and pricing pressures in the marketplace resulted in decreased sales, lower than anticipated gross margins and continuing operating losses. As a result of these factors, during our fourth quarter 2006 goodwill impairment testing, we determined that the goodwill of our Endoscopic Technologies business was impaired and consequently we recorded an impairment charge of \$46.7 million in the year ended December 31, 2006 to reduce the carrying amount of this business to its fair value. We have taken and are continuing to take corrective action to address the business and operational issues associated with the Endoscopic Technologies business in an effort to ensure a return to sales growth and profitability.

Our facilities are subject to periodic inspection by the United States Food and Drug Administration ("FDA") for, among other things, conformance to Quality System Regulation and Current Good Manufacturing Practice ("CGMP") requirements. We are committed to the principles and strategies of systems-based quality management for improved CGMP compliance, operational performance and efficiencies through our Company-wide quality systems initiative. However, there can be no assurance that our actions will ensure that we will not receive a warning letter or other regulatory action which may include consent decrees or fines.

### **Critical Accounting Estimates**

Preparation of our financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Note 1 to the consolidated financial statements in our Annual Report on Form 10-K for the year-ended December 31, 2006 describes the significant accounting policies used in preparation of the consolidated financial statements. The most significant areas involving management judgments and estimates are described below and are considered by management to be critical to understanding the financial condition and results of operations of CONMED Corporation. There have been no significant changes in our critical accounting estimates during the third quarter of 2007.

## Revenue Recognition

Revenue is recognized when title has been transferred to the customer which is at the time of shipment. The following policies apply to our major categories of revenue transactions:

- Sales to customers are evidenced by firm purchase orders. Title and the risks and rewards of ownership are transferred to the customer when product is shipped under our stated shipping terms. Payment by the customer is due under fixed payment terms.
- We place certain of our capital equipment with customers in return for commitments to purchase disposable products over time periods generally ranging from one to three years. In these circumstances, no revenue is recognized upon capital equipment shipment and we recognize revenue upon the disposable product shipment. The cost of the equipment is amortized over the term of individual commitment agreements.
- Product returns are only accepted at the discretion of the Company and in accordance with our “Returned Goods Policy”. Historically the level of product returns has not been significant. We accrue for sales returns, rebates and allowances based upon an analysis of historical customer returns and credits, rebates, discounts and current market conditions.
- Our terms of sale to customers generally do not include any obligations to perform future services. Limited warranties are provided for capital equipment sales and provisions for warranty are provided at the time of product sale based upon an analysis of historical data.
- Amounts billed to customers related to shipping and handling have been included in net sales. Shipping and handling costs are included in selling and administrative expense.
- We sell to a diversified base of customers around the world and, therefore, believe there is no material concentration of credit risk.
- We assess the risk of loss on accounts receivable and adjust the allowance for doubtful accounts based on this risk assessment. Historically, losses on accounts receivable have not been material. Management believes that the allowance for doubtful accounts of \$1.0 million at September 30, 2007 is adequate to provide for probable losses resulting from accounts receivable.

## Inventory Reserves

We maintain reserves for excess and obsolete inventory resulting from the inability to sell our products at prices in excess of current carrying costs. The markets in which we operate are highly competitive, with new products and surgical procedures introduced on an on-going basis. Such marketplace changes may result in our products becoming obsolete. We make estimates regarding the future recoverability of the costs of our products and record a provision for excess and obsolete inventories based on historical experience, expiration of sterilization dates and expected future trends. If actual product life cycles, product demand or acceptance of new product introductions are less favorable than projected by management, additional inventory write-downs may be required. We believe that our current inventory reserves are adequate.

## **Business Acquisitions**

We have a history of growth through acquisitions. Assets and liabilities of acquired businesses are recorded under the purchase method of accounting at their estimated fair values as of the date of acquisition. Goodwill represents costs in excess of fair values assigned to the underlying net assets of acquired businesses. Other intangible assets primarily represent allocations of purchase price to identifiable intangible assets of acquired businesses. We have accumulated goodwill of \$294.7 million and other intangible assets of \$189.5 million as of September 30, 2007.

In accordance with Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets," ("SFAS 142"), goodwill and intangible assets deemed to have indefinite lives are not amortized, but are subject to at least annual impairment testing. The identification and measurement of goodwill impairment involves the estimation of the fair value of our business. Estimates of fair value are based on the best information available as of the date of the assessment, which primarily incorporate management assumptions about expected future cash flows and contemplate other valuation techniques. Future cash flows may be affected by changes in industry or market conditions or the rate and extent to which anticipated synergies or cost savings are realized with newly acquired entities.

Intangible assets with a finite life are amortized over the estimated useful life of the asset. Intangible assets which continue to be subject to amortization are also evaluated to determine whether events and circumstances warrant a revision to the remaining period of amortization. An intangible asset is determined to be impaired when estimated undiscounted future cash flows indicate that the carrying amount of the asset may not be recoverable. An impairment loss is recognized by reducing the recorded value to its current fair value. Although no goodwill or other intangible asset impairment has been recorded in the current year, there can be no assurance that future impairment will not occur. It is our policy to perform annual impairment tests in the fourth quarter.

During the fourth quarter of 2006, after completing our annual goodwill impairment analysis, we determined that the goodwill of our CONMED Endoscopic Technologies business was impaired and consequently we recorded a goodwill impairment charge of \$46.7 million.

## **Pension Plan**

We sponsor a defined benefit pension plan covering substantially all our employees. Major assumptions used in the accounting for the plan include the discount rate, expected return on plan assets, rate of increase in employee compensation levels and expected mortality. Assumptions are determined based on Company data and appropriate market indicators, and are evaluated annually as of the plan's measurement date. A change in any of these assumptions would have an effect on net periodic pension costs reported in the consolidated financial statements.

Higher market interest rates have resulted in us increasing the discount rate used in determining pension expense from 5.55% in 2006 to 5.90% in 2007. This rate

was determined by using the Citigroup Pension Liability Index rate which, we believe, is a reasonable indicator of our plan's future payment stream.

We have used an expected rate of return on pension plan assets of 8.0% for purposes of determining the net periodic pension benefit cost. In determining the expected return on pension plan assets, we consider the relative weighting of plan assets, the historical performance of total plan assets and individual asset classes and economic and other indicators of future performance. In addition, we consult with financial and investment management professionals in developing appropriate targeted rates of return.

We have estimated our rate of increase in employee compensation levels at 3.0% consistent with our internal budgeting.

Based on these and other factors, pension expense for the year-ended December 31, 2007 is estimated at approximately \$6.9 million consistent with the expense recorded in 2006. For the nine month period ended September 30, 2007 we recorded \$5.2 million in pension expense.

### **Stock Based Compensation**

We adopted Statement of Financial Accounting Standards No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123R") effective January 1, 2006. SFAS 123R requires that all share-based payments to employees, including grants of employee stock options, restricted stock units, and stock appreciation rights be recognized in the financial statements based on their fair values. Prior to January 1, 2006, we accounted for stock-based compensation in accordance with Accounting Principles Board Opinion No. 25 "Accounting for Stock Issued to Employees" ("APB 25"). No compensation expense was recognized for stock options under the provisions of APB 25 since all options granted had an exercise price equal to the market value of the underlying stock on the grant date.

SFAS 123R was adopted using the modified prospective transition method. Under this method, the provisions of SFAS 123R apply to all awards granted or modified after the date of adoption. In addition, compensation expense must be recognized for any nonvested stock option awards outstanding as of the date of adoption. We recognize such expense using a straight-line method over the vesting period. Prior periods have not been restated.

We elected to adopt the alternative transition method, as permitted by FASB Staff Position No. FAS 123R-3 "Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards," to calculate the tax effects of stock-based compensation pursuant to SFAS 123R for those employee awards that were outstanding upon adoption of SFAS 123R. The alternative transition method allows the use of a simplified method to calculate the beginning pool of excess tax benefits available to absorb tax deficiencies recognized subsequent to the adoption of SFAS 123R.

### **Income Taxes**

The recorded future tax benefit arising from net deductible temporary differences and tax carryforwards is approximately \$35.0 million at September 30, 2007. Management believes that our earnings during the periods when the temporary differences become deductible will be sufficient to realize the related future income tax benefits.

We operate in multiple taxing jurisdictions, both within and outside the United States. We face audits from these various tax authorities regarding the amount of taxes due. Such audits can involve complex issues and may require an extended period of time to resolve. The Internal Revenue Service ("IRS") has completed examinations of our United States federal income tax returns through 2004. Tax years subsequent to 2004 are currently under examination. Substantially all material state jurisdictions are closed for examination for tax years through 2002.

We have established a valuation allowance to reflect the uncertainty of realizing the benefits of certain net operating loss carryforwards recognized in connection with an acquisition. Any subsequently recognized tax benefits associated with the valuation allowance would be allocated to reduce goodwill. In assessing the need for a valuation allowance, we estimate future taxable income, considering the feasibility of ongoing tax planning strategies and the realizability of tax loss carryforwards. Valuation allowances related to deferred tax assets may be impacted by changes to tax laws, changes to statutory tax rates and future taxable income levels.

We adopted FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" ("FIN 48") on January 1, 2007. The impact of this pronouncement was not material to our consolidated financial statements (See Note 4 to the Consolidated Condensed Financial Statements for further discussion).

## Results of Operations

The following table presents, as a percentage of net sales, certain categories included in our consolidated statements of income for the periods indicated:

	Three months ended September 30, 2006		September 30, 2007	
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of sales	51.8	49.9	51.7	49.8
Gross profit	48.2	50.1	48.3	50.2
Selling and administrative expense	36.3	35.0	36.2	34.8
Research and development expense	4.7	4.8	4.7	4.6
Other expense	1.3	0.0	0.9	(0.8)
Income from operations	5.9	10.3	6.5	11.6
Loss on early extinguishment of debt	0.0	0.0	0.1	0.0
Interest expense	3.2	2.3	3.0	2.5
Income before income taxes	2.7	8.0	3.4	9.1
Provision for income taxes	0.6	2.9	1.0	3.3
Net income	2.1%	5.1%	2.4%	5.8%

### *Three months ended September 30, 2007 compared to three months ended September 30, 2006*

Sales for the quarter ended September 30, 2007 were \$164.4 million, an increase of \$9.4 million (6.1%) compared to sales of \$155.0 million in the same period a year ago. Favorable foreign currency exchange rates (when compared to the foreign currency exchange rates in the same period a year ago) increased sales by approximately \$3.2 million.

Cost of sales increased to \$82.1 million in the quarter ended September 30, 2007 as compared to \$80.3 million in the same period a year ago on increased sales volumes. Gross profit margins increased to 50.1% in the quarter ended September 30, 2007 as compared to 48.2% in the same period a year ago. The increase of 1.9 percentage points is comprised of improved gross margins in our Endoscopic Technologies product lines (0.9 percentage points) as a result of the completion of the transfer of production lines from C.R. Bard to CONMED during 2006 and improved gross margins in our Patient Care, Electrosurgery and Endosurgery product lines as a result of higher selling prices (1.3 percentage points) offsetting a decline in our Arthroscopy and Powered Instrument product lines (0.5 percentage points) caused by higher production variances. Improved product mix also contributed to the increase in gross profit margins (0.2 percentage points).

Selling and administrative expense increased to \$57.5 million in the quarter ended September 30, 2007 as compared to \$56.2 million in the same period a year ago. Selling and administrative expense as a percentage of net sales decreased 1.3 percentage points to 35.0% in the quarter ended September 30, 2007 as compared to 36.3% in the same period a year ago. The decrease of 1.3 percentage points is attributable to greater leveraging of our cost structure as benefit costs (0.7 percentage points), distribution expense (0.5 percentage points) and other administrative costs (0.1 percentage points) declined as a percentage of net sales.

Research and development expense totaled \$7.9 million in the quarter ended September 30, 2007 as compared to \$7.3 million in the same period a year ago. As a percentage of net sales, research and development expense remained flat at 4.8% in the quarter ended September 30, 2007, as compared to 4.7% in the same period a year ago.

As discussed in Note 10 to the Consolidated Condensed Financial Statements, other expense in the quarter ended September 30, 2006 consisted of \$0.4 million in costs related to severance payments due to the closing of a manufacturing plant, \$1.0 million in charges related to the termination of a product line, and \$0.6 million in Endoscopic Technologies acquisition-related costs.

Interest expense in the quarter ended September 30, 2007 was \$3.9 million compared to \$5.0 million in the same period a year ago. The decrease in interest expense is due primarily to lower weighted average borrowings outstanding in the quarter ended September 30, 2007 as compared to the same period a year ago. Also contributing to the decrease in interest expense were lower weighted average interest rates on our borrowings (inclusive of the finance charge on our accounts receivable sale facility) which declined to 5.18% for the quarter ended September 30, 2007 as compared to 5.82% in the same period a year ago.

A provision for income taxes has been recorded at an effective tax rate of 36.1% for the quarter ended September 30, 2007 compared with 21.1% recorded in the same period a year ago. During the third quarter of 2006, we filed our United States federal income tax return for 2005. As a result of the filing, we identified a greater benefit than was originally anticipated associated with the extraterritorial income exclusion rules and research and development tax credit. The net effect of these adjustments was a \$0.6 million reduction in income tax expense in the third quarter of 2006 resulting in a lower effective tax rate in the

third quarter of 2006 as compared to the current period. A reconciliation of the United States statutory income tax rate to our effective tax rate is included in our Annual Report on Form 10-K for the year-ended December 31, 2006, Note 7 to the Consolidated Financial Statements.

*Nine months ended September 30, 2007 compared to nine months ended September 30, 2006*

Sales for the nine months ended September 30, 2007 were \$504.7 million, an increase of \$27.8 million (5.8%) compared to sales of \$476.9 million in the same period a year ago. Favorable foreign currency exchange rates (when compared to the foreign currency exchange rates in the same period a year ago) increased sales by approximately \$9.1 million.

Cost of sales increased to \$251.3 million in the nine months ended September 30, 2007 as compared to \$246.5 million in the same period a year ago on increased sales volumes. Gross profit margins increased to 50.2% in the nine months ended September 30, 2007 as compared to 48.3% in the same period a year ago. The increase of 1.9 percentage points is comprised of improved gross margins in our Endoscopic Technologies product lines (0.7 percentage points) as a result of the completion of the transfer of production lines from C.R. Bard to CONMED during 2006 and improved gross margins in our Patient Care, Electrosurgery and Endosurgery product lines as a result of higher selling prices (0.9 percentage points). Improved product mix also contributed to the increase in gross profit margins (0.3 percentage points).

Selling and administrative expense increased to \$175.5 million in the nine months ended September 30, 2007 as compared to \$172.7 million in the same period a year ago. Selling and administrative expense as a percentage of sales decreased 1.4 percentage points to 34.8% in the nine months ended September 30, 2007 as compared to 36.2% in the same period a year ago. The decrease of 1.4 percentage points is attributable to greater leveraging of our cost structure as benefit costs (0.7 percentage points), distribution expense (0.2 percentage points) and other administrative costs (0.5 percentage points) declined as a percentage of net sales.

Research and development expense totaled \$23.0 million in the nine months ended September 30, 2007 as compared to \$22.6 million in the same period a year ago. As a percentage of net sales, research and development expense remained flat at 4.6% in the nine months ended September 30, 2007, as compared to 4.7% in the same period a year ago.

As discussed in Note 10 to the Consolidated Condensed Financial Statements, other expense (income) in the nine months ended September 30, 2007 consisted of a \$1.8 million charge related to the closing of our manufacturing facility in Montreal, Canada and a sales office in France, a \$0.1 million charge related to the termination of our surgical lights product offering, and \$6.1 million in income related to the settlement of the antitrust case with Johnson & Johnson. In the nine months ended September 30, 2006, other expense consisted of \$0.4 million in costs related to the closing of our manufacturing facility in Montreal, Canada; \$0.6 million in costs related to the write-off of inventory in settlement of a patent dispute; \$1.1 million in charges related to the termination of a product line; and \$2.1 million in Endoscopic Technologies acquisition-related costs.

During the nine months ended September 30, 2006, we recorded \$0.7 million in losses on the early extinguishment of debt in connection with the refinancing of our senior credit agreement.



Interest expense in the nine months ended September 30, 2007 was \$12.7 million compared to \$14.5 million in the same period a year ago. The decrease in interest expense is due to lower weighted average borrowings outstanding and weighted average interest rates in the nine months ended September 30, 2007 as compared to the same period a year ago. The weighted average interest rates on our borrowings (inclusive of the finance charge on our accounts receivable sale facility) decreased to 5.47% in the nine months ended September 30, 2007 as compared to 5.54% in the same period a year ago.

A provision for income taxes has been recorded at an effective tax rate of 36.1% for the nine months ended September 30, 2007 and 29.4% for the same period a year ago. The effective rate for the nine months ended September 30, 2006 is lower than that recorded in the current period as a result of the settlement in the first quarter of 2006 of the 2001 through 2003 IRS income tax return examinations. Due to the settlement of the income tax examinations, we adjusted our reserves to consider positions taken in our income tax return for periods subsequent to 2003 resulting in a \$0.5 million reduction in income tax expense. During the third quarter of 2006, we filed our United States federal income tax return for 2005. As a result of the filing, we identified a greater benefit than was originally anticipated associated with the extraterritorial income exclusion rules and research and development tax credit resulting in a \$0.6 million reduction in income tax expense. The net effect of these adjustments in the first quarter and third quarter 2006 was a \$1.1 million reduction in income tax expense in the nine months ended September 30, 2006 as compared to the current period. A reconciliation of the United States statutory income tax rate to our effective tax rate is included in our Annual Report on Form 10-K for the year-ended December 31, 2006, Note 7 to the Consolidated Financial Statements.

### Operating Segment Results:

Segment information is prepared on the same basis that we review financial information for operational decision-making purposes. We conduct our business through five principal operating segments: CONMED Endoscopic Technologies, CONMED Endosurgery, CONMED Electrosurgery, CONMED Linvatec and CONMED Patient Care. Based upon the aggregation criteria for segment reporting under Statement of Financial Accounting Standards No. 131 "Disclosures about Segments of an Enterprise and Related Information" (SFAS 131), we have grouped our CONMED Endosurgery, CONMED Electrosurgery and CONMED Linvatec operating segments into a single reporting segment. The economic characteristics of CONMED Patient Care and CONMED Endoscopic Technologies do not meet the criteria for aggregation due to the lower overall operating income (loss) of these segments.

The following tables summarize the Company's results of operations by reportable segment for the three and nine months ended September 30, 2006 and 2007.

### CONMED Endosurgery, CONMED Electrosurgery and CONMED Linvatec

	Three months ended September 30, 2006		Nine months ended September 30, 2006	
	2006	2007	2006	2007
Net sales	\$ 123,937	\$ 133,366	\$ 377,704	\$ 409,290
Income from operations	14,551	18,229	50,523	61,938
Operating Margin	11.7%	13.7%	13.4%	15.1%



Product offerings include a complete line of endo-mechanical instrumentation for minimally invasive laparoscopic procedures, electrosurgical generators and related surgical instruments, arthroscopic instrumentation for use in orthopedic surgery and small bone, large bone and specialty powered surgical instruments.

- Arthroscopy sales increased \$4.0 million (7.3%) in the quarter ended September 30, 2007 to \$58.8 million from \$54.8 million in the same period a year ago. Arthroscopy sales increased \$17.5 million (10.4%) in the nine months ended September 30, 2007 to \$186.0 million from \$168.4 million in the same period a year ago. These increases are principally a result of increased sales of our procedure specific, resection and video imaging products for arthroscopy and general surgery.
- Powered surgical instrument sales increased \$3.1 million (9.3%) in the quarter ended September 30, 2007 to \$36.3 million from \$33.2 million in the same period a year ago. Powered surgical instrument sales increased \$9.3 million (9.2%) in the nine months ended September 30, 2007 to \$109.9 million from \$100.6 million in the same period a year ago. These increases are principally a result of increased sales of our large bone and small bone handpieces.
- Electrosurgery sales decreased \$0.4 million (1.7%) in the quarter ended September 30, 2007 to \$23.0 million from \$23.4 million in the same period a year ago. Electrosurgery sales decreased \$1.8 million (2.5%) in the nine months ended September 30, 2007 to \$69.1 million from \$70.9 million in the same period a year ago. These decreases are principally a result of decreased sales of our System 5000™ electrosurgical generators and pencils offset by increased sales of our ABC® handpieces.
- Endosurgery sales increased \$2.7 million (21.4%) in the quarter ended September 30, 2007 to \$15.3 million from \$12.6 million in the same period a year ago. Endosurgery sales increased \$6.5 million (17.2%) in the nine months ended September 30, 2007 to \$44.3 million from \$37.8 million. These increases are principally a result of increased sales of hand held instruments, suction irrigation products and trocars.
- Operating margins as a percentage of net sales increased 2.0 percentage points to 13.7% in the quarter ended September 30, 2007 compared to 11.7% in 2006 while operating margins increased 1.7 percentage points to 15.1% in the nine months ended September 30, 2007 compared to 13.4% in the same period a year ago. The increases in operating margins in the quarter and nine months ended September 30, 2007 are due to increases in gross margins of 0.1 and 0.4 percentage points, respectively, compared to the same periods a year ago as a result of higher selling prices. The remaining increases in operating margins in the quarter and nine months ended September 30, 2007 are attributable to lower costs in the 2007 periods associated with the termination of a product offering and facility closure costs discussed in Note 10 to the Consolidated Condensed Financial Statements (1.2 and 0.3 percentage points in the quarter

and nine months ended September 30, 2007, respectively) and lower distribution and other administrative expenses (0.7 and 1.0 percentage points in the quarter and nine months ended September 30, 2007, respectively).

### CONMED Patient Care

	Three months ended		Nine months ended	
	September 30, 2006	September 30, 2007	September 30, 2006	September 30, 2007
Net sales	\$ 18,345	\$ 18,546	\$ 57,065	\$ 56,222
Income (loss) from operations	339	1,110	(1,109)	872
Operating Margin	1.8%	6.0%	(1.9%)	1.6%

Product offerings include a line of vital signs and cardiac monitoring products including pulse oximetry equipment and sensors, ECG electrodes and cables, cardiac defibrillation and pacing pads and blood pressure cuffs. We also offer a complete line of reusable surgical patient positioners and suction instruments and tubing for use in the operating room, as well as a line of IV products.

- Patient Care sales increased \$0.2 million (1.1%) in the quarter ended September 30, 2007 to \$18.5 million from \$18.3 million in the same period a year ago. Patient care sales decreased \$0.9 million (1.6%) in the nine months ended September 30, 2007 to \$56.2 million from \$57.1 million in the same period a year ago. These decreases are principally a result of decreased sales of our suction instrument and ECG electrode product lines.
- Operating margins as a percentage of net sales increased 4.2 percentage points to 6.0% for the quarter ended September 30, 2007 compared to 1.8% in 2006 while operating margins increased 3.5 percentage points to 1.6% for the nine months ended September 30, 2007 compared to -1.9% in the same period a year ago. The increases in operating margins in the quarter and nine months ended September 30, 2007 are primarily due to increases in gross margins of 6.0 and 4.2 percentage points, respectively, compared to the same periods a year ago as a result of higher selling prices, offset by higher selling, administrative and research and development costs (1.8 and 0.7 percentage points, respectively), in the quarter and nine months ended September 30, 2007 compared to the same period a year ago.

### CONMED Endoscopic Technologies

	Three months ended		Nine months ended	
	September 30, 2006	September 30, 2007	September 30, 2006	September 30, 2007
Net sales	\$ 12,699	\$ 12,536	\$ 42,151	\$ 39,208
Loss from operations	(4,439)	(1,449)	(10,830)	(5,092)
Operating Margin	(35.0%)	(11.6%)	(25.7%)	(13.0%)



Product offerings include a comprehensive line of minimally invasive endoscopic diagnostic and therapeutic instruments used in procedures which require examination of the digestive tract.

- Endoscopic Technologies sales decreased \$0.2 million (1.6%) in the quarter ended September 30, 2007 from \$12.7 million to \$12.5 million in the same period a year ago. Endoscopic Technologies sales decreased \$2.9 million (6.9%) in the nine months ended September 30, 2007 to \$39.2 million from \$42.1 million in the same period a year ago. These decreases are principally a result of decreased sales of forceps and biliary products as a result of increased competition and pricing pressures as well as production and operational issues which resulted in product shortages and backorders during the first half of the year.
- Operating margins as a percentage of net sales increased 23.4 percentage points to -11.6% in the quarter ended September 30, 2007 compared to -35.0% in 2006 while operating margins increased 12.7 percentage points to -13.0% for the nine months ended September 30, 2007 compared to -25.7% in the same period a year ago. The increases in operating margins in the quarter and nine months ended September 30, 2007 are primarily due to increases in gross margins of 11.4 and 9.3 percentage points, respectively, compared to the same periods a year ago as a result of the completion of the transfer of production lines from C.R. Bard to CONMED during 2006. The remaining increases in operating margins of 12.0 and 3.4 percentage points in the quarter and nine months ended September 30, 2007 are attributable to lower costs in the 2007 periods associated with acquisition-related costs (discussed in Note 10 to the Consolidated Condensed Financial Statements) and other administrative expenses.

## **Liquidity and Capital Resources**

Our liquidity needs arise primarily from capital investments, working capital requirements and payments on indebtedness under the senior credit agreement. We have historically met these liquidity requirements with funds generated from operations, including sales of accounts receivable and borrowings under our revolving credit facility. In addition, we use term borrowings, including borrowings under our senior credit agreement and borrowings under separate loan facilities, in the case of real property purchases, to finance our acquisitions. We also have the ability to raise funds through the sale of stock or we may issue debt through a private placement or public offering. We generally attempt to minimize our cash balances on-hand and use available cash to pay down debt or repurchase our common stock.

### **Cash provided by operations**

Our net working capital position was \$204.0 million at September 30, 2007. Net cash provided by operating activities was \$35.5 million in the nine months ended September 30, 2007 and \$40.8 million in the same period a year ago.

Net cash provided by operating activities decreased by \$5.3 million in 2007 as compared to 2006 as higher net income was offset by increases in inventory levels from their December 31, 2006 levels in our arthroscopy and powered instrument product lines in anticipation of continued sales growth and to accommodate sales orders for new products.

### **Investing cash flows**

Net cash used in investing activities in the nine months ended September 30, 2007 consisted of capital expenditures, the purchase of a business and additional cash consideration paid for a business acquisition as a result of a purchase price adjustment. Capital expenditures were \$16.0 million and \$16.7 million for the nine months ended September 30, 2007 and 2006, respectively. The decrease in capital expenditures in the nine months ended September 30, 2007 as compared to the same period a year ago is primarily due to the completion of certain manufacturing and distribution infrastructure improvements. The purchase of a business resulted in a \$4.6 million payment while a purchase price adjustment resulted in a payment of \$1.2 million in additional consideration.

### **Financing cash flows**

Net cash used in financing activities in the nine months ended September 30, 2007 consisted primarily of the following: \$11.1 million in proceeds from the issuance of common stock under our equity compensation plans and employee stock purchase plan and \$24.7 million in repayments of term borrowings under our senior credit agreement.

Our \$235.0 million senior credit agreement (the "senior credit agreement") consists of a \$100.0 million revolving credit facility and a \$135.0 million term loan. There was \$19.0 million outstanding on the revolving credit facility as of September 30, 2007. Our available borrowings on the revolving credit facility at September 30, 2007 were \$76.0 million with approximately \$5.0 million of the facility set aside for outstanding letters of credit. There were \$59.3 million in borrowings outstanding on the term loan at September 30, 2007.

The scheduled principal payments on the term loan portion of the amended and restated senior credit agreement are \$1.4 million annually through December 2011, increasing to \$53.6 million in 2012 with the remaining balance outstanding due and payable on April 12, 2013. We may also be required, under certain circumstances, to make additional principal payments based on excess cash flow as defined in the senior credit agreement. Interest rates on the term loan portion of the senior credit agreement are at LIBOR plus 1.50% (6.63% at September 30, 2007) or an alternative base rate; interest rates on the revolving credit facility portion of the senior credit agreement are at LIBOR plus 1.35% or an alternative base rate. For those borrowings where the Company elects to use the alternative base rate, the base rate will be the greater of the Prime Rate or the Federal Funds Rate in effect on such date plus 0.50%, plus a margin of 0.75% for term loan borrowings or 0.50% for borrowings under the revolving credit facility.

The senior credit agreement is collateralized by substantially all of our personal property and assets, except for our accounts receivable and related rights which are pledged in connection with our accounts receivable sales agreement. The amended and restated credit agreement contains covenants and restrictions which, among other things, require the maintenance of certain financial ratios, and restrict dividend payments and the incurrence of certain indebtedness and other

activities, including acquisitions and dispositions. We were in full compliance with these covenants and restrictions as of September 30, 2007. We are also required, under certain circumstances, to make mandatory prepayments from net cash proceeds from any issue of equity and asset sales.

Mortgage notes outstanding in connection with the property and facilities utilized by our CONMED Linvatec subsidiary consist of a note bearing interest at 7.50% per annum with semiannual payments of principal and interest through June 2009 (the "Class A note"); and a note bearing interest at 8.25% per annum compounded semiannually through June 2009, after which semiannual payments of principal and interest will commence, continuing through June 2019 (the "Class C note"). The principal balances outstanding on the Class A note and Class C note aggregated \$4.4 million and \$10.2 million, respectively, at September 30, 2007. These mortgage notes are secured by the CONMED Linvatec property and facilities.

We have outstanding \$150.0 million in 2.50% convertible senior subordinated notes (the "Notes") due 2024. The Notes represent subordinated unsecured obligations and are convertible under certain circumstances, as defined in the bond indenture, into a combination of cash and CONMED common stock. Upon conversion, the holder of each Note will receive the conversion value of the Note payable in cash up to the principal amount of the Note and CONMED common stock for the Note's conversion value in excess of such principal amount. Amounts in excess of the principal amount are at an initial conversion rate, subject to adjustment, of 26.1849 shares per \$1,000 principal amount of the Note (which represents an initial conversion price of \$38.19 per share). The Notes mature on November 15, 2024 and are not redeemable by us prior to November 15, 2011. Holders of the Notes will be able to require that we repurchase some or all of the Notes on November 15, 2011, 2014 and 2019.

Our Board of Directors has authorized a share repurchase program under which we may repurchase up to \$50.0 million of our common stock in any calendar year. We did not repurchase any shares during the first nine months of 2007. We have financed the repurchases and may finance additional repurchases through the proceeds from the issuance of common stock under our stock option plans, from operating cash flow and from available borrowings under our revolving credit facility.

Management believes that cash flow from operations, including accounts receivable sales, cash and cash equivalents on hand and available borrowing capacity under our senior credit agreement will be adequate to meet our anticipated operating working capital requirements, debt service, funding of capital expenditures and common stock repurchases in the foreseeable future.

#### **Off-balance sheet arrangements**

We have an accounts receivable sales agreement pursuant to which we and certain of our subsidiaries sell on an ongoing basis certain accounts receivable to CONMED Receivables Corporation ("CRC"), a wholly-owned, bankruptcy-remote, special-purpose subsidiary of CONMED Corporation. CRC may in turn sell up to an aggregate \$50.0 million undivided percentage ownership interest in such receivables (the "asset interest") to a bank (the "purchaser"). The purchaser's share of collections on accounts receivable are calculated as defined in the accounts receivable sales agreement, as amended. Effectively, collections on the pool of receivables flow first to the purchaser and then to CRC, but to the extent that the purchaser's share of collections may be less than the amount of the purchaser's asset interest, there



is no recourse to CONMED or CRC for such shortfall. For receivables which have been sold, CONMED Corporation and its subsidiaries retain collection and administrative responsibilities as agent for the purchaser. As of September 30, 2007, the undivided percentage ownership interest in receivables sold by CRC to the purchaser aggregated \$40.0 million, which has been accounted for as a sale and reflected in the balance sheet as a reduction in accounts receivable. Expenses associated with the sale of accounts receivable, including the purchaser's financing costs to purchase the accounts receivable were \$2.2 million in the nine months ended September 30, 2007 and are included in interest expense.

There are certain statistical ratios, primarily related to sales dilution and losses on accounts receivable, which must be calculated and maintained on the pool of receivables in order to continue selling to the purchaser. The pool of receivables is in full compliance with these ratios. Management believes that additional accounts receivable arising in the normal course of business will be of sufficient quality and quantity to meet the requirements for sale under the accounts receivables sales agreement. In the event that new accounts receivable arising in the normal course of business do not qualify for sale, then collections on sold receivables will flow to the purchaser rather than being used to fund new receivable purchases. To the extent that such collections would not be available to CONMED in the form of new receivables purchases, we would need to access an alternate source of working capital, such as our \$100.0 million revolving credit facility. Our accounts receivable sales agreement, as amended, also requires us to obtain a commitment (the "purchaser commitment"), on an annual basis, from the purchaser to fund the purchase of our accounts receivable. The purchaser commitment was amended effective October 23, 2006 whereby it was extended through October 31, 2008 under substantially the same terms and conditions.

#### **New accounting pronouncements**

See Note 13 to the Consolidated Condensed Financial Statements for a discussion of new accounting pronouncements.

#### **Item 3. Quantitative and Qualitative Disclosures About Market Risk**

There have been no significant changes in our primary market risk exposures or in how these exposures are managed during the three and nine month periods ended September 30, 2007. Reference is made to Item 7A. of our Annual Report on Form 10-K for the year-ended December 31, 2006 for a description of Qualitative and Quantitative Disclosures About Market Risk.

#### **Item 4. Controls and Procedures**

An evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended ("Exchange Act")) 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-Finance and Chief Financial Officer ("the Certifying Officers") as of September 30, 2007. Based on that evaluation, the Certifying Officers concluded that the Company's disclosure controls and procedures are effective. There have been no changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the

quarter ended September 30, 2007 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## **PART II OTHER INFORMATION**

### **Item 1. Legal Proceedings**

Reference is made to Item 3 of the Company's Annual Report on Form 10-K for the year-ended December 31, 2006 and to Note 12 of the Notes to Consolidated Condensed Financial Statements included in Part I of this Report for a description of certain legal matters.

### **Item 5. Other Information**

On November 5, 2007, the Board of Directors approved an amendment to Sections 5.1 and 5.2 of the by-laws so as to permit a Direct Registration Program, or book entry ownership, with respect to CONMED Corporation common stock, as required by Rule 4350(1) of the Nasdaq Listing Rules. The by-laws as amended and restated as of November 5, 2007 are attached as Exhibit 3.1.

**Item 6. Exhibits**

**Exhibits**

<u>Exhibit No.</u>	<u>Description of Exhibit</u>
3.1	Amended By-laws of the Company
31.1	Certification of Joseph J. Corasanti pursuant to Rule 13a-14(a) or Rule 15d-14(a), of the Securities Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Robert D. Shallish, Jr. pursuant to Rule 13a-14(a) or Rule 15d-14(a), of the Securities Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Joseph J. Corasanti and Robert D. Shallish, Jr. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

**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.

**CONMED CORPORATION**

(Registrant)

Date: November 5, 2007

/s/ Robert D. Shallish, Jr.  
Robert D. Shallish, Jr.  
Vice President – Finance and  
Chief Financial Officer

**Exhibit Index**

<b><u>Exhibit</u></b>		<b><u>Sequential Page Number</u></b>
<u>31.1</u>	Certification of Joseph J. Corasanti pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	E-1
<u>31.2</u>	Certification of Robert D. Shallish, Jr. pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.	E-2
<u>32.1</u>	Certification of Joseph J. Corasanti and Robert D. Shallish, Jr. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	E-3
<u>3.1</u>	Amended By-laws of the Company	E-4