

Edgar Filing: CRYOLIFE INC - Form 10-K/A

CRYOLIFE INC  
Form 10-K/A  
April 30, 2003

AMENDMENT NO. 1  
FORM 10-K/A

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE  
SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2002  
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 1-13165

CRYOLIFE, INC.

(Exact name of registrant as specified in its charter)

Florida 59-2417093  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

1655 Roberts Boulevard N.W., Kennesaw, GA 30144  
(Address of principal executive offices) (zip code)

Registrant's telephone number, including area code (770) 419-3355

Securities registered pursuant to Section  
12(b) of the Act:

TITLE OF EACH CLASS	NAME OF EACH EXCHANGE ON WHICH REGISTERED
Common Stock, \$.01 par value	New York Stock Exchange
Preferred Share Purchase Rights	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None

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 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K Section 229.405 of this chapter is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). [ X ] Yes [ ] No

As of June 30, 2002, the aggregate market value of the voting stock of the Registrant held by non-affiliates of the registrant was \$272,880,824 computed using the closing price of \$16.06 per share of Common Stock on June 28, 2002, the last trading day of the registrant's most recently completed second fiscal quarter, as reported by NYSE, based on the assumption that directors and executive officers are affiliates.

As of February 24, 2003 the number of outstanding shares of Common Stock of the registrant was 19,573,970.

This Amendment to Form 10-K is being filed solely to correct the Company's Consolidated Statement of Operations. As previously filed, the entry "(including write-down of \$32,715 in 2002)" was beneath "Human Tissue Preservation Services" under "Revenues." As corrected, that entry is below "Human Tissue Preservation Services" under "Costs and Expenses." All other information remains unchanged. Except as modified herein, the Company incorporates into this Form 10-K/A the contents of the annual report on Form 10-K filed on February 27, 2003. The Company does not undertake to update any item on that annual report, as amended.

### ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

Our financial statements and supplementary data required by this item are submitted as a separate section of this amendment to our annual report on Form 10-K. See "Financial Statements" commencing on page F-1.

### PART IV

### ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K.

The following are filed as part of this report:

#### (a) 1. Financial Statements

Independent Auditors' Report-Deloitte & Touche LLP, Report of Independent Public Accountants-Arthur Andersen LLP, Copy of Report of Independent Public Accountants, Consolidated Balance Sheets as of December 31, 2002 and 2001, Consolidated Statements of Operations as of December 31, 2002, 2001 and 2000, Consolidated Statements of Cash Flows as of December 31, 2002, 2001 and 2000, Consolidated Statements of Shareholders' Equity for the years ended December 31, 2002, 2001, 2000, and 1999, and Notes to Consolidated Financial Statements.

#### 2. Financial Statement Schedule

Independent Auditors' Report on Schedule II

Schedule II--Valuation and Qualifying Accounts

All other financial statement schedules not listed above are omitted, as the required information is not applicable or the information is presented in the consolidated financial statements or related notes.

#### 3. A. Exhibits

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The following exhibits are filed herewith or incorporated herein by reference:

EXHIBIT NUMBER -----	DESCRIPTION -----
2.1	Asset Purchase Agreement among the Company and United Cryopreservation Foundation, Inc., United Transplant Foundation, Inc. and QV, Inc. dated September 11, 1996. (Incorporated by reference to Exhibit 2.2 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 1996.)
2.2	Agreement and Plan of Merger dated as of March 5, 1997 among Ideas for Medicine, Inc., J. Crayton Pruitt, Sr., M.D., Thomas Benham, Thomas Alexandris, Tom Judge, Natalie Judge, Helen Wallace, J. Crayton Pruitt, Jr., M.D., and Johanna Pruitt, and CryoLife, Inc. and CryoLife Acquisition Corporation. (Incorporated by reference to Exhibit 2.1 to the Registrant's Current Report on Form 8-K filed on March 19, 1997.)
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2.3	Asset Purchase Agreement by and between Horizon Medical Products, Inc. and Ideas for Medicine, Inc. dated September 30, 1998. (Incorporated by reference to Exhibit 2 to Horizon Medical Products, Inc.'s Current Report on Form 8-K filed with the Securities and Exchange Commission on October 14, 1998.)
2.4+	Asset Purchase Agreement, dated October 9, 2000, by and between Horizon and IFM. (Incorporated by reference to Exhibit 2.4 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2000.)
3.1	Restated Certificate of Incorporation of the Company. (Incorporated by reference to Exhibit 3.1 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 1999.)
3.2	ByLaws of the Company, as amended. (Incorporated by reference to Exhibit 3.2 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 1995.)
3.3	Articles of Amendment to the Articles of Incorporation of the Company. (Incorporated by reference to Exhibit 3.3 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2000).
4.1	Form of Certificate for the Company's Common Stock. (Incorporated by reference to Exhibit 4.1 to the Registrant's Registration Statement on Form S-1 (No. 33-56388).
4.2	Form of Certificate for the Company's Common Stock. (Incorporated by reference to Exhibit 4.2 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 1997.)
10.1	Lease, by and between New Market Partners III, Laing Properties, Inc., General Partner, as Landlord, and the Company, as Tenant, dated February 13, 1986, as amended by that Amendment to Lease, by and between the parties, dated April 7, 1986, as amended by that Amendment to Lease, by and between the parties, dated May 15, 1987, as amended by that Second Amendment to Lease, by and between the parties, dated June 22, 1988, as amended by that Third Amendment to Lease, by and between the parties, dated April 4, 1989, as amended by that Fourth Amendment to Lease, by and between the parties, dated April 4, 1989 as

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amended by that Fifth Amendment to Lease, by and between the parties, dated October 15, 1990. (Incorporated by reference to Exhibit 10.1 to the Registrant's Registration Statement on Form S-1 (No. 33-56388).)

- 10.1(a) Seventh Amendment to Lease dated February 13, 1986, by and between New Market Partners III, Laing Properties, Inc., General Partner, as Landlord, and the Company as tenant, dated May 15, 1996. (Incorporated by reference to Exhibit 10.1(a) to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 1996.)
- 10.1(b) Eighth Amendment to Lease dated February 13, 1986, by and between New Market Partners III, Laing Properties, Inc., General Partner, as Landlord, and the Company as tenant, dated November 18, 1998. (Incorporated by reference to Exhibit 10.12 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002.)
- 10.1(c) Ninth Amendment to Lease dated February 13, 1986, by and between New Market Partners III, Laing Properties, Inc., General Partner, as Landlord, and the Company as tenant, dated July 25, 2001. (Incorporated by reference to Exhibit 10.13 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002.)
- 10.1(d) Tenth Amendment to Lease dated February 13, 1986, by and between New Market Partners III, Laing Properties, Inc., General Partner, as Landlord, and the Company as tenant, dated June 25, 2002. (Incorporated by reference to Exhibit 10.42 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002.)

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- 10.2 Lease by and between Newmarket Partners I, Laing Properties, Inc. and Laing Management Company, General Partner, as Landlord, and the Company as Tenant, dated July 23, 1993. (Incorporated by reference to Exhibit 10.2 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 1993.)
- 10.2(a) First Amendment to Lease dated July 23, 1993, by and between Newmarket Partners I, Laing Properties, Inc. and Laing Management Company, General Partner, as Landlord, and the Company as Tenant dated June 9, 1994. (Incorporated by reference to Exhibit 10.15 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002.)
- 10.2(b) Second Amendment to Lease dated July 23, 1993, by and between Newmarket Partners I, Laing Properties, Inc. and Laing Management Company, General Partner, as Landlord, and the Company as Tenant dated June 6, 1998. (Incorporated by reference to Exhibit 10.16 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002.)
- 10.2(c) Third Amendment to Lease dated July 23, 1993, by and between Newmarket Partners I, Laing Properties, Inc. and Laing Management Company, General Partner, as Landlord, and the Company as Tenant dated August 3, 2001. (Incorporated by reference to Exhibit 10.17 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002.)
- 10.2(d) Fourth Amendment to Lease dated July 23, 1993, by and between

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Newmarket Partners I, Laing Properties, Inc. and Laing Management Company, General Partner, as Landlord, and the Company as Tenant dated June 25, 2002. (Incorporated by reference to Exhibit 10.18 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002.)

- 10.3 1993 Employee Stock Incentive Plan adopted on July 6, 1993. (Incorporated by reference to Exhibit 10.3 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 1993.)
- 10.4 1989 Incentive Stock Option Plan for the Company, adopted on March 23, 1989. (Incorporated by reference to Exhibit 10.2 to the Registrant's Registration Statement on Form S-1 (No. 33-56388).)
- 10.5 Incentive Stock Option Plan, dated as of April 5, 1984. (Incorporated by reference to Exhibit 10.3 to the Registrant's Registration Statement on Form S-1 (No. 33-56388).)
- 10.6 Form of Stock Option Agreement and Grant under the Incentive Stock Option and Employee Stock Incentive Plans. (Incorporated by reference to Exhibit 10.4 to the Registrant's Registration Statement on Form S-1 (No. 33-56388).)
- 10.7 CryoLife, Inc. Profit Sharing 401(k) Plan, as adopted on December 17, 1991. (Incorporated by reference to Exhibit 10.5 to the Registrant's Registration Statement on Form S-1 (No. 33-56388).)
- 10.8 Form of Supplemental Retirement Plan, by and between the Company and its Officers-- Parties to Supplemental Retirement Plans: Steven G. Anderson, David M. Fronk, Sidney B. Ashmore, James C. Vander Wyk, Albert E. Heacox, Kirby S. Black, and David Ashley Lee. (Incorporated by reference to Exhibit 10.6 to the Registrant's Registration Statement on Form S-1 (No. 33-56388).)
- 10.9(a) Employment Agreement, by and between the Company and Steven G. Anderson. (Incorporated by reference to Exhibit 10.9(a) to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 1998.)
- 10.9(b) Employment Agreement, by and between the Company and Albert E. Heacox. (Incorporated by reference to Exhibit 10.7(c) to the Registrant's Registration Statement on Form S-1 (No. 33-56388).)
- 10.9(c) Employment Agreement, by and between the Company and D. Ashley Lee, dated December 12, 1994. (Incorporated by reference to Exhibit 10.9(c) to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2000.)
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- 10.9(d) Employment Agreement, by and between the Company and James C. Vander Wyk, Ph.D. (Incorporated by reference to Exhibit 10.9(f) to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 1995.)
- 10.9(e) Employment Agreement, by and between the Company and Kirby S. Black, Ph.D. (Incorporated by reference to Exhibit 10.9(g) to the Registrant's Annual Report on Form 10-K/A for the fiscal year ended December 31, 1996.)
- 10.9(f) Employment Agreement, by and between the Company and David M. Fronk.

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(Incorporated by reference to Exhibit 10.9(g) to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 1998.)

- 10.9(g) Employment Agreement, by and between the Company and Sidney B. Ashmore. (Incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2001.)
- 10.9(h) Employment Agreement, by and between the Company and D. Ashley Lee, dated September 3, 2002. (Incorporated by reference to Exhibit 10.4 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002.)
- 10.9(i) Employment Agreement, by and between the Company and Sidney B. Ashmore, dated September 3, 2002. (Incorporated by reference to Exhibit 10.5 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002.)
- 10.9(j) Employment Agreement, by and between the Company and Kirby S. Black, dated September 3, 2002. (Incorporated by reference to Exhibit 10.6 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002.)
- 10.9(k) Employment Agreement, by and between the Company and Albert E. Heacox, dated September 3, 2002. (Incorporated by reference to Exhibit 10.7 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002.)
- 10.9(l) Employment Agreement, by and between the Company and David M. Fronk, dated September 3, 2002. (Incorporated by reference to Exhibit 10.8 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002.)
- 10.9(m) Employment Agreement, by and between the Company and James C. Vander Wyk, dated September 3, 2002. (Incorporated by reference to Exhibit 10.9 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002.)
- 10.9(n) Employment Agreement, by and between the Company and Steven G. Anderson, dated September 3, 2002. (Incorporated by reference to Exhibit 10.10 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002.)
- 10.10 Form of Secrecy and Noncompete Agreement, by and between the Company and it's Officers. (Incorporated by reference to Exhibit 10.9 to the Registrant's Registration Statement on Form S-1 (No. 33-56388).)
- 10.11 Terms of Agreement Between Bruce J. Van Dyne, M.D. and CryoLife, Inc. dated November 1, 1999. (Incorporated by reference to Exhibit 10.11 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 1999.)
- 10.12 Technology Acquisition Agreement between the Company and Nicholas Kowanko, Ph.D., dated March 14, 1996. (Incorporated by reference to Exhibit 10.14 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 1995.)
- 10.13 Option Agreement, by and between the Company and Duke University,

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dated July 9, 1990, as amended by that Option Agreement Extension, by and between the parties, dated July 9, 1991. (Incorporated by reference to Exhibit 10.20 to the Registrant's Registration Statement on Form S-1 (No. 33-56388).)

- 10.14 Research and License Agreement by and between Medical University of South Carolina and CryoLife dated November 15, 1985, as amended by Amendment to the Research and License Agreement dated February 25, 1986 by and between the parties and an Addendum to Research and License Agreement by and between the parties, dated March 4, 1986. (Incorporated by reference to Exhibit 10.23 to the Registrant's Registration Statement on Form S-1 (No. 33-56388).)
- 10.15 CryoLife, Inc. Non-Employee Directors Stock Option Plan, as amended. (Incorporated by reference to Appendix 2 to the Registrant's Definitive Proxy Statement filed with the Securities and Exchange Commission on April 17, 1998.)
- 10.16 Lease Agreement between the Company and Aml Land Development--I Limited Partnership, dated April 18, 1995. (Incorporated by reference to Exhibit 10.26 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 1995.)
- 10.16(a) First Amendment to Lease Agreement, dated April 18, 1995, between the Company and Aml Land Development--I Limited Partnership dated August 6, 1999. (Incorporated by reference to Exhibit 10.16(a) to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 1999.)
- 10.16(b) Restatement and Amendment to Funding Agreement between the Company and Aml Land Development- I Limited Partnership, dated August 6, 1999. (Incorporated by reference to Exhibit 10.16(b) to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2000.)
- 10.18 CryoLife, Inc. Employee Stock Purchase Plan (Incorporated by reference to Exhibit "A" of the Registrant's Definitive Proxy Statement filed with the Securities and Exchange Commission on April 10, 1996.)
- 10.19 Noncompetition Agreement between the Company and United Cryopreservation Foundation, Inc. dated September 11, 1996. (Incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 1996.)
- 10.20 Noncompetition Agreement between the Company and QV, Inc. dated September 11, 1996. (Incorporated by reference to Exhibit 10.3 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 1996.)
- 10.21 Revolving Term Loan Facility between the Company and NationsBank N.A., dated August 30, 1996. (Incorporated by reference to Exhibit 10.4 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 1996.)
- 10.22 Technology License Agreement between the Company and Colorado State University Research Foundation dated March 28, 1996. (Incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 1996.)
- 10.23 Noncompetition Agreement between the Company and United Transplant Foundation, Inc. dated September 11, 1996. (Incorporated by reference

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to Exhibit 10.2 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 1996.)

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- 10.24(a) First Amendment of Third Amended and Restated Loan Agreement between CryoLife, Inc., as Borrower and NationsBank, N.A. (South), as Lender, dated April 14, 1997. (Incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 1997.)
- 10.24(b) Second Modification of Third Amended and Restated Loan Agreement dated December 16, 1997 by and between the Registrant and NationsBank, N.A. (Incorporated by reference to Exhibit 4.2 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 1997.)
- 10.24(c) Fourth Modification of Third Amended and Restated Loan Agreement dated December 16, 1997 by and between the Company and Bank of America, N.A. and First Modification of Revolving Note dated December 31, 1999. (Incorporated by reference to Exhibit 10.24 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 1999)
- 10.25 Reserved.
- 10.26 CryoLife, Inc. 1998 Long-Term Incentive Plan. (Incorporated by reference to Appendix 2 to the Registrant's Definitive Proxy Statement filed with the Securities and Exchange Commission on April 17, 1998.)
- 10.27 Consulting Agreement dated March 5, 1997 between CryoLife Acquisition Corporation and J. Crayton Pruitt, Sr., M.D. (Incorporated by reference to Exhibit 10.2 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 1997.)
- 10.28 Subordinated Convertible Debenture dated March 5, 1997 between the Company and J. Crayton Pruitt, Sr., M.D. (Incorporated by reference to Exhibit 10.3 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 1997.)
- 10.29 Lease Agreement dated March 5, 1997 between the Company and J. Crayton Pruitt, Sr., M.D. (Incorporated by reference to Exhibit 10.4 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 1997.)
- 10.30 Lease Guaranty dated March 5, 1997 between J. Crayton Pruitt Family Trust U/T/A and CryoLife, Inc., as Guarantor for CryoLife Acquisition Corporation. (Incorporated by reference to Exhibit 10.5 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 1997.)
- 10.31 Form of Non-Competition Agreement dated March 5, 1997 between the Company and J. Crayton Pruitt, Sr., M.D., Thomas Benham, Thomas Alexandris, Tom Judge, Natalie Judge, Helen Wallace, J. Crayton Pruitt, Jr., M.D., and Johanna Pruitt. (Incorporated by reference to Exhibit 10.6 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 1997.)
- 10.32 Standard Form of Agreements Between Owner and Design/Builder by and between the Company and Choate Design and Build Company dated January 19, 2000. (Incorporated by reference to Exhibit 10.32 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 1999)



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- 10.33 Construction Loan and Permanent Financing Agreement with Bank of America dated April 25, 2000. (Incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2000.)
- 10.33(a) Second Amendment to Construction Loan and Permanent Financing Agreement, dated July 30, 2002 by and between the Company and Bank of America. (Incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002.)
- 10.33(b) Promissory Note by and between the Company and Bank of America, dated July 30, 2002. (Incorporated by reference to Exhibit 10.2 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002.)
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- 10.34 Sublease Agreement between Horizon and IFM, dated October 9, 2000. (Incorporated by reference to Exhibit 10.34 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2000.)
- 10.35 Terms of Agreement between Ronald C. Elkins, MD and CryoLife, Inc., dated November 7, 2000. (Incorporated by reference to Exhibit 10.35 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2000.)
- 10.36 Rights Agreement between the Company and Chemical Mellon Shareholder Services, L.L.C., as Rights Agent, dated as of November 27, 1995. (Incorporated by reference to Exhibit 10.36 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2000.)
- 10.37 International Distribution Agreement, dated September 17, 1998, between the Company and Century Medical, Inc. (Incorporated by reference to Exhibit 10.37 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2000.)
- 10.38 Assignment and Assumption Agreement, dated March 30, 2001, by and among Horizon, Vascutech and IFM. (Incorporated by reference to Exhibit 10.2 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2001.)
- 10.39 Assignment of Sublease, dated March 30, 2001, by and among Horizon, Vascutech, and IFM. (Incorporated by reference to Exhibit 10.3 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2001.)
- 10.40 Security Agreement, dated March 30, 2001, by Vascutech in favor of IFM. (Incorporated by reference to Exhibit 10.4 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2001.)
- 10.41 2002 Stock Incentive Plan (Incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2002.)
- 10.42 Settlement and Release Agreement, dated August 2, 2002, by and between Colorado State University Research Foundation, the Company and Dr. E. Christopher Orton. (Incorporated by reference to Exhibit 10.3 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002.)

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- 10.43 Letter Agreement between the Company and FDA, dated September 5, 2002. (Incorporated by reference to Exhibit 10.38 to the registrant's report on Form 8-K filed on September 6, 2002).
- 10.44\* Letter Agreement between the Company and FDA, dated November 8, 2002.
- 10.45\* Letter Agreement between the Company and FDA, dated January 8, 2003.
- 21.1\* Subsidiaries of CryoLife, Inc.
- 23.1\* Consent of Deloitte & Touche LLP.
- 23.2\* Notice regarding consent of Arthur Andersen LLP.
- 99.1\*\* Certification Pursuant To 18 U.S.C. Section 1350, As Adopted Pursuant To Section 906 Of The Sarbanes-Oxley Act Of 2002.

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\* Filed with the original Form 10-K for fiscal year ending December 31, 2002, which was filed on February 27, 2003.

\*\* Filed herewith.

+ In accordance with Item 601(b)(2) of Regulation S-K, the schedules and certain exhibits to this exhibit have been omitted and a list of the schedules and exhibits has been placed at the end of the Exhibit. The Registrant will furnish supplementally a copy of any omitted schedule or exhibit to the Commission upon request.

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### 3.B. Executive Compensation Plans and Arrangements.

1. 1993 Employee Stock Incentive Plan adopted on July 6, 1993. (Exhibit 10.2 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 1994.)
2. 1989 Incentive Stock Option Plan for the Company, adopted on March 23, 1989 (Exhibit 10.2 to the Registrant's Registration Statement on Form S-1 (No. 33-56388).)
3. Incentive Stock Option Plan, dated as of April 5, 1984 (Exhibit 10.3 to the Registrant's Registration Statement on Form S-1 (No. 33-56388).)
4. Form of Stock Option Agreement and Grant under the Incentive Stock Option and Employee Stock Incentive Plans (Exhibit 10.4 to the Registrant's Registration Statement on Form S-1 (No. 33-56388).)
5. CryoLife, Inc. Profit Sharing 401(k) Plan, as adopted on December 17, 1991 (Exhibit 10.5 to the Registrant's Registration Statement on Form S-1 (No. 33-56388).)
6. Form of Supplemental Retirement Plan, by and between the Company and its Officers-- Parties to Supplemental Retirement Plans: Steven G. Anderson, David M. Fronk, Sidney B. Ashmore, James C. Vander Wyk, Albert E. Heacox, Kirby S. Black and David Ashley Lee. (Exhibit 10.6 to the Registrant's Registration Statement on Form S-1 (No. 33-56388).)
7. Employment Agreement, by and between the Company and Steven G. Anderson. (Incorporated by reference to Exhibit 10.9(a) to the Registrant's Annual

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Report on Form 10-K for the year ended December 31, 1998.)

8. Employment Agreement, by and between the Company and David M. Fronk. (Incorporated by reference to Exhibit 10.9(g) to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1998.)
  9. Employment Agreement, by and between the Company and Albert E. Heacox. (Incorporated by reference to Exhibit 10.7(c) to the Registrant's Registration Statement on Form S-1 (No. 33-56388).)
  10. Reserved.
  11. Employment Agreement, by and between the Company and James C. Vander Wyk, Ph.D. (Incorporated by reference to Exhibit 10.9(f) to the Registrant's Annual Report on Form 10-K for the year ended December 31, 1995.)
  12. Employment Agreement, by and between the Company and D. Ashley Lee. (Incorporated by reference to Exhibit 10.9(c) to the Registrant's Annual Report on Form 10-K for the year ended December 31, 2000.)
  13. Employment Agreement, by and between the Company and Sidney B. Ashmore. (Incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2001.)
  14. CryoLife, Inc. Non-Employee Directors Stock Option Plan, as amended. (Incorporated by reference to Appendix 2 to the Registrant's Definitive Proxy Statement filed with the Securities and Exchange Commission on April 17, 1998.)
  15. CryoLife, Inc. Employee Stock Purchase Plan. (Incorporated by reference to Exhibit "A" of the Registrant's Definitive Proxy Statement filed with the Securities and Exchange Commission on April 10, 1996.)
  16. Employment Agreement by and between the Company and Kirby S. Black (Incorporated by reference to Exhibit 10.9(g) to the Registrant's Annual Report on Form 10-K/A for the fiscal year ended December 31, 1996.)
  17. CryoLife, Inc. 1998 Long-Term Incentive Plan. (Incorporated by reference to Appendix 2 to the Registrant's Definitive Proxy Statement filed with the Securities and Exchange Commission on April 17, 1998.)
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18. Terms of Agreement Between Bruce J. Van Dyne, M.D. and CryoLife, Inc., dated November 1, 1999. (Incorporated by reference to Exhibit 10.11 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 1999.)
  19. Terms of Agreement between Ronald C. Elkins, MD and CryoLife, Inc., dated November 7, 2000. (Incorporated by reference to Exhibit 10.35 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2000.)
  20. 2002 Stock Incentive Plan (Incorporated by reference to Exhibit 10.1 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended June 30, 2002.)
  21. Employment Agreement, by and between the Company and D. Ashley Lee, dated September 3, 2002. (Incorporated by reference to Exhibit 10.4 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002.)

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22. Employment Agreement, by and between the Company and Sidney B. Ashmore, dated September 3, 2002. (Incorporated by reference to Exhibit 10.5 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002.)
23. Employment Agreement, by and between the Company and Kirby S. Black, dated September 3, 2002. (Incorporated by reference to Exhibit 10.6 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002.)
24. Employment Agreement, by and between the Company and Albert E. Heacox, dated September 3, 2002. (Incorporated by reference to Exhibit 10.7 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002.)
25. Employment Agreement, by and between the Company and David M. Fronk, dated September 3, 2002. (Incorporated by reference to Exhibit 10.8 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002.)
26. Employment Agreement, by and between the Company and James C. Vander Wyk, dated September 3, 2002. (Incorporated by reference to Exhibit 10.9 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002.)
27. Employment Agreement, by and between the Company and Steven G. Anderson, dated September 3, 2002. (Incorporated by reference to Exhibit 10.10 to the Registrant's Quarterly Report on Form 10-Q for the quarter ended September 30, 2002.)

(b) Reports on Form 8-K

1. NONE.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this amendment to the registrant's report on Form 10-K to be signed on its behalf by the undersigned, thereunto duly authorized.

CRYOLIFE, INC.

April 30, 2003

By /s/ Steven G. Anderson

-----  
Steven G. Anderson,  
President, Chief Executive  
Officer and Chairman of  
the Board of Directors

CERTIFICATIONS

I, Steven G. Anderson, Chairman, President, and Chief Executive Officer, certify that:

1. I have reviewed this annual report on Form 10-K of CryoLife, Inc.;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report.
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and
  - c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: April 30, 2003

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/s/ Steven G. Anderson

-----  
Steven G. Anderson  
Chairman, President, and Chief  
Executive Officer

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I, David Ashley Lee, Vice President, Treasurer, and Chief Financial Officer, certify that:

1. I have reviewed this annual report on Form 10-K of CryoLife, Inc.;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report.
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
  - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
  - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the "Evaluation Date"); and
  - c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
  - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
  - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this annual report whether there were significant changes in internal controls or in other factors that could significantly affect internal controls

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subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: April 30, 2003

/s/ David Ashley Lee

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David Ashley Lee  
Vice President, Treasurer, and Chief  
Financial Officer

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors  
CryoLife, Inc.

We have audited, the accompanying consolidated balance sheet of CRYOLIFE, INC. (a Florida corporation) AND SUBSIDIARIES ("the Company") as of December 31, 2002 and the related consolidated statement of operations, shareholders' equity, and cash flows for the year ended December 31, 2002. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the Company as of December 31, 2001 and for each of the two years then ended were audited by other auditors who have ceased operations. Those auditors expressed an unqualified opinion on those financial statements in their report dated March 27, 2002.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Company as of December 31, 2002 and the results of their operations and their cash flows for the year ended December 31, 2002 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the consolidated financial statements, the Company changed its method of accounting for goodwill and other intangible assets to conform to Statement of Financial Accounting Standards No. 142 "Goodwill and Other Intangible Assets", which was adopted by the Company as of January 1, 2002.

/s/ Deloitte & Touche LLP  
Atlanta, Georgia  
February 24, 2003

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The following report of Arthur Andersen LLP ("Andersen") is a copy of the report previously issued by Andersen on March 27, 2002. The report of Andersen is included in this annual report on Form 10-K pursuant to rule 2-02(e) of regulation S-X. The Company has not been able to obtain a reissued report from Andersen. Andersen has not consented to the inclusion of its report in this annual report on Form 10-K. Because Andersen has not consented to the inclusion of its report in this annual report, it may be difficult to seek remedies against Andersen, and the ability to seek relief against Andersen may be impaired.

### REPORT OF INDEPENDENT PUBLIC ACCOUNTANTS

To CryoLife, Inc.

We have audited, the accompanying consolidated balance sheets of CYROLIFE, INC. (a Florida corporation) AND SUBSIDIARIES as of December 31, 2001 and 2000 and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of CryoLife, Inc. and subsidiaries as of December 31, 2001 and 2000 and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2001 in conformity with accounting principles generally accepted in the United States.

/s/ Arthur Andersen LLP  
Atlanta, Georgia  
March 27, 2002

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CryoLife, Inc.  
Consolidated Balance Sheets  
(in thousands, except per share data)

ASSETS



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December 31,

2002

Current assets:

Cash and cash equivalents	\$	10,277	\$
Marketable securities, at market		14,583	
Receivables:			
Trade accounts, less allowance for doubtful accounts of \$75 in 2002 and \$100 in 2001		6,930	
Note receivable, less allowance of \$250 in 2001		--	
Income taxes		11,312	
Other		512	
Total receivables		18,754	
Deferred preservation costs, net		4,332	
Inventories		4,585	
Prepaid expenses		2,413	
Deferred income taxes		6,734	
Total current assets		61,678	

Property and equipment:

Land	1,009
Equipment	22,403
Furniture and fixtures	5,275
Leasehold improvements	32,971
Construction in progress	189
	61,847
Less accumulated depreciation and amortization	23,717
Net property and equipment	38,130

Other assets:

Goodwill, less accumulated amortization of \$501 in 2001	--
Patents, less accumulated amortization of \$1,014 in 2002 and \$1,102 in 2001	5,324
Other, less accumulated amortization of \$397 in 2002 and \$135 in 2001	1,282
Total assets	\$ 106,414 \$

See accompanying notes to consolidated financial statements.

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LIABILITIES AND SHAREHOLDERS' EQUITY  
December 31,

2002

Current liabilities:

Accounts payable	\$	3,874	\$
Accrued expenses and other current liabilities		6,823	
Accrued compensation		1,627	
Accrued procurement fees		3,769	
Current maturities of capital lease obligation		2,169	
Current maturities of long-term debt		5,600	
Convertible debenture		--	
Total current liabilities		23,862	

Capital lease obligations, less current maturities	971
Bank line of credit, less current maturities	--
Deferred income taxes	986
Other long-term liabilities	795
Total liabilities	26,614

Shareholders' equity:

Preferred stock \$.01 par value per share; authorized 5,000 shares including 2,000 shares of series A junior participating preferred stock; no shares issued	--
Common stock \$.01 par value per share; authorized 75,000 shares; issued 20,935 in 2002 and 20,172 shares in 2001	209
Additional paid-in capital	73,630
Retained earnings	12,786
Deferred compensation	(21)
Accumulated other comprehensive income, net of tax	282
Treasury stock; 1,361 shares in 2002 and 1,286 shares in 2001, at cost	(7,086)
Total shareholders' equity	79,800

Total liabilities and shareholders' equity	\$	106,414	\$
--	----	---------	----

See accompanying notes to consolidated financial statements.

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CryoLife, Inc.  
Consolidated Statements of Operations  
(in thousands, except per share data)

Year Ended December 31,	2002	2001	2000
<b>Revenues:</b>			
Human tissue preservation services	\$ 55,373	\$ 75,552	\$ 75,552
Products	21,597	11,130	11,130
Research grants and distribution revenue	825	989	989
<b>Total revenues</b>	<b>77,795</b>	<b>87,671</b>	<b>87,671</b>
<b>Costs and expenses:</b>			
Human tissue preservation services (including write-down of \$32,715 in 2002)	55,363	31,165	31,165
Products	10,270	5,464	5,464
General, administrative, and marketing	47,530	33,844	33,844
Research and development	4,597	4,737	4,737
Nonrecurring charges	1,399	--	--
Interest expense	692	96	96
Interest income	(895)	(1,967)	(1,967)
Other expense (income), net	273	852	852
<b>Total costs and expenses</b>	<b>119,229</b>	<b>74,191</b>	<b>74,191</b>
<b>(Loss) income before income taxes</b>	<b>(41,434)</b>	<b>13,480</b>	<b>13,480</b>
<b>Income tax (benefit) expense</b>	<b>(13,673)</b>	<b>4,314</b>	<b>4,314</b>
<b>Net (loss) income</b>	<b>\$ (27,761)</b>	<b>\$ 9,166</b>	<b>\$ 9,166</b>
<b>(Loss) earnings per share:</b>			
Basic	\$ (1.43)	\$ 0.49	\$ 0.49
Diluted	\$ (1.43)	\$ 0.47	\$ 0.47
<b>Weighted average shares outstanding:</b>			
Basic	19,432	18,808	18,808
Diluted	19,432	19,660	19,660

See accompanying notes to consolidated financial statements.

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### Consolidated Statements of Cash Flows (in thousands)

Year Ended December 31,	2002	2001	2000
<b>Net cash flows from operating activities:</b>			
Net (loss) income	\$ (27,761)	\$ 9,166	\$
Adjustments to reconcile net (loss) income to net cash flows (used by) provided by operating activities:			
Loss (gain) on sale of marketable equity securities	240	(9)	
Depreciation of property and equipment	5,222	4,203	
Amortization	201	404	
Provision for doubtful accounts	50	304	
Write-down of deferred preservation costs and inventories	35,816	--	
Other non-cash adjustments to income	1,419	348	
Deferred income taxes	(5,568)	624	
Tax effect of non-qualified option exercises	481	421	
Changes in operating assets and liabilities:			
Trade and other receivables	7,076	(2,707)	
Income taxes	(9,755)	(983)	
Deferred preservation costs	(12,848)	(3,888)	
Inventories	(1,427)	(2,265)	
Prepaid expenses and other assets	(59)	(1,121)	
Accounts payable	3,313	(1,814)	
Accrued expenses and other liabilities	1,489	3,796	
<b>Net cash flows (used by) provided by operating activities</b>	<b>(2,111)</b>	<b>6,479</b>	
<b>Net cash flows from investing activities:</b>			
Capital expenditures	(4,100)	(14,329)	
Other assets	(2,598)	(689)	
Purchases of marketable securities	(9,970)	(29,336)	
Sales and maturities of marketable securities	21,780	24,235	
Proceeds from notes receivable	1,169	2,020	
<b>Net cash flows provided by (used in) investing activities</b>	<b>6,281</b>	<b>(18,099)</b>	
<b>Net cash flows from financing activities:</b>			
Principal payments of debt	(1,600)	(1,050)	
Proceeds from debt issuance	--	1,165	
Principal payments on obligations under capital leases	(609)	(291)	
Proceeds from exercise of options and issuance of stock	1,472	1,502	
Purchase of treasury stock	(663)	--	
<b>Net cash flows (used in) provided by financing activities</b>	<b>(1,400)</b>	<b>1,326</b>	
Increase (decrease) in cash	2,770	(10,294)	
Effect of exchange rate changes on cash	303	18	
Cash and cash equivalents, beginning of year	7,204	17,480	
<b>Cash and cash equivalents, end of year</b>	<b>\$ 10,277</b>	<b>\$ 7,204</b>	<b>\$</b>
<b>Supplemental disclosures of cash flow information - cash paid during the year for:</b>			
Interest	\$ 636	\$ 896	\$
Income taxes	2,874	4,996	

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Non-cash investing and financing activities:

Conversion of convertible debenture	\$	4,393	\$	--	\$
Establishment of capital lease obligation	\$	--	\$	2,506	\$
Purchase of property and equipment in accounts payable and accrued expenses	\$	6	\$	203	\$

See accompanying notes to consolidated financial statements.

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CryoLife, Inc.  
Consolidated Statements of Shareholders' Equity  
(in thousands)

	Common Shares Outstanding Shares	Amount	Additional Paid-In Capital	Retained Earnings	Deferred Compensation	Accumulated Other Comprehensive Income (Loss)
Balance at December 31, 1999	20,041	\$200	\$64,359	\$23,564	\$ (57)	\$ (785)
Net income	--	--	--	7,817	--	--
Other comprehensive loss, net of taxes	--	--	--	--	--	(303)
Comprehensive income						
Exercise of options	36	1	338	--	--	--
Employee stock purchase plan	--	--	239	--	--	--
Amortization of deferred compensation	--	--	--	--	12	--
Purchase of treasury stock	--	--	--	--	--	--
Balance at December 31, 2000	20,077	201	64,936	31,381	(45)	(1,088)
Net income	--	--	--	9,166	--	--
Other comprehensive income, net of taxes	--	--	--	--	--	943
Comprehensive income						
Exercise of options	87	1	1,268	--	--	--
Employee stock purchase plan	8	--	624	--	--	--
Amortization of deferred compensation	--	--	--	--	12	--
Balance at December 31, 2001	20,172	202	66,828	40,547	(33)	(145)
Net loss	--	--	--	(27,761)	--	--
Other comprehensive income, net of taxes	--	--	--	--	--	427
Comprehensive loss						
Exercise of options	119	1	1,578	--	--	--
Employee stock purchase plan	98	1	836	--	--	--

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Conversion of convertible debenture	546	5	4,388	--	--	--
Amortization of deferred compensation	--	--	--	--	12	--
Purchase of treasury stock	--	--	--	--	--	--
-----						
Balance at December 31, 2002	20,935	\$209	\$73,630	\$12,786	\$(21)	\$282
=====						

See accompanying notes to consolidated financial statements.

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CRYOLIFE, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

NATURE OF BUSINESS

Founded in 1984, CryoLife, Inc. (the "Company") is a leader in the development and commercialization of implantable living human tissues for use in cardiovascular and vascular surgeries throughout the U.S. and Canada. Historically, the Company has been a leader in the development and commercialization of implantable living human tissues for use in orthopaedic surgeries throughout the U.S. and Canada. The Company suspended processing of orthopaedic tissue from August 2002 until late February 2003 as a result of a recall order from the FDA. (See Note 2 for further discussion). The Company's human tissue cryopreservation services are marketed in North America, Europe, South America, and Asia. The Company's BioGlue(R) Surgical Adhesive is FDA approved in the U.S. as an adjunct to sutures and staples for use in adult patients in open surgical repair of large vessels, is CE marked in the European Community and is approved in Canada, Australia and certain countries within the Middle East, South America, Asia, and South Africa for use in cardiovascular, vascular, pulmonary, and soft tissue repair. The Company's bioprosthetic implantable devices include stentless porcine heart valves marketed in Europe, South America, the Middle East, Canada, and South Africa, and SynerGraft(R) processed bovine vascular grafts, which are CE marked in the European Community. Until October 9, 2000 the Company served as an original equipment manufacturer for single-use medical devices for use in vascular surgical procedures.

In February 2001 the Company formed a wholly owned subsidiary, AuraZyme Pharmaceuticals, Inc., to foster the commercial development of the Company's light-activated drug delivery systems that have potential application in cancer treatment and fibrinolysis (blood clot dissolving) and other drug delivery applications.

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany balances are eliminated.

USE OF ESTIMATES

The preparation of the accompanying consolidated financial statements in conformity with accounting principles generally accepted in the U.S. requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

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Estimates and assumptions are used when accounting for depreciation, allowance for doubtful accounts, write-downs of deferred preservation costs, valuation of long-lived tangible and intangible assets, commitments and contingencies, disclosure of the fair value of stock based compensation, and the related pro-forma expense and income taxes.

### REVENUE RECOGNITION

The Company recognizes revenue in accordance with SEC Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" ("SAB 101"), which provides guidance on applying generally accepted accounting principles to revenue recognition issues. Revenues for human tissue preservation services are recognized when services are completed and tissue is delivered to the customer. The Company has recorded the estimated amount of credits issued and to be issued for tissues recalled pursuant to the FDA Order as a service revenue return. Revenues for products are recognized at the time the product is shipped, at which time title passes to the customer. There are no further performance obligations and delivery occurs upon shipment. Revenues from research grants are recognized in the period the associated costs are incurred. The Company assesses the likelihood of collection based on a number of factors, including past transaction history with the customer and the credit-worthiness of the customer.

### SHIPPING AND HANDLING CHARGES

Fees charged to customers for shipping and handling of preserved tissues and products are included in human tissue preservation service revenues and product

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revenues, respectively. The costs for shipping and handling of preserved human tissues and products are included as a component of cost of human tissue preservation services and cost of products, respectively.

### CASH AND CASH EQUIVALENTS

Cash equivalents consist primarily of highly liquid investments with insignificant interest rate risk and maturity dates of 90 days or less at the time of acquisition. The carrying value of cash equivalents approximates fair value.

### MARKETABLE SECURITIES

The Company maintains cash equivalents and investments in several large, well-capitalized financial institutions, and the Company's policy disallows investment in any securities rated less than "investment-grade" by national rating services.

Management determines the appropriate classification of debt securities at the time of purchase and reevaluates such designations as of each balance sheet date. Debt securities are classified as held-to-maturity when the Company has the positive intent and ability to hold the securities to maturity. Held-to-maturity securities are stated at amortized cost. Debt securities not classified as held-to-maturity or trading and marketable equity securities not classified as trading are classified as available-for-sale. At December 31, 2002 and 2001 all marketable equity securities and debt securities were designated as available-for-sale.

Available-for-sale securities are stated at their fair values, with the unrealized gains and losses, net of tax, reported in a separate component of shareholders' equity. Interest income, dividends, realized gains and losses, and declines in value judged to be other than temporary are included in investment income. The cost of securities sold is based on the specific identification method.

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### DEFERRED PRESERVATION COSTS

Tissue is procured from deceased human donors by organ and tissue procurement agencies, which consign the tissue to the Company for processing and preservation. Preservation costs related to tissue held by the Company are deferred until revenue is recognized upon shipment of the tissue to the implanting hospital. Deferred preservation costs consist primarily of laboratory expenses, tissue procurement fees, fringe and facility allocations, and freight-in charges, and are stated, net of reserve, on a first-in, first-out basis.

As of December 31, 2002 the deferred preservation costs were \$2.0 million for allograft heart valve tissues, \$620,000 for non-valved cardiac tissues, \$1.7 million for vascular tissues, and zero for orthopaedic tissues. For the year ended December 31, 2002, the Company recorded a write-down of deferred preservation costs of \$8.7 million for valved cardiac tissues, \$2.9 million for non-valved cardiac tissues, \$11.9 million for vascular tissues, and \$9.2 million for orthopaedic tissue totaling \$32.7 million. These write-downs were recorded as a result of the matters discussed in Note 2, FDA Order on Human Tissue Preservation. The amount of these write-downs reflects management's estimate based on information currently available to it. These estimates may prove inaccurate, as the scope and impact of the FDA Order are determined. Management will continue to evaluate the recoverability of these deferred preservation costs based on the factors discussed in Note 2 and record additional write-downs if it becomes clear that additional impairments have occurred. The write-down creates a new cost basis which cannot be written back up if these tissues become saleable. The cost of human tissue preservation services may be favorably impacted depending on the future level of tissue shipments related to previously written-down deferred preservation costs. The shipment levels of these written-down tissues will be affected by the amount and timing of the release of tissues processed after September 5, 2002, as a result of the Agreement with the FDA, since written-down tissues may be shipped if tissues processed after the Agreement are not available for shipment.

### INVENTORIES

Inventories are comprised of implantable surgical adhesives and bioprosthetic products and are valued at the lower of cost (first-in, first-out) or market.

### PROPERTY AND EQUIPMENT

Property and equipment are stated at cost. Depreciation is provided over the estimated useful lives of the assets, generally five to ten years, on a straight-line basis. Leasehold improvements are amortized on a straight-line basis over the lease term or the estimated useful lives of the assets, whichever is shorter. Interest is capitalized in connection with the expansion of the corporate headquarters and manufacturing facility.

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### INTANGIBLE ASSETS

Beginning with the Company's adoption of Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142") on January 1, 2002 the goodwill resulting from business acquisitions is not amortized, but is instead subject to periodic impairment testing in accordance with SFAS 142. Patent costs are amortized over the expected useful lives of the patents (primarily 17 years) using the straight-line method. Other intangibles, which consist primarily of manufacturing rights and agreements, are amortized over the expected useful lives of the related assets (primarily five years). As a result of the FDA Order, the Company determined that an evaluation of the possible impairment of intangible assets under SFAS 142 was necessary. The Company engaged an independent valuation expert to perform the valuation using a



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discounted cash flow methodology, and as a result of this analysis, the Company determined that goodwill related to its tissue processing reporting unit was fully impaired as of September 30, 2002. Therefore, the Company recorded a write-down of \$1.4 million in goodwill during the quarter ended September 30, 2002. Management does not believe an impairment exists related to the other intangible assets that were assessed in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144").

Scheduled amortization of intangible assets for the next five years is as follows (in thousands):

2003	\$	180
2004		150
2005		150
2006		136
2007		109
		-----
	\$	725
		=====

### LONG-LIVED ASSETS

SFAS 144 requires the write-down of a long-lived asset to be held and used if the carrying value of the asset or the asset group to which the asset belongs is not recoverable. The carrying value of the asset or asset group is not recoverable if it exceeds the sum of the undiscounted future cash flows expected to result from the use and eventual disposition of the asset or asset group. As of September 30, 2002, in applying SFAS 144, the Company determined that the asset groups consisted of the long-lived assets related to the Company's two reporting segments, as these asset groups represent the lowest level at which identifiable cash flows are largely independent of the cash flows of other assets and liabilities. The Company used a fourteen-year period for the undiscounted future cash flows. This period of time was selected based upon the remaining life of the primary assets of the asset groups, which are leasehold improvements. The undiscounted future cash flows related to these asset groups exceeded their carrying values as of September 30, 2002 and December 31, 2002 and therefore management has concluded that there is not an impairment of the Company's long-lived intangible, except for goodwill discussed above, and tangible assets related to the tissue preservation business or medical device business. However, depending on the Company's ability to rebuild demand for its tissue preservation services, the outcome of discussions with the FDA regarding the shipping of orthopaedic tissues, and the future effects of adverse publicity surrounding the FDA Order and reported infections on preservation revenues, these assets may become impaired. Management will continue to evaluate the recoverability of these assets in accordance with SFAS 144.

### ACCRUED PROCUREMENT FEES

Tissue is procured from deceased human donors by organ procurement agencies and tissue banks ("Agencies"), which consign the tissue to the Company for processing and preservation. The Company reimburses the Agencies for their costs to recover the tissue and passes on these costs to the customer when the tissue is shipped and the service is complete. The Company accrues the procurement fees due to the Agencies at the time the tissue is received based on contractual agreements between the Company and the Agencies.

### PRODUCT LIABILITY CLAIMS

In the normal course of business as a medical device and services company the Company has product liability complaints filed against it. The Company maintains claims-made insurance policies to mitigate its financial exposure to product liability claims. Claims-made insurance policies cover only those asserted claims and incidents that are reported to the insurance carrier while the policy is in effect. Thus, a claims-made policy does not represent a transfer of risk for claims and incidents that have been incurred but not reported to the

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insurance carrier. The Company periodically evaluates its exposure to unreported product liability claims, and records accruals as necessary for the estimated

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cost of unreported claims related to services performed and products sold. As of December 31, 2002 the Company accrued \$3.6 million in estimated costs for unreported product liability claims related to services performed and products sold prior to December 31, 2002. The Company engaged an independent actuarial firm to perform an analysis of the unreported product claims as of December 31, 2002. The unreported product loss liability was estimated using a frequency-severity approach; whereas, projected losses were calculated by multiplying the estimated number of claims by the estimated average cost per claim. The estimated claims were calculated based on the reported claim development method and the Bornhuetter-Ferguson method using a blend of the Company's historical claim emergence and industry data. The estimated cost per claim was calculated using a lognormal claims model blending the Company's historical average cost per claim with industry claims data. The expense was recorded in general, administrative, and marketing expenses and was included as a component of accrued expenses and other current liabilities on the Consolidated Balance Sheet.

### INCOME TAXES

Deferred income tax assets and liabilities are recognized for the future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted income tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. A valuation allowance is established when it is more likely than not that the full value of a deferred tax asset will not be recovered.

### EARNINGS PER SHARE

Earnings per share is computed on the basis of the weighted average number of common shares outstanding plus the effect of outstanding stock options, computed using the treasury stock method.

### STOCK-BASED COMPENSATION

On December 31, 2002 the Company was required to adopt SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure" ("SFAS 148"). SFAS 148 amends SFAS No. 123, "Accounting for Stock-Based Compensation" to provide alternative methods of transition for companies that voluntarily elect to adopt the fair value recognition and measurement methodology prescribed by SFAS 123. In addition, regardless of the method a company elects to account for stock-based compensation arrangements, SFAS 148 requires additional disclosures in the Summary of Significant Accounting Policies footnote of both interim and annual financial statements regarding the method the company uses to account for stock-based compensation and the effect of such method on the Company's reported results. The Company has determined that the adoption of SFAS 148 will not have a material effect on the financial position, results of operations, and cash flows of the Company.

The Company has elected to follow Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations ("APB 25") in accounting for its employee stock options because, as discussed below, the alternative fair value accounting provided for under SFAS 123 requires use of option valuation models that were not developed for use in valuing employee stock options. Under APB 25, because the exercise price of the Company's employee stock options equals the market price of the underlying stock on the date of the grant, no compensation expense is recognized.

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Pro forma information regarding net income and earnings per share is required by SFAS 123, which requires that the information be determined as if the Company has accounted for its employee stock options granted under the fair value method of that statement. The fair values for these options were estimated at the dates of grant using a Black-Scholes option pricing model with the following weighted-average assumptions:

	2002	2001	2000
Expected dividend yield	0%	0%	0%
Expected stock price volatility	.630	.600	.540
Risk-free interest rate	3.67%	4.73%	6.39%
Expected life of options	5.3 Years	4.2 Years	4.3 Years

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected stock price volatility. Because

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the Company's employee stock options have characteristics significantly different from those of traded options and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

For purposes of pro forma disclosures, the estimated fair values of the options are amortized to expense over the options' vesting periods. The Company's pro forma information follows (in thousands, except per share data):

	2002	2001	2000
Net (loss) income--as reported	\$ (27,761)	\$ 9,166	\$ 7,817
Deduct: Total stock-based employee compensation expense determined under the fair value based method for all awards, net of tax	1,287	2,232	1,183
Net (loss) income--pro forma	\$ (29,048)	\$ 6,934	\$ 6,634
 (Loss) earnings per share--as reported:			
Basic	\$ (1.43)	\$ 0.49	\$ 0.42
Diluted	\$ (1.43)	\$ 0.47	\$ 0.41
 (Loss) earnings per share--pro forma:			
Basic	\$ (1.49)	\$ 0.37	\$ 0.36
Diluted	\$ (1.49)	\$ 0.35	\$ 0.35

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### STOCK SPLIT

On November 27, 2000 the Board of Directors declared a three-for-two stock split, effected in the form of a stock dividend, payable on December 27, 2000, to shareholders of record on December 8, 2000. All share and per share information in the accompanying consolidated financial statements has been adjusted to reflect this split.

### COMPREHENSIVE INCOME

SFAS No. 130, "Reporting Comprehensive Income" ("SFAS 130"), established standards for the reporting and display of comprehensive income and its components in a full set of comparative general-purpose financial statements. The statement became effective for the Company in 1998. Comprehensive income is defined in SFAS 130 as net income plus other comprehensive income, which, under existing accounting standards, includes foreign currency items, minimum pension liability adjustments and unrealized gains and losses on certain investments in debt and equity securities.

### TRANSLATION OF FOREIGN CURRENCIES

Assets and liabilities are translated at the exchange rate as of the balance sheet date. All revenue and expense accounts are translated at a weighted-average of exchange rates in effect during the year. Translation adjustments are recorded as a separate component of other comprehensive income in shareholders' equity.

### NEW ACCOUNTING PRONOUNCEMENTS

The Company will be required to adopt SFAS No. 143, "Accounting for Asset Retirement Obligations" ("SFAS 143") on January 1, 2003. SFAS 143 addresses accounting and reporting for retirement costs of long-lived assets resulting from legal obligations associated with acquisition, construction, or development transactions. The Company has determined that the adoption of SFAS 143 will not have a material effect on the results of operations or financial position of the Company, as the Company does not currently have any relevant transactions.

The Company will be required to adopt SFAS No. 145, "Rescission of FASB Statements 4, 44 and 64, Amendment to FASB Statement 13, and Technical Corrections" ("SFAS 145"), on January 1, 2003. SFAS 145 rescinds SFAS No. 4, 44 and 64, which required gains and losses from extinguishments of debt to be classified as extraordinary items. SFAS 145 also amends SFAS No. 13 eliminating inconsistencies in certain sale-leaseback transactions. The provisions of SFAS 145 are effective for fiscal years beginning after May 15, 2002. The Company has determined that the adoption of SFAS 145 will not have a material effect on the results of operations or financial position of the Company, as the Company does not currently have any relevant transactions.

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The Company will be required to adopt SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" ("SFAS 146") on January 1, 2003. SFAS 146 requires that costs associated with exit or disposal activities be recorded at their fair values when a liability has been incurred. Under previous guidance, certain exit costs were accrued upon management's commitment to an exit plan, which is generally before an actual liability has been incurred. The Company will adopt SFAS 146 for restructuring plans entered into after December 31, 2002.

## 2. FDA ORDER ON HUMAN TISSUE PRESERVATION

On August 13, 2002 the Company received an order from the Atlanta district

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office of the FDA regarding the non-valved cardiac, vascular, and orthopaedic tissue processed by the Company since October 3, 2001 (the "FDA Order"). The FDA Order followed an April 2002 FDA Form 483 Notice of Observations ("FDA 483") and an FDA Warning Letter dated June 17, 2002 (the "Warning Letter"). Subsequently, the Company responded to the Warning Letter. Revenue from human tissue preservation services accounted for 78% of the Company's revenues for the six months ended June 30, 2002, and of those revenues 67% or \$26.9 million was derived from preservation of tissues subject to the FDA Order. The FDA Order contains the following principal provisions:

- o The FDA alleges that, based on its inspection of the Company's facility on March 25 through April 12, 2002, certain human tissue processed and distributed by the Company may be in violation of 21 Code of Federal Regulations ("CFR") Part 1270. (Part 1270 requires persons or entities engaged in the recovery, screening, testing, processing, storage, or distribution of human tissue to perform certain medical screening and testing on human tissue intended for transplantation. The rule also imposes requirements regarding procedures for the prevention of contamination or cross-contamination of tissues during processing and the maintenance of certain records related to these activities.)
- o The FDA alleges that the Company has not validated procedures for the prevention of infectious disease contamination or cross-contamination of tissue during processing at least since October 3, 2001.
- o Non-valved cardiac, vascular, and orthopaedic tissue processed by the Company from October 3, 2001 to September 5, 2002 must be retained until it is recalled, destroyed, the safety is confirmed, or an agreement is reached with the FDA for its proper disposition under the supervision of an authorized official of the FDA.
- o The FDA strongly recommends that the Company perform a retrospective review of all tissue in inventory (i.e. currently in storage at the Company) that is not referenced in the FDA Order to assure that it was recovered, processed, stored, and distributed in conformance with 21 CFR 1270.
- o The Center for Devices and Radiological Health ("CDRH"), a division of the FDA, is evaluating whether there are similar risks that may be posed by the Company's allograft heart valves, and will take further regulatory action if appropriate.

Pursuant to the FDA Order, the Company placed non-valved cardiac, vascular, and orthopaedic tissue subject to the FDA Order on quality assurance quarantine and recalled the non-valved cardiac, vascular, and orthopaedic tissues subject to the FDA Order (i.e. processed since October 3, 2001) that had been distributed but not implanted. In addition, the Company ceased processing non-valved cardiac, vascular, and orthopaedic tissues. The Company appealed the FDA Order on August 14, 2002 and requested a hearing with the FDA, which was originally set for December 12, 2002. Due to the Agreement discussed below, the Company withdrew its request for a hearing with the FDA. After the FDA issued its order regarding the recall, Health Canada also issued a recall on the same types of tissue and other countries have inquired about the circumstances surrounding the FDA Order.

After receiving the FDA Order, the Company met with representatives of the FDA's CDRH division regarding CDRH's review of the Company's processed allograft heart valves, which are not subject to the FDA Order. On August 21, 2002 the FDA publicly stated that allograft heart valves have not been included in the FDA Order as these devices are essential for the correction of congenital cardiac lesions in neonate and pediatric patients and no satisfactory alternative device

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exists. However, the FDA also publicly stated that it then still had serious concerns regarding the Company's processing and handling of allograft heart valves. The FDA also recommended that surgeons carefully consider using

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processed allografts from alternative sources, that surgeons inform prospective patients of the FDA's concerns regarding the Company's allograft heart valves, and that patients be carefully monitored for both fungal and bacterial infections.

On September 5, 2002 the Company reached an agreement with the FDA (the "Agreement") that supplements the FDA Order and allows the tissues subject to recall (processed between October 3, 2001 and September 5, 2002) to be released for distribution after the Company completes steps to assure that the tissue is used for approved purposes and that patients are notified of risks associated with tissue use. Specifically, the Company must obtain physician prescriptions, and tissue packaging must contain specified warning labels. The Agreement calls for the Company to undertake to identify third-party records of donor tissue testing, and to destroy tissue from donors in whom microorganisms associated with an infection are found. The Agreement allowing distribution of tissues subject to the recall had a 45-business day term and was renewed on November 8, 2002 and on January 8, 2003. This most recent renewal expires on March 20, 2003. The Company is unable to predict whether or not the FDA will grant further renewals of the Agreement. In addition, pursuant to the Agreement, the Company agreed to perform additional procedures in the processing of non-valved cardiac and vascular tissues and subsequently resumed processing these tissues. The Agreement contained the requirement that tissues subject to the FDA Order be replaced with tissues processed under validated methods. The Company also agreed to establish a corrective action plan within 30 days from September 5, 2002 with steps to validate processing procedures. The corrective action plan was submitted on October 5, 2002.

As a result of the adverse publicity surrounding the FDA Warning Letter and FDA Order and related tissue infections, the Company's procurement of cardiac tissues, from which heart valves and non-valved cardiac tissues are processed, decreased 25% in the fourth quarter of 2002 as compared to the fourth quarter of 2001. Although the Company expects to be able to maintain the current level of cardiac tissue procurement, there is no guarantee that sufficient tissue will be available. The Company has continued to process and distribute heart valves since the receipt of the FDA Order, as these tissues are not subject to the FDA Order.

On September 17, 2002 the Company resumed the procurement and processing of vascular tissues. The Company limited its vascular procurement until it addressed the observations detailed in the FDA 483 and had fully evaluated the demand for the vascular tissues. The Company's procurement of vascular tissue decreased 65% in the fourth quarter of 2002 as compared to the fourth quarter of 2001. The Company expects that vascular procurement will increase significantly following the close out of the FDA 483.

On December 31, 2002 the FDA clarified the Agreement noting that non-valved cardiac and vascular tissues processed since September 5, 2002 are not subject to the FDA Order. Specifically, for non-valved cardiac and vascular tissue processed since September 5, 2002, the Company is not required to obtain physician prescriptions, label the tissue as subject to a recall, or require special steps regarding procurement agency records of donor screening and testing beyond those required for all processors of human tissue. A renewal of the Agreement that expires on March 20, 2003 is therefore not needed in order for the Company to continue to distribute non-valved cardiovascular and vascular

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tissues processed since September 5, 2002.

On February 14, 2003 the FDA confirmed that the Company has completed the corrective actions necessary to close out the April 2002 FDA 483 that preceded the Warning Letter and FDA Order. The close out of the 483 followed a two-week inspection of the Company's processing operations. As a result of the close out of the 483, the Company believes it can resume processing and distributing orthopaedic tissues but has not received confirmation of this from the FDA. The Company resumed processing orthopaedic tissues in late February 2003. Prior to shipment of orthopaedic tissues, the Company will confirm with the FDA that they do not disagree with the Company regarding its interpretation of the close out of the FDA 483. The Company will continue to process vascular tissues on a limited basis until it can fully evaluate the demand level for its vascular tissue preservation services.

A new FDA 483 was issued in connection with the inspection, but corrective action was implemented on most of its observations during the inspection. The Company believes the observations, most of which focus on the Company's systems for handling complaints, will not materially affect the Company's operations.

As a result of the FDA Order, the Company recorded a reduction to pretax income of \$12.6 million in the quarter ended June 30, 2002. The reduction was comprised of a net \$8.9 million increase to cost of human tissue preservation services, a \$2.4 million reduction to revenues (and accounts receivable) for the estimated return of the tissues subject to recall by the FDA Order, and a \$1.3 million

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accrual recorded in general, administrative, and marketing expenses for retention levels under the Company's product liability and directors' and officers' insurance policies of \$1.2 million (see Note 9), and for estimated expenses of \$75,000 for packaging and handling for the return of affected tissues under the FDA Order. The net increase of \$8.9 million to cost of preservation services was comprised of a \$10.0 million write-down of deferred preservation costs for tissues subject to the FDA Order, offset by a \$1.1 million decrease in cost of preservation services due to the estimated tissue returns resulting from the FDA Order (the costs of such recalled tissue are included in the \$10.0 million write-down). The Company evaluated many factors in determining the magnitude of impairment to deferred preservation costs as of June 30, 2002, including the impact of the FDA Order, the possibility of continuing action by the FDA or other U.S. and foreign government agencies, and the possibility of unfavorable actions by physicians, customers, procurement organizations, and others. As a result of this evaluation, management believed that since all non-valved cardiac, vascular, and orthopaedic allograft tissues processed since October 3, 2001 were under recall pursuant to the FDA Order, and since the Company did not know if it would obtain a favorable resolution of its appeal and request for modification of the FDA Order, the deferred preservation costs for tissues subject to the FDA Order had been significantly impaired. The Company estimated that this impairment approximated the full balance of the deferred preservation costs of the tissues subject to the FDA Order, which included the tissues stored by the Company and the tissues to be returned to the Company, and therefore recorded a write-down of \$10.0 million for these assets.

In the quarter ended September 30, 2002 the Company recorded a reduction to pretax income of \$24.6 million as a result of the FDA Order. The reduction was comprised of a net \$22.2 million increase to cost of human tissue preservation services, a \$1.4 million write-down of goodwill, and a \$1.0 million reduction to revenues (and accounts receivable) for the estimated return of the tissues shipped during the third quarter subject to recall by the FDA Order. The net \$22.2 million increase to cost of preservation services was comprised of a \$22.7

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million write-down of deferred preservation costs, offset by a \$0.5 million decrease in cost of preservation services due to the estimated and actual tissue returns resulting from the FDA Order (the costs of such recalled tissue are included in the \$22.7 million write-down).

The Company evaluated multiple factors in determining the magnitude of impairment to deferred preservation costs at September 30, 2002, including the impact of the FDA Order, the possibility of continuing action by the FDA or other U.S. and foreign government agencies, the possibility of unfavorable actions by physicians, customers, procurement organizations, and others, the progress made to date on the corrective action plan, and the requirement in the Agreement that tissues subject to the FDA Order be replaced with tissues processed under validated methods. As a result of this evaluation, management believed that all tissues subject to the FDA Order, as well as the majority of tissues processed prior to October 3, 2001, including heart valves, which were not subject to the FDA Order, were fully impaired. Management believed that most of the Company's customers would only order tissues processed after the September 5, 2002 Agreement or tissues processed under future procedures approved by the FDA once those tissues were available. The Company anticipated that the tissues processed under the Agreement would be available early to mid-November. Thus, the Company recorded a write-down of deferred preservation costs for processed tissues in excess of the supply required to meet demand prior to the release of these interim processed tissues. The Company did not record any further write-downs of deferred preservation costs in the fourth quarter of 2002. As of December 31, 2002 the balance of deferred preservation costs were \$2.0 million for allograft heart valve tissues, \$620,000 for non-valved cardiac tissues, \$1.7 million for vascular tissues, and zero for orthopaedic tissues.

As a result of the write-down of deferred preservation costs, the Company recorded \$6.3 million in income tax receivables and \$4.5 million in deferred tax assets. Upon destruction or shipment of the remaining tissues associated with the deferred preservation costs write-down, the deferred tax asset will become deductible in the Company's tax return. An expected refund of approximately \$8.5 million will be generated through a carry back of operating losses and write-downs of deferred preservation costs. In addition, the Company recorded \$2.5 million in income tax receivables related to estimated tax payments for 2002. The Company received payment of the \$2.5 million in January of 2003.

On September 3, 2002 the Company announced a reduction in employee force of approximately 105 employees. In the third quarter of 2002 the Company recorded accrued restructuring costs of approximately \$690,000, for severance and related costs of the employee force reduction. The expense was recorded in general, administrative, and marketing expenses and was included as a component of accrued expenses and other current liabilities on the Consolidated Balance Sheet. During the year ended December 31, 2002 the Company utilized \$580,000 of

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the accrued restructuring costs, including \$505,000 for salary and severance payments, \$64,000 for placement services for affected employees, and \$11,000 in other related costs. As of December 31, 2002, the remaining balance of accrued restructuring costs was \$110,000.

The Company expects its liquidity to decrease significantly over the next year due to the anticipated significant decrease in revenues throughout at least the first half of 2003 as compared to the prior year period, as a result of the reported tissue infections, the FDA Order and associated adverse publicity, and an expected decrease in cash due to the anticipated increased legal and professional costs relating to the defense of lawsuits (discussed in Note 9) and



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ongoing FDA compliance. The Company believes that anticipated revenue generation, expense management including the cessation of the development of the bioprosthetic valves, savings resulting from the reduction in the number of employees to reflect the reduction in revenues, tax refunds expected to be at least \$11 million (\$2.5 million of estimated tax payments remitted for the 2002 tax year which were received in January of 2003, and approximately \$8.5 million of loss carrybacks generated from operating losses and write-downs of deferred preservation costs), and the Company's existing cash and marketable securities will enable the Company to meet its liquidity needs through at least December 31, 2003, even if the term loan is called in its entirety. There is no assurance that the Company will be able to return to the level of demand for its tissue services that existed prior to the FDA Order due to the adverse publicity or as a result of customers and to tissue banks switching to competitors. Failure of the Company to maintain sufficient demand for its services, would have a material adverse effect on the Company's business, financial condition, results of operations, and cash flows.

### 3. CASH EQUIVALENTS AND MARKETABLE SECURITIES

The following is a summary of cash equivalents and marketable securities, all of which are classified as available-for-sale (in thousands):

DECEMBER 31, 2002	COST BASIS	ADJUSTMENTS TO COST BASIS	ADJUSTED COST BASIS	UNREALIZED HOLDING GAINS/ (LOSSES)
	-----	-----	-----	-----
Cash equivalents:				
Money market funds	\$ 52	\$ --	\$ 52	\$ --
Municipal obligations	7,175	--	7,175	--
	-----	-----	-----	-----
	\$ 7,227	\$ --	\$ 7,227	\$ --
	=====	=====	=====	=====
Marketable securities:				
Municipal obligations	\$ 14,276	\$ --	\$ 14,276	\$ 307
	=====	=====	=====	=====
DECEMBER 31, 2001	COST BASIS	ADJUSTMENTS TO COST BASIS	ADJUSTED COST BASIS	UNREALIZED HOLDING GAINS/ (LOSSES)
	-----	-----	-----	-----
Cash equivalents:				
Money market funds	\$ 1,301	\$ --	\$ 1,301	\$ --
Municipal obligations	500	--	500	--
	-----	-----	-----	-----
	\$ 1,801	\$ --	\$ 1,801	\$ --
	=====	=====	=====	=====
Marketable securities:				
Municipal obligations	17,696	--	17,696	147
Debt securities	6,227	(1,217)	5,010	--
Equity securities	3,900	(343)	3,557	10
Certificates of deposit	63	--	63	--
	-----	-----	-----	-----
	\$ 27,886	(1,560)	\$ 26,326	\$ 157
	=====	=====	=====	=====

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The Adjustments to Cost Basis column includes a \$1.6 million loss recorded in 2001 for an other than temporary decline in the market value of debt and equity securities. Gross realized losses on sales of available-for-sale securities totaled \$240,000 in 2002 and gross realized gains on sales of available-for-sale

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securities totaled \$9,000 in 2001. Differences between cost and market listed above, consisting of a net unrealized holding gain less deferred taxes of \$104,000 and \$50,000, at December 31, 2002 and 2001, respectively, are included as a separate component of other comprehensive income in shareholders' equity.

At December 31, 2002 and 2001 approximately \$1.2 million and zero, respectively, of marketable securities had a maturity date of less than 90 days, approximately \$8.0 million and \$3.4 million, respectively, had a maturity date between 90 days and 1 year, and approximately \$5.4 million and \$14.5 million, respectively, had a maturity date between 1 and 5 years, and approximately zero and \$8.6 million, respectively, matured in more than 5 years or did not have a maturity date.

#### 4. IDEAS FOR MEDICINE, INC.

On March 5, 1997 the Company acquired the stock of Ideas for Medicine, Inc. ("IFM"), a medical device company specializing in the manufacture and distribution of single-use medical devices, for consideration of approximately \$4.5 million in cash and approximately \$5.0 million in convertible debentures plus related expenses. The acquisition was recorded under the purchase method of accounting. The cash portion of the purchase price was financed by borrowings under the Company's revolving term loan agreement. Pursuant to the purchase agreement, an additional consideration of \$700,000 was paid in January 2000. In connection with this acquisition, the Company also entered into a consulting agreement with the former majority shareholder of IFM requiring monthly payments to such shareholder of approximately \$17,000 until March 2002.

On September 30, 1998 the Company completed the sale of substantially all of the IFM product line and certain related assets, consisting of inventory, equipment, and intellectual property, to Horizon Medical Products, Inc. ("HMP") for \$15 million in cash pursuant to an asset purchase agreement. Concurrently, IFM and HMP signed a Manufacturing Agreement (the "Agreement") that provided for the manufacture by IFM of specified minimum dollar amounts of IFM products to be purchased exclusively by HMP over each of the four years following the sale. Thereafter, responsibility for such manufacturing was to be assumed by HMP.

The Company recorded deferred income at the transaction date totaling \$2.9 million, representing the selling price less the net book value of the assets sold, which included \$7.7 million of goodwill, net of accumulated amortization, and the costs related to the sale. The income was deferred because the sale and manufacturing agreements represented, in the aggregate, a single transaction for which the related income should be recognized over the term of the manufacturing agreement. Accordingly, the deferred income was reflected in cost of goods sold during 1999 to maintain margins that would have been approximately equal over the four-year period of the Agreement on the products manufactured and sold by IFM to HMP. During 1999 amortization of deferred income totaled \$1.2 million.

On June 22, 1999 IFM notified HMP that it was in default of certain provisions of the Agreement. Specifically, HMP was in violation of the payment provisions contained within the Agreement, which called for inventory purchases to be paid for within 45 days of delivery. Additionally, HMP was in violation due to nonpayment of interest related to such past due accounts receivable.

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After notification of the default, HMP indicated to the Company that it would not be able to meet and did not meet the minimum purchase requirements outlined in the Agreement. At December 31, 1999, the Company determined that it had incurred an impairment loss on its IFM assets due to the significant uncertainties related to the Company's ability to realize its investment in IFM. In calculating the amount of the impairment loss, management used its best estimate to determine the realizable value of its increase in working capital due to the HMP default and the recoverability of IFM's long-lived assets, consisting primarily of leasehold improvements and equipment. As a result, management recorded a \$2.1 million impairment loss on working capital and a \$2.6 million impairment loss on leasehold improvements. Additionally, the Company offset the above charges with \$2.5 million of deferred income recorded in connection with the sale of the IFM product line to HMP. The net pretax effect of the above nonrecurring charges was \$2.2 million and has been included under the caption "Nonrecurring charges" in the 1999 Consolidated Statement of Operations.

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On October 9, 2000 the Company sold substantially all of the remaining assets of IFM to HMP. The assets consisted primarily of inventory, equipment and leasehold improvements, which had a net book value of \$2.4 million at the date of sale. The terms of the transaction required HMP to pay the Company the sum of approximately \$5.9 million, payable in equal monthly installments of principal and interest of \$140,000. The note consists of a portion, approximately \$3.8 million, which bears interest at 9% per year, and a non-interest-bearing portion of approximately \$2.1 million. The note also required an additional \$1 million principal payment at any time prior to April 3, 2001. If the \$1 million payment was made when due, and no other defaults existed under the note, then \$1 million of the non-interest-bearing portion of the note would be forgiven. In addition, at such time as the principal balance has been paid down to \$1.1 million and there have been no defaults under the promissory note, the remainder of the note will be forgiven and the note will be canceled. The Company had recorded as notes receivable only the balances owed on the interest-bearing portion of the note. Due to uncertainties regarding HMP's ability to pay the full amount of the note, the Company also recorded reserves against these notes such that the gain from the sale is deferred until the full amount of the note is deemed collectible. In addition, the Company entered into a sublease agreement with HMP under which HMP assumed responsibility for the IFM manufacturing facility. Also, substantially all of the employees of IFM have become employees of HMP.

On March 30, 2001, HMP sold the IFM assets to a wholly owned subsidiary of LeMaitre Vascular, Inc. ("LeMaitre"), and the remaining portion of the Company's note receivable from HMP and the sublease agreement was assumed by the LeMaitre subsidiary and the payment schedule was restructured. On April 2, 2001 the Company received a scheduled \$1 million principal payment from LeMaitre and, as a result, \$1 million of the non-interest-bearing portion of the note was forgiven in accordance with the terms of the assumed note. At December 31, 2001 the Company reassessed the collectibility of the note receivable based on the payment record and general creditworthiness of LeMaitre. As a result, the Company reduced the reserve on the note receivable to \$250,000 from \$963,000, and recorded a non-recurring pretax gain of \$713,000 in the fourth quarter of 2001 that is included within Other Income in the Consolidated Statements of Operations. During 2002, LeMaitre remitted payment for the remaining balance of the note receivable. During 2002, the Company reduced the reserve on the note receivable to zero, and recorded a \$250,000 non-recurring pretax gain that is included within Other Income in the Consolidated Statements of Operations.

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### 5. INVENTORIES

Inventories at December 31 are comprised of the following (in thousands):

	2002	2001
Raw materials	\$ 2,341	\$ 1,987
Work in process	306	1,183
Finished goods	1,938	3,089
	\$ 4,585	\$ 6,259
	=====	=====

### 6. LONG-TERM DEBT

Long-term debt at December 31 consists of the following (in thousands):

	2002
5-year term loan, bearing interest equal to the Adjusted LIBOR plus 1.5%, to be adjusted monthly	\$ 5,600
7% convertible debenture, due in March 2002	--
	5,600
Total debt	5,600
Less current maturities	5,600
	--
Total long-term debt	\$ -----

On April 25, 2000 the Company entered into a loan agreement permitting the Company to borrow up to \$8 million under a line of credit during the expansion of the Company's corporate headquarters and manufacturing facilities. Borrowings under the line of credit accrued interest equal to Adjusted LIBOR plus 2%

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adjusted monthly. On June 1, 2001, the line of credit was converted to a term loan (the "Term Loan") to be paid in 60 equal monthly installments of principal plus interest computed at Adjusted LIBOR plus 1.5% (2.94% at December 31, 2002). At December 31, 2002 the principal balance of the Term Loan was \$5.6 million. The Term Loan is secured by substantially all of the Company's assets. The Term Loan contains certain restrictive covenants including, but not limited to, maintenance of certain financial ratios, a minimum tangible net worth requirement, and the requirement that no materially adverse event has occurred. The lender has notified the Company that the FDA Order, as described in Note 2, and the inquiries of the SEC, as described in Note 9, have had a material adverse effect on the Company that constitutes an event of default. Additionally, as of December 31, 2002, the Company is in violation of the debt coverage ratio and net worth financial covenants. As of February 24, 2003 the lender has elected not to declare an event of default, but reserves the right to exercise any such right under the terms of the Term Loan. Therefore, all amounts due under the Term Loan as of December 31, 2002 are reflected as a current liability on the Consolidated Balance Sheets.

In March 1997 the Company issued a \$5.0 million convertible debenture in

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connection with the Ideas for Medicine, Inc. acquisition. The debenture accrued interest at 7% and was convertible into common stock of the Company at any time prior to the due date of March 5, 2002 at \$8.05 per common share. On March 30, 1998 \$607,000 of the convertible debenture was converted into 75,000 shares of the Company's common stock, and on March 4, 2002 the remaining \$4.4 million was converted into 546,000 shares of the Company's common stock.

On July 30, 2002 the Company entered into a line of credit agreement with the same lender as for the Term Loan, permitting the Company to borrow up to \$10 million. Borrowings under the line of credit agreement accrue interest equal to Adjusted LIBOR plus 1.25% adjusted monthly. This loan is secured by substantially all of the Company's assets. On August 21, 2002 the lender notified the Company that, as a result of the FDA Order, as discussed in Note 2, it was not entitled to any further advances under the line of credit. On November 27, 2002 the lender notified the Company that it had cancelled the unfunded commitment of the line of credit, as the Company was in default of certain provisions and financial covenants of the line of credit agreement. The Company had no outstanding borrowings on the line of credit at the time of cancellation.

Scheduled maturities of long-term debt for the next five years are as follows (in thousands):

2003	\$	1,600
2004		1,600
2005		1,600
2006		800
2007		--
Thereafter		--
	-----	
	\$	5,600

Total interest costs were \$692,000, and \$915,000, and \$528,000, in 2002, and 2001, and 2000 which included zero, \$819,000, and \$229,000, respectively, of interest capitalized in connection with the expansion of the corporate headquarters and manufacturing facilities.

### 7. DERIVATIVES

The Company's Term Loan, which accrues interest computed at Adjusted LIBOR plus 1.5%, exposes the Company to changes in interest rates going forward. On March 16, 2000, the Company entered into a \$4.0 million notional amount forward-starting interest swap agreement, which took effect on June 1, 2001 and expires in 2006. This swap agreement was designated as a cash flow hedge to effectively convert a portion of the Term Loan balance to a fixed rate basis, thus reducing the impact of interest rate changes on future income. This agreement involves the receipt of floating rate amounts in exchange for fixed rate interest payments over the life of the agreement, without an exchange of the underlying principal amounts. The differential to be paid or received is recognized in the period in which it accrues as an adjustment to interest expense on the Term Loan.

On January 1, 2001 the Company adopted SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133") as amended. SFAS 133 requires the Company to recognize all derivative instruments on the balance sheet at fair

value, and changes in the derivative's fair value must be recognized currently

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in earnings or other comprehensive income, as applicable. The adoption of SFAS 133 impacts the accounting for the Company's forward-starting interest rate swap agreement. Upon adoption of SFAS 133, the Company recorded an unrealized loss of approximately \$175,000 related to the interest rate swap, which was recorded as part of long-term liabilities and accumulated other comprehensive income as the cumulative effect of adopting SFAS 133 within the Statement of Shareholders' Equity.

In August 2002 the Company determined that changes in the derivative's fair value could no longer be recorded in other comprehensive income, as a result of the uncertainty of future cash payments on the Term Loan caused by the lender's ability to declare an event of default as discussed in Note 6. Beginning in August 2002 the Company began recording all changes in the fair value of the derivative into other expense/income on the Consolidated Statements of Operations, and is amortizing the amounts previously recorded in other comprehensive income of \$292,000 into other expense/income over the remaining life of the swap agreement through June 2006. If the lender accelerates the payments due under the term loan by declaring an event of default, any remaining balance in other comprehensive income will be reclassified into other expense/income during that period.

At December 31, 2002 the notional amount of this swap agreement was \$2.8 million, and the fair value of the interest rate swap agreement, as estimated by the bank based on its internal valuation models, was a liability of \$280,000. The fair value of the swap agreement is recorded as part of short-term liabilities. For the year ended December 31, 2002 the Company recorded a loss of \$20,000 on the interest rate swap. The unamortized value of the swap agreement, recorded in the accumulated other comprehensive income account of shareholders' equity, was \$260,000 at December 31, 2002.

8. FAIR VALUES OF FINANCIAL INSTRUMENTS

SFAS No. 107, "Disclosures about Fair Value of Financial Instruments", requires the Company to disclose estimated fair values for its financial instruments. The carrying amounts of receivables and accounts payable approximate their fair values due to the short-term maturity of these instruments. The carrying value of the Company's other financial instruments approximated fair value at December 31, 2002 and 2001.

9. COMMITMENTS AND CONTINGENCIES

LEASES

The Company leases equipment, furniture, office, and manufacturing space under various leases with terms of up to 15 years. Commencing January 5, 1998 the Company leased office and manufacturing facilities under a capital lease for \$24,125 per month with an interest rate at 8% per annum through January 2008 from the former majority shareholder of IFM. This lease is subject to a sublease agreement as discussed in Note 4. Certain leases contain escalation clauses and renewal options for additional periods. Rent expense is computed on the straight-line method over the term of the lease with the offsetting accrual recorded in other long-term liabilities. Future minimum lease payments under noncancelable leases as of December 31, 2002 are as follows (in thousands):

	Capitalized Leases	Open Lea
2003	\$ 843	\$ 2

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2004	843	2
2005	843	2
2006	843	1
2007	265	1
Thereafter	--	16
-----		
Total minimum lease payments	3,637	\$ 27
=====		
Less amount representing interest	497	
-----		
Present value of net minimum lease payments	3,140	
Less current portion	2,169	
Capital lease obligation, less current portion	\$ 971	
=====		

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Property acquired under capital leases through December 31, 2002 consists of the following (in thousands):

Equipment	\$ 403
Furniture and fixtures	890
Leasehold improvements	3,199
Accumulated depreciation	(907)
	-----
	\$ 3,585
	=====

Total rental expense for operating leases amounted to \$2,470,000, \$2,243,000, and \$1,478,000, for 2002, 2001, and 2000, respectively. Total rental income under the sublease was \$310,000 in 2002, \$310,000 in 2001, and \$95,000 in 2000.

Due to cross default provisions included in the Company's debt agreements, as of December 31, 2002 the Company was in default of certain capital lease agreements maintained with the lender of the Term Loan. Therefore, all amounts due under these capital leases are reflected as a current liability on the Consolidated Balance Sheets as of December 31, 2002.

LITIGATION, CLAIMS, AND ASSESSMENTS

In the normal course of business as a medical device and services company the Company has product liability complaints filed against it. As of February 24, 2003 21 cases had been filed against the Company between May 18, 2000 and January 30, 2003. The cases are currently in the pre-discovery or discovery stages. Of these cases, 14 allege product liability claims arising out of the Company's orthopaedic tissue services, six allege product liability claims arising out of the Company's allograft heart valve tissue services, and one alleges product liability claims arising out of the non-tissue products made by Ideas for Medicine, when it was a subsidiary of the Company.

Included in these cases is the complaint filed against the Company in the Superior Court of Cobb County, Georgia, on July 12, 2002 by Steve Lykins, as Trustee for the benefit of next of kin of Brian Lykins. This complaint alleges strict liability, negligence, professional negligence, and breach of warranties related to tissue implanted in November of 2001. The plaintiff seeks unspecified compensatory and punitive damages.

The Company maintains claims-made insurance policies, which the Company believes to be adequate to defend against these suits. The Company's insurance company

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has been notified of these actions. The Company intends to vigorously defend against these claims. Nonetheless, an adverse judgment or judgments imposing aggregate liabilities in excess of the Company's insurance coverage could have a material adverse effect on the Company's financial position, results of operations, and cash flows.

Claims-made insurance policies cover only those asserted claims and incidents that are reported to the insurance carrier while the policy is in effect. Thus, a claims-made policy does not represent a transfer of risk for claims and incidents that have been incurred but not reported to the insurance carrier. The Company periodically evaluates its exposure to unreported product liability claims, and records accruals as necessary for the estimated cost of unreported claims related to services performed and products sold. During the year ended December 31, 2002 the Company accrued \$3.6 million in estimated costs for unreported product liability claims related to services performed and products sold during 2002 and prior years. The expense was recorded in general, administrative, and marketing expenses and was included as a component of accrued expenses and other current liabilities on the Consolidated Balance Sheets.

Several putative class action lawsuits were filed in July through September 2002 against the Company and certain officers of the Company alleging that the defendants violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated there under. During the third quarter of 2002 the U.S. District Court for the Northern District of Georgia consolidated the suits, and on November 14, 2002 lead plaintiffs were named. A consolidated complaint was filed on January 15, 2003, seeking the Court's certification of the litigation as a class action on behalf of all purchasers of the Company's stock between April 2, 2001 and August 14, 2002. The consolidated complaint also seeks recovery of compensatory damages in an unspecified amount and various fees and expenses of litigation, including attorneys' fees. The principal allegations of the consolidated complaint are that the Company failed to disclose its alleged lack of compliance with certain FDA regulations regarding the handling

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and processing of certain tissues and other product safety matters. Although the Company considers all of the claims in the consolidated complaint to be without merit and intends to defend against them vigorously, the Company is unable to predict at this time the final outcome of these claims. The Company carries directors' and officers' liability insurance policies, which the Company currently believes should be adequate to address these claims. Nonetheless, an adverse judgment in excess of the Company's insurance coverage could have a material adverse effect on the Company's financial position, results of operations, and cash flows.

The Company received notice in October 2002 that a complaint had been filed instituting a shareholder derivative action against the Company and Company officers and directors Steven G. Anderson, Albert E. Heacox, John W. Cook, Ronald C. Elkins, Virginia C. Lacy, Ronald D. McCall, Alexander C. Schwartz, and Bruce J. Van Dyne. The suit was filed in the Superior Court of Gwinnett County, Georgia, by Rosemary Lichtenberger. The suit alleges the individual defendants breached their fiduciary duties to the Company by causing or allowing the Company to engage in practices that caused the Company to suffer damages by being out of compliance with FDA guidelines, and by causing the Company to issue press releases that erroneously portrayed CryoLife's products, operations, financial results, and future prospects. The complainant seeks undisclosed damages, costs and attorney's fees, punitive damages, and prejudgment interest against the individual defendants derivatively on behalf of the Company as a nominal defendant. By an order entered on January 21, 2003, the lawsuit was stayed until discovery commences in the consolidated complaint of the class



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action lawsuit. In January 2003 the Company received notice that another shareholder derivative lawsuit was filed in the Superior Court of Fulton County, Georgia by Robert F. Frailey against the Company as a nominal defendant, and Company officers and directors Steven G. Anderson, Bruce J. Van Dyne, John W. Cook, Ronald D. McCall, Ronald C. Elkins, Virginia C. Lacy and Alexander C. Schwartz. The complaint asserts claims for breach of fiduciary duty, abuse of control, gross mismanagement, and waste of corporate assets. As in the Lichtenberger action, the Frailey action alleges that the defendant officers and directors caused the Company to suffer damages by being out of compliance with FDA guidelines, and by causing the Company to issue press releases that erroneously portrayed CryoLife's products, operations, financial results, and future prospects. The complaint also alleges improper insider trading by certain Company officers and directors. The complainant seeks declaratory relief, damages of unspecified amount, litigation expenses including attorneys' and experts' fees, and unspecified equitable or injunctive relief against the individual defendants derivatively on behalf of the Company as a nominal defendant. The Frailey complaint has not yet been served on any of the named defendants.

The Company's Board of Directors has established a committee that is independent of management to investigate the Claims asserted in the Lichtenberger and Frailey complaints and report back to the Board with its recommendations for action in response to the shareholders' demands. The independent committee has engaged independent legal counsel to assist in the investigation. The committee is in the process of its investigation.

On August 7, 2002 the Company announced the settlement of its ongoing litigation with Colorado State University Research Foundation ("CSURF") over the ownership of the Company's SynerGraft technology. The settlement resolves all disputes between the parties and extinguishes all CSURF ownership claims to any aspect of the Company's SynerGraft technology. The settlement includes an unconditional assignment to the Company of CSURF tissue engineering patents, trade secrets and know-how relating to tissue decellularization and recellularization. The technology assignment supercedes the 1996 technology license, which was terminated by the terms of the settlement. Payment terms include a nonrefundable advance of \$400,000 paid by the Company to CSURF that will be applied to earned royalties as they accrue through March 2011. The Company recorded these amounts as prepaid royalties and will expense the amounts as the royalties accrue. The earned royalty rate is a maximum of 0.75% of net revenues from products or tissue services utilizing the SynerGraft technology. Royalties earned under the agreement for revenues through December 31, 2002 were approximately \$37,000.

On August 17, 2002 the Company received a letter from the U.S. Securities and Exchange Commission (the "SEC Letter") that stated that the Company was subject to an investigation related to the Company's August 14, 2002 announcement of the FDA Order and requesting information from the Company from the period between September 1, 2001 through the date of the Company's response to the SEC Letter. The SEC Letter stated, in part, that "We are trying to determine whether there have been any violations of the federal securities laws. The investigation and the subpoena do not mean that we have concluded that anyone has broken the law. Also, the investigation does not mean that we have a negative opinion of any

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person, entity or security." The staff of the SEC subsequently confirmed that its investigation was informal in nature, and that it did not have subpoena power. At the present time, the Company is unable to predict the outcome of this matter.

The Company has concluded that it is probable that it will incur losses relating to claims and litigation of at least \$1.2 million, which represents the

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aggregate amount of the Company's deductibles under its product liability and directors' and officers' insurance policies. Therefore the Company has recorded an accrual of \$1.2 million as of December 31, 2002.

### 10. STOCK OPTION PLANS

The Company has stock option plans which provide for grants of options to employees and directors to purchase shares of the Company's common stock at exercise prices generally equal to the fair values of such stock at the dates of grant, which generally become exercisable over a five-year vesting period and expire within ten years of the grant dates. Under the 1993 Employee Incentive Stock Option Plan, the 1998 Long-Term Incentive Plan, the 2002 Stock Incentive Plan, and the amended and restated Nonemployee Director's Plan, the Company has authorized the grant of options of up to 1,050,000, 900,000, 974,000, and 594,000 shares of common stock, respectively. As of December 31, 2002 and 2001, there were 427,000 and 128,000, respectively, shares of common stock reserved for future issuance under the Company's stock option plans. A summary of stock option transactions under the plans follows:

	Shares	Exercise Price	Weighted Average Exercise Price
Outstanding at December 31, 1999	1,519,000	\$ 2.33-11.50	\$
Granted	492,000	11.50-29.15	
Exercised	(416,000)	2.33-9.00	
Canceled	(45,000)	6.83-9.00	
Outstanding at December 31, 2000	1,550,000	\$ 5.67-29.15	\$
Granted	370,000	23.68-34.10	
Exercised	(145,000)	5.67-11.63	
Canceled	(13,000)	8.50-29.15	
Outstanding at December 31, 2001	1,762,000	\$ 6.83-34.10	\$
Granted	1,133,000	2.20-29.25	
Exercised	(119,000)	6.83-11.63	
Canceled	(390,000)	2.20-34.10	
Outstanding at December 31, 2002	2,386,000	\$ 2.20-31.99	\$

The following table summarizes information concerning currently outstanding and exercisable options:

Options Outstanding				Options Exercisable	
Range of Exercise Price	Number Outstanding	Weighted Average Remaining Contract Life	Weighted Average Exercise Price	Number Exercisable	
\$ 2.20-2.20	644,000	5.02	\$ 2.20	180,000	
6.59-8.50	551,000	3.14	7.75	269,000	
9.00-11.63	635,000	2.45	11.38	466,000	
12.92-30.86	425,000	4.34	27.65	157,000	
31.99-31.99	131,000	3.48	31.99	103,000	

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----- \$ 2.20-31.99	----- 2,386,000 =====	----- 3.70	----- \$ 12.10	----- 1,175,000 =====
------------------------	-----------------------------	---------------	-------------------	-----------------------------

In September 1999, the Company granted options to a nonemployee to purchase 18,000 shares of common stock at an exercise price of \$8.21 per share. In connection with the issuance of these options, the Company recognized \$60,000 as deferred compensation for the estimated fair value of the options. Deferred compensation is amortized ratably over the vesting period of the options in accordance with SFAS No. 123, "Accounting for Stock-Based Compensation" ("SFAS 123").

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Other information concerning stock options follows:

	2002 -----	2001 -----	2000 -----
Weighted average fair value of options granted during the year	\$ 4.23	\$ 15.20	\$ 6.97
Number of shares as to which options are exercisable at end of year	1,175,000	915,000	791,000

11. SHAREHOLDER RIGHTS PLAN

On November 27, 1995 the Board of Directors adopted a shareholder rights plan to protect long-term share value for the Company's shareholders. Under the plan, the Board declared a distribution of one Right for each outstanding share of the Company's Common Stock to shareholders of record on December 11, 1995. Additionally, the Company has further authorized and directed the issuance of one Right with respect to each Common Share that shall become outstanding between December 11, 1995 and the earliest of the Right's exercise date or expiration date. Each Right entitles the registered holder to purchase from the Company one-thirtieth of a share of a newly created Series A Junior Participating Preferred Stock at an exercise price of \$100. The Rights, which expire on November 27, 2005, may be exercised only if certain conditions are met, such as the acquisition of 15% or more of the Company's Common Stock by a person or affiliated group ("Acquiring Person").

In the event the Rights become exercisable, each Right will enable the owner, other than the Acquiring Person, to purchase, at the Right's then current exercise price, that number of shares of Common Stock with a market value equal to twice the exercise price times the number of one-tenth's of a share of Series A Junior Participating Preferred Stock for which the Right is then exercisable. In addition, unless the Acquiring Person owns more than 50% of the outstanding shares of Common Stock, the Board of Directors may elect to exchange all outstanding Rights (other than those owned by such Acquiring Person) at an exchange ratio of one share of Common Stock per Right appropriately adjusted to reflect any stock split, stock dividend or similar transaction.

12. STOCK REPURCHASE

On July 18, 2002 the Company's Board of Directors authorized the purchase of up

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to \$10 million in shares of its common stock. The purchase of shares was to be made from time-to-time in open market or privately negotiated transactions on such terms as management deemed appropriate. As of December 31, 2002 the Company had repurchased 68,000 shares of its common stock for an aggregate purchase price of \$663,000. No further purchases are anticipated in the near term.

On October 14, 1998 the Company's Board of Directors authorized the Company to purchase up to 1.5 million shares of its common stock. As of December 31, 2001, and 2000, the Company had purchased an aggregate of 1,159,000 and 1,159,000 shares, respectively, of its common stock for an aggregate purchase price of \$8,258,000 and \$8,258,000, respectively. No further purchases are anticipated under this authorization.

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### 13. ACCUMULATED OTHER COMPREHENSIVE INCOME

Components of comprehensive income/(loss) consist of the following, net of tax (in thousands):

	----- December ----- 2002 -----
Net (loss) income	\$ (27,761)
Unrealized gain on investments	95
Change in fair value of interest rate swap (including cumulative effect of adopting SFAS 133 in 2001)	30
Translation adjustment	303
	-----
Comprehensive income	\$ (27,333) =====

The tax effect on the change in unrealized gain/loss on investments is \$55,000 and \$575,000 for the years ended December 31, 2002 and 2001, respectively. The tax effect on the change in fair value of the interest rate swap is \$4,000 and \$93,000 for the years ended December 31, 2002 and 2001, respectively. The translation adjustment is not currently adjusted for income taxes, as it relates to a permanent investment in a foreign subsidiary.

### 14. EMPLOYEE BENEFIT PLANS

The Company has a 401(k) savings plan (the "Plan") providing retirement benefits to all employees who have completed at least three months of service. The Company makes matching contributions of 50% of each participant's contribution up to 5% of each participant's salary. Total company contributions approximated \$404,000, \$384,000, and \$355,000, for 2002, 2001, and 2000, respectively. Additionally, the Company may make discretionary contributions to the Plan that are allocated to each participant's account. No such discretionary contributions were made in 2002, 2001, or 2000.

On May 16, 1996 the Company's shareholders approved the CryoLife, Inc. Employee Stock Purchase Plan (the "ESPP"). The ESPP allows eligible employees the right

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to purchase common stock on a quarterly basis at the lower of 85% of the market price at the beginning or end of each three-month offering period. As of December 31, 2002 and 2001 there were 543,000 and 657,000, respectively, shares of common stock reserved under the ESPP and there had been 357,000 and 243,000, respectively, shares issued under the plan.

### 15. EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share (in thousands, except per share data):

	2002	2001	2000
	-----	-----	-----
Numerator for basic and diluted earnings per share:			
(loss) income available to common shareholders	\$ (27,761)	\$ 9,166	\$
	=====	=====	=====
Denominator for basic earnings per share:			
weighted-average shares	19,432	18,808	
Effect of dilutive stock options	--	852	
	-----	-----	-----
Denominator for diluted earnings per share:			
adjusted weighted-average shares	19,432	19,660	
	=====	=====	=====
(Loss) earnings per share:			
Basic	\$ (1.43)	\$ 0.49	\$
	=====	=====	=====
Diluted	\$ (1.43)	\$ 0.47	\$
	=====	=====	=====

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Since the Company has a net loss in the current year, all common stock equivalents are anti-dilutive. For the year ended December 31, 2002 the Company had stock options that are considered common stock equivalents and would have resulted in 966,000 additional dilutive shares pursuant to the provisions of SFAS 128.

On July 23, 2002 the Company's Board of Directors authorized the purchase of up to \$10 million of its common stock. As of February 24, 2003 the Company had repurchased 68,000 shares of its common stock for \$663,000. No further purchases are anticipated in the near term.

### 16. INCOME TAXES

Income tax (benefit) expense consists of the following (in thousands):

	2002	2001
	-----	-----

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Current:				
Federal	\$	(8,000)	\$	4,680
State		(164)		115
		-----		-----
		(8,164)		4,795
Deferred		(5,509)		(481)
		-----		-----
	\$	(13,673)	\$	4,314
		=====		=====

Such amounts differ from the amounts computed by applying the U.S. federal and state income tax rate of 34% in 2002, 35% in 2001, and 34% in 2000 to pretax income as a result of the following (in thousands):

		2002		2001	
		-----		-----	
Tax (benefit) expense at statutory rate	\$	(14,088)	\$	4,718	\$
Increase (reduction) in income taxes					
Resulting from:					
Entertainment expenses		83		50	
State income taxes, net of federal benefit		(167)		108	
Nontaxable interest income		(202)		(242)	
Research and development credits		--		(200)	
Foreign sales corporation		(27)		(60)	
Other		728		(60)	
		-----		-----	
	\$	(13,673)	\$	4,314	\$
		=====		=====	

For the year ended December 31, 2002, the Company generated federal income tax losses of approximately \$27 million. These losses will be carried back to prior years to offset income taxes paid and should result in approximately \$8.5 million in refunds to the Company.

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The tax effects of temporary differences which give rise to deferred tax liabilities and assets at December 31 are as follows (in thousands):

		2002		2001
		-----		-----
Long-term deferred tax (liabilities) assets:				
Property	\$	(865)	\$	(550)
Intangible assets		(210)		153
Impairment of IFM long-lived assets		--		(52)
Other		89		--
		-----		-----
		(986)		(449)
Current deferred tax assets (liabilities):				
Unrealized loss on interest rate swap		88		93

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Unrealized loss on marketable securities	(104)	449
Allowance for bad debts	26	32
Accrued expenses	1,875	13
Prepaid items	(56)	--
Deferred preservation costs and inventory reserves	4,845	96
Other	60	5
	6,734	688
Net deferred tax assets	\$ 5,748	\$ 239

At December 31, 2002 the Company has recorded a net deferred tax asset of \$5.7 million. If the temporary differences that generated the net deferred tax asset become fully deductible in 2003, the Company will have sufficient pre-tax earnings in 2001 to carryback these losses and realize the deferred tax asset. If some of the temporary differences become deductible in future years, the realization of the deferred tax asset may be dependent on generating sufficient taxable income in future periods. Although realization is not ensured, the Company believes that it is more likely than not that the deferred tax asset will be realized.

### 17. EXECUTIVE INSURANCE PLAN

Pursuant to a supplemental life insurance program for certain executive officers of the Company, the Company and the executives share in the premium payments and ownership of insurance policies on the lives of such executives. Upon death of the insured party, policy proceeds equal to the premium contribution are due to the Company with the remaining proceeds due to the designated beneficiaries of the insured party. The Company's aggregate premium contributions under this program were \$74,000, \$75,000, and \$53,000, for 2002, 2001, and 2000, respectively.

### 18. EQUIPMENT ON LOAN TO IMPLANTING HOSPITALS

The Company consigns liquid nitrogen freezers with certain implanting hospitals for tissue storage. The freezers are the property of the Company. At December 31, 2002 freezers with a total cost of approximately \$2.3 million and related accumulated depreciation of approximately \$1.5 million were located at the implanting hospitals' premises. Depreciation is provided over the estimated useful lives of the freezers on a straight-line basis.

### 19. TRANSACTIONS WITH RELATED PARTIES

The Company expensed \$90,000, \$87,000, and \$78,000 during 2002, 2001, and 2000, respectively, relating to services performed by a law firm whose sole proprietor is a member of the Company's Board of Directors and a shareholder of the Company. The Company expensed \$100,000, \$100,000, and \$102,000 in 2002, 2001 and 2000, respectively, relating to consulting services performed by a member of the Company's Board of Directors and a shareholder of the Company. In addition, the Company expensed \$240,000, \$473,000 and \$44,000 in 2002, 2001, and 2000, respectively, relating to research performed by the university where the same Director and shareholder holds a significant position. The Company expensed \$4,500, zero, and zero in 2002, 2001 and 2000, respectively, relating to consulting services performed by a member of the Company's Board of Directors and a shareholder of the Company. The Company paid \$35,000, \$210,000 and \$210,000, in 2002, 2001, and 2000, respectively, relating to consulting services performed by a shareholder of the Company.

## 20. SEGMENT AND GEOGRAPHIC INFORMATION

The Company has two reportable segments: Human Tissue Preservation Services and Implantable Medical Devices. The Company's segments are organized according to services and products.

The HUMAN TISSUE PRESERVATION SERVICES segment includes external revenue from cryopreservation services of cardiovascular, vascular, and orthopaedic human tissue. The IMPLANTABLE MEDICAL DEVICES segment includes external revenue from product sales of BioGlue Surgical Adhesive and bioprosthetic devices, including stentless porcine heart valves, SynerGraft treated porcine heart valves, and SynerGraft treated bovine vascular grafts. There are no intersegment sales.

The primary measure of segment performance, as viewed by the Company's management, is segment gross margin, or net external revenues less cost of preservation services and products. The Company does not segregate assets by segment; therefore asset information is excluded from the segment disclosures below.

The following table summarizes revenues, cost of preservation services and products, and gross margin for the Company's operating segments (in thousands):

	Revenue	Cost of Preservation Services and Products
	-----	-----
2002:		
Human Tissue Preservation Services	\$ 55,373	\$ 55,363
Implantable Medical Devices	21,597	10,270
All Other a	825	--
	-----	-----
	\$ 77,795	\$ 65,633
	=====	=====
2001:		
Human Tissue Preservation Services	\$ 75,552	\$ 31,165
Implantable Medical Devices	11,130	5,464
All Other a	989	--
	-----	-----
	\$ 87,671	\$ 36,629
	=====	=====
2000:		
Human Tissue Preservation Services	\$ 67,096	\$ 27,500
Implantable Medical Devices	7,176	4,068
All Other a	2,824	1,779
	-----	-----
	\$ 77,096	\$ 33,347
	=====	=====

a The All Other designation includes 1) grant revenue and 2) distribution revenues and 3) revenues and cost of sales of IFM, a single-use medical device business, through October 9, 2000, the date of the sale of substantially all of the remaining assets of IFM.



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Net revenues by product for the years ended December 31, 2002, 2001 and 2000 were as follows (in thousands):

Revenue	2002	2001
	-----	-----
Human tissue preservation services:		
Cardiovascular tissue	\$ 23,413	\$ 28,606
Vascular tissue	17,826	24,488
Orthopaedic tissue	14,134	22,458
	-----	-----
Total preservation services	55,373	75,552
BioGlue surgical adhesive	20,898	10,595
Bioprosthetic devices	699	535
Single-use medical devices		--
Grant and distribution revenue	825	989
	-----	-----
	\$ 77,795	\$ 87,671
	-----	-----

Net revenues by geographic location for the years ended December 31, 2002, 2001 and 2000 were as follows (in thousands):

Revenue b	2002	2001
	-----	-----
U.S.	\$ 71,188	\$ 81,657
International	6,607	6,014
	-----	-----
	\$ 77,795	\$ 87,671
	-----	-----

b Net external revenues are attributed to countries based on the location of the customer.

At December 31, 2002, 2001, and 2000, over 95% of the long-lived assets of the Company were held in the U.S., where all Company manufacturing facilities and the corporate headquarters are located.

## 20. SUBSEQUENT EVENTS

On February 20, 2003 the Company received a letter from the FDA that stated that a 510(k) premarket notification should be filed for the Company's CryoValve SG and that premarket approval marketing authorization should be obtained for the Company's CryoVein SG when used for arteriovenous ("A-V") access. The agency's position is that use of the SynerGraft technology in the processing of allograft heart valves represents a modification to the Company's legally marketed CryoValve allograft, and that femoral veins used for A-V access are medical devices that require premarket approval. CryoLife will be providing the agency with information to demonstrate that femoral veins used for A-V access should

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continue to be regulated as human tissue under Parts 1270 and 1271 of the FDA's regulations. The FDA letter did not question the safety or efficacy of the SynerGraft process or the CryoVein A-V access implant.

The Company has advised the FDA that it will voluntarily suspend use of the SynerGraft technology in the processing of allograft heart valves and vascular tissue until the regulatory status of the CryoValve SG and CryoVein SG is resolved. The FDA has not suggested that these tissues be recalled. Until such time as the issues surrounding the SG tissue are resolved, the Company will employ its traditional processing methods on these tissues. Distribution of allograft heart valves and vascular tissue processed using the Company's traditional processing protocols will continue. The outcome of the discussions with the FDA regarding the use of the SynerGraft process on human tissue could result in a reduction in SynerGraft processed cardiovascular and vascular tissue which would reduce the revenues and gross margins with respect to cardiovascular and vascular tissues.

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### SELECTED QUARTERLY FINANCIAL INFORMATION (UNAUDITED) (In thousands except per share data)

REVENUE	Year	First Quarter	Second Quarter	Third Quarter	Fou Qua
	2002	\$ 25,471	\$ 23,264	\$ 16,889	\$
	2001	21,432	21,697	22,567	
	2000	19,623	19,454	19,524	
<hr/>					
NET INCOME (LOSS)	Year	First Quarter	Second Quarter	Third Quarter	Fou Qua
	2002	\$ 3,104	\$ (5,522)	\$ (19,646)	\$
	2001	1,970	2,540	2,692	
	2000	1,604	1,979	2,308	
<hr/>					
EARNINGS (LOSS) PER SHARE - DILUTED	Year	First Quarter	Second Quarter	Third Quarter	Fou Qua
	2002	\$ 0.16	\$ (0.28)	\$ (1.01)	\$
	2001	0.10	0.13	0.14	
	2000	0.09	0.10	0.12	

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INDEPENDENT AUDITORS' REPORT  
To the Board of Directors and Stockholders of  
CryoLife, Inc.

We have audited the consolidated financial statements of CryoLife, Inc. and

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Subsidiaries as of and for the year ended December 31, 2002 and have issued our report thereon dated February 24, 2003 which report includes an explanatory paragraph because the Company changed its method of accounting for goodwill and other intangible assets to conform to Statement of Financial Accounting Standards No. 142 "Goodwill and Other Intangible Assets", which was adopted by the Company as of January 1, 2002; such report is included elsewhere in this Form 10-K. Our audit also included the 2002 financial statement schedules of CryoLife, Inc., listed in Item 14. These financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion based on our audit. The financial statements of the Company as of December 31, 2001 and 2000 and for the years then ended were audited by other auditors who have ceased operations. Those auditors expressed an unqualified opinion on the 2001 and 2000 financial statements in their report dated March 29, 2002. Those auditors also audited the 2001 and 2000 financial statement schedules listed in Item 14, and their report dated March 29, 2002 expressed an unqualified opinion on those financial statement schedules.

In our opinion, such 2002 financial statement schedules, when considered in relation to the basic 2002 financial statements taken as a whole, present fairly in all material respects the information set forth therein.

/s/Deloitte & Touche LLP

Atlanta, Georgia  
February 24, 2003

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### SCHEDULE II

#### CRYOLIFE, INC. AND SUBSIDIARIES

#### VALUATION AND QUALIFYING ACCOUNTS

YEARS ENDED DECEMBER 31, 2002, 2001, AND 2000

DESCRIPTION	BALANCE BEGINNING OF PERIOD	ADDITIONS	DEDUCTIONS	B E P
Year ended December 31, 2002				
Allowance for doubtful accounts	\$ 100,000	\$ 53,000	\$ 78,000	\$
Deferred preservation costs	300,000	320,000	570,000	
Year ended December 31, 2001				
Allowance for doubtful accounts	\$ 85,000	\$ 338,000	\$ 323,000	\$
Deferred preservation costs	229,000	280,000	209,000	
Year ended December 31, 2000				
Allowance for doubtful accounts	\$ 528,000	\$ 21,000	\$ 464,000	\$
Deferred preservation costs	151,000	230,000	152,000	

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