

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

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**FORM 10-Q**

**QUARTERLY REPORT UNDER SECTION 13 OR 15(D) OF THE  
SECURITIES EXCHANGE ACT OF 1934**

**For the quarterly period ended June 30, 2003**

Commission file number: 0-9165

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**STRYKER CORPORATION**

(Exact name of registrant as specified in its charter)

**Michigan**

(State or other jurisdiction of  
Incorporation or organization)

**38-1239739**

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

**P.O. Box 4085, Kalamazoo, Michigan**

(Address of principal executive offices)

**49003-4085**

(Zip Code)

Registrant's telephone number, including area code: **(269) 385-2600**

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

YES ☒ NO ☐

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

199,144,729 shares of Common Stock, \$.10 par value, as of July 31, 2003.

## PART I. – FINANCIAL INFORMATION

### ITEM 1. FINANCIAL STATEMENTS

#### CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)

Stryker Corporation and Subsidiaries

(in millions, except per share amounts)

|  | June 30<br>2003 | December 31<br>2002 |
|--|-----------------|---------------------|
| <b>ASSETS</b>  |                 |                     |
| <i>Current Assets</i>  |                 |                     |
| Cash and cash equivalents  | \$47.1          | \$37.8              |
| Accounts receivable, less allowance of \$48.9 (\$43.7 in 2002)   | 446.7           | 406.7               |
| Inventories  | 460.4           | 426.5               |
| Deferred income taxes  | 254.0           | 227.5               |
| Prepaid expenses and other current assets  | 70.7            | 52.8                |
| Total current assets   | 1,278.9         | 1,151.3             |
| <br><i>Property, Plant and Equipment, less allowance for depreciation of \$446.9 (\$405.5 in 2002)</i> | <br>555.2       | <br>519.2           |
| <br><i>Other Assets</i>  |                 |                     |
| Goodwill   | 476.5           | 460.0               |
| Other intangibles, less accumulated amortization of \$119.5 (\$99.3 in 2002)                           | 476.9           | 475.1               |
| Deferred charges, less accumulated amortization of \$326.4 (\$274.1 in 2002)                           | 141.2           | 123.7               |
| Other  | 77.3            | 86.2                |
|  | 1,171.9         | 1,145.0             |
|  | \$3,006.0       | \$2,815.5           |
| <br><b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>  |                 |                     |
| <i>Current Liabilities</i>   |                 |                     |
| Accounts payable   | \$137.7         | \$106.0             |
| Accrued compensation   | 146.0           | 161.4               |
| Restructuring and acquisition-related liabilities  | 21.3            | 25.5                |
| Income taxes   | 104.7           | 133.2               |
| Accrued expenses and other liabilities   | 292.0           | 270.7               |
| Current maturities of long-term debt   | 6.5             | 10.7                |
| Total current liabilities  | 708.2           | 707.5               |
| <br><i>Long-Term Debt, excluding current maturities</i>  | <br>358.9       | <br>491.0           |
| <i>Other Liabilities</i>   | 120.3           | 118.8               |
| <i>Stockholders' Equity</i>  |                 |                     |
| Common stock, \$.10 par value:   |                 |                     |
| Authorized - 500.0 shares  |                 |                     |
| Outstanding - 198.8 shares (198.1 in 2002)   | 19.9            | 19.8                |
| Additional paid-in capital   | 145.0           | 120.7               |
| Retained earnings  | 1,654.2         | 1,442.6             |
| Deferred stock-based compensation  | (3.3)           | -                   |
| Accumulated other comprehensive gain (loss)  | 2.8             | (84.9)              |
| Total stockholders' equity   | 1,818.6         | 1,498.2             |
|  | \$3,006.0       | \$2,815.5           |

See accompanying notes to condensed consolidated financial statements.

# CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS (Unaudited)

Stryker Corporation and Subsidiaries

(in millions, except per share amounts)

|  | Three Months Ended<br>June 30 |         | Six Months Ended<br>June 30 |           |
|--|-------------------------------|---------|-----------------------------|-----------|
|  | 2003                          | 2002    | 2003                        | 2002      |
| Net sales                                      | \$891.7                       | \$733.9 | \$1,738.6                   | \$1,436.8 |
| Cost of sales                                  | 326.9                         | 267.1   | 627.7                       | 522.0     |
| Gross profit                                   | 564.8                         | 466.8   | 1,110.9                     | 914.8     |
| Research, development and engineering expenses | 44.9                          | 34.4    | 88.1                        | 68.0      |
| Selling, general and administrative expenses   | 348.4                         | 287.9   | 685.9                       | 565.1     |
|  | 393.3                         | 322.3   | 774.0                       | 633.1     |
| Other expense (income):                        |                               |         |                             |           |
| Interest expense                               | 6.4                           | 10.0    | 13.4                        | 20.6      |
| Intangibles amortization                       | 10.1                          | 5.8     | 19.1                        | 11.8      |
| Other  | (0.8)                         | 0.5     | (2.3)                       | 0.1       |
|  | 15.7                          | 16.3    | 30.2                        | 32.5      |
| Earnings before income taxes                   | 155.8                         | 128.2   | 306.7                       | 249.2     |
| Income taxes                                   | 48.3                          | 42.3    | 95.1                        | 82.2      |
| Net earnings                                   | \$107.5                       | \$85.9  | \$211.6                     | \$167.0   |
| Net earnings per share of common stock:        |                               |         |                             |           |
| Basic  | \$.54                         | \$.44   | \$1.07                      | \$.85     |
| Diluted  | \$.53                         | \$.42   | \$1.04                      | \$.82     |
| Average outstanding shares for the period:     |                               |         |                             |           |
| Basic  | 198.6                         | 197.4   | 198.4                       | 197.2     |
| Diluted  | 203.1                         | 203.6   | 202.9                       | 203.7     |

See accompanying notes to condensed consolidated financial statements.

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (Unaudited)  
Stryker Corporation and Subsidiaries  
(in millions, except per share amounts)

|  | Common<br>Stock | Additional<br>Paid-In<br>Capital | Retained<br>Earnings | Deferred<br>Stock-Based<br>Compensation | Accumulated<br>Other<br>Comprehensive<br>Gain (Loss) | Total     |
|--|-----------------|----------------------------------|----------------------|---|--|-----------|
| Balances at January 1, 2003  | \$19.8          | \$120.7                          | \$1,442.6            | \$0.0                                   | (\$84.9)   | \$1,498.2 |
| Net earnings   |                 |                                  | 211.6                |   |  | 211.6     |
| Net unrealized losses on securities,<br>net of income tax benefit  |                 |                                  |                      |   | (0.2)  | (0.2)     |
| Net unrealized gains related to<br>cash flow hedges  |                 |                                  |                      |   | 4.9  | 4.9       |
| Foreign currency translation adjustments   |                 |                                  |                      |   | 83.0   | 83.0      |
| Comprehensive earnings for the six<br>months ended June 30, 2003   |                 |                                  |                      |   |  | 299.3     |
| Issuance of 0.7 shares of common stock<br>under stock option and benefit plans,<br>including \$10.9 income tax benefit | 0.1             | 20.9                             |                      |   |  | 21.0      |
| Issuance of restricted stock   |                 | 3.4                              |                      | (3.4)                                   |  | 0.0       |
| Amortization of deferred stock-based<br>compensation   |                 |                                  |                      | 0.1                                     |  | 0.1       |
| Balances at June 30, 2003  | \$19.9          | \$145.0                          | \$1,654.2            | (\$3.3)                                 | \$2.8  | \$1,818.6 |

*See accompanying notes to condensed consolidated financial statements.*

In 2002, the Company declared a cash dividend of twelve cents per share to shareholders of record on December 31, 2002, payable on January 31, 2003. No cash dividends have been declared during 2003.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)  
Stryker Corporation and Subsidiaries  
(in millions)

|  | Three Months Ended<br>June 30 |         | Six Months Ended<br>June 30 |         |
|--|-------------------------------|---------|-----------------------------|---------|
|  | 2003                          | 2002    | 2003                        | 2002    |
| <i>Operating Activities</i>  |                               |         |                             |         |
| Net earnings   | \$107.5                       | \$85.9  | \$211.6                     | \$167.0 |
| Adjustments to reconcile net earnings to net cash provided by operating activities:                    |                               |         |                             |         |
| Depreciation   | 23.1                          | 21.5    | 46.2                        | 40.3    |
| Amortization   | 30.6                          | 23.7    | 60.2                        | 45.1    |
| Payments of restructuring and acquisition-related liabilities  | (2.9)                         | (1.0)   | (3.8)                       | (3.1)   |
| Other  | 1.3                           | 0.5     | 4.0                         | 1.0     |
| Changes in operating assets and liabilities, net of effects of business and product line acquisitions: |                               |         |                             |         |
| Proceeds from accounts receivable securitization   | 51.5                          | -       | 51.5                        | -       |
| Accounts receivable  | (54.3)                        | (14.3)  | (67.1)                      | (27.1)  |
| Inventories  | 7.7                           | (7.8)   | (15.6)                      | (19.1)  |
| Deferred charges   | (25.3)                        | (24.2)  | (53.5)                      | (45.3)  |
| Accounts payable   | 5.5                           | (5.9)   | 28.6                        | 7.9     |
| Payments of acquisition purchase liabilities   | (0.2)                         | -       | (0.4)                       | (0.3)   |
| Accrued expenses   | 52.4                          | 38.7    | 23.0                        | 14.2    |
| Income taxes   | (86.1)                        | (16.3)  | (49.0)                      | 5.1     |
| Other  | 10.3                          | 9.3     | (10.4)                      | (12.9)  |
| Net cash provided by operating activities  | 121.1                         | 110.1   | 225.3                       | 172.8   |
| <i>Investing Activities</i>  |                               |         |                             |         |
| Business and product line acquisitions, net of cash acquired   | (4.5)                         | (6.2)   | (8.8)                       | (11.3)  |
| Purchases of property, plant and equipment   | (30.9)                        | (31.7)  | (60.1)                      | (53.3)  |
| Proceeds from sales of property, plant and equipment   | 0.1                           | -       | 0.2                         | 0.2     |
| Net cash used in investing activities  | (35.3)                        | (37.9)  | (68.7)                      | (64.4)  |
| <i>Financing Activities</i>  |                               |         |                             |         |
| Proceeds from borrowings   | 183.0                         | 82.7    | 351.9                       | 288.2   |
| Payments on borrowings   | (267.5)                       | (178.4) | (489.4)                     | (399.4) |
| Dividends paid   | -                             | -       | (23.8)                      | (19.7)  |
| Proceeds from exercise of stock options  | 7.5                           | 5.1     | 13.6                        | 18.8    |
| Other  | 0.2                           | 0.3     | 0.3                         | 0.2     |
| Net cash used in financing activities  | (76.8)                        | (90.3)  | (147.4)                     | (111.9) |
| Effect of exchange rate changes on cash and cash equivalents   | (1.5)                         | 9.4     | 0.1                         | 5.6     |
| Increase (decrease) in cash and cash equivalents   | \$7.5                         | (\$8.7) | \$9.3                       | \$2.1   |

See accompanying notes to condensed consolidated financial statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)  
Stryker Corporation and Subsidiaries  
June 30, 2003  
(in millions, except share and per share amounts)

NOTE 1  
BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The results of operations for the six-month period ended June 30, 2003 are not necessarily indicative of the results that may be expected for the year ended December 31, 2003.

The balance sheet at December 31, 2002 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2002 (the "2002 Form 10-K").

NOTE 2  
COMPREHENSIVE GAIN

The Company follows Financial Accounting Standards Board (FASB) Statement No. 130, *Reporting Comprehensive Income*, in accounting for comprehensive income and its components. The comprehensive gain for the six months ended June 30, 2003 and 2002 was \$299.3 and \$240.5, respectively, and for the three months ended June 30, 2003 and 2002 was \$163.8 and \$173.6, respectively.

NOTE 3  
ACCOUNTS RECEIVABLE SECURITIZATION

The Company's accounts receivable securitization facility is described in detail in Note 1 to the consolidated financial statements included in the Company's 2002 Form 10-K. The amounts of accounts receivable interests sold by Stryker Funding Corporation (SFC) under the facility, net of SFC's retained interest, totaled \$181.5 at June 30, 2003 and \$130.0 at December 31, 2002 and are reflected in the condensed consolidated balance sheets as reductions of accounts receivable.

On April 24, 2003, the Company entered into an amended and restated accounts receivable securitization facility pursuant to which it increased the aggregate undivided percentage ownership interest in receivables that SFC may sell to bank administered commercial paper conduits from \$130.0 to \$200.0. SFC had sold an additional \$51.5 of undivided percentage ownership interests in accounts receivable as of June 30, 2003. The proceeds from the sale of additional accounts receivable interests were used to reduce outstanding borrowings under the Company's unsecured credit facilities.

NOTE 4  
INVENTORIES

Inventories are as follows:

|                   | June 30        | December 31    |
|-------------------|----------------|----------------|
|                   | 2003           | 2002           |
| Finished goods    | \$353.8        | \$319.2        |
| Work-in-process   | 43.6           | 51.8           |
| Raw material      | 68.2           | 60.7           |
| FIFO Cost         | 465.6          | 431.7          |
| Less LIFO reserve | 5.2            | 5.2            |
|                   | <u>\$460.4</u> | <u>\$426.5</u> |

NOTE 5  
RESTRUCTURING AND ACQUISITION-RELATED LIABILITIES

Note 6 in the Company's 2002 Form 10-K describes restructuring and acquisition-related pretax charges (credits) recorded by the Company in 2002, 2001 and 2000.

The following table provides a rollforward from December 31, 2002 to June 30, 2003 of the remaining liabilities associated with business acquisition purchase liabilities and restructuring and acquisition-related charges recorded by the Company:

|                               | Distributor  | Severance and | Facility<br>Closures and<br>Contractual<br>Obligations | Total         |
|-------------------------------|--------------|---------------|--|---------------|
|                               | Conversions  | Related Costs |  |               |
| Balances at December 31, 2002 | \$3.0        | \$21.9        | \$0.6  | \$25.5        |
| Payments                      | (0.3)        | (3.7)         | (0.2)  | (4.2)         |
| Balances at June 30, 2003     | <u>\$2.7</u> | <u>\$18.2</u> | <u>\$0.4</u>   | <u>\$21.3</u> |

NOTE 6  
STOCK OPTIONS AND RESTRICTED STOCK AWARDS

The Company has key employee and director stock option plans which are described more fully in Note 8 of the Company's 2002 Form 10-K. The Company follows Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, in accounting for its stock option plans. Under APB Opinion No. 25, no compensation expense is recognized because the exercise price of the Company's stock options equals the market price of the underlying stock on the measurement date (date of grant). Had compensation expense for the Company's stock-based compensation plans been determined based on the fair value at the grant dates for awards under those plans consistent with the method of FASB Statement No. 123, *Accounting for Stock-Based Compensation*, the Company's net earnings and net earnings per share would have been as follows:

|                                 | Three Months Ended<br>June 30 |               | Six Months Ended<br>June 30 |                |
|---------------------------------|-------------------------------|---------------|-----------------------------|----------------|
|                                 | 2003                          | 2002          | 2003                        | 2002           |
| Net earnings:                   |                               |               |                             |                |
| As reported                     | \$107.5                       | \$85.9        | \$211.6                     | \$167.0        |
| Deduct: Compensation expense    |                               |               |                             |                |
| --fair value method             | 4.6                           | 4.3           | 9.2                         | 7.9            |
| Pro forma                       | <u>\$102.9</u>                | <u>\$81.6</u> | <u>\$202.4</u>              | <u>\$159.1</u> |
| Basic net earnings per share:   |                               |               |                             |                |
| As reported                     | \$.54                         | \$.44         | \$1.07                      | \$.85          |
| Pro forma                       | .52                           | .41           | 1.02                        | .81            |
| Diluted net earnings per share: |                               |               |                             |                |
| As reported                     | \$.53                         | \$.42         | \$1.04                      | \$.82          |
| Pro forma                       | .51                           | .41           | 1.00                        | .79            |

During the second quarter of 2003, the Company issued 50,000 shares of restricted stock to its newly appointed President and Chief Operating Officer. The stock vests ratably on the first five anniversary dates of the grant, provided that the recipient is still employed by the Company. The aggregate market value of the restricted stock at the date of issuance of \$3.4, as measured at the quoted price of the Company's common stock, has been recorded as deferred stock-based compensation, a separate component of stockholders' equity, and is being amortized over the five-year vesting period.

#### NOTE 7

#### SEGMENT INFORMATION

The Company segregates its operations into two reportable business segments: Orthopaedic Implants and MedSurg Equipment. The Orthopaedic Implants segment sells orthopaedic reconstructive (hip, knee, and shoulder), trauma and spinal implants, bone cement and the bone growth factor osteogenic protein-1 (OP-1). The MedSurg Equipment segment sells powered surgical instruments, endoscopic systems, medical video imaging equipment, hospital beds and stretchers, craniomaxillofacial implants and image-guided surgical systems. Other includes Physical Therapy Services and corporate administration, interest expense and interest income.

The Company's reportable segments are business units that offer different products and services and are managed separately because each business requires different manufacturing, technology and marketing strategies.



Sales and net earnings (loss) by business segment follow:

|   | Orthopaedic<br><u>Implants</u> | MedSurg<br><u>Equipment</u> | <u>Other</u> | <u>Total</u> |
|---|--------------------------------|-----------------------------|--------------|--------------|
| <u>Three Months Ended June 30, 2003</u> |                                |                             |              |              |
| Net sales                               | \$522.2                        | \$312.9                     | \$56.6       | \$891.7      |
| Segment net earnings (loss)             | 70.9                           | 40.6                        | (4.0)        | 107.5        |
| <u>Three Months Ended June 30, 2002</u> |                                |                             |              |              |
| Net sales                               | \$414.8                        | \$267.8                     | \$51.3       | \$733.9      |
| Segment net earnings (loss)             | 60.5                           | 30.9                        | (5.5)        | 85.9         |
| <u>Six Months Ended June 30, 2003</u>   |                                |                             |              |              |
| Net sales                               | \$1,013.0                      | \$617.0                     | \$108.6      | \$1,738.6    |
| Segment net earnings (loss)             | 141.8                          | 80.4                        | (10.6)       | 211.6        |
| <u>Six Months Ended June 30, 2002</u>   |                                |                             |              |              |
| Net sales                               | \$809.8                        | \$526.4                     | \$100.6      | \$1,436.8    |
| Segment net earnings (loss)             | 119.4                          | 60.9                        | (13.3)       | 167.0        |

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

### *Results of Operations*

The tables below outline the components of the condensed consolidated statements of earnings as a percentage of net sales and the period-to-period percentage change in dollar amounts:

|  | <u>Percentage of Net Sales</u> |             |                  |
|--|--------------------------------|-------------|------------------|
|  | Six months ended               |             | Percentage       |
|  | June 30                        |             | Change           |
|  | <u>2003</u>                    | <u>2002</u> | <u>2003/2002</u> |
| Net sales                                      | 100.0                          | 100.0       | 21               |
| Cost of sales                                  | <u>36.1</u>                    | <u>36.3</u> | 20               |
| Gross profit                                   | 63.9                           | 63.7        | 21               |
| Research, development and engineering expenses | 5.1                            | 4.7         | 30               |
| Selling, general and administrative expenses   | 39.5                           | 39.3        | 21               |
| Other expense (income)                         | <u>1.7</u>                     | <u>2.3</u>  | (7)              |
| Earnings before income taxes                   | 17.6                           | 17.3        | 23               |
| Income taxes                                   | <u>5.5</u>                     | <u>5.7</u>  | 16               |
| Net earnings                                   | 12.2                           | 11.6        | 27               |
|  | ====                           | ====        |                  |

|  | <u>Percentage of Net Sales</u> |              |                  |
|--|--------------------------------|--------------|------------------|
|  | Three months ended             |              | Percentage       |
|  | June 30                        |              | Change           |
|  | <u>2003</u>                    | <u>2002</u>  | <u>2003/2002</u> |
| Net sales                                      | 100.0                          | 100.0        | 22               |
| Cost of sales                                  | <u>36.7</u>                    | <u>36.4</u>  | 22               |
| Gross profit                                   | 63.3                           | 63.6         | 21               |
| Research, development and engineering expenses | 5.0                            | 4.7          | 31               |
| Selling, general and administrative expenses   | 39.1                           | 39.2         | 21               |
| Other expense (income)                         | <u>1.8</u>                     | <u>2.2</u>   | (4)              |
| Earnings before income taxes                   | 17.5                           | 17.5         | 22               |
| Income taxes                                   | <u>5.4</u>                     | <u>5.8</u>   | 14               |
| Net earnings                                   | 12.1                           | 11.7         | 25               |
|  | <u>-----</u>                   | <u>-----</u> |                  |

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

|                              | <u>Six Months Ended</u> |              | Percentage       |
|------------------------------|-------------------------|--------------|------------------|
|                              | June 30                 |              | Change           |
|                              | <u>2003</u>             | <u>2002</u>  | <u>2003/2002</u> |
| Domestic/international sales |                         |              |                  |
| Domestic                     | \$1,113.4               | \$943.3      | 18               |
| International                | <u>625.2</u>            | <u>493.5</u> | 27               |
| Total net sales              | \$1,738.6               | \$1,436.8    | 21               |
|                              | =====                   | =====        |                  |
| Product line sales           |                         |              |                  |
| Orthopaedic Implants         | \$1,013.0               | \$809.8      | 25               |
| MedSurg Equipment            | 617.0                   | 526.4        | 17               |
| Physical Therapy Services    | <u>108.6</u>            | <u>100.6</u> | 8                |
| Total net sales              | \$1,738.6               | \$1,436.8    | 21               |
|                              | =====                   | =====        |                  |

|                              | <u>Three Months Ended</u> |              | <u>Percentage</u> |
|------------------------------|---------------------------|--------------|-------------------|
|                              | <u>June 30</u>            |              | <u>Change</u>     |
|                              | <u>2003</u>               | <u>2002</u>  | <u>2003/2002</u>  |
| Domestic/international sales |                           |              |                   |
| Domestic                     | \$567.2                   | \$478.1      | 19                |
| International                | <u>324.5</u>              | <u>255.8</u> | 27                |
| Total net sales              | \$891.7                   | \$733.9      | 22                |
|                              | =====                     | =====        |                   |
| Product line sales           |                           |              |                   |
| Orthopaedic Implants         | \$522.2                   | \$414.8      | 26                |
| MedSurg Equipment            | 312.9                     | 267.8        | 17                |
| Physical Therapy Services    | <u>56.6</u>               | <u>51.3</u>  | 10                |
| Total net sales              | \$891.7                   | \$733.9      | 22                |
|                              | =====                     | =====        |                   |

Stryker Corporation's net sales increased 21% in the first six months of 2003 to \$1,738.6 million from \$1,436.8 million in 2002. Net sales grew by 12% as a result of increased unit volume and changes in product mix; 5% due to changes in foreign currency exchange rates; 2% as a result of higher selling prices; and 2% due to acquired businesses and product lines. For the second quarter of 2003, net sales were \$891.7 million representing a 22% increase over net sales of \$733.9 million in the second quarter of 2002. Net sales grew by 12% as a result of increased unit volume and favorable product mix, 2% as a result of higher selling prices, 2% due to acquired businesses and product lines and 6% due to changes in foreign currency exchange rates.

The Company's domestic sales were \$1,113.4 million for the first half of 2003 and \$567.2 million for the second quarter of 2003, representing increases of 18% and 19%, respectively, as a result of strong shipments of Orthopaedic Implants and MedSurg Equipment and higher revenue from Physical Therapy Services.

International sales were \$625.2 million for the first half of 2003 and \$324.5 million for the second quarter of 2003, representing increases of 27% in both periods as a result of higher shipments of Orthopaedic Implants and MedSurg Equipment. The impact of foreign currency comparisons to the dollar value of international sales was favorable by \$76.0 million in the first half and by \$39.3 million in the second quarter. Excluding the impact of foreign currency, international sales increased 11% in both the first half and second quarter of 2003.

Worldwide sales of Orthopaedic Implants were \$1,013.0 million for the first half of 2003 and \$522.2 million for the second quarter of 2003, representing increases of 25% and 26%, respectively, based on higher shipments of reconstructive (hip, knee, and shoulder), trauma and spinal implants. Excluding the impact of foreign currency, sales of Orthopaedic Implants increased 18% in the first half of 2003 and 19% in the second quarter.

Worldwide sales of MedSurg Equipment were \$617.0 million for the first half of 2003 and \$312.9 million for the second quarter, representing increases of 17% in both periods based on higher shipments of powered surgical instruments, endoscopic systems, hospital beds and stretchers and craniomaxillofacial implants. Excluding the impact of foreign currency, sales of MedSurg Equipment increased 14% in the first half of 2003 and 13% in the second quarter.

Physical Therapy Services revenues were \$108.6 million for the first half of 2003 and \$56.6 million for the second quarter of 2003, representing increases of 8% and 10%, respectively, as a result of new physical therapy centers and higher revenues from existing centers.

Cost of sales in the first half of 2003 represented 36.1% of sales compared to 36.3% in the same period of 2002. In the second quarter the cost of sales percentage increased to 36.7% from 36.4% in the second quarter of 2002. The decrease in the cost of sales percentage in the first half is due to the faster sales growth in the higher margin Orthopaedic Implants business and increased sales of non-royalty based products. The higher cost of sales percentage in the second quarter is partially due to redundant costs related to the transition of certain production facilities and higher product obsolescence resulting from new product launches.

Research, development and engineering expenses represented 5.1% of sales in the first half of 2003 compared to 4.7% in the same period of 2002 and increased 30% to \$88.1 million. In the second quarter, these expenses increased 31% and represented 5.0% of sales in 2003 compared to 4.7 % in 2002. The higher spending level in both periods is the result of the Company's product launches in the first half of 2003 and continued focus on new product development for anticipated product launches throughout the remainder of the year.

Selling, general and administrative expenses increased 21% in the first half of 2003 and represented 39.5% of sales compared to 39.3% in the same period of 2002. In the second quarter, these expenses increased 21% and represented 39.1% of sales in 2003 compared to 39.2% in 2002. The increase in selling, general and administrative expenses is partially due to an increase in sales commission expense as a result of the 21% increase in net sales in the first half of 2003 and the 22% increase in net sales in the second quarter of 2003. In addition, the Company incurred \$7.4 million and \$3.6 million increases in insurance costs in the first half and second quarter, respectively, resulting from increased premiums charged by third-party insurers and the establishment of a wholly-owned captive insurance company as more fully described in Other Matters. The increase in selling, general and administrative expenses as a percentage of sales in the first half is primarily due to higher distribution costs associated with the increased sales mix of Orthopaedic Implants and the increase in insurance costs.

Interest expense declined to \$13.4 million in the first half of 2003 from \$20.6 million in 2002 and declined to \$6.4 million in the second quarter of 2003 from \$10.0 million in 2002 as a result of lower outstanding debt balances and lower interest rates. The increase in intangibles amortization in the first half of 2003 to \$19.1 million from \$11.8 million in the same period of 2002 and to \$10.1 million in the second quarter from \$5.8 million in the second quarter of 2002 is primarily the result of the increased intangible assets recorded as a result of the July 1, 2002, acquisition of the Surgical Dynamics Inc. spinal implant business (SDI) from Tyco International Ltd. as more fully described in Other Matters. Other income was \$2.3 million in the first half of 2003 compared to other expense of \$0.1 million in 2002 due to higher foreign currency transaction gains in the current year compared to 2002. Other income was \$0.8 million in the second quarter compared to other expense of \$0.5 million in 2002 due to lower foreign currency transaction losses in the current year compared to 2002.

The Company's effective income tax rate was 31.0% for the six month and second quarter periods of 2003 compared to a 33.0% effective income tax rate for the same periods of 2002 and an effective annual income tax rate of 31.8% for the year ended December 31, 2002. The income tax rate reduction results primarily from increased manufacturing in lower tax jurisdictions.

Net earnings for the first half of 2003 were \$211.6 million, an increase of 27% when compared to net earnings of \$167.0 million in the first half of 2002. Basic net earnings per share increased 26% in 2003 to \$1.07 from \$.85 in 2002, and diluted net earnings per share increased 27% to \$1.04 in 2003 from \$.82 in 2002. Net earnings for the second quarter of 2003 were \$107.5 million representing a 25%

increase over net earnings of \$85.9 million in the second quarter of 2002. Basic net earnings per share increased 23% in the second quarter to \$.54 in 2003 from \$.44 in 2002, and diluted net earnings per share increased 26% in the second quarter to \$.53 in 2003 from \$.42 in 2002.

### *Liquidity and Capital Resources*

The Company's working capital at June 30, 2003, increased \$126.9 million to \$570.7 million from \$443.8 million at December 31, 2002 including the effect of the sale of an additional \$51.5 million of accounts receivable pursuant to the accounts receivable securitization facility, as more fully described below. The increase in working capital resulted from growth in the Company's overall business and the use of strong cash earnings to fund increases in accounts receivable, inventory and prepaid expenses and to pay current liabilities due in the first six months of 2003, primarily for accrued bonuses, income taxes and dividends. Accounts receivable days sales outstanding, excluding the effect of the Company's accounts receivable securitization program, increased 5 days to 63 days at June 30, 2003 from 58 days at December 31, 2002. Days sales in inventory increased 2 days to 128 days at June 30, 2003 from 126 days at December 31, 2002. The higher days sales outstanding and days sales in inventory at June 30, 2003 are due in part to higher international balances attributable to the weakening of the U.S. dollar relative to the local foreign currency balances during the second quarter. In addition, the higher days sales outstanding at June 30, 2003 is due to an increase in the aging of certain international accounts receivable, particularly in Europe and Canada.

The Company generated cash of \$225.3 million from operations in the first six months of 2003 compared to \$172.8 million in 2002. In the second quarter, the Company generated cash from operations of \$121.1 million compared to \$110.1 million in 2002. The increase in cash provided by operating activities in the first six months and second quarter of 2003 compared to the same periods in 2002 is primarily due to strong cash earnings and the expansion of the accounts receivable securitization facility, described below, which provided \$51.5 million of proceeds. These increases were partially offset by increases in trade accounts receivable and higher required income tax payments primarily in the United States, Europe and Japan.

In the first half of 2003, the Company used cash of \$60.1 million for capital expenditures, \$8.8 million for business and product line acquisitions, and \$23.8 million for the payment of dividends. The Company also borrowed an additional \$351.9 million under its existing credit facilities to fund cash flow needs during the first half of 2003 and made repayments of \$489.4 million against the credit facilities. Total borrowings declined by \$136.3 million during the first half of 2003.

The Company had \$47.1 million in cash and cash equivalents at June 30, 2003. The Company had outstanding borrowings totaling \$365.4 million at the end of the first half of 2003. Current maturities of long-term debt at June 30, 2003 were \$6.5 million and will decrease to \$0.2 million for the twelve months ending June 30, 2004 and 2005. The Company's \$250.0 million 364-day revolving credit agreement expires in December 2003 and is renewable at the Company's and the lenders' discretion. The Company's \$750.0 million five-year, non-amortizing, revolving credit agreement expires in December 2006. The Company believes its cash on hand as well as anticipated cash flows from operations will be sufficient to fund future operating and investing activities and required debt repayments. Should additional funds be required, the Company had \$720.0 million of additional borrowing capacity available under its existing credit facilities at June 30, 2003.

On April 24, 2003, the Company entered into an amended and restated accounts receivable securitization facility pursuant to which it increased the aggregate undivided percentage ownership interest in receivables that Stryker Funding Corporation (SFC) may sell to bank administered commercial paper conduits from \$130.0 million to \$200.0 million. SFC had sold an additional \$51.5 million of undivided percentage ownership interests in accounts receivable as of June 30, 2003. The proceeds from

the sale of additional accounts receivable interests were used to reduce outstanding borrowings under the Company's unsecured credit facilities.

#### *Other Matters*

On July 1, 2002, the Company acquired SDI from Tyco International Ltd. for \$135.0 million in cash. The acquisition expanded the Company's spinal product line by adding interbody spinal cages for the United States market as well as other thoracolumbar and cervical spinal fixation devices. The acquisition was funded using existing credit facilities.

The acquisition of SDI was accounted for using the purchase method of accounting. The results of operations for the acquired business are included in the Company's Consolidated Financial Statements beginning July 1, 2002. The purchase price of \$135.0 million in cash, less a contractually required adjustment based on the decrease in SDI's working capital between April 30, 2002 and closing, and liabilities assumed have been allocated to the assets acquired based on their estimated fair value at the date of acquisition. The purchase price allocation was finalized in the second quarter of 2003. Based on the final purchase price allocation (as adjusted for the determined working capital adjustment amount), \$84.5 million of the purchase price was allocated to patent licensing agreements to be amortized over their remaining life of 8 years, \$9.4 million to inventory, \$36.9 million to deferred tax assets related to future tax deductions, \$5.2 million to other tangible assets and \$7.6 million to liabilities assumed. Immediately after the acquisition was consummated, management of the Company began to implement an integration plan to combine Stryker and SDI. In conjunction with the integration plan, the Company recorded additional purchase liabilities of \$3.6 million, which were included in the preliminary purchase price allocation. The additional purchase liabilities include \$3.1 million for severance and related costs and \$0.5 million for contractual obligations. The severance and related costs were provided for workforce reductions covering 37 SDI employees. The workforce reductions were completed during the fourth quarter of 2002 with severance payments to be made through the third quarter of 2003. The Company's pro forma consolidated financial results did not differ significantly as a result of the SDI acquisition.

The Company is partially self-insured for product liability claims. In January 2003, the Company established a wholly-owned captive insurance company to manage its self-insured retention limits. The captive insurance company provides insurance reserves for estimated liabilities for product claims incurred but not reported based on actuarially determined liabilities. The actuarial valuations are based on historical information along with certain assumptions about future events.

During the second quarter of 2003, the Company issued 50,000 shares of restricted stock to its newly appointed President and Chief Operating Officer. The stock vests ratably on the first five anniversary dates of the grant, provided that the recipient is still employed by the Company. The aggregate market value of the restricted stock at the date of issuance of \$3.4 million, as measured at the quoted price of the Company's common stock, has been recorded as deferred stock-based compensation, a separate component of stockholders' equity, and is being amortized over the five-year vesting period.

The Company has certain investments in net assets in international locations that are not hedged that are subject to translation gains and losses due to changes in foreign currencies. In the first half of 2003, the strengthening of foreign currencies relative to the U.S. dollar increased the value of these investments in net assets by \$83.0 million. This gain eliminated the previously-recorded cumulative loss of \$68.6 million that had been recorded as a separate component of stockholders' equity at December 31, 2002.

### *Forward-Looking Statements*

The information contained in this report may contain information that includes or is based on forward-looking statements within the meaning of the federal securities laws that are subject to risks and uncertainties. These statements may be identified by the use of words such as "anticipates," "expects," "estimates," "projects," "intends" and "believes" and variations thereof and other terms of similar meaning. Factors that could cause the Company's actual results and financial condition to differ from the Company's expectations include, but are not limited to: regulatory actions, including cost-containment measures, that could adversely affect the price of or demand for the Company's products; changes in reimbursement levels from third-party payors; a significant increase in product liability claims; changes in economic conditions that adversely affect the level of demand for the Company's products; changes in foreign exchange markets; changes in financial markets; and changes in the competitive environment.

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

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

There have been no material changes from the information provided in the Company's Annual Report on Form 10-K for the year ended December 31, 2002.

### ITEM 4. CONTROLS AND PROCEDURES

An evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures was carried out under the supervision and with the participation of the Company's management, including the Chairman of the Board and Chief Executive Officer and the Vice President and Chief Financial Officer ("the Certifying Officers") as of June 30, 2003. Based on that evaluation, the Certifying Officers concluded that the Company's disclosure controls and procedures are effective to bring to the attention of the Company's management the relevant information necessary to permit an assessment of the need to disclose material developments and risks pertaining to the Company's business in its periodic filings with the Securities and Exchange Commission. There was no change to the Company's internal control over financial reporting during the quarter ended June 30, 2003 that materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

## **PART II. – OTHER INFORMATION**

### **ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS**

On June 2, 2003 the Company issued 50,000 shares of restricted stock to its newly appointed President and Chief Operating Officer as an inducement to his employment with the Company. See Note 6 to Notes to Condensed Consolidated Financial Statements (Unaudited). The issuance of the restricted stock was a transaction not involving any public offering and, accordingly, was exempt from the registration requirements of the Securities Act of 1933 by virtue of the provisions of Section 4(2) thereof.

### **ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K**

#### **(a) Exhibits**

- 10.1\* Executive employment agreement dated as of April 22, 2003 between Stryker Corporation and Stephen P. MacMillan
- 10.2\* Restricted stock agreement made as of June 1, 2003 by Stryker Corporation with Stephen P. MacMillan
- 31.1 Certification of Principal Executive Officer of Stryker Corporation pursuant to Rule 13a-14(a)
- 31.2 Certification of Principal Financial Officer of Stryker Corporation pursuant to Rule 13a-14(a)
- 32.1 Certification by Chief Executive Officer of Stryker Corporation pursuant to 18 U.S.C. Section 1350
- 32.2 Certification by Chief Financial Officer of Stryker Corporation pursuant to 18 U.S.C. Section 1350

\* compensation arrangement

#### **(b) Reports on Form 8-K**

Reports on Form 8-K filed during the second quarter of 2003.

Form 8-K dated April 16, 2003

Item 7. Financial Statements and Exhibits - Press release dated April 16, 2003.

Item 9. Regulation FD Disclosure

Form 8-K dated April 22, 2003

Item 7. Financial Statements and Exhibits - Press release dated April 22, 2003.

Item 9. Regulation FD Disclosure



## 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.

STRYKER CORPORATION  
(Registrant)

August 11, 2003  
Date

/s/ JOHN W. BROWN  
John W. Brown, Chairman  
and Chief Executive Officer  
(Principal Executive Officer)

August 11, 2003  
Date

/s/ DEAN H. BERGY  
Dean H. Bergy, Vice President,  
Chief Financial Officer and Secretary  
(Principal Financial Officer)

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