

**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, 2005**

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.)

**2725 Fairfield Road, Kalamazoo, Michigan**

(Address of principal executive offices)

**49002**

(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 by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act):

YES ☒ NO ☐

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

403,507,233 shares of Common Stock, \$.10 par value, as of June 30, 2005.

## 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 2005	December 31 2004
<b>ASSETS</b>		
<i>Current Assets</i>		
Cash and cash equivalents	\$118.4	\$349.4
Marketable securities	212.0	-
Accounts receivable, less allowance of \$56.3 (\$54.7 in 2004)	749.6	751.1
Inventories	576.3	552.5
Deferred income taxes	418.5	407.5
Prepaid expenses and other current assets	96.6	82.1
Total current assets	2,171.4	2,142.6
<i>Property, Plant and Equipment, less allowance for depreciation of \$543.2 (\$524.2 in 2004)</i>	738.5	700.5
<i>Other Assets</i>		
Goodwill	519.9	506.3
Other intangibles, less accumulated amortization of \$219.9 (\$200.7 in 2004)	434.3	456.9
Loaner instrumentation, less accumulated amortization of \$390.1 (\$375.7 in 2004)	242.1	202.4
Deferred income taxes	31.7	38.6
Other	29.9	36.5
	1,257.9	1,240.7
	<u>\$4,167.8</u>	<u>\$4,083.8</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<i>Current Liabilities</i>		
Accounts payable	\$180.6	\$214.5
Accrued compensation	200.8	244.0
Income taxes	116.9	187.0
Accrued expenses and other liabilities	444.9	458.7
Current maturities of long-term debt	8.5	9.3
Total current liabilities	951.7	1,113.5
<i>Long-Term Debt, excluding current maturities</i>	0.7	0.7
<i>Other Liabilities</i>	226.6	217.6
<i>Stockholders' Equity</i>		
Common stock, \$.10 par value:		
Authorized - 1,000.0 shares		
Outstanding - 403.5 shares (402.5 in 2004)	40.4	40.3
Additional paid-in capital	244.2	218.1
Retained earnings	2,655.0	2,297.6
Deferred stock-based compensation	(2.0)	(2.3)
Accumulated other comprehensive gain	51.2	198.3
Total stockholders' equity	2,988.8	2,752.0
	<u>\$4,167.8</u>	<u>\$4,083.8</u>

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 June 30		Six Months Ended June 30	
	2005	2004	2005	2004
Net sales	\$1,218.6	\$1,043.0	\$2,421.1	\$2,078.1
Cost of sales	422.2	364.7	851.3	732.9
Gross profit	796.4	678.3	1,569.8	1,345.2
Research, development and engineering expenses	65.9	50.5	126.5	100.1
Selling, general and administrative expenses	457.5	396.5	907.7	807.8
Intangibles amortization	11.4	11.2	27.8	24.0
	534.8	458.2	1,062.0	931.9
Operating income	261.6	220.1	507.8	413.3
Other expense	0.2	1.9	0.8	1.0
Earnings before income taxes	261.4	218.2	507.0	412.3
Income taxes	77.1	65.5	149.6	123.7
Net earnings	\$184.3	\$152.7	\$357.4	\$288.6
Net earnings per share of common stock:				
Basic	\$.46	\$.38	\$.89	\$.72
Diluted	\$.45	\$.37	\$.87	\$.70
Average outstanding shares for the period:				
Basic	403.3	400.8	403.1	400.3
Diluted	411.3	410.8	411.3	410.0

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 Stock	Additional Paid-In Capital	Retained Earnings	Deferred Stock-based Compensation	Accumulated Other Comprehensive Gain (Loss)	Total
Balances at January 1, 2005	\$40.3	\$218.1	\$2,297.6	(\$2.3)	\$198.3	\$2,752.0
Net earnings			357.4			357.4
Net unrealized losses on securities, net of income tax benefit					(0.1)	(0.1)
Reduction in unfunded pension losses, net of income tax effect					0.5	0.5
Foreign currency translation adjustments					(147.5)	(147.5)
Comprehensive earnings for the six months ended June 30, 2005						210.3
Issuance of 1.0 shares of common stock under stock option and benefit plans, including \$12.3 income tax benefit	0.1	26.1				26.2
Amortization of deferred stock-based compensation				0.3		0.3
Balances at June 30, 2005	\$40.4	\$244.2	\$2,655.0	(\$2.0)	\$51.2	\$2,988.8

See accompanying notes to condensed consolidated financial statements.

In 2004, the Company declared a cash dividend of nine cents per share to shareholders of record on December 31, 2004, payable on January 31, 2005. No cash dividends have been declared during 2005.

# CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

Stryker Corporation and Subsidiaries

(in millions)

	Three Months Ended June 30		Six Months Ended June 30	
	2005	2004	2005	2004
<i>Operating Activities</i>				
Net earnings	\$184.3	\$152.7	\$357.4	\$288.6
Adjustments to reconcile net earnings to net cash provided by operating activities:				
Depreciation	26.4	25.1	53.5	50.8
Amortization	43.0	35.9	89.8	71.2
Income tax benefit from exercise of stock options	5.8	16.5	12.3	24.5
Payments of restructuring and acquisition-related liabilities	-	(0.3)	-	(3.4)
Other	1.5	1.8	3.8	2.6
Changes in operating assets and liabilities, net of effects of acquisitions:				
Reductions of accounts receivable securitization	-	(155.0)	-	(150.0)
Accounts receivable	(1.9)	5.6	(29.2)	(56.3)
Inventories	(34.0)	(30.0)	(46.6)	(52.9)
Loaner instrumentation	(54.3)	(38.7)	(109.2)	(75.1)
Accounts payable	8.4	(0.3)	(30.0)	18.5
Payments of acquisition purchase liabilities	(1.3)	(0.2)	(1.3)	(0.2)
Accrued expenses	55.9	45.2	(6.7)	14.5
Income taxes	(55.4)	(36.5)	(78.1)	(27.3)
Other	8.8	22.9	3.5	(2.9)
Net cash provided by operating activities	187.2	44.7	219.2	102.6
<i>Investing Activities</i>				
Acquisitions, net of cash acquired	(3.0)	(5.1)	(53.1)	(14.9)
Purchases of marketable securities	(212.9)	-	(212.9)	-
Purchases of property, plant and equipment	(71.1)	(43.1)	(116.4)	(74.2)
Proceeds from sales of property, plant and equipment	0.2	-	0.4	7.8
Net cash used in investing activities	(286.8)	(48.2)	(382.0)	(81.3)
<i>Financing Activities</i>				
Proceeds from borrowings	198.1	118.4	246.7	380.4
Payments on borrowings	(197.9)	(118.6)	(246.5)	(390.5)
Dividends paid	-	-	(36.2)	(28.0)
Proceeds from exercise of stock options	5.8	14.2	11.7	20.1
Other	(17.2)	0.2	(27.2)	0.3
Net cash provided by (used in) financing activities	(11.2)	14.2	(51.5)	(17.7)
Effect of exchange rate changes on cash and cash equivalents	(15.5)	3.0	(16.7)	(6.9)
Increase (decrease) in cash and cash equivalents	(\$126.3)	\$13.7	(\$231.0)	(\$3.3)

See accompanying notes to condensed consolidated financial statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)  
Stryker Corporation and Subsidiaries  
June 30, 2005

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 United States 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, 2005 are not necessarily indicative of the results that may be expected for the year ended December 31, 2005.

The balance sheet at December 31, 2004 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, 2004 (the "2004 Form 10-K").

NOTE 2  
COMPREHENSIVE EARNINGS

The Company follows Financial Accounting Standards Board (FASB) Statement No. 130, *Reporting Comprehensive Income*, in accounting for comprehensive earnings and its components. The comprehensive earnings for the six months ended June 30, 2005 and 2004 were \$210.3 million and \$263.8 million, respectively, and for the three months ended June 30, 2005 and 2004 were \$85.6 million and \$150.1 million, 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 2004 Form 10-K. There were no amounts of undivided percentage ownership interests in accounts receivable sold by Stryker Funding Corporation under the facility at June 30, 2005 or December 31, 2004.

NOTE 4  
INVENTORIES

Inventories are as follows (in millions):

	June 30	December 31
	2005	2004
Finished goods	\$438.4	\$429.1
Work-in-process	63.7	53.4
Raw material	79.3	75.1
FIFO Cost	581.4	557.6
Less LIFO reserve	5.1	5.1
	<u>\$576.3</u>	<u>\$552.5</u>

NOTE 5  
ACQUISITION

On February 23, 2005, the Company acquired eTrauma.com Corp. (eTrauma) for approximately \$50.0 million in cash plus certain transaction costs. The acquisition expanded the Company's endoscopic products and medical video imaging equipment product offerings by adding eTrauma's proprietary Picture Archive and Communications Systems (PACs) image management and viewing software. The acquisition of eTrauma was accounted for using the purchase method of accounting. The results of operations for the acquired business are included in the Company's condensed consolidated financial statements beginning February 23, 2005 and did not materially impact the Company's reported operating results. Pro forma consolidated results of operations would not differ significantly as a result of the eTrauma acquisition.

The purchase price has been preliminarily allocated to the assets acquired and liabilities assumed based on their estimated fair value at the date of acquisition. Based on the preliminary purchase price allocation, \$22.0 million was allocated to identifiable intangibles, to be amortized over their remaining lives of five to eight years, and \$31.5 million was allocated to goodwill. Immediately after the acquisition was consummated, management of the Company began to implement an integration plan to combine Stryker and eTrauma. In conjunction with the integration plan, the Company recorded additional purchase liabilities for severance and related costs of \$0.3 million, which were included in the purchase price allocation.

NOTE 6  
ACQUISITION-RELATED LIABILITIES

The following table provides a rollforward from December 31, 2004 to June 30, 2005 of the liabilities associated with business acquisition purchase liabilities recorded by the Company. These liabilities are included within accrued expenses and other liabilities in the condensed consolidated balance sheets.

(in millions)	Distributor Conversions	Severance and Related Costs	Total
Balances at December 31, 2004	\$2.5	\$0.0	\$2.5
Addition from business acquisition	--	0.3	0.3
Payments	(1.2)	(0.1)	(1.3)
Balances at June 30, 2005	\$1.3	\$0.2	\$1.5

NOTE 7  
CAPITAL STOCK

The Company has key employee and director stock option plans which are described more fully in Note 8 of the Company's 2004 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 (in millions, except per share data):

	Three Months Ended June 30		Six Months Ended June 30	
	2005	2004	2005	2004
Net earnings:				
As reported	\$184.3	\$152.7	\$357.4	\$288.6
Deduct: Compensation expense --fair value method	(6.5)	(6.6)	(12.9)	(12.8)
Pro forma	\$177.8	\$146.1	\$344.5	\$275.8
Basic net earnings per share:				
As reported	\$.46	\$.38	\$.89	\$.72
Pro forma	\$.44	\$.36	\$.85	\$.69
Diluted net earnings per share:				
As reported	\$.45	\$.37	\$.87	\$.70
Pro forma	\$.43	\$.36	\$.84	\$.67

In December 2004, the FASB issued a revision to Statement No. 123, *Share-Based Payment*. This revision supersedes APB Opinion No. 25 and its related implementation guidance. On April 14, 2005, the United States Securities and Exchange Commission adopted a new rule allowing companies to delay the required adoption date of the Statement to their first fiscal year beginning after June 15, 2005. Based on this ruling, the Company plans to adopt the provisions of the Statement effective January 1, 2006 rather than July 1, 2005 as previously required by the revised Statement. The revised Statement requires companies to recognize the cost of stock options based on the grant-date fair value pursuant to their employee stock option plans over the period during which the recipient is



required to provide services in exchange for the options, typically the vesting period. Pursuant to the requirements of the Statement, the Company plans to adopt the provisions of the Statement using the modified-retrospective transition method provided in the Statement. Under this method, the Company will restate all prior periods presented on a consistent basis, based on the pro forma expense previously disclosed pursuant to the provisions of Statement No. 123. The Company does not believe the adoption of this Statement will have a material impact on the trend of net earnings or net earnings per share.

#### NOTE 8 RETIREMENT PLANS

Certain of the Company's subsidiaries have both funded and unfunded defined benefit plans covering some or all of their employees. The components of net periodic benefit cost are as follows (in millions):

	Three Months Ended June 30		Six Months Ended June 30	
	2005	2004	2005	2004
Service cost	\$2.3	\$1.5	\$4.4	\$3.2
Interest cost	1.6	1.3	3.2	2.8
Expected return on plan assets	(1.3)	(1.2)	(2.5)	(2.1)
Amortization of transition amounts and prior service cost	0.2	--	0.4	0.1
Recognized actuarial loss	0.1	0.2	0.2	0.3
Net periodic benefit cost	<u>\$2.9</u>	<u>\$1.8</u>	<u>\$5.7</u>	<u>\$4.3</u>

The Company previously disclosed in its 2004 Form 10-K that it anticipated contributing approximately \$11.8 million to its defined benefit plans in 2005 to meet minimum funding requirements. As of June 30, 2005, \$2.0 million of contributions have been made.

NOTE 9  
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, spine and micro implant systems, bone cement and the bone growth factor osteogenic protein-1 (OP-1). The MedSurg Equipment segment sells powered surgical instruments, endoscopic products, medical video imaging equipment, hospital beds and stretchers and surgical navigation systems. The Other category 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 (in millions):

	Orthopaedic <u>Implants</u>	MedSurg <u>Equipment</u>	<u>Other</u>	<u>Total</u>
<u>Three Months Ended June 30, 2005</u>				
Net sales	\$724.8	\$427.4	\$66.4	\$1,218.6
Segment net earnings (loss)	125.7	64.7	(6.1)	184.3
<u>Three Months Ended June 30, 2004</u>				
Net sales	\$630.9	\$349.5	\$62.6	\$1,043.0
Segment net earnings (loss)	110.8	47.2	(5.3)	152.7
<u>Six Months Ended June 30, 2005</u>				
Net sales	\$1,439.2	\$850.4	\$131.5	\$2,421.1
Segment net earnings (loss)	241.4	126.2	(10.2)	357.4
<u>Six Months Ended June 30, 2004</u>				
Net sales	\$1,264.0	\$691.1	\$123.0	\$2,078.1
Segment net earnings (loss)	208.6	92.2	(12.2)	288.6

NOTE 10  
CONTINGENCIES

The Company is involved in various proceedings, legal actions and claims arising in the normal course of business, including proceedings related to product, labor, intellectual property and other matters. Such matters are subject to many uncertainties, and outcomes are not predictable with assurance. The Company records amounts for losses that are deemed to be probable and subject to reasonable estimate. The Company does not anticipate material losses as a result of these proceedings beyond amounts already provided in the accompanying Consolidated Financial Statements.

In December 2003, the Company announced that its subsidiary, Physiotherapy Associates, Inc., and Stryker received a subpoena from the United States Attorney's Office in Boston, Massachusetts, in connection with a Department of Justice investigation of Physiotherapy Associates' billing and coding practices. In March 2005, the Company announced that it received a subpoena from the United States Department of Justice requesting documents for the period January 2002 through the present relating to "any and all consulting contracts, professional service agreements, or remuneration agreements between Stryker Corporation and any orthopedic

surgeon, orthopedic surgeon in training, or medical school graduate using or considering the surgical use of hip or knee joint replacement/reconstruction products manufactured or sold by Stryker Corporation." The Company is fully cooperating with the Department of Justice regarding these matters.

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

### *Executive Level Overview*

Stryker Corporation (the "Company" or "Stryker") is a leader in the worldwide orthopaedic market and is one of the world's largest medical device companies. Stryker offers the most broadly-based range of orthopaedic products and has a significant presence in other medical specialties. 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, spine and micro implant systems, bone cement and the bone growth factor osteogenic protein-1 (OP-1). The MedSurg Equipment segment sells powered surgical instruments, endoscopic products, medical video imaging equipment, hospital beds and stretchers and surgical navigation systems. The Other category includes Physical Therapy Services and corporate administration, interest expense and interest income.

Domestic sales accounted for 64% of total revenues in the first half of 2005 and 2004 and 64% in the second quarter of 2005 compared to 65% in 2004. Most of the Company's products are marketed directly to more than 6,000 hospitals and to doctors and other health-care facilities. Stryker primarily maintains separate and dedicated sales forces for each of its principal product lines to provide focus and a high level of expertise to each medical specialty served.

International sales accounted for 36% of total revenues in the first half of 2005 and 2004 and 36% in the second quarter of 2005 compared to 35% in 2004. The Company's products are sold in more than 100 countries through both company owned sales subsidiaries and branches and third-party dealers and distributors.

The Company's business is generally not seasonal in nature; however, the number of orthopaedic implant surgeries is lower during the summer months.

### *Outlook for 2005*

The Company's outlook for 2005 continues to be optimistic regarding the markets it participates in and the underlying growth rates in orthopaedic procedures. The Company expects diluted net earnings per share for 2005 to approximate \$1.75. The financial expectations for 2005 include a net sales increase in the range of 14% to 15% as a result of strong growth in shipments of Orthopaedic Implants and MedSurg Equipment, favorable foreign currency exchange rate movements and higher revenue from Physical Therapy Services. If foreign currency exchange rates hold at current levels, the Company anticipates no significant impact on net sales in the third quarter of 2005 and a favorable impact on net sales for the full year of 2005 of approximately \$15 to \$20 million. Excluding the effect of foreign currency exchange rates, the Company expects sales growth in the range of 14% to 15% in 2005, which is comparable to the 15% sales growth, excluding the effect of foreign currency exchange rates, reported for the first six months and second quarter of 2005.

The Company has paid off substantially all previously outstanding borrowings under its existing credit facilities and eliminated the amounts previously outstanding under its accounts receivable securitization facility and expects to generate cash earnings (net earnings, plus noncash adjustments) in excess of its needs to fund future working capital requirements. The Company anticipates investing in future business growth, including business and product line acquisitions to supplement its current product offerings, loaner instrumentation for surgical implants in support of new product launches and future building expansions, including manufacturing facility expansions for certain divisions.

## Results of Operations

The table below outlines 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
	2005	2004	2005/2004
Net sales	100.0	100.0	17%
Cost of sales	35.2	35.3	16
Gross profit	64.8	64.7	17
Research, development and engineering expenses	5.2	4.8	26
Selling, general and administrative expenses	37.5	38.9	12
Intangibles amortization	1.1	1.2	16
Operating income	21.0	19.9	23
Other expense	0.0	0.0	(20)
Earnings before income taxes	20.9	19.8	23
Income taxes	6.2	6.0	21
Net earnings	14.8	13.9	24

	<u>Percentage of Net Sales</u>		
	Three Months Ended		Percentage
	June 30		Change
	2005	2004	2005/2004
Net sales	100.0	100.0	17%
Cost of sales	34.6	35.0	16
Gross profit	65.4	65.0	17
Research, development and engineering expenses	5.4	4.8	30
Selling, general and administrative expenses	37.5	38.0	15
Intangibles amortization	0.9	1.1	2
Operating income	21.5	21.1	19
Other expense	0.0	0.2	(89)
Earnings before income taxes	21.5	20.9	20
Income taxes	6.3	6.3	18
Net earnings	15.1	14.6	21

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

	Six Months Ended June 30		Percentage Change
	2005	2004	2005/2004
Domestic/international sales			
Domestic	\$1,558.8	\$1,335.1	17%
International	862.3	743.0	16
Total net sales	<u>\$2,421.1</u>	<u>\$2,078.1</u>	17

Product line sales			
Orthopaedic Implants	\$1,439.2	\$1,264.0	14
MedSurg Equipment	850.4	691.1	23
Physical Therapy Services	131.5	123.0	7
Total net sales	<u>\$2,421.1</u>	<u>\$2,078.1</u>	17

	Three Months Ended June 30		Percentage Change
	2005	2004	2005/2004
Domestic/international sales			
Domestic	\$784.1	\$677.2	16%
International	434.5	365.8	19
Total net sales	<u>\$1,218.6</u>	<u>\$1,043.0</u>	17

Product line sales			
Orthopaedic Implants	\$724.8	\$630.9	15
MedSurg Equipment	427.4	349.5	22
Physical Therapy Services	66.4	62.6	6
Total net sales	<u>\$1,218.6</u>	<u>\$1,043.0</u>	17

The tables below set forth additional sales growth information for significant products within the Company's Orthopaedic Implants and MedSurg Equipment product lines on both a reported basis and a constant currency basis that excludes the impact of changes in foreign currency exchange rates:

	<u>Percentage Change</u>	
	Six Months Ended	
	June 30	
	<u>2005/2004</u>	
	<u>Reported</u>	<u>Constant</u>
		<u>Currency</u>
Worldwide Orthopaedic Implants sales:		
Hips	8%	6%
Knees	15	13
Trauma	21	18
Spine	17	15
Micro implants	14	12

Worldwide MedSurg Equipment sales:		
Powered surgical instruments and surgical navigation systems	19	18
Endoscopic products and medical video imaging equipment	29	28
Patient handling and emergency medical equipment	22	20

	<u>Percentage Change</u>	
	Three Months Ended	
	June 30	
	<u>2005/2004</u>	
	<u>Reported</u>	<u>Constant</u>
		<u>Currency</u>
Worldwide Orthopaedic Implants sales:		
Hips	8%	5%
Knees	16	14
Trauma	21	19
Spine	22	20
Micro implants	15	12

Worldwide MedSurg Equipment sales:		
Powered surgical instruments and surgical navigation systems	19	18
Endoscopic products and medical video imaging equipment	27	26
Patient handling and emergency medical equipment	21	20

Stryker Corporation's net sales increased 17% in the first six months of 2005 to \$2,421.1 million from \$2,078.1 million in 2004. For the second quarter of 2005 net sales were \$1,218.6 million, representing a 17% increase over net sales of \$1,043.0 million in the second quarter of 2004. Net sales for both the first six months and the second quarter of 2005 grew by 12% as a result of increased unit volume and favorable product mix; 2% due to changes in foreign currency exchange rates, 2% as a result of higher selling prices and 1% due to acquisitions.

The Company's domestic sales were \$1,558.8 million for the first half of 2005 and \$784.1 million for the second quarter of 2005, representing increases of 17% and 16%, respectively, as a result of strong shipments of Orthopaedic Implants and MedSurg Equipment and higher revenue from Physical Therapy Services.

International sales were \$862.3 million for the first half of 2005 and \$434.5 million for the second quarter of 2005, representing increases of 16% and 19%, respectively, 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 \$34.7 million in the first half and by \$18.2 million in the second quarter. Excluding the impact of foreign currency, international sales increased 11% in the first half of 2005 and 14% in the second quarter of 2005.

Worldwide sales of Orthopaedic Implants were \$1,439.2 million for the first half of 2005 and \$724.8 million for the second quarter of 2005, representing increases of 14% and 15%, respectively, based on higher shipments of reconstructive, trauma, spine and micro implant systems, the bone growth factor OP-1 and bone cement. Excluding the impact of foreign currency, sales of Orthopaedic Implants increased 12% in the first half of 2005 and 13% in the second quarter of 2005. Sales of hip implant systems increased 8% in both the first half and second quarter of 2005 (6% and 5%, respectively, excluding changes in foreign currency exchange rates) due to strong growth in the Trident ceramic-on-ceramic hip system in Europe and Canada partially offset by slower growth in the United States. Sales of knee implant systems increased 15% in the first half of 2005 and 16% in the second quarter (13% and 14%, respectively, excluding changes in foreign currency exchange rates) due to strong growth in the recently launched Triathlon knee system in the United States and the Scorpio knee system in the international markets. Sales of trauma implant systems increased 21% in both the first half and second quarter of 2005 (18% and 19%, respectively, excluding changes in foreign currency exchange rates) as a result of the full-scale launch of the Gamma3 Hip Fracture System in the United States, Japan and Europe in the second half of 2004. Strong growth in the Company's T2 Nailing System, both in the United States and internationally, also drove trauma sales growth in the first half and second quarter of 2005. Sales of spinal implant systems increased 17% in the first half of 2005 and 22% in the second quarter (15% and 20%, respectively, excluding changes in foreign currency exchange rates) primarily due to strong sales growth of cervical and interbody products in the United States, Japan and the Pacific region, as well as strong growth of lumbar products in Europe in the second quarter of 2005. Sales of micro implant systems increased 14% in the first half of 2005 and 15% in the second quarter (12% in both the first half and second quarter of 2005 excluding changes in foreign currency exchange rates) as a result of solid worldwide sales of micro implant products for hand indications and strong domestic sales of products for neuro indications.

Worldwide sales of MedSurg Equipment were \$850.4 million for the first half of 2005 and \$427.4 million for the second quarter, representing increases of 23% and 22%, respectively, as a result of higher shipments of powered surgical instruments and surgical navigation systems, endoscopic products, and patient handling and emergency medical equipment. Excluding the impact of foreign currency, sales of MedSurg Equipment increased 22% for the first half of 2005 and 21% for the second quarter of 2005. Sales of powered surgical instruments and surgical navigation systems increased 19% in both the first half and second quarter of 2005 (18% in both periods excluding changes in foreign currency exchange rates) due to strong sales growth in heavy-duty powered instruments and interventional pain products in the United States. Sales of endoscopic products increased 29% in the first half of 2005 and 27% in the second quarter (28% and 26%, respectively, excluding changes in foreign currency exchange rates) as a result of strong growth in medical video imaging equipment and solid growth in general surgery products in the United States. Sales of patient handling and emergency medical equipment increased 22% in the first half of 2005 and 21% in the second quarter (20% in both periods excluding changes in foreign currency exchange rates) due to strong growth in hospital and maternity beds and emergency medical equipment in the United States.

Physical Therapy Services revenues were \$131.5 million for the first half of 2005 and \$66.4 million for the second quarter of 2005, representing increases of 7% and 6%, respectively, with growth coming from new physical therapy centers.

Cost of sales in the first half of 2005 represented 35.2% of sales compared to 35.3% in the same period of 2004. In the second quarter the cost of sales percentage decreased to 34.6% from 35.0% in the second quarter of 2004. The slight decrease in the cost of sales percentage in the second quarter of 2005 is primarily due to increased average selling prices for the Company's products partially offset by faster sales growth in the lower margin MedSurg Equipment business.

Research, development and engineering expenses represented 5.2% of sales in the first half of 2005 compared to 4.8% in the same period of 2004 and increased 26% to \$126.5 million. In the second quarter, these expenses increased 30% to \$65.9 million and represented 5.4% of sales in 2005 compared to 4.8% in 2004. The higher spending level is the result of the Company's continued focus on new product development for anticipated product launches throughout the remainder of the year and in future years and continued investments in new technologies, together with, beginning in the third quarter of 2004, spending associated with the continued development of products acquired from SpineCore, Inc. (SpineCore).

Selling, general and administrative expenses increased 12% in the first half of 2005 and represented 37.5% of sales compared to 38.9% in the same period of 2004. In the second quarter, these expenses increased 15% and represented 37.5% of sales in 2005 compared to 38.0% in 2004. The decrease in selling, general and administrative expenses as a percent of sales in the first half of 2005 is due to lower meeting costs and slower growth in insurance premiums. The decrease in these costs as a percent of sales in the second quarter of 2005 is due to slower growth in insurance premiums and compensation costs relative to the Company's growth in net sales. These decreases are partially offset by an increase in sales commission expense as a result of the 17% growth in net sales in both the first half and second quarter of 2005.

The Company's effective income tax rate was 29.5% in the first half and second quarter of 2005 compared to a 30.0% effective income tax rate for the same periods of 2004 and an effective annual income tax rate of 35.0% for the year ended December 31, 2004. The effective income tax rate for the year ended December 31, 2004 reflects the non-deductibility, for income tax purposes, of substantially all of the \$120 million upfront payment made in the third quarter of 2004 to acquire SpineCore. The income tax rate reduction in the first half and second quarter of 2005 compared to the same periods of 2004 results primarily from increased manufacturing in lower tax jurisdictions.

Net earnings in the first half of 2005 were \$357.4 million, an increase of 24% when compared to net earnings of \$288.6 million in the first half of 2004. Basic net earnings per share increased 24% in the first half of 2005 to \$.89 from \$.72 in 2004, and diluted net earnings per share increased 24% to \$.87 in the first half of 2005 from \$.70 in 2004. Net earnings for the second quarter of 2005 were \$184.3 million representing a 21% increase over net earnings of \$152.7 million in the second quarter of 2004. Basic net earnings per share increased 21% in the second quarter of 2005 to \$.46 from \$.38 in 2004, and diluted net earnings per share increased 22% in the second quarter of 2005 to \$.45 from \$.37 in 2004.

#### *Liquidity and Capital Resources*

The Company's working capital at June 30, 2005, increased \$190.6 million to \$1,219.7 million from \$1,029.1 million at December 31, 2004. The increase in working capital resulted from growth in the Company's overall business and the use of cash earnings to fund increases in inventory and prepaid expenses and to pay current liabilities due in the first quarter of 2005, primarily for accounts payable, accrued bonuses, income taxes and dividends. Accounts receivable days sales outstanding decreased three days to 55 days at June 30, 2005 from 58 days at December 31, 2004. Days sales in inventory increased two days to 124 days at June 30, 2005 from 122 days at December 31, 2004. The decrease in days sales outstanding at June 30, 2005 is primarily due to improved asset management and collections of aged receivables in certain European markets. The increase in days sales in inventory is primarily due to normal movements in inventory levels across the Company.



The Company generated cash of \$219.2 million from operations in the first six months of 2005 compared to \$102.6 million in 2004. In the second quarter, the Company generated cash from operations of \$187.2 million compared to \$44.7 million in 2004. The increase in cash provided by operating activities in the first six months and second quarter of 2005 compared to the same periods in 2004 is primarily due to the elimination of amounts outstanding under the accounts receivable securitization facility in the second quarter of 2004. In the first half of 2005, the Company used cash of \$53.1 million for acquisitions, \$116.4 million for capital expenditures and \$36.2 million for the payment of dividends. In the second quarter of 2005, the Company invested \$212.9 million in marketable securities. These securities are classified as available-for-sale investments in accordance with the provisions of Financial Accounting Standards Board (FASB) Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*.

On February 23, 2005, the Company acquired eTrauma.com Corp. (eTrauma) for approximately \$50.0 million plus certain transaction costs. The acquisition expanded the Company's endoscopic and medical video imaging equipment product offerings by adding eTrauma's proprietary Picture Archive and Communications Systems (PACs) image management and viewing software. The acquisition of eTrauma was accounted for using the purchase method of accounting. The results of operations for the acquired business are included in the Company's Condensed Consolidated Financial Statements beginning February 23, 2005 and did not materially impact the Company's reported operating results. Pro forma consolidated results of operations would not differ significantly as a result of the eTrauma acquisition.

The purchase price has been preliminarily allocated to the assets acquired and liabilities assumed based on their estimated fair value at the date of acquisition. Based on the preliminary purchase price allocation, \$22.0 million was allocated to identifiable intangibles, to be amortized over their remaining lives of five to eight years, and \$31.5 million was allocated to goodwill. Immediately after the acquisition was consummated, management of the Company began to implement an integration plan to combine Stryker and eTrauma. In conjunction with the integration plan, the Company recorded additional purchase liabilities for severance and related costs of \$0.3 million, which were included in the purchase price allocation.

The Company had \$118.4 million in cash and cash equivalents at June 30, 2005. The Company had outstanding borrowings totaling \$9.2 million at the end of the first half of 2005. Current maturities of long-term debt at June 30, 2005 were \$8.5 million and will decrease to \$0.7 million in 2006. The Company believes its cash on hand and marketable securities, as well as anticipated cash flows from operations, will be sufficient to fund future operating capital requirements, future manufacturing facility construction and other capital expenditures, future business and product line acquisitions to supplement its current product offerings and loaner instrumentation for surgical implants in support of new product launches. Should additional funds be required, the Company had \$819.3 million of additional borrowing capacity available under all of its existing credit facilities, including the Company's \$750.0 million five-year, nonamortizing, revolving credit agreement that expires in December 2006. In addition, the Company had \$200.0 million of eligible accounts receivable that could be sold through its accounts receivable securitization facility at June 30, 2005.

#### *Other Matters*

The Company has certain investments in net assets in international locations that are not hedged. These investments are subject to translation gains and losses due to changes in foreign currencies. In the first half of 2005, the weakening of foreign currencies relative to the U.S. dollar decreased the value of these investments in net assets by \$147.5 million. This loss reduced the previously-recorded cumulative gain from strengthening of foreign currencies that had been recorded as a separate component of stockholders' equity.

In December 2003, the Company announced that its subsidiary, Physiotherapy Associates, Inc., and Stryker received a subpoena from the United States Attorney's Office in Boston, Massachusetts, in connection with a Department of Justice investigation of Physiotherapy Associates' billing and coding practices. In March 2005, the Company announced that it received a subpoena from the United States Department of Justice requesting documents for the period January 2002 through the present relating to "any and all consulting contracts, professional service agreements, or remuneration agreements between Stryker Corporation and any orthopedic

surgeon, orthopedic surgeon in training, or medical school graduate using or considering the surgical use of hip or knee joint replacement/reconstruction products manufactured or sold by Stryker Corporation." The Company is fully cooperating with the Department of Justice regarding these matters.

On October 22, 2004, the President of the United States signed the American Jobs Creation Act of 2004 (the Act). The Act creates a temporary incentive for United States corporations to repatriate accumulated income earned in foreign jurisdictions by providing an 85% dividends-received deduction for certain dividends from controlled foreign corporations. The deduction is subject to a number of limitations, and significant uncertainty remains about the way to interpret numerous provisions in the Act. Due to these factors, the Company is not yet in a position to determine whether, and to what extent, it might repatriate foreign earnings that have not yet been remitted to the United States. Based on its current analysis, the Company may repatriate up to \$775.0 million, with a related income tax expense and liability of up to \$38.2 million. The Company plans to finalize its assessment after Congress or the Treasury Department provides additional clarifying language on key elements of the repatriation provision.

In December 2004, the FASB issued a revision to Statement No. 123, *Share-Based Payment*. This revision supersedes Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, and its related implementation guidance. On April 14, 2005, the United States Securities and Exchange Commission adopted a new rule allowing companies to delay the required adoption date of the Statement to their first fiscal year beginning after June 15, 2005. Based on this ruling, the Company plans to adopt the provisions of the Statement effective January 1, 2006 rather than July 1, 2005 as previously required by the revised Statement. The revised Statement requires companies to recognize the cost of stock options based on the grant-date fair value pursuant to their employee stock option plans over the period during which the recipient is required to provide services in exchange for the options, typically the vesting period. Pursuant to the requirements of the Statement, the Company plans to adopt the provisions of the Statement using the modified-retrospective transition method provided in the Statement. Under this method, the Company will restate all prior periods presented on a consistent basis, based on the pro forma expense previously disclosed pursuant to the provisions of Statement No. 123. The Company does not believe the adoption of this Statement will have a material impact on the trend of net earnings or net earnings per share.

#### *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; unanticipated issues arising in connection with clinical studies and eventual United States Food and Drug Administration approval of OP-1, the FlexiCore and CerviCore spinal implant products or other new product introductions; 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, 2004.

### ITEM 4. CONTROLS AND PROCEDURES

**Evaluation of Disclosure Controls and Procedures** – An evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of June 30, 2005 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 and Chief Financial Officer ("the Certifying Officers"). 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 second quarter of 2005 that materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

**Other Matters** – The Company has begun the process of implementing new Enterprise Resource Planning (ERP) systems at certain of its divisions. An ERP system is a fully-integrated set of programs and databases that incorporate order processing, production planning and scheduling, purchasing, accounts receivable and inventory management and accounting. In the first quarter of 2006, the Company anticipates its Orthopaedics division will begin to transition to its new ERP system. In connection with this ERP system implementation, the Company will update its internal controls over financial reporting, as necessary, to accommodate modifications to its business processes and accounting procedures. The Company does not believe that this ERP system implementation will have an adverse effect on the Company's internal control over financial reporting.

## PART II. – OTHER INFORMATION

### ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

- (a) The Company issued 2,305 shares of Common Stock in the second quarter of 2005 as performance incentive awards to certain employees. These shares were not registered under the Securities Act of 1933 based on the conclusion that the awards would not be events of sale within the meaning of Section 2(a)(3) of the Act.

### ITEM 6. EXHIBITS

#### (a) Exhibits

- 31(i) Certification of Principal Executive Officer of Stryker Corporation pursuant to Rule 13a-14(a)
- 31(ii) Certification of Principal Financial Officer of Stryker Corporation pursuant to Rule 13a-14(a)
- 32(i) Certification by Chief Executive Officer of Stryker Corporation pursuant to 18 U.S.C. Section 1350
- 32(ii) Certification by Chief Financial Officer of Stryker Corporation pursuant to 18 U.S.C. Section 1350

## 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 1, 2005  
Date

/s/ STEPHEN P. MACMILLAN  
Stephen P. MacMillan, President  
and Chief Executive Officer  
(Principal Executive Officer)

August 1, 2005  
Date

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

## EXHIBIT INDEX

### Exhibit 31 - Rule 13a-14(a) Certifications

- (i) Certification of Principal Executive Officer of Stryker Corporation
- (ii) Certification of Principal Financial Officer of Stryker Corporation

### Exhibit 32 - 18 U.S.C. Section 1350 Certifications

- (i) Certification by Chief Executive Officer of Stryker Corporation
- (ii) Certification by Chief Financial Officer of Stryker Corporation