

CONMED CORP
Form 10-Q
May 07, 2007

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended
March 31, 2007

Commission File Number 0-16093

CONMED CORPORATION
(Exact name of registrant as specified in its charter)

New York
(State or other jurisdiction of
incorporation or organization)

16-0977505
(I.R.S. Employer
Identification No.)

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

13502
(Zip Code)

(315) 797-8375
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

The number of shares outstanding of registrant's common stock, as of May 1, 2007 is 28,289,449 shares.

CONMED CORPORATION

**QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTER ENDED MARCH 31, 2007**

PART I FINANCIAL INFORMATION

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

| | <u>Three Months Ended</u> | |
|------------------------------------|----------------------------------|--------------------|
| | <u>March 31,</u> | |
| | <u>2006</u> | <u>2007</u> |
| Net sales | \$ 158,466 | \$ 171,014 |
| Cost of sales | 80,566 | 85,789 |
| Gross profit | 77,900 | 85,225 |
| Selling and administrative expense | 58,374 | 59,805 |
| Research and development expense | 7,825 | 7,594 |
| Other expense (income) | 570 | (5,414) |
| | 66,769 | 61,985 |
| Income from operations | 11,131 | 23,240 |
| Interest expense | 4,866 | 4,516 |
| Income before income taxes | 6,265 | 18,724 |
| Provision for income taxes | 1,925 | 6,802 |
| Net income | \$ 4,340 | \$ 11,922 |
| Per share data: | | |
| Net income | | |
| Basic | \$.15 | \$.43 |
| Diluted | .15 | .42 |
| Weighted average common shares | | |
| Basic | 28,082 | 27,987 |
| Diluted | 28,358 | 28,559 |

See notes to consolidated condensed financial statements.

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

| | December 31, <u>2006</u> | March 31, <u>2007</u> |
|---|--------------------------------|--------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 3,831 | \$ 4,537 |
| Accounts receivable, net | 75,120 | 74,785 |
| Settlement receivable | - | 11,000 |
| Inventories | 151,687 | 153,841 |
| Income taxes receivable | 747 | 1,921 |
| Deferred income taxes | 15,212 | 15,225 |
| Prepaid expenses and other current assets | 3,286 | 3,037 |
| Total current assets | 249,883 | 264,346 |
| Property, plant and equipment, net | 116,480 | 117,146 |
| Goodwill | 290,512 | 290,878 |
| Other intangible assets, net | 191,135 | 189,631 |
| Other assets | 13,561 | 13,285 |
| Total assets | \$ 861,571 | \$ 875,286 |

LIABILITIES AND SHAREHOLDERS' EQUITY

| | | |
|-----------------------------------|----------|----------|
| Current liabilities: | | |
| Current portion of long-term debt | \$ 3,148 | \$ 3,148 |
| Accounts payable | 41,823 | 41,534 |
| Accrued compensation and benefits | 17,712 | 14,723 |
| Accrued interest | 727 | 1,986 |
| Other current liabilities | 11,795 | 14,119 |
| Total current liabilities | 75,205 | 75,510 |
| Long-term debt | 264,676 | 256,885 |
| Deferred income taxes | 51,004 | 57,266 |
| Other long-term liabilities | 30,332 | 28,595 |
| Total liabilities | 421,217 | 418,256 |

Commitments and contingencies

Shareholders' equity:

| | | |
|--|---|---|
| Preferred stock, par value \$.01 per share; authorized 500,000 shares; none outstanding | - | - |
| Common stock, par value \$.01 per share; 100,000,000 shares authorized; 31,304,203 and | | |

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| | | |
|--|------------|------------|
| 31,299,203 shares issued in 2006 and 2007, respectively | 313 | 313 |
| Paid-in capital | 284,858 | 285,710 |
| Retained earnings | 247,425 | 257,897 |
| Accumulated other comprehensive income | (8,612) | (7,978) |
| Less 3,321,545 and 3,125,761 shares of common stock in treasury, at cost in 2006 and 2007, respectively | (83,630) | (78,912) |
| Total shareholders' equity | 440,354 | 457,030 |
| Total liabilities and shareholders' equity | \$ 861,571 | \$ 875,286 |

See notes to consolidated condensed financial statements.

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

| | <u>Three Months Ended</u> | |
|---|----------------------------------|--------------------|
| | <u>March 31,</u> | |
| | <u>2006</u> | <u>2007</u> |
| Cash flows from operating activities: | | |
| Net income | \$ 4,340 | \$ 11,922 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 2,723 | 3,059 |
| Amortization | 4,605 | 4,573 |
| Stock option expense | 814 | 852 |
| Deferred income taxes | 2,121 | 6,177 |
| Gain on legal settlement | - | (6,072) |
| Increase (decrease) in cash flows from changes in assets and liabilities: | | |
| Sale of accounts receivable | (3,000) | 3,000 |
| Accounts receivable | 5,167 | (2,665) |
| Inventories | (7,836) | (4,638) |
| Accounts payable | 2,770 | (3,523) |
| Income taxes receivable | (1,453) | (1,102) |
| Accrued compensation and benefits | 30 | (2,989) |
| Accrued interest | 1,778 | 1,259 |
| Other assets | (571) | 1,021 |
| Other liabilities | 2,523 | 342 |
| Net cash provided by operating activities | 14,011 | 11,216 |
| Cash flows from investing activities: | | |
| Proceeds from sale of equity investment | 1,205 | - |
| Payments related to business acquisitions | - | (883) |
| Purchases of property, plant and equipment | (4,908) | (3,868) |
| Net cash used in investing activities | (3,703) | (4,751) |
| Cash flows from financing activities: | | |
| Net proceeds from common stock issued under employee plans | 772 | 3,268 |
| Repurchase of common stock | (3,406) | - |
| Payments on long term debt | (6,465) | (7,791) |
| Net change in cash overdrafts | (183) | (1,694) |
| Excess tax benefits from stock-based compensation | 13 | - |
| Net cash used in financing activities | (9,269) | (6,217) |
| Effect of exchange rate changes on cash and cash equivalents | 160 | 458 |

| | | |
|--|----------|----------|
| Net increase in cash and cash equivalents | 1,199 | 706 |
| Cash and cash equivalents at beginning of period | 3,454 | 3,831 |
| Cash and cash equivalents at end of period | \$ 4,653 | \$ 4,537 |

See notes to consolidated condensed financial statements.

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

Note 1 – Operations and significant accounting policies**Organization and operations**

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

Note 2 - Interim financial information

The accompanying unaudited consolidated condensed financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for annual financial statements. In the opinion of management, all adjustments (consisting only of normal recurring accruals) considered necessary for a fair presentation have been included. Results for the period ended March 31, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007.

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

Note 3 – Other comprehensive income

Comprehensive income (loss) consists of the following:

| | Three months ended | |
|---|---------------------------|--------------------|
| | March 31, | |
| | <u>2006</u> | <u>2007</u> |
| Net income | \$ 4,340 | \$ 11,922 |
| Other comprehensive income: | | |
| Pension liability | - | 145 |
| Foreign currency translation adjustment | 173 | 489 |
| Comprehensive income | \$ 4,513 | \$ 12,556 |

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Accumulated other comprehensive income (loss) consists of the following:

| | Cumulative Pension Liability | Accumulated Other Translation Adjustments | Comprehensive Income (loss) |
|--|---|--|--|
| Balance, December 31, 2006 | \$ (12,386) | \$ 3,774 | \$ (8,612) |
| Pension liability | 145 | - | 145 |
| Foreign currency translation adjustments | - | 489 | 489 |
| Balance, March 31, 2007 | \$ (12,241) | \$ 4,263 | \$ (7,978) |

Note 4 – Income Taxes

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

The Internal Revenue Service (“IRS”) has completed examinations of our United States federal income tax returns through 2004. Tax years subsequent to 2004 are subject to future examination. Tax years 1998-2000 are subject to limited examination by the IRS. Substantially all material state jurisdictions are closed for examination for tax years through 2002.

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

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

Note 5 - Inventories

Inventories consist of the following:

| | December 31, <u>2006</u> | March 31, <u>2007</u> |
|-----------------|-------------------------------------|----------------------------------|
| Raw materials | \$ 50,225 | \$ 56,005 |
| Work-in-process | 17,815 | 20,930 |
| Finished goods | 83,647 | 76,906 |

| | | | | |
|-------|----|---------|----|---------|
| Total | \$ | 151,687 | \$ | 153,841 |
|-------|----|---------|----|---------|

Note 6 – Earnings per share

Basic earnings per share (“basic EPS”) is computed by dividing net income by the weighted average number of common shares outstanding for the reporting period. Diluted earnings per share (“diluted EPS”) gives effect to all dilutive potential shares

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outstanding resulting from employee stock options, restricted stock units and stock appreciation rights during the period. The following table sets forth the computation of basic and diluted earnings per share for the three month periods ended March 31, 2006 and 2007.

| | Three months ended March 31, | |
|---|---|--------------------|
| | <u>2006</u> | <u>2007</u> |
| Net income | \$ 4,340 | \$ 11,922 |
| Basic – weighted average shares outstanding | 28,082 | 27,987 |
| Effect of dilutive potential securities | 276 | 572 |
| Diluted – weighted average shares outstanding | 28,358 | 28,559 |
| Basic EPS | \$.15 | \$.43 |
| Diluted EPS | .15 | .42 |

The shares used in the calculation of diluted EPS exclude options and SARs to purchase shares where the exercise price was greater than the average market price of common shares for the period. Such shares aggregated approximately 1.7 million and 0.6 million for the three months ended March 31, 2006 and 2007, respectively. Upon conversion of our 2.50% convertible senior subordinated notes (the "Notes"), the holder of each Note will receive the conversion value of the Note payable in cash up to the principal amount of the Note and CONMED common stock for the Note's conversion value in excess of such principal amount. As of March 31, 2007, our share price has not exceeded the conversion price of the Notes, therefore the conversion value was less than the principal amount of the Notes. Under the net share settlement method and in accordance with Emerging Issues Task Force ("EITF") Issue 04-8, "The Effect of Contingently Convertible Debt on Diluted Earnings per Share", there were no potential shares issuable under the Notes to be used in the calculation of diluted EPS. The maximum number of shares we may issue with respect to the Notes is 5,750,000.

Note 7 – Goodwill and other intangible assets

The changes in the net carrying amount of goodwill for the three months ended March 31, 2007 are as follows:

| | |
|---|------------|
| Balance as of January 1, 2007 | \$ 290,512 |
| Adjustments to goodwill resulting from business acquisitions finalized | 392 |
| Foreign currency translation | (26) |
| Balance as of March 31, 2007 | \$ 290,878 |

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

| | December 31, 2006 | March 31, 2007 |
|-----------------------|------------------------------|---------------------------|
| CONMED Electrosurgery | \$ 16,645 | \$ 16,645 |
| CONMED Endosurgery | 42,419 | 42,422 |
| CONMED Linvatec | 173,007 | 172,981 |
| CONMED Patient Care | 58,441 | 58,830 |
| Balance | \$ 290,512 | \$ 290,878 |

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

Other intangible assets consist of the following:

| | <u>December 31, 2006</u> | | <u>March 31, 2007</u> | |
|---------------------------------------|---|--|---|--|
| | <u>Gross Carrying Amount</u> | <u>Accumulated Amortization</u> | <u>Gross Carrying Amount</u> | <u>Accumulated Amortization</u> |
| Amortized intangible assets: | | | | |
| Customer relationships | \$ 113,376 | \$ (24,498) | \$ 113,694 | \$ (25,368) |
| Patents and other intangible assets | 39,609 | (24,696) | 38,942 | (24,981) |
| Unamortized intangible assets: | | | | |
| Trademarks and tradenames | 87,344 | - | 87,344 | - |
| | \$ 240,329 | \$ (49,194) | \$ 239,980 | \$ (50,349) |

Other intangible assets primarily represent allocations of purchase price to identifiable intangible assets of acquired businesses. The weighted average amortization period for intangible assets which are amortized is 25 years. Customer relationships are being amortized over a weighted average life of 36 years. Patents and other intangible assets are being amortized over a weighted average life of 11 years.

Amortization expense related to intangible assets which are subject to amortization totaled \$1,278 and \$1,405 in the three months ended March 31, 2006 and 2007, respectively. These amounts have been included in selling and administrative expense on the Consolidated Condensed Statement of Income.

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

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| | |
|------|----------|
| 2007 | \$ 5,608 |
| 2008 | 5,608 |
| 2009 | 5,701 |
| 2010 | 5,031 |
| 2011 | 4,826 |
| 2012 | 4,768 |

Table of Contents**Note 8 — Guarantees**

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

Changes in the carrying amount of service and product warranties for the three months ended March 31, 2007 are as follows:

| | |
|-------------------------------|----------|
| Balance as of January 1, 2007 | \$ 3,617 |
| Provision for warranties | 1,488 |
| Claims made | (1,487) |
| Balance as of March 31, 2007 | \$ 3,618 |

Note 9 – Pension plan

Net periodic pension costs consist of the following:

| | Three months ended March 31, | |
|---|---------------------------------|-------------|
| | <u>2006</u> | <u>2007</u> |
| Service cost | \$ 1,405 | \$ 1,381 |
| Interest cost on projected benefit obligation | 827 | 737 |
| Expected return on plan assets | (795) | (683) |
| Net amortization and deferral | 298 | 229 |
| Net periodic pension cost | \$ 1,735 | \$ 1,664 |

We previously disclosed in our Annual Report on Form 10-K for the year-ended December 31, 2006 that we expect to make \$12.0 million in contributions to our pension plan in 2007. We made \$3.0 million in contributions for the quarter ended March 31, 2007.

Note 10 — Other expense (income)

Other expense (income) consists of the following:

| <u>2006</u> | <u>2007</u> |
|-------------|-------------|
|-------------|-------------|

| | | |
|---------------------------------|--------|------------|
| Acquisition-related costs | \$ 514 | \$ - |
| Termination of product offering | 56 | 90 |
| Facility closure costs | - | 568 |
| Litigation settlement | - | (6,072) |
| Other income | \$ 570 | \$ (5,414) |

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On September 30, 2004, we acquired the business operations of the Endoscopic Technologies Division of C.R. Bard, Inc. (the "Endoscopic Technologies acquisition"). As part of the acquisition, manufacturing of the acquired products was conducted in various C.R. Bard facilities under a transition agreement. During the quarter ended March 31, 2006, we incurred \$0.5 million of acquisition and transition-integration related charges associated with the Endoscopic Technologies acquisition which have been recorded in other expense (income). The Endoscopic Technologies acquisition transition was completed during 2006.

During 2004, we elected to terminate our surgical lights product line. We instituted a customer replacement program whereby all currently installed surgical lights were replaced by CONMED. We incurred approximately \$0.1 million in costs related to the surgical lights customer replacement program during the quarters ended March 31, 2006 and 2007, respectively, which were recorded in other expense (income). We anticipate incurring an additional \$0.3 million as the surgical lights customer replacement program is completed.

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

In November 2003, we commenced litigation against Johnson & Johnson and several of its subsidiaries, including Ethicon, Inc. for violations of federal and state antitrust laws. In the lawsuit we claimed that Johnson & Johnson engaged in illegal and anticompetitive conduct with respect to sales of product used in endoscopic surgery, resulting in higher prices to consumers and the exclusion of competition. We sought relief including an injunction restraining Johnson & Johnson from continuing its anticompetitive practices as well as receiving the maximum amount of damages allowed by law. During the litigation, Johnson & Johnson represented that the marketing practices which gave rise to the litigation have been altered with respect to CONMED. On March 31, 2007, CONMED and Johnson & Johnson settled the litigation. Under the terms of the final settlement agreement, CONMED received a payment of \$11.0 million from Johnson & Johnson on April 12, 2007 in return for which we terminated the lawsuit. After deducting legal and other related costs, we have recorded a pre-tax gain of \$6.1 million related to the settlement which we have recorded in other expense (income).

Note 11 — Business Segments and Geographic Areas

CONMED conducts its business through five principal operating units, CONMED Endoscopic Technologies, CONMED Endosurgery, CONMED Electrosurgery, CONMED Linvatec and CONMED Patient Care. We believe each of our segments are similar in the nature of products, production processes, customer base, distribution methods and regulatory environment. In accordance with Statement of Financial Accounting Standards No. 131 "Disclosures About Segments of an Enterprise and Related Information" ("SFAS 131"), our CONMED Endosurgery, CONMED Electrosurgery and CONMED Linvatec operating units also have similar economic characteristics and therefore qualify for aggregation under SFAS 131.

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Our CONMED Patient Care and CONMED Endoscopic Technologies operating units do not qualify for aggregation under SFAS 131 since their economic characteristics do not meet the criteria for aggregation as a result of the lower overall operating income (loss) in these segments.

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

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

| | <u>2006</u> | <u>2007</u> |
|--|-------------|-------------|
| Arthroscopy | 54,700 | 62,243 |
| Powered Surgical Instruments | 34,200 | 37,550 |
| Electrosurgery | 23,375 | 24,026 |
| Endosurgery | 11,846 | 13,575 |
| CONMED Endosurgery, Electrosurgery and Linvatec | 124,121 | 137,394 |
| CONMED Patient Care | 19,611 | 20,361 |
| CONMED Endoscopic Technologies | 14,734 | 13,259 |
| Total | \$ 158,466 | \$ 171,014 |

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

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

| | <u>2006</u> | <u>2007</u> |
|--|-------------|-------------|
| CONMED Endosurgery, Electrosurgery and Linvatec | 16,441 | 18,793 |
| CONMED Patient Care | 264 | 1,027 |
| CONMED Endoscopic Technologies | (2,372) | (1,211) |
| Corporate | (3,202) | 4,631 |
| Income from Operations | 11,131 | 23,240 |
| Interest expense | 4,866 | 4,516 |
| Income before income taxes | \$ 6,265 | \$ 18,724 |

Note 12 – Legal proceedings

From time to time, we are a defendant in certain lawsuits alleging product liability, patent infringement, or other claims incurred in the ordinary course of business. Likewise, from time to time, the Company may receive a subpoena from a government agency such as the Equal Employment Opportunity Commission, Occupational Safety and Health Administration, the Department of Labor, the Treasury Department, and other federal and state agencies or foreign

governments or government agencies. These

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subpoenae may or may not be routine inquiries, or may begin as routine inquiries and over time develop into enforcement actions of various types. The product liability claims are generally covered by various insurance policies, subject to certain deductible amounts and maximum policy limits. When there is no insurance coverage, as would typically be the case primarily in lawsuits alleging patent infringement or in connection with certain government investigations, we establish sufficient reserves to cover probable losses associated with such claims. We do not expect that the resolution of any pending claims or investigations will have a material adverse effect on our financial condition or results of operations.

Manufacturers of medical products may face exposure to significant product liability claims. To date, we have not experienced any product liability claims that are material to our financial statements or condition, but any such claims arising in the future could have a material adverse effect on our business or results of operations. We currently maintain commercial product liability insurance of \$25 million per incident and \$25 million in the aggregate annually, which we believe is adequate. This coverage is on a claims-made basis.

Our operations are subject, and in the past have been subject, to a number of environmental laws and regulations governing, among other things, air emissions, wastewater discharges, the use, handling and disposal of hazardous substances and wastes, soil and groundwater remediation and employee health and safety. In some jurisdictions environmental requirements may be expected to become more stringent in the future. In the United States certain environmental laws can impose liability for the entire cost of site restoration upon each of the parties that may have contributed to conditions at the site regardless of fault or the lawfulness of the party's activities. While we do not believe that the present costs of environmental compliance and remediation are material, there can be no assurance that future compliance or remedial obligations could not have a material adverse effect on our financial condition or results of operations.

On April 7, 2006, CONMED received a copy of a complaint filed in the United States District for the Northern District of New York on behalf of a purported class of former CONMED Linvatec sales representatives. The complaint alleges that the former sales representatives were entitled to, but did not receive, severance in 2003 when CONMED Linvatec restructured its distribution channels. We believe that the maximum exposure related to this complaint is \$2.5 to \$3.0 million, not including any interest, fees or costs that might be awarded if the five named plaintiffs were to prevail on their own behalf as well as on behalf of all members of the purported class. CONMED Linvatec did not generally pay severance during the 2003 restructuring because the former sales representatives were offered sales positions with CONMED Linvatec's new manufacturer's representatives. Other than three of the five named plaintiffs in the class action, nearly all of CONMED Linvatec's former sales representatives accepted such positions.

The Company has filed motions which, if granted, would result in the dismissal of the case, subject to any appeals the plaintiffs could pursue. The Court held a hearing on the Company's motions on January 5, 2007, and took the matter under advisement. There is no fixed time frame within the Court must rule on the motions. The Company believes there is no merit to the claims asserted in the Complaint.

Note 13 – New accounting pronouncements

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, "Fair Value Measurements" ("SFAS 157") which is effective for fiscal years

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beginning after November 15, 2007 and for interim periods within those years. SFAS 157 defines fair value, establishes a framework for measuring fair value and expands the related disclosure requirements. We are currently evaluating the potential impact of this statement.

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

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

Forward-looking statements

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

Forward-looking statements are not guarantees of future performance

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

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

- changes in regulatory requirements; and
- the availability, terms and deployment of capital.

See “Management’s Discussion and Analysis of Financial Condition and Results of Operations” below and “Risk Factors” and “Business” in our Annual Report on Form 10-K for the year-ended December 31, 2006 for a further discussion of these factors. You are

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cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. We do not undertake any obligation to publicly release any revisions to these forward-looking statements to reflect events or circumstances after the date of this Quarterly Report on Form 10-Q or to reflect the occurrence of unanticipated events.

Overview:

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

| | Three months ended | |
|------------------------------|---------------------------|--------------------|
| | March 31, | |
| | <u>2006</u> | <u>2007</u> |
| Arthroscopy | 34.5% | 36.4% |
| Powered Surgical Instruments | 21.6 | 22.0 |
| Electrosurgery | 14.7 | 14.0 |
| Patient Care | 12.4 | 11.9 |
| Endosurgery | 7.5 | 8.0 |
| Endoscopic Technologies | 9.3 | 7.7 |
| Consolidated Net Sales | 100% | 100% |

A significant amount of our products are used in surgical procedures with the majority of our revenues derived from the sale of disposable products. We manufacture substantially all of our products in facilities located in the United States, Mexico, and Finland. We market our products both domestically and internationally directly to customers and through distributors. International sales represent a significant portion of our business. During the three months ended March 31, 2007, sales to purchasers outside of the United States accounted for 41.8% of total net sales.

Business Environment and Opportunities

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

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

We have a variety of research and development initiatives focused in each of our principal product lines. Among the most significant of these efforts is the Endotracheal Cardiac Output Monitor (“ECOM”). Our ECOM product offering is expected to provide an innovative alternative to catheter monitoring of cardiac output with a specially designed endotracheal tube which utilizes proprietary bio-impedance technology. Also of significance are our research and development efforts in the area of tissue-sealing for electrosurgery.

Continued innovation and commercialization of new proprietary products and processes are essential elements of our long-term growth strategy. In February 2007, we unveiled several new products at the American Academy of Orthopaedic Surgeons Annual Meeting which we believe further enhance our product offerings and reputation as an

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innovator as exemplified by the IM4000 High Definition Camera System, our first high definition camera system designed for use in both arthroscopic and multi-specialty endoscopy.

Business Challenges

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

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

Critical accounting policies

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

Revenue Recognition

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

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- Sales to customers are evidenced by firm purchase orders. Title and the risks and rewards of ownership are transferred to the customer when product is shipped under our stated shipping terms. Payment by the customer is due under fixed payment terms.
- We place certain of our capital equipment with customers in return for commitments to purchase disposable products over time periods generally ranging from one to three years. In these circumstances, no revenue is recognized upon capital equipment shipment and we recognize revenue upon the disposable product shipment. The cost of the equipment is amortized over the term of individual commitment agreements.
- Product returns are only accepted at the discretion of the Company and in accordance with our “Returned Goods Policy”. Historically the level of product returns has not been significant. We accrue for sales returns, rebates and allowances based upon an analysis of historical customer returns and credits, rebates, discounts and current market conditions.
- Our terms of sale to customers generally do not include any obligations to perform future services. Limited warranties are provided for capital equipment sales and provisions for warranty are provided at the time of product sale based upon an analysis of historical data.
- Amounts billed to customers related to shipping and handling have been included in net sales. Shipping and handling costs are included in selling and administrative expense.
- We sell to a diversified base of customers around the world and, therefore, believe there is no material concentration of credit risk.
- We assess the risk of loss on accounts receivable and adjust the allowance for doubtful accounts based on this risk assessment. Historically, losses on accounts receivable have not been material. Management believes that the allowance for doubtful accounts of \$1.3 million at March 31, 2007 is adequate to provide for probable losses resulting from accounts receivable.

Inventory Reserves

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

Business Acquisitions

We have a history of growth through acquisitions. Assets and liabilities of acquired businesses are recorded under the purchase method of accounting at their estimated fair values as of the date of acquisition. Goodwill represents costs in excess of fair values assigned to the underlying net assets of acquired businesses. Other intangible assets primarily represent allocations of purchase price to

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identifiable intangible assets of acquired businesses. We have accumulated goodwill of \$290.9 million and other intangible assets of \$189.6 million as of March 31, 2007.

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

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

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

Pension Plan

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

Higher market interest rates have resulted in us increasing the discount rate used in determining pension expense from 5.55% in 2006 to 5.90% in 2007. This rate was determined by using the Citigroup Pension Liability Index rate which, we believe, is a reasonable indicator of our plan's future payment stream.

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

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

Based on these and other factors, pension expense for the year-ended December 31,

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2007 is estimated at approximately \$6.7 million as compared to \$6.9 million in 2006. Actual expense may vary significantly from this estimate. For the three month period ended March 31, 2007 we recorded \$1.7 million in pension expense.

Stock Based Compensation

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

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

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

Income Taxes

The recorded future tax benefit arising from net deductible temporary differences and tax carryforwards is approximately \$35.0 million at March 31, 2007. Management believes that our earnings during the periods when the temporary differences become deductible will be sufficient to realize the related future income tax benefits.

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

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

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

Results of operations***Three months ended March 31, 2007 compared to three months ended March 31, 2006***

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

| | Three Months Ended March 31, | |
|------------------------------------|---|-------------|
| | 2006 | 2007 |
| Net sales | 100.0% | 100.0% |
| Cost of sales | 50.8 | 50.2 |
| Gross profit | 49.2 | 49.8 |
| Selling and administrative expense | 36.8 | 35.0 |
| Research and development expense | 4.9 | 4.4 |
| Other expense | 0.4 | (3.2) |
| Income from operations | 7.1 | 13.6 |
| Interest expense | 3.2 | 2.6 |
| Income before income taxes | 3.9 | 11.0 |
| Provision for income taxes | 1.2 | 4.0 |
| Net income | 2.7% | 7.0% |

Sales for the quarterly period ended March 31, 2007 were \$171.0 million, an increase of \$12.5 million (7.9%) compared to sales of \$158.5 million in the comparable 2006 period with the increase occurring in all product lines except Endoscopic Technologies. Favorable foreign currency exchange rates (when compared to the foreign currency exchange rates in the same period a year ago) accounted for approximately \$2.8 million of the increase.

Cost of sales increased to \$85.8 million in the quarterly period ended March 31, 2007 as compared to \$80.6 million in the same period a year ago on overall increases in sales volumes as described above. Gross profit margins increased 0.6 percentage points to 49.8% in the quarterly period ended March 31, 2007 as compared to 49.2% in the same period a year ago. The increase of 0.6 percentage points is comprised of a 0.2 percentage point improvement in our Patient Care product lines with the remaining 0.4 percentage point improvement in our Endoscopic Technologies product lines as a result of the completion of the transfer of production lines from C.R. Bard to CONMED during 2006.

Selling and administrative expense increased to \$59.8 million in the quarterly period ended March 31, 2007 as compared to \$58.4 million in the same period a year ago. Selling and administrative expense as a percentage of net sales decreased to 35.0% in the quarterly period ended March 31, 2007 as compared to 36.8% in the same period a year ago. This decrease of 1.8 percentage points is primarily attributable to decreased selling and administrative expenses associated with lower benefit costs (1.2 percentage points) and lower sales force and distribution costs (0.6 percentage points).

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Research and development expense totaled \$7.6 million in the quarterly period ended March 31, 2007 as compared to \$7.8 million in the same period a year ago. As a percentage of net sales, research and development expense decreased 0.5 percentage points to 4.4% in the quarterly period ended March 31, 2007 as compared to 4.9% in the same period a year ago. The decrease in research and development expense is a result of lower spending on the ECOM project in the Patient Care business (0.2 percentage points) as well as decreased spending in the Endoscopic Technologies business (0.3 percentage points) as certain biliary and other projects near completion.

As discussed in Note 10 to the Consolidated Condensed Financial Statements, other income in the quarterly period ended March 31, 2007 consisted of a \$0.6 million charge related to closing of a manufacturing facility, \$0.1 million charge related to the termination of our surgical lights product offering, and \$6.1 million in income related to the settlement of the antitrust case with Johnson & Johnson. Other expense in the quarterly period ended March 31, 2006 consisted of \$0.5 million in Bard Endoscopic Technologies acquisition-related costs and \$0.1 million in charges related to the termination of a product line.

Interest expense in the quarterly period ended March 31, 2007 was \$4.5 million as compared to \$4.9 million in the same period a year ago. The decrease in interest expense is due primarily to lower weighted average borrowings outstanding in the quarterly period ended March 31, 2007 as compared to the same period a year ago. The weighted average interest rates on our borrowings (inclusive of the finance charge on our accounts receivable sale facility) also declined to 5.12% in the quarterly period ended March 31, 2007 as compared to 5.44% in the same period a year ago due in part to lower borrowing costs in our present senior credit agreement which we entered into in the second quarter of 2006.

A provision for income taxes has been recorded at an effective tax rate of 36.3% for the quarterly period ended March 31, 2007 compared to the 30.7% effective rate recorded in the same period a year ago. The effective rate for the quarterly period ended March 31, 2007 is higher than that recorded in the same period a year ago as a result of the settlement in the first quarter of 2006 of the 2001 through 2003 IRS income tax return examinations. Due to the settlement of the income tax examinations, we adjusted our reserves to consider positions taken in our income tax return for periods subsequent to 2003. The net effect of these adjustments and the settlement was a reduction in income tax expense recorded in the quarter ended March 31, 2006 of \$0.5 million. A reconciliation of the United States statutory income tax rate to our effective tax rate is included in our Annual Report on Form 10-K for the year-ended December 31, 2006, Note 7 to the Consolidated Financial Statements.

Operating Segment Results:

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

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The following tables summarize the Company's results of operations by segment for the quarterly period ended March 31, 2006 and 2007:

CONMED Endosurgery, CONMED Electrosurgery and CONMED Linvatec

| | <u>2006</u> | <u>2007</u> |
|------------------------|-------------|-------------|
| Net sales | \$ 124,121 | \$ 137,394 |
| Income from operations | 16,441 | 18,793 |
| Operating margin | 13.2% | 13.7% |

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

- Arthroscopy sales increased \$7.5 million (13.7%) in the quarterly period ended March 31, 2007 to \$62.2 million from \$54.7 million in the comparable 2006 period as a result of increased sales of our procedure specific, resection and video imaging products for arthroscopy and general surgery, and our integrated operating room systems and equipment.
- Powered surgical instrument sales increased \$3.4 million (9.9%) in the quarterly period ended March 31, 2007 to \$37.6 million from \$34.2 million in the comparable 2006 period, as a result of increased sales of our large bone and small bone powered instrument handpieces.
- Electrosurgery sales increased \$0.6 million (2.6%) in the quarterly period ended March 31, 2007 to \$24.0 million from \$23.4 million in the comparable 2006 period, as a result of increased sales of our Ultraclean® products, ground pads and ABC® handpieces.
- Endosurgery sales increased \$1.7 million (14.3%) in the quarterly period ended March 31, 2007 to \$13.6 million from \$11.9 million in the comparable 2006 period as a result of increased sales of suction irrigation, hand held instruments and skin staplers.
- Operating margins as a percentage of net sales increased 0.5 percentage points to 13.7% in 2007 compared to 13.2% in 2006 principally as a result of lower sales force-related expenses.

CONMED Patient Care

| | <u>2006</u> | <u>2007</u> |
|------------------------|-------------|-------------|
| Net sales | \$ 19,611 | \$ 20,361 |
| Income from operations | 264 | 1,027 |
| Operating margin | 1.3% | 5.0% |

Product offerings include a line of vital signs and cardiac monitoring products including pulse oximetry equipment & sensors, ECG electrodes and cables, cardiac defibrillation & pacing pads and blood pressure cuffs. We also offer a complete line

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of reusable surgical patient positioners and suction instruments & tubing for use in the operating room, as well as a line of IV products and hydrogel-based wound care dressings.

- Patient care sales increased \$0.8 million (4.1%) in the quarterly period ended March 31, 2007 to \$20.4 million from \$19.6 million in the comparable 2006 period principally as a result of increased sales of our suction instruments.
- Operating margins as a percentage of net sales increased 3.7 percentage points to 5.0% in 2007 compared to 1.3% in 2006. Gross margins increased 2.0 percentage points in the first quarter 2007 as compared to the same period in 2006 primarily as a result of higher selling prices in the current quarter. In addition, selling and administrative expenses decreased 0.5 percentage points driven by lower sales force and distribution costs. Research and development expense decreased 1.2 percentage points in 2007 compared to 2006 as a result of decreased spending on the development of the ECOM project which is currently undergoing clinical evaluations.

CONMED Endoscopic Technologies

| | <u>2006</u> | <u>2007</u> |
|-------------------------------|-------------|-------------|
| Net sales | \$ 14,734 | \$ 13,259 |
| Income (loss) from operations | (2,372) | (1,211) |
| Operating Margin | (16.1%) | (9.1%) |

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

- Endoscopic Technologies sales decreased \$1.5 million (10.2%) in the quarterly period ended March 31, 2007 to \$13.2 million from \$14.7 million in the comparable 2006 period as a result of decreased sales in our forceps, biliary and pulmonary products as a result of increased competition and pricing pressures as well as production and operational issues which have resulted in product shortages and backorders.
- Operating margins as a percentage of net sales increased 7.0 percentage points to (9.1%) in 2007 compared to (16.1%) in 2006. This increase is due mainly to increased gross margins (4.7 percentage points) as a result of the completion of the transfer of production lines from C.R. Bard to CONMED and decreased spending in research and development (4.3 percentage points) as certain biliary and other projects near completion. Offsetting these improvements was a 2.0 percentage point increase as a percentage of net sales in selling and administrative costs.

Liquidity and capital resources

Our liquidity needs arise primarily from capital investments, working capital requirements and payments on indebtedness under the senior credit agreement. We have historically met these liquidity requirements with funds generated from operations,

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including sales of accounts receivable and borrowings under our revolving credit facility. In addition, we use term borrowings, including borrowings under our senior credit agreement and borrowings under separate loan facilities, in the case of real property purchases, to finance our acquisitions. We also have the ability to raise funds through the sale of stock or we may issue debt through a private placement or public offering. We generally attempt to minimize our cash balances on-hand and use available cash to pay down debt or repurchase our common stock.

Cash provided by operations

Our net working capital position was \$188.8 million at March 31, 2007. Net cash provided by operating activities was \$11.2 million in the quarterly period ended March 31, 2007 and \$14.0 million in the quarterly period ended March 31, 2006.

Net cash provided by operating activities decreased by \$2.8 million in 2007 as compared to 2006 as higher net income in the current quarter as compared to the 2006 period was offset by the non-cash nature of the gain on the settlement of the Johnson & Johnson litigation as this amount was a receivable at March 31, 2007 (See Note 10 to the consolidated condensed financial statements).

Investing cash flows

Net cash used in investing activities in the quarterly period ended March 31, 2007 consisted of capital expenditures and additional cash consideration paid for a business acquisition as a result of a purchase price adjustment. Capital expenditures were \$4.9 million and \$3.9 million for the quarterly period ended March 31, 2006 and 2007, respectively. The decrease in capital expenditures in the quarterly period ended March 31, 2007 as compared to the same period a year ago is primarily due to completion of certain infrastructure improvements.

Financing cash flows

Net cash used in financing activities in the three months ended March 31, 2007 consisted primarily of the following: \$3.3 million in proceeds from the issuance of common stock under our stock option plans and employee stock purchase plan; \$7.8 million in repayments of term borrowings under our senior credit agreement; and \$1.7 million net change in cash overdrafts.

Our \$235.0 million senior credit agreement (the "senior credit agreement") consists of a \$100.0 million revolving credit facility and a \$135.0 million term loan. There were no borrowings outstanding on the revolving credit facility as of March 31, 2007. Our available borrowings on the revolving credit facility at March 31, 2007 were \$95.0 million with approximately \$5.0 million of the facility set aside for outstanding letters of credit. There were \$95.0 million in borrowings outstanding on the term loan at March 31, 2007.

The scheduled principal payments on the term loan portion of the senior credit agreement are \$1.4 million annually through December 2011, increasing to \$88.3 million in 2012 with the remaining balance outstanding due and payable on April 12, 2013. We may also be required, under certain circumstances, to make additional principal payments based on excess cash flow as defined in the senior credit agreement. Interest rates on the term loan portion of the senior credit agreement are at LIBOR plus 1.75% (7.07% at March 31, 2007) or an alternative base rate; interest rates on the revolving credit facility portion of the senior credit agreement are at LIBOR plus 1.50% or an alternative base rate. For those borrowings where the Company elects to use the

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alternative base rate, the base rate will be the greater of the Prime Rate or the Federal Funds Rate in effect on such date plus 0.50%, plus a margin of 0.75% for term loan borrowings or 0.50% for borrowings under the revolving credit facility.

The senior credit agreement is collateralized by substantially all of our personal property and assets, except for our accounts receivable and related rights which are pledged in connection with our accounts receivable sales agreement. The senior credit agreement contains covenants and restrictions which, among other things, require the maintenance of certain financial ratios, and restrict dividend payments and the incurrence of certain indebtedness and other activities, including acquisitions and dispositions. We were in full compliance with these covenants and restrictions as of March 31, 2007. We are also required, under certain circumstances, to make mandatory prepayments from net cash proceeds from any issue of equity and asset sales.

Mortgage notes outstanding in connection with the property and facilities utilized by our CONMED Linvatec subsidiary consist of a note bearing interest at 7.50% per annum with semiannual payments of principal and interest through June 2009 (the "Class A note"); and a note bearing interest at 8.25% per annum compounded semiannually through June 2009, after which semiannual payments of principal and interest will commence, continuing through June 2019 (the "Class C note"). The principal balances outstanding on the Class A note and Class C note aggregated \$5.2 million and \$9.8 million, respectively, at March 31, 2007. These mortgage notes are secured by the CONMED Linvatec property and facilities.

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

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

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

Off-balance sheet arrangements

We have an accounts receivable sales agreement pursuant to which we and certain of our subsidiaries sell on an ongoing basis certain accounts receivable to CONMED

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Receivables Corporation (“CRC”), a wholly-owned, bankruptcy-remote, special-purpose subsidiary of CONMED Corporation. CRC may in turn sell up to an aggregate \$50.0 million undivided percentage ownership interest in such receivables (the “asset interest”) to a bank (the “purchaser”). The purchaser’s share of collections on accounts receivable are calculated as defined in the accounts receivable sales agreement, as amended. Effectively, collections on the pool of receivables flow first to the purchaser and then to CRC, but to the extent that the purchaser’s share of collections may be less than the amount of the purchaser’s asset interest, there is no recourse to CONMED or CRC for such shortfall. For receivables which have been sold, CONMED Corporation and its subsidiaries retain collection and administrative responsibilities as agent for the purchaser. As of March 31, 2007, the undivided percentage ownership interest in receivables sold by CRC to the purchaser aggregated \$47.0 million, which has been accounted for as a sale and reflected in the balance sheet as a reduction in accounts receivable. Expenses associated with the sale of accounts receivable, including the purchaser’s financing costs to purchase the accounts receivable were \$0.7 million in the three month period ended March 31, 2007 and are included in interest expense.

There are certain statistical ratios, primarily related to sales dilution and losses on accounts receivable, which must be calculated and maintained on the pool of receivables in order to continue selling to the purchaser. The pool of receivables is in full compliance with these ratios. Management believes that additional accounts receivable arising in the normal course of business will be of sufficient quality and quantity to meet the requirements for sale under the accounts receivables sales agreement. In the event that new accounts receivable arising in the normal course of business do not qualify for sale, then collections on sold receivables will flow to the purchaser rather than being used to fund new receivable purchases. To the extent that such collections would not be available to CONMED in the form of new receivables purchases, we would need to access an alternate source of working capital, such as our \$100 million revolving credit facility. Our accounts receivable sales agreement, as amended, also requires us to obtain a commitment (the “purchaser commitment”) from the purchaser to fund the purchase of our accounts receivable. The purchaser commitment was amended effective October 23, 2006 whereby it was extended through October 31, 2008 under substantially the same terms and conditions.

New accounting pronouncements

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

Item 3. Quantitative and qualitative disclosures about market risk

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

Item 4. Controls and procedures

An evaluation of the effectiveness of the design and operation of the Company’s disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (“Exchange Act”)) was carried out under the supervision and with the participation of the Company’s management, including the President and Chief Executive Officer and the Vice President-Finance and Chief Financial Officer (“the Certifying Officers”) as of March 31, 2007. Based on that evaluation, the

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Certifying Officers concluded that the Company's disclosure controls and procedures are effective to bring to the attention of the Company's management the relevant information necessary to permit an assessment of the need to disclose material developments and risks pertaining to the Company's business in its periodic filings with the Securities and Exchange Commission. There have been no changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended March 31, 2007 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

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

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Item 6. Exhibits

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

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SIGNATURES

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

**CONMED
CORPORATION**
(Registrant)

Date: May 4, 2007

/s/ Robert D. Shallish, Jr.
Robert D. Shallish, Jr.
Vice President - Finance
(Principal Financial Officer)

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Exhibit Index

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