STRYKER CORP
Form 10-Q
April 29, 2010

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2010

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from _____ to _____

Commission file number: 0-9165

STRYKER CORPORATION

(Exact name of registrant as specified in its charter)

Michigan	**38-1239739**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
2825 Airview Boulevard, Kalamazoo, Michigan	**49002**
(Address of principal executive offices)	**(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. YES x NO ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES x NO ¨

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES ¨ NO x

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

396,698,933 shares of Common Stock, $.10 par value, as of March 31, 2010.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS
CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)

Stryker Corporation and Subsidiaries

(in millions, except per share amounts)

	March 31 2010	December 31 2009
ASSETS		
Current Assets		
Cash and cash equivalents	$1,202.5	$658.7
Marketable securities	2,735.1	2,296.1
Accounts receivable, less allowance of $66.9 ($66.3 in 2009)	1,120.6	1,147.1
Inventories	961.0	943.0
Deferred income taxes	616.8	602.2
Prepaid expenses and other current assets	239.4	204.1
Total current assets	6,875.4	5,851.2
Property, Plant and Equipment, less allowance for depreciation of $1,043.0 ($1,016.1 in 2009)	925.0	947.6
Other Assets		
Goodwill	951.2	956.8
Other intangibles, less accumulated amortization of $429.4 ($421.0 in 2009)	666.3	634.7
Loaner instrumentation, less accumulated amortization of $704.1 ($771.3 in 2009)	290.0	285.4
Deferred income taxes	254.7	258.9
Other	135.8	136.7
Total assets	$10,098.4	$9,071.3
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities		
Accounts payable	$230.7	$200.2
Accrued compensation	250.0	354.1
Income taxes	166.0	134.7
Dividend payable	59.5	59.7
Accrued expenses and other liabilities	671.0	674.3
Current maturities of debt	27.6	18.0
Total current liabilities	1,404.8	1,441.0
Long-term debt	996.2	-
Other Liabilities	1,026.6	1,035.2
Shareholders Equity		
Common stock, $.10 par value:		
Authorized - 1,000.0 shares		
Outstanding 396.7 shares (397.9 in 2009)	39.7	39.8
Additional paid-in capital	925.4	899.9
Retained earnings	5,553.7	5,397.4

Accumulated other comprehensive gain	152.0	258.0
Total shareholders equity	6,670.8	6,595.1
Total liabilities & shareholders equity	$10,098.4	$9,071.3

See accompanying notes to Condensed Consolidated Financial Statements.

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CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS (Unaudited)

Stryker Corporation and Subsidiaries

(*in millions, except per share amounts*)

	Three Months Ended	
	March 31	
	2010	2009
Net sales	$1,799.1	$1,601.3
Cost of sales	581.4	515.5
Gross profit	1,217.7	1,085.8
Research, development and engineering expenses	90.0	80.4
Selling, general and administrative expenses	667.8	616.6
Intangibles amortization	13.5	9.6
	771.3	706.6
Operating income	446.4	379.2
Other income (expense)	(0.6)	7.2
Earnings before income taxes	445.8	386.4
Income taxes	124.1	105.3
Net earnings	$321.7	$281.1
Net earnings per share:		
Basic	$0.81	$0.71
Diluted	$0.80	$0.71
Weighted-average outstanding shares for the period:		
Basic	397.2	396.7
Diluted	400.1	398.6

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, 2010	$39.8	$899.9	$5,397.4	$258.0	$6,595.1
Net earnings			321.7		321.7
Unrealized gains on securities, net of income taxes				3.7	3.7
Unfunded pension gains, net of income taxes				0.6	0.6
Foreign currency translation adjustments				(110.3)	(110.3)
Comprehensive earnings for the three months ended March 31, 2010					215.7
Issuance of 0.9 shares of common stock under stock option and benefit plans, including $9.0 excess income tax benefit	0.1	11.7			11.8
Repurchase and retirement of 2.1 shares of common stock	(0.2)	(5.0)	(105.9)		(111.1)
Share-based compensation		18.8			18.8
Cash dividends declared of $0.15 per share of common stock			(59.5)		(59.5)
Balances at March 31, 2010	$39.7	$925.4	$5,553.7	$152.0	$6,670.8

See accompanying notes to Condensed Consolidated Financial Statements.

In February 2010 the Company declared a quarterly dividend of $0.15 per share payable April 30, 2010 to shareholders of record at the close of business on March 30, 2010.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

Stryker Corporation and Subsidiaries

(*in millions*)

	Three Months Ended March 31	
	2010	2009
Operating Activities		
Net earnings	$321.7	$281.1
Adjustments to reconcile net earnings from operations to net cash provided by operating activities:		
Depreciation	40.8	37.9
Amortization	58.4	53.8
Share-based compensation	18.8	16.7
Income tax benefit from exercise of stock options	14.9	4.2
Excess income tax benefit from exercise of stock options	(9.0)	(2.7)
Other	2.5	2.6
Changes in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable	9.2	53.5
Inventories	(30.1)	(51.8)
Loaner instrumentation	(52.1)	(43.9)
Accounts payable	33.1	2.5
Accrued expenses and other liabilities	(109.7)	(170.3)
Income taxes	14.5	116.2
Other	(38.2)	(27.4)
Net cash provided by operating activities	274.8	272.4
Investing Activities		
Acquisitions, net of cash acquired	(57.4)	(2.6)
Purchases of marketable securities	(1,041.2)	(1,198.6)
Proceeds from sales of marketable securities	524.3	1,100.4
Purchases of property, plant and equipment	(31.1)	(30.6)
Proceeds from sales of property, plant and equipment	-	0.7
Net cash used in investing activities	(605.4)	(130.7)
Financing Activities		
Proceeds from borrowings	17.3	10.5
Payments on borrowings	(7.1)	(9.6)
Proceeds from issuance of long-term debt, net	996.1	-
Issuance cost of long-term debt	(10.5)	-
Dividends paid	(59.7)	(158.6)
Proceeds from exercise of stock options	1.3	1.3
Repurchase and retirement of common stock	(111.1)	-
Excess income tax benefit from exercise of stock options	9.0	2.7
Other	62.7	20.0
Net cash provided by (used in) financing activities	898.0	(133.7)
Effect of exchange rate changes on cash and cash equivalents	(23.6)	(23.3)
Increase (decrease) in cash and cash equivalents	$543.8	$(15.3)

See accompanying notes to Condensed Consolidated Financial Statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Stryker Corporation and Subsidiaries

March 31, 2010

NOTE 1

BASIS OF PRESENTATION

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) 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 U.S. GAAP 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 three-month period ended March 31, 2010 are not necessarily indicative of the results that may be expected for the year ended December 31, 2010. The balance sheet at December 31, 2009 has been derived from the audited Consolidated Financial Statements at that date but does not include all of the information and footnotes required by U.S. GAAP for complete financial statements.

Recently Adopted Accounting Standards: The Company adopted the provisions of the *Improvement to Financial Reporting by Enterprises Involved with Variable Interest Entities Topic* of the Financial Accounting Standard Board (FASB) Accounting Standard Codification (Codification) on January 1, 2010. The topic requires a qualitative approach to identifying a controlling financial interest in a variable interest entity (VIE), and requires ongoing assessment of whether an entity is a VIE and whether an interest in a VIE makes the holder the primary beneficiary of the VIE. There was no impact to the Condensed Consolidated Financial Statements as a result of the adoption of this topic of the FASB Codification.

The Company adopted the provisions of the *Fair Value Measurements and Disclosures Topic Improving Disclosures About Fair Value Measurements* of the FASB Codification on January 1, 2010. This topic requires companies to make new disclosures about recurring and nonrecurring fair-value measurements including significant transfers into and out of Level 1 and Level 2 fair value measurements, and information on purchases, sales, issuances, and settlements on a gross basis in the reconciliation of Level 3 fair value measurements. The enhanced disclosures about recurring and nonrecurring fair value measurements are included in Note 2 to the Condensed Consolidated Financial Statements.

Recently Issued Accounting Standards: In 2009 the FASB amended the provisions of the *Revenue Recognition for Multiple-Deliverable Revenue Arrangements Topic* of the FASB Codification. This topic amends prior guidance and requires an entity to apply the relative selling price allocation method in order to estimate the selling price for all units of accounting, including delivered items, when vendor-specific objective evidence or acceptable third-party evidence does not exist. These provisions are effective for revenue arrangements entered into or which contain material modifications in fiscal years beginning on or after June 15, 2010, applied prospectively. The Company is currently reviewing the effect of this new topic on its Condensed Consolidated Financial Statements.

NOTE 2

FINANCIAL INSTRUMENTS

The Company s financial instruments consist of cash, cash equivalents, marketable securities, accounts receivable, other investments, accounts payable, debt and foreign currency exchange contracts. The Company s estimates of fair value for financial instruments approximate their carrying amounts as of March 31, 2010 and December 31, 2009.

Pursuant to the requirements of *Fair Value Measurements and Disclosures Topic* of the FASB Codification, the Company s financial assets and liabilities measured at fair value on a recurring basis are classified and disclosed in one of the following three categories:

Level 1: Financial instruments with unadjusted, quoted prices listed on active market exchanges.

Level 2: Financial instruments lacking unadjusted, quoted prices from active market exchanges, including over-the-counter traded financial instruments. The prices for the financial instruments are determined using prices for recently traded financial instruments with similar underlying terms as well as directly or indirectly observable inputs, such as interest rates and yield curves that are observable at commonly quoted intervals.

Level 3: Financial instruments that are not actively traded on a market exchange. This category includes situations where there is little, if any, market activity for the financial instrument. The prices are determined using significant unobservable inputs or valuation techniques.

The following describes the methods the Company uses to estimate the fair value of the Company s financial assets and liabilities:

Cash and cash equivalents:

The Company considers the carrying values of these financial instruments to approximate fair value because of the short period of time between origination of the instruments and their expected realization.

Available-for-sale marketable securities:

The Company s Level 2 available-for-sale marketable securities primarily include U.S. government and agency securities, foreign government debt securities, asset-backed debt securities, commercial paper, corporate debt securities, and certificates of deposit. The Company s Level 2 available-for-sale marketable securities values are determined using prices for recently traded financial instruments with similar underlying terms as well as directly or indirectly observable inputs, such as interest rates and yield curves that are observable at commonly quoted intervals. The Company s Level 3 available-for-sale marketable securities include corporate debt securities. The Company s Level 3 available-for-sale marketable securities valuations are based on the income approach, specifically, discounted cash flow analyses that utilize significant inputs based on the Company s estimates and assumptions. Using this approach, estimates for timing and amount of cash flows and expected holding periods of the securities were used and the expected future cash flows were calculated over the expected life of each security and were discounted to a single present value using an estimated market required rate of return.

Trading marketable securities and Auction Rate Securities (ARS) Rights:

The Company s Level 1 trading marketable securities consist of mutual funds and are valued using a market approach, based on quoted prices for the specific mutual fund from transactions in active exchange markets.

The Company s Level 3 trading marketable securities include investments in ARS, the majority of which are triple A rated (per Standard & Poor s) and collateralized by student loans guaranteed by the U.S. Department of Education. The interest rates of these ARS investments are reset through an auction process, most commonly at intervals of 7, 28 and 35 days.

Beginning in February 2008, liquidity issues in the global credit markets resulted in the failure of auctions for all of the ARS investments held by the Company, as the amount of securities submitted for sale in those auctions exceeded the amount of purchase bids. As of March 31, 2010, the Company held $139.9 million, at par value, of ARS investments. In 2008 the Company entered into an ARS Rights agreement (Rights) with UBS Financial Services Inc. (UBS), one of its investment providers, whereby the Company received the right to sell its ARS at par value to UBS at any time during the period from June 30, 2010 through July 2, 2012. These ARS Rights are nontransferable securities registered with the U.S. Securities and Exchange Commission (SEC). The Company has elected to apply the fair value option to its ARS Rights pursuant to the provisions of the *Fair Value Option for Financial Assets and Financial Liabilities Topic* of the FASB Codification. As a result of this election, in the first quarter of 2010, the Company recorded a loss of $1.9 million in other income (expense) to recognize the change in fair value estimate of its ARS Rights. The loss was offset by a corresponding gain in the fair value estimate of the related trading marketable securities. The Company intends to exercise its ARS Rights described above when it becomes due and has, therefore, classified the ARS as current marketable securities within its Condensed Consolidated Balance Sheets as of March 31, 2010 and December 31, 2009.

As a result of the illiquidity in the market for ARS investments, the Company has estimated the fair value of its ARS and ARS Rights using a Level 3 valuation methodology. The Company s Level 3 valuations of its ARS and ARS Rights are based on the income approach, specifically, discounted cash flow analyses that utilize significant inputs based on the Company s estimates and assumptions. The discounted cash flow analyses included the following assumptions at March 31, 2010: current coupon rates, expected maturity and current discount rates. The current coupon rates are based on forecasted interest rates, specifically, the 3-month U.S. Treasury bill plus the applicable coupon spread, generally 120 basis points. The expected maturity assumption is based on the weighted average remaining term for the underlying student loans financed by the trusts that issued the ARS. Based on available information, the expected maturity reflects a 17-year assumption. The current discount rates reflect a base rate, a credit spread and an illiquidity premium. The base rate corresponds to the 3-month Libor, which is also the base rate that matches the credit spread. The credit spread is consistent with triple A rated investments collateralized by student loans that are guaranteed by the U.S. Government under the Federal Family Education Loan Program. The illiquidity premium estimate is a proxy for additional return required in holding illiquid assets. The Company s valuation was supported by a broker pricing valuation that incorporates transaction details, such as contractual terms, maturity, timing and anticipated amounts of future cash flows, as well as assumptions about liquidity and credit valuation adjustments by marketplace participants at March 31, 2010. These adjustments are subject to future changes as the underlying market conditions and marketplace sources change.

Foreign currency exchange contracts:

The Company values foreign currency exchange contracts using a market approach based on foreign currency exchange rates obtained from active markets. The estimated fair value of forward currency exchange contracts represents the measurement of the contracts at month-end spot rates as adjusted by current forward points. At March 31, 2010, the fair value carrying amount of the Company s forward currency exchange contracts assets and liabilities were $3.6 million and $1.3 million, respectively.

The following tables summarize the valuation of the Company s financial instruments by the aforementioned pricing categories (in millions):

	Total	Quoted Prices in Active Markets (Level 1)	Prices with Other Observable Inputs (Level 2)	Prices with Unobservable Inputs (Level 3)
At March 31, 2010				
Assets:				
Cash and cash equivalents	$1,202.5	$1,202.5	$ -	$ -
Available-for-sale marketable securities				
Corporate and asset backed debt securities	1,383.9	-	1,383.2	0.7
Foreign government debt securities	714.7	-	714.7	-
U.S. agency debt securities	252.6	-	252.6	-
Certificates of deposit	98.3	-	98.3	-
Other	161.5	-	161.5	-
Total available-for-sale marketable securities	2,611.0	-	2,610.3	0.7
Trading marketable securities				
Municipal debt securities (ARS)	124.8	-	-	124.8
Mutual funds	41.5	41.5	-	-
Total trading marketable securities	166.3	41.5	-	124.8
ARS Rights	15.1	-	-	15.1
Foreign currency exchange contracts	3.6	-	3.6	-
	$3,998.5	$1,244.0	$2,613.9	$140.6
Liabilities:				
Deferred compensation arrangements	$41.5	$41.5	$ -	$ -
Foreign currency exchange contracts	1.3	-	1.3	-

$42.8	$41.5	$1.3	$ -

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	Total	Quoted Prices in Active Markets (Level 1)	Prices with Other Observable Inputs (Level 2)	Prices with Unobservable Inputs (Level 3)
At December 31, 2009				
Assets:				
Cash and cash equivalents	$658.7	$658.7	$ -	$ -
Available-for-sale marketable securities				
Corporate and asset backed debt securities	1,047.8	-	1,047.1	0.7
Foreign government debt securities	742.1	-	742.1	
U.S. agency debt securities	166.3	-	166.3	
Certificates of deposit	92.1	-	92.1	
Other	109.2	-	109.2	
Total available-for-sale marketable securities	2,157.5	-	2,156.8	0.7
Trading marketable securities				
Municipal debt securities (ARS)	139.3	-	-	139.3
Mutual funds	39.3	39.3	-	-
Total trading marketable securities	178.6	39.3	-	139.3
ARS Rights	17.0	-	-	17.0
Foreign currency exchange contracts	8.3	-	8.3	-
Total	$ 3,020.1	$698.0	$ 2,165.1	$157.0
Liabilities:				
Deferred compensation arrangements	$39.3	$39.3	$ -	$ -
Foreign currency exchange contracts	6.2	-	6.2	-
Total	$45.5	$39.3	$6.2	$ -

The following table presents a rollforward of the assets measured at fair value on a recurring basis using unobservable inputs (Level 3) (in millions):

At March 31, 2010	
Balance as of January 1, 2010	$157.0
Transfers into Level 3	-
Settlements	(16.4)
Other	-
Balance as of March 31, 2010	$140.6

At December 31, 2009	
Balance as of January 1, 2009	$168.9
Transfers into Level 3	-
Settlements	(10.5)
Other	(1.4)
Balance as of December 31, 2009	$157.0

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The following tables present a summary of the Company s marketable securities (in millions):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
At March 31, 2010				
Available-for-sale marketable securities:				
Corporate and asset backed debt securities	$1,377.9	$6.5	$(0.5)	$1,383.9
Foreign government debt securities	712.3	2.5	(0.1)	714.7
U.S. agency debt securities	252.3	0.5	(0.2)	252.6
Certificates of deposit	98.3	-	-	98.3
Other	161.3	0.2	-	161.5
Total available-for-sale marketable securities	$2,602.1	$9.7	$(0.8)	2,611.0
Trading marketable securities:				
Municipal debt securities (ARS)				124.8
Mutual funds				41.5
Total trading marketable securities				166.3
Total marketable securities				$2,777.3
Reported as:				
Current assets-Marketable securities				$2,735.1
Noncurrent assets-Other				42.2
				$2,777.3

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized (Losses)	Estimated Fair Value
At December 31, 2009				
Available-for-sale marketable securities:				
Corporate and asset backed debt securities	$1,043.6	$5.2	$(1.0)	$1,047.8
Foreign government debt securities	742.2	0.9	(1.0)	742.1
U.S. agency debt securities	165.9	0.5	(0.1)	166.3
Certificates of deposit	92.0	0.1	-	92.1
Other	109.1	0.1	-	109.2
Total available-for-sale marketable securities	$2,152.8	$6.8	$(2.1)	2,157.5
Trading marketable securities:				
Municipal debt securities (ARS)				139.3
Mutual funds				39.3
Total trading marketable securities				178.6
Total marketable securities				$2,336.1

Reported as:	
Current assets-Marketable securities	$2,296.1
Noncurrent assets-Other	40.0
	$2,336.1

The cost and estimated fair value of available-for-sale marketable securities at March 31, 2010, by contractual maturity, are as follows (in millions):

	Cost	Estimated Fair Value
Due in one year or less	$848.4	$848.8
Due after one year through three years	1,708.0	1,716.3
Due after three years	45.7	45.9
	$ 2,602.1	$ 2,611.0

The gross unrealized losses and fair value of the Company s investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that the individual securities have been in a continuous unrealized loss position, at March 31, 2010 are as follows (in millions):

	Less Than 12 months			12 months or Greater			Total		
	Number of Investments	Fair Value	Unrealized Losses	Number of Investments	Fair Value	Unrealized Losses	Number of Investments	Fair Value	Unrealized Losses
Available-for-sale marketable securities:									
Corporate and asset backed debt securities	147	$ 419.9	$0.5	-	$ -	$ -	147	$ 419.9	$0.5
U.S. agency debt securities	33	119.7	0.2	-	-	-	33	119.7	0.2
Foreign government debt securities	19	106.1	0.1	-	-	-	19	106.1	0.1
Total	199	$ 645.7	$0.8	-	$ -	$ -	199	$ 645.7	$0.8

The unrealized losses on the Company s investments in corporate and asset backed and U.S. agency debt securities were primarily caused by increases in interest yields as a result of continued challenging conditions in the global credit markets. While many of these investments have been downgraded by rating agencies since their initial purchase, less than 1% of the Company s investments in corporate and asset-backed debt securities had a credit quality rating of less than single A (per Standard & Poor s or Fitch). Because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at March 31, 2010.

The unrealized losses on the Company s investments in foreign government debt securities were also caused by interest rate increases. Because the decline in market value is attributable to changes in interest rates and because the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity, the Company does not consider those investments to be other-than-temporarily impaired at March 31, 2010.

Pursuant to the Company s investment policy, all individual marketable security investments must have a minimum credit quality of single A (per Standard & Poor s or Fitch) or A2 (per Moody s Corporation) at the time of acquisition, while the overall portfolio of marketable securities must maintain a minimum average credit quality of double A (per Standard & Poor s or Fitch) or Aa (per Moody s Corporation). In the event of a rating downgrade below the minimum credit quality subsequent to purchase, the marketable security investment is evaluated to determine the appropriate action to take to minimize the overall risk to the Company s marketable security investment portfolio. As of March 31, 2010, approximately 1% of the Company s investments in marketable securities had a credit quality rating of less than single A (per Standard & Poor s or Fitch) and A2 (per Moody s Corporation). As of March 31, 2010, approximately 1% of the Company s investments in marketable securities were held in asset backed debt securities. The majority of the Company s asset backed debt securities relates to investments in U.S. agency-issued mortgage backed securities, where the recovery of the full amount by the investor is guaranteed by the issuing Federal agency.

The Company s interest and marketable securities income, which is included in other income (expense), for the three months ended March 31, 2010 and 2009, was $13.1 million and $15.6 million respectively.

NOTE 3

DERIVATIVE INSTRUMENTS AND HEDGING STRATEGIES

The Company follows the provisions of the *Derivatives and Hedging Topic* of the FASB Codification, which requires the Company to recognize all derivatives on the Condensed Consolidated Balance Sheets at fair value.

The Company enters into forward currency exchange contracts to mitigate the impact of currency fluctuations on transactions denominated in nonfunctional currencies, thereby limiting risk to the Company that would otherwise result from changes in exchange rates. These currency exposures principally relate to intercompany receivables and payables arising from intercompany purchases of manufactured products. The duration of the forward currency exchange contracts corresponds to the anticipated period the intercompany receivables and payables remain outstanding. The Company does not designate these contracts as hedges; therefore, all forward currency exchange contracts are recorded at their fair value each period, with resulting gains and losses included in other income (expense) in the Condensed Consolidated Statements of Earnings as an offset to the gains and losses recognized on the intercompany receivables and payables. For the three months ended March 31, 2010, recognized foreign currency transaction gains included in other income (expense) in the Condensed Consolidated Statements of Earnings was $1.3 million. For the three months ended March 31, 2009, recognized foreign currency transaction losses included in other income (expense) in the Condensed Consolidated Statements of Earnings was $0.4 million.

At March 31, 2010, the Company had outstanding forward currency exchange contracts to purchase $480.1 million and sell $407.1 million of various currencies (principally U.S. dollars and euros) with original maturities ranging from 9 to 93 days. The maximum length of time over which the Company is limiting its exposure to the reduction in value of nonfunctional receivables and payables through foreign currency exchange contracts is through June 30, 2010.

At March 31, 2010, the fair value carrying amount of the Company s forward currency exchange contracts assets and liabilities was $3.6 million and $1.3 million, respectively, and was included as a component of prepaid expenses and other current assets and accrued expenses and other liabilities, respectively, in the Condensed Consolidated Balance Sheets. The estimated fair value of forward currency exchange contracts represents the measurement of the contracts at month-end spot rates as adjusted by current forward points. The Company is exposed to credit loss in the event of nonperformance by counterparties on its outstanding forward currency exchange contracts but does not anticipate nonperformance by any of its counterparties.

NOTE 4

COMPREHENSIVE EARNINGS

The Company follows the *Comprehensive Income Topi*c of the FASB Codification in accounting for comprehensive earnings and its components. The comprehensive earnings for the three months ended March 31, 2010 and 2009 were $215.7 million and $185.6 million, respectively.

NOTE 5

INVENTORIES

Inventories are as follows (in millions):

	March 31 2010	December 31 2009
Finished goods	$735.0	$730.4
Work-in-process	89.3	84.0
Raw materials	148.2	140.1
FIFO cost	972.5	954.5
Less LIFO reserve	(11.5)	(11.5)
	$961.0	$943.0

NOTE 6

ACQUISITIONS

Business and product line acquisitions completed in the first quarter of 2010 for $57.4 million included the previously announced acquisition of assets used to produce the Sonopet Ultrasonic Aspirator control consoles, handpieces and accessories from Mutoh Co., Ltd. and Synergetics USA, Inc. These acquisitions, which are expected to enhance the Company s product offerings within its Orthopaedic Implants and MedSurg Equipment segments, did not have a material effect on the Company s consolidated net sales or operating income for the quarter ended March 31, 2010. These acquisitions were accounted for pursuant to the requirements of the *Business Combinations Topic* of the FASB Codification. The assets acquired and liabilities assumed as a result of the acquisitions were included in the Company s Condensed Consolidated Balance Sheet as of March 31, 2010 and did not have a material effect on the Company s Condensed Consolidated Balance Sheet as of March 31, 2010. The purchase price for each of the acquisitions was primarily allocated to identifiable intangible assets acquired based on their estimated fair values on the acquisition date. The fair value assigned to identifiable intangible assets acquired was determined primarily by using the income approach. Purchased identifiable intangible assets are amortized on a straight-line basis over their respective estimated useful lives. The purchase price was based upon a preliminary valuation, and the Company s estimates and assumptions are subject to change within the measurement period as valuations are finalized.

In 2004 the Company acquired all of the outstanding stock of SpineCore, Inc. (SpineCore), a developer of artificial lumbar and cervical discs for an upfront payment of $120.0 million in cash plus certain transaction costs. Terms of the transaction also include potential milestone and royalty payments of up to an additional $240.0 million upon commercialization of SpineCore s products in the United States. The potential milestone payments are expected to be capitalized at their fair values as intangible assets at the time of payment. Current products under development include the FlexiCore lumbar artificial disc and the CerviCore cervical artificial disc.

The Company believes that the technologies acquired in the SpineCore acquisition will result in the introduction of new products and additional future sales. However, unanticipated issues may arise that could further delay or terminate a product s development prior to regulatory approval or commercialization, which could have an unfavorable impact on the Company s operating results. As of March 31, 2010, the Company had not encountered significant issues and expects completion of the development and initial U.S. commercialization of the FlexiCore lumbar artificial disc and the CerviCore cervical artificial disc following receipt of all required regulatory approvals.

NOTE 7

RESTRUCTURING CHARGES

Restructuring charges recorded by the Company in 2009 and 2008 are described in Note 7 to the Consolidated Financial Statements included in the Company s 2009 Form 10-K.

The following table provides a rollforward of the remaining liabilities, included within accrued expenses and other liabilities in the Condensed Consolidated Balance Sheet, related to the restructuring charges recorded by the Company in 2009 and 2008 (in millions):

	Agent Conversions	Severance and Related Costs	Contractual Obligations and Other Charges
Balances at January 1, 2010	$5.9	$3.4	$2.5
Payments	(5.9)	(1.3)	(0.5)
Balances at March 31, 2010	$0.0	$2.1	$2.0

The restructuring projects initiated in 2009 and 2008 are substantially complete. The Company expects the contractual obligations and other charges to be completed and final severance payments to be made in the fourth quarter of 2010.

NOTE 8

LONG-TERM DEBT

The Company s long-term debt is summarized as follows:

	March 31 2010	December 31 2009
3.00% senior unsecured notes, due January 15, 2015	$499.5	$ -
4.375% senior unsecured notes, due January 15, 2020	496.7	-
Other	27.6	18.0
Total debt	1,023.8	18.0
Less current maturities	(27.6)	(18.0)
Long-term debt	$996.2	$ -

On January 15, 2010, the Company sold $500.0 million of senior unsecured notes due January 15, 2015 (the 2015 Notes) and $500.0 million of senior unsecured notes due January 15, 2020 (the 2020 Notes). The 2015 Notes bear interest at 3.00% per year and, unless previously redeemed, will mature on January 15, 2015. The 2020 Notes bear interest at 4.375% per year and, unless previously redeemed, will mature on January 15, 2020. The Company received net proceeds of $996.1 million, net of an offering discount of $3.9 million. The 2015 Notes and 2020 Notes carry effective interest rates of 3.02% and 4.46%, respectively. The Company intends to use the net proceeds from the offering for working capital and other general corporate purposes, including acquisitions, stock repurchases and other business opportunities.

The carrying amounts of the Company s long-term debt approximate their fair values, based on the quoted interest rates for similar types and amounts of borrowing agreements.

Debt issuance costs of $10.5 million were incurred in connection with the sale of the senior unsecured notes. These costs were capitalized and are being amortized to interest expense over the lives of the related senior unsecured notes. At March 31, 2010, total unamortized debt issuance costs were $10.1 million.

The weighted average interest rate for all borrowing was 3.7% at March 31, 2010.

In addition to the senior unsecured notes, the Company had current debt outstanding under various debt instruments totaling $27.6 and $18.0 million at March 31, 2010 and December 31, 2009, respectively.

NOTE 9

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 5.8 million and 23.4 million shares of common stock were outstanding during the quarters ended March 31, 2010 and 2009, respectively, 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.

NOTE 10

CAPITAL STOCK

In December 2009 the Company s Board of Directors authorized the Company to purchase up to $750.0 million of the Company s common stock. The manner, timing and amount of any purchases will be determined by the Company s management based on their evaluation of market conditions, stock price and other factors and will be subject to regulatory considerations. Purchases may be made from time to time in the open market, in privately negotiated transactions or otherwise. During the first quarter of 2010, the Company repurchased 2.1 million shares of common stock in the open market at a cost of $111.1 million pursuant to the repurchase program. Shares repurchased under the share repurchase program are available for general corporate purposes, including offsetting dilution associated with stock option and other equity-based employee benefit plans.

NOTE 11

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 March 31	
	2010	2009
Service cost	$4.1	$3.9
Interest cost	3.2	2.9
Expected return on plan assets	(2.3)	(2.4)
Amortization of prior service cost and transition amount	0.3	0.3
Recognized actuarial loss	-	0.2
Net periodic benefit cost	$5.3	$4.9

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The Company previously disclosed in its 2009 Form 10-K that it anticipated contributing approximately $19.0 million to its defined benefit plans in 2010 to meet minimum funding requirements. As of March 31, 2010, $4.0 million of contributions have been made.

NOTE 12

INCOME TAXES

The Company operates in multiple income tax jurisdictions both inside and outside the United States. Income tax authorities in these jurisdictions regularly perform audits of the Company s income tax filings. Accordingly, management must determine the appropriate allocation of income to each of these jurisdictions based on current interpretations of complex income tax regulations. Income tax audits associated with the allocation of this income and other complex issues, including inventory transfer pricing and cost sharing, product royalty and foreign branch arrangements, may require an extended period of time to resolve and may result in significant income tax adjustments if changes to the income allocation are required between jurisdictions with different income tax rates. In 2010 the Company reached settlements related to certain income tax audits both inside and outside the United States.

In April 2009 the U.S. Internal Revenue Service (IRS) proposed adjustments to the Company s previously filed 2003, 2004 and 2005 income tax returns related to income tax positions the Company has taken for its cost sharing arrangements with two wholly owned entities operating in Ireland. The Company believes it followed the applicable tax law and Treasury regulations and will vigorously defend these income tax positions. If the IRS were ultimately to prevail with respect to its proposed adjustments, such adjustments could have a material unfavorable impact on the Company s income tax expense and net earnings in future periods.

NOTE 13

SEGMENT INFORMATION

The Company segregates its operations into two reportable business segments: Orthopaedic Implants and MedSurg Equipment. The Orthopaedic Implants segment includes orthopaedic reconstructive (hip and knee), trauma and spinal implant systems and other related products. The MedSurg Equipment segment includes surgical equipment and surgical navigation systems; endoscopic and communications systems; patient handling and emergency medical equipment; as well as other related products. The Other category includes corporate administration, interest expense, interest and marketable securities income and share-based compensation, which includes compensation related to both employee and director stock option and restricted stock grants.

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 2009 Form 10-K.

Sales and net earnings by business segment follow (in millions):

	Orthopaedic Implants	MedSurg Equipment	Other	Total
Three Months Ended March 31, 2010:				
Net sales	$1,076.9	$722.2	$ -	$1,799.1
Segment net earnings (loss)	235.9	120.0	(34.2)	321.7
Three Months Ended March 31, 2009:				
Net sales	$973.2	$628.1	$ -	$1,601.3
Segment net earnings (loss)	187.4	114.1	(20.4)	281.1

NOTE 14

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 and intellectual property, and other matters. The outcomes of these matters will generally not be known for prolonged periods of time. In certain of the legal proceedings, the claimants seek damages, as well as other compensatory relief, which could result in the payment of significant claims and settlements. For legal matters for which management has