STERIS CORP
Form 10-Q
August 07, 2007
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2007

or

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

For the transition period from to

Commission File Number 1-14643

STERIS Corporation

(Exact name of registrant as specified in its charter)

Ohio	**34-1482024**
(State or other jurisdiction of	**(IRS Employer**
incorporation or organization)	**Identification No.)**
5960 Heisley Road,	**44060-1834**

Mentor, Ohio
(Address of principal executive offices) **(Zip code)**
440-354-2600

(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

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

Large Accelerated Filer x Accelerated Filer ¨ Non-Accelerated Filer ¨

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

The number of common shares outstanding as of July 31, 2007: 64,817,144

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STERIS Corporation

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

STERIS CORPORATION

CONSOLIDATED BALANCE SHEETS

(in thousands)

	June 30, 2007 (Unaudited)	March 31, 2007
Assets		
Current assets:		
Cash and cash equivalents	$ 57,946	$ 52,296
Accounts receivable (net of allowances of $8,513 and $9,911, respectively)	207,650	251,207
Inventories, net	153,213	131,997
Current portion of deferred income taxes, net	14,838	14,560
Prepaid expenses and other current assets	33,022	34,660
Total current assets	466,669	484,720
Property, plant, and equipment, net	386,313	388,899
Goodwill and intangibles, net	331,993	332,947
Other assets	2,901	2,604
Total assets	$ 1,187,876	$ 1,209,170
Liabilities and shareholders equity		
Current liabilities:		
Current portion of long-term indebtedness	$ 777	$ 777
Accounts payable	64,162	76,184
Accrued income taxes	13,978	18,761
Accrued payroll and other related liabilities	42,905	59,003
Accrued expenses and other	62,273	62,674
Total current liabilities	184,095	217,399
Long-term indebtedness	109,780	100,800
Deferred income taxes, net	24,025	17,826
Other liabilities	97,321	98,853
Total liabilities	415,221	434,878
Serial preferred shares, without par value; 3,000 shares authorized; no shares issued or outstanding		
Common shares, without par value; 300,000 shares authorized; 70,040 shares issued; 64,741 and 64,982 shares outstanding, respectively	92,852	102,466
Retained earnings	668,778	667,267
Accumulated other comprehensive income (loss)	11,025	4,559
Total shareholders equity	772,655	774,292
Total liabilities and shareholders equity	$ 1,187,876	$ 1,209,170

See notes to consolidated financial statements.

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STERIS CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share amounts)

(Unaudited)

	Three Months Ended June 30,	
	2007	**2006**
Revenues:		
Product	$ 172,369	$ 165,759
Service	108,575	99,308
Total revenues	280,944	265,067
Cost of revenues:		
Product	101,875	95,293
Service	60,357	56,399
Total cost of revenues	162,232	151,692
Gross profit	118,712	113,375
Operating expenses:		
Selling, general, and administrative	86,495	78,414
Research and development	9,259	8,395
Restructuring expenses	1,391	1,105
Total operating expenses	97,145	87,914
Income from continuing operations	21,567	25,461
Non-operating expenses, net:		
Interest expense	1,235	1,769
Interest and miscellaneous income	(462)	(679)
Total non-operating expenses, net	773	1,090
Income from continuing operations before income tax expense	20,794	24,371
Income tax expense	7,591	10,314
Net income from continuing operations	13,203	14,057
Discontinued operations:		
Gain on the sale of discontinued operations, net of tax		627
Net income	$ 13,203	$ 14,684
Basic earnings per common share:		
Income from continuing operations	$ 0.20	$ 0.21
Income from discontinued operations	$	$ 0.01
Net income	$ 0.20	$ 0.22
Diluted earnings per common share:		

Income from continuing operations	$	0.20	$	0.21
Income from discontinued operations	$		$	0.01
Net income	$	0.20	$	0.22
Cash dividends declared per common share outstanding	$	0.05	$	0.04

See notes to consolidated financial statements.

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STERIS CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	Three Months Ended June 30, 2007	2006
Operating activities:		
Net income	$ 13,203	$ 14,684
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation, depletion, and amortization	15,582	14,884
Deferred income taxes	(2,705)	(7,159)
Share-based compensation	1,615	2,092
Loss on the disposal of property, plant, equipment, and intangibles, net	565	
Gain on the sale of discontinued operations, net of tax		(627)
Other items	(365)	134
Changes in operating assets and liabilities, excluding the effects of business acquisitions:		
Accounts receivable, net	45,106	40,438
Inventories, net	(19,380)	(20,280)
Other current assets	1,685	(18,759)
Accounts payable	(12,422)	(19,393)
Accruals and other, net	(23,458)	(12,691)
Net cash provided by (used in) operating activities	19,426	(6,677)
Investing activities:		
Purchases of property, plant, equipment, and intangibles, net	(9,691)	(12,415)
Proceeds from the sale of property, plant, equipment, and intangibles	22	
Proceeds from the sale of discontinued operations		2,927
Net cash used in investing activities	(9,669)	(9,488)
Financing activities:		
Proceeds under credit facilities, net	8,980	73,660
Payments on long-term obligations and capital leases, net		(212)
Repurchases of common shares	(21,235)	(50,134)
Cash dividends paid to common shareholders	(3,259)	(2,679)
Stock option and other equity transactions, net	8,096	195
Tax benefit from stock options exercised	2,067	163
Net cash (used in) provided by financing activities	(5,351)	20,993
Effect of exchange rate changes on cash and cash equivalents	1,244	2,002
Increase in cash and cash equivalents	5,650	6,830
Cash and cash equivalents at beginning of period	52,296	72,732
Cash and cash equivalents at end of period	$ 57,946	$ 79,562

See notes to consolidated financial statements.

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STERIS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

(dollars in thousands, except per share amounts)

1. Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

STERIS Corporation, an Ohio corporation, develops, manufactures and markets infection prevention, contamination control, microbial reduction, and surgical and critical care support products and services for healthcare, pharmaceutical, scientific, research, industrial, and governmental customers throughout the world. As used in this Quarterly Report, STERIS Corporation and its subsidiaries together are called STERIS, the Company, we, us, or our, unless otherwise noted.

We operate in three business segments: Healthcare, Life Sciences, and STERIS Isomedix Services (Isomedix). We describe our business segments in note 11 to our consolidated financial statements titled, Business Segment Information. Our fiscal year ends on March 31. References in this Quarterly Report to a particular year or year-end mean our fiscal year. The significant accounting policies applied in preparing the accompanying consolidated financial statements of the Company are summarized below:

Interim Financial Statements

We prepared the accompanying unaudited consolidated financial statements of the Company according to accounting principles generally accepted in the United States (U.S. GAAP) for interim financial information and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. This means that they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. Our interim consolidated financial statements contain all material adjustments (including normal recurring accruals and adjustments) management believes are necessary to fairly state our financial condition, results of operations, and cash flows for the periods presented.

These interim consolidated financial statements should be read together with the consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended March 31, 2007, filed with the Securities and Exchange Commission (SEC) on May 30, 2007. The Consolidated Balance Sheet at March 31, 2007 was derived from the audited consolidated financial statements at that date, but does not include all of the information and footnotes required by U.S. GAAP for complete financial statements.

Principles of Consolidation

We use the consolidation method to report our investment in our subsidiaries. Consolidation means that we combine the accounts of our wholly-owned subsidiaries with our accounts. Therefore, the accompanying consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. We eliminate inter-company accounts and transactions when we consolidate these accounts.

Use of Estimates

We make certain estimates and assumptions when preparing financial statements according to U.S. GAAP that affect the reported amounts of assets and liabilities at the financial statement dates and the reported amounts of revenues and expenses during the periods presented. These estimates and assumptions involve judgments with respect to many factors that are difficult to predict and are beyond our control. Actual results could be materially different from these estimates. We revise the estimates and assumptions as new information becomes available. This means that operating results for the three-month period ended June 30, 2007 are not necessarily indicative of results that may be expected for future quarters or for the full fiscal year ending March 31, 2008.

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STERIS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

(dollars in thousands, except per share amounts)

Recently Adopted Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48 (FIN No. 48), Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109. This interpretation clarifies the recognition threshold and measurement attribute for financial statement recognition and measurement of tax positions taken or expected to be taken on a tax return. Under FIN No. 48, the economic benefit associated with a tax position is only recognized if it is more likely than not that the tax position will be sustained. After this threshold is met, a tax position is reported at the largest amount of benefit that is more likely than not to be ultimately sustained. FIN No. 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN No. 48 requires the cumulative effect of adoption to be recorded as an adjustment to the opening balance of retained earnings. We adopted FIN No. 48 effective April 1, 2007, as required. Prior to April 1, 2007, we regularly assessed our positions with respect to tax exposures and recorded liabilities for uncertain income tax positions according to Statement of Financial Accounting Standards No. 5 (SFAS No. 5), Accounting for Contingencies. We describe the impact of adopting FIN No. 48 further in note 8 to our consolidated financial statements titled, Income Tax Expense.

New Accounting Pronouncements

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159 (SFAS No. 159), The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of SFAS 115, which permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. Unrealized gains and losses arising after adoption are reported in earnings. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. We are currently evaluating the impact of adopting SFAS No. 159 on our consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157 (SFAS No. 157), Fair Value Measurements. SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS No. 157 does not require new fair value measurements, rather it applies under existing accounting pronouncements that require or permit fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. We are currently evaluating the impact of adopting SFAS No. 157 on our consolidated financial statements.

Significant Accounting Policies

A detailed description of our significant and critical accounting policies, estimates, and assumptions is included in our Annual Report on Form 10-K for the year ended March 31, 2007, filed with the SEC on May 30, 2007. Our significant and critical accounting policies, estimates, and assumptions have not changed materially from March 31, 2007, other than the adoption of FIN No. 48 as described above.

2. Restructuring

We recognize restructuring expenses as incurred as required under the provisions of Statement of Financial Accounting Standards No. 146 (SFAS No. 146), Accounting for Costs Associated with Exit or Disposal Activities. In addition, we assessed the property, plant and equipment associated with the related facilities for impairment under Statement of Financial Accounting Standards No. 144 (SFAS No. 144), Accounting for the Impairment or Disposal of Long-Lived Assets. Asset impairment and accelerated depreciation expenses

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STERIS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

(dollars in thousands, except per share amounts)

primarily relate to an adjustment in the carrying value of the related facilities to their estimated fair value. In addition, the remaining useful lives of other property, plant and equipment associated with the related operations were reevaluated based on the respective restructuring plan, resulting in the acceleration of depreciation and amortization of certain assets.

Fiscal 2006 Restructuring Plan

During the three months ended June 30, 2007 and 2006, we recorded $1,391 and $1,105 in restructuring expenses, respectively, primarily related to the previously announced transfer of the Erie, Pennsylvania manufacturing operations to Monterrey, Mexico (the Fiscal 2006 Restructuring Plan), which is intended to improve our cost structure. Additional information regarding the Fiscal 2006 Restructuring Plan is included in our Annual Report on Form 10-K for the year ended March 31, 2007, filed with the SEC on May 30, 2007.

The costs incurred during the first quarter of fiscal 2008 and fiscal 2007 are associated with our Healthcare business segment. Since the inception of the Fiscal 2006 Restructuring Plan, we have incurred restructuring expenses of $31,580, with restructuring expenses of $31,166 and $414 related to the Healthcare and Life Sciences segments, respectively, primarily related to the transfer of manufacturing operations to Monterrey, Mexico.

We anticipate incurring approximately an additional $3,000 in restructuring expenses during fiscal 2008 in connection with the transfer of the manufacturing operations to Mexico. Restructuring expenses to be incurred include compensation and benefits, severance, accelerated depreciation and other expenses.

The following tables summarize our total restructuring expenses for the first quarter of fiscal 2008 and fiscal 2007:

	Three Months Ended June 30,	
Fiscal 2006 Restructuring Plan	**2007**	**2006**
Asset impairment and accelerated depreciation	$ 1,059	$ 705
Severance, payroll and other related costs	332	390
Other		10
Total restructuring charges	$ 1,391	$ 1,105

Liabilities related to the Fiscal 2006 Restructuring Plan activities are recorded as current liabilities on the accompanying Consolidated Balance Sheets within Accrued expenses and other. The following table summarizes our liabilities related to these restructuring activities:

	Fiscal 2006 Restructuring Plan			
	March 31,	**Fiscal 2008**		**June 30,**
	2007	**Provision**	**Payments**	**2007**
Severance and termination benefits	$ 1,799	$ 332	$ (209)	$ 1,922
Lease termination obligation	157	(13)	(144)	
Total	$ 1,956	$ 319	$ (353)	$ 1,922

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STERIS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

(dollars in thousands, except per share amounts)

European Restructuring Plan

During the third quarter of fiscal 2007, we adopted a restructuring plan related to certain of our European operations (the European Restructuring Plan). We did not incur any restructuring expenses related to the European Restructuring Plan in the three months ended June 30, 2007. We are continuing to evaluate our European operations for opportunities to enhance performance, but we have not committed to any additional specific restructuring actions.

Liabilities related to the European Restructuring Plan activities are recorded as current liabilities on the accompanying Consolidated Balance Sheets within Accrued expenses and other. The following table summarizes our liabilities related to these restructuring activities:

	March 31,	European Restructuring Plan Fiscal 2008		June 30,
	2007	Provision	Payments	2007
Severance and termination benefits	$ 638	$	$ (238)	$ 400
Lease termination obligation	219		(33)	186
Fixed asset impairment	105			105
Total	$ 962	$	$ (271)	$ 691

3. Comprehensive Income

Statement of Financial Accounting Standards No. 130, Reporting Comprehensive Income, establishes standards for reporting comprehensive income. Comprehensive income includes net income as currently reported under U.S. GAAP and other comprehensive income. Other comprehensive income considers the effects of additional economic events that are not required to be recorded in determining net income, but rather are reported as a separate component of shareholders equity. The following table illustrates the components of our comprehensive income:

	Three Months Ended June 30,	
	2007	2006
Net income	$ 13,203	$ 14,684
Cumulative foreign currency translation adjustment	6,131	8,823
Amortization of pension and postretirement benefit plans costs, net of tax	322	
Unrealized gains on investments	13	
Total comprehensive income	$ 19,669	$ 23,507

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STERIS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

(dollars in thousands, except per share amounts)

4. Property, Plant and Equipment

Information related to the major categories of our depreciable assets is as follows:

	June 30, 2007	March 31, 2007
Land and land improvements (1)	$ 25,720	$ 25,553
Buildings and leasehold improvements	182,471	180,672
Machinery and equipment	271,382	268,852
Information systems	123,793	115,137
Radioisotope	139,531	133,723
Construction in progress (1)	32,585	40,098
Total property, plant, and equipment	775,482	764,035
Less: accumulated depreciation and depletion	(389,169)	(375,136)
Property, plant, and equipment, net	$ 386,313	$ 388,899

(1) Land is not depreciated. Construction in progress is not depreciated until placed in service.

5. Inventories, Net

Inventories, net are stated at the lower of cost or market. We use the last-in, first-out (LIFO) and first-in, first-out (FIFO) cost methods. An actual valuation of inventory under the LIFO method is made only at the end of the fiscal year based on the inventory levels and costs at that time. Accordingly, interim LIFO calculations are based on management s estimates of expected year-end inventory levels and are subject to the final fiscal year-end LIFO inventory valuation. Inventory costs include material, labor, and overhead. Inventories, net consisted of the following:

	June 30, 2007	March 31, 2007
Raw materials	$ 42,550	$ 42,672
Work in process	39,626	30,443
Finished goods	71,037	58,882
Inventories, net	$ 153,213	$ 131,997

6. Debt

Indebtedness was as follows:

	June 30, 2007	March 31, 2007
Private Placement	$ 100,000	$ 100,000
Credit facility	8,980	
Other debt	1,577	1,577
Total	110,557	101,577
Less: current portion	777	777
Long-term portion	$ 109,780	$ 100,800

Additional information regarding our indebtedness is included in our Annual Report on Form 10-K for the year ended March 31, 2007, filed with the SEC on May 30, 2007.

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STERIS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

(dollars in thousands, except per share amounts)

7. Additional Consolidated Balance Sheets Information

Additional information related to our Consolidated Balance Sheets is as follows:

	June 30, 2007	March 31, 2007
Accrued payroll and other related liabilities:		
Compensation and related items	$ 13,965	$ 19,617
Accrued vacation	13,060	13,265
Accrued bonuses	2,804	8,436
Accrued employee commissions	5,295	9,989
Other postretirement benefit obligations-current portion	6,789	6,789
Other employee benefit plans obligations-current portion	992	907
Total accrued payroll and other related liabilities	$ 42,905	$ 59,003
Accrued expenses and other:		
Deferred revenues	$ 23,267	$ 22,919
Self-insured risk retention-GRIC-current portion	4,396	4,096
Other self-insured risks	610	541
Accrued dealer commissions	6,270	6,474
Accrued warranty	6,393	5,893
Other	21,337	22,751
Total accrued expenses and other	$ 62,273	$ 62,674
Other liabilities:		
Self-insured risk retention-GRIC-long-term portion	$ 12,223	$ 12,506
Other postretirement benefit obligations-long-term portion	73,949	74,275
Defined benefit pension plans obligations-long-term portion	10,112	11,466
Other employee benefit plans obligations-long-term portion	1,037	606
Total other liabilities	$ 97,321	$ 98,853

8. Income Tax Expense

Income tax expense includes United States federal, state and local, and foreign income taxes, and is based on reported pre-tax income. The effective income tax rates for continuing operations for the three-month periods ended June 30, 2007 and 2006 were 36.5% and 42.3%, respectively. We benefited from improved profitability from foreign locations during the three-month period ended June 30, 2007, while the three-month period ended June 30, 2006 was negatively impacted by discrete item adjustments.

Income tax expense is provided on an interim basis based upon our estimate of the annual effective income tax rate, adjusted each quarter for discrete items. In determining the estimated annual effective income tax rate, we analyze various factors, including projections of our annual earnings and taxing jurisdictions in which the earnings will be generated, the impact of state and local income taxes, our ability to use tax credits and net operating loss carryforwards, and available tax planning alternatives.

Effective April 1, 2007, we adopted the provisions of FIN No. 48. In accordance with FIN No. 48, we recognized a cumulative-effect adjustment of $8,433, increasing our liability for unrecognized tax benefits,

STERIS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

(dollars in thousands, except per share amounts)

interest, and penalties and reducing the Apri1 1, 2007 balance of retained earnings. At April 1, 2007, we had $15,207 in unrecognized tax benefits, of which $8,702 would affect the effective tax rate if recognized.

In conjunction with the adoption of FIN No. 48, we classified uncertain tax positions as long-term liabilities within Deferred income taxes, net in our accompanying Consolidated Balance Sheets, unless expected to be paid within 12 months. We currently do not anticipate any significant increase or decrease within the next 12 months. We recognize accrued interest and penalties related to unrecognized tax benefits within Income tax expense in our accompanying Consolidated Statements of Income. At April 1, 2007, we had accrued $3,449 and $2,906 for the potential payment of interest and penalties, respectively.

There were no significant changes to any of these amounts during the first quarter of fiscal 2008.

We file income tax returns in the United States and in various state, local, and foreign jurisdictions. As of April 1, 2007, we are subject to United States Federal income tax examinations for the tax years 1999 through 2007. In addition, with limited exceptions, we are subject to foreign, state and local tax examinations for the tax years 2002 through 2007.

9. Benefit Plans

We provide defined benefit pension plans for certain manufacturing and plant administrative personnel throughout the world as determined by collective bargaining agreements or employee benefit standards set at the time of acquisition of certain businesses. In addition to providing pension benefits to certain employees, we sponsor an unfunded postretirement benefits plan for two groups of United States employees comprised substantially of the same employees who receive pension benefits under the United States defined benefit pension plans. Benefits under this plan include retiree life insurance and retiree medical insurance, including prescription drug coverage and Medicare supplemental coverage. Additional information regarding our defined benefit pension plans and other postretirement benefits plan is included in our Annual Report on Form 10-K for the year ended March 31, 2007, filed with the SEC on May 30, 2007.

Components of the net periodic benefit cost for our defined benefit pension plans and other postretirement medical benefit plan were as follows:

	Defined Benefit Pension Plans				Other Postretirement	
	U.S. Qualified		International		Benefits Plan	
Three Months Ended June 30,	**2007**	**2006**	**2007**	**2006**	**2007**	**2006**
Service cost	$ 26	$ 49	$ 116	$ 109	$	$
Interest cost	701	693	76	80	1,161	1,168
Expected return on plan assets	(801)	(680)	(110)	(97)		
Recognized losses	103	94			247	231
Amortization of transition obligation	(27)	(27)				
Net periodic benefit cost	$ 2	$ 129	$ 82	$ 92	$ 1,408	$ 1,399

We contribute amounts to the defined benefit pension plans at least sufficient to meet the minimum requirements as stated in applicable employee benefit laws and local tax laws. We record liabilities for the difference between the fair value of the plan assets and the benefit obligation (the projected benefit obligation for pension plans and the accumulated post-retirement benefit obligation for other postretirement benefits plans) on our accompanying Consolidated Balance Sheets.

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STERIS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

(dollars in thousands, except per share amounts)

10. Contingencies

We are involved in various patent, product liability, consumer, environmental, tax proceedings and claims, governmental investigations, and other legal and regulatory proceedings that arise from time to time in the ordinary course of business. In accordance with SFAS No. 5, we record accruals for such contingencies to the extent that we conclude that their occurrence is both probable and estimable. We consider many factors in making these assessments, including the professional judgment of experienced members of management and our legal counsel. We have estimated the likelihood of unfavorable outcomes and the amounts of such potential losses. In management s opinion, the ultimate outcome of these proceedings and claims is not expected to have a material adverse effect on our consolidated financial position, results of operations, or cash flows. However, the ultimate outcome of litigation is unpredictable and actual results could be materially different from our estimates. We record expected recoveries under applicable insurance contracts when we are assured of recovery.

The United States Food & Drug Administration (FDA) and the United States Department of Justice are continuing to conduct an investigation involving our SYSTEM 1® sterile processing system. We received requests for documents in connection with the investigation. We continue to respond to these requests and cooperate with the government agencies regarding this matter. There can be no assurance that the ultimate outcome of the investigation will not result in an action by the government agencies or that the government agencies will not initiate administrative proceedings, civil proceedings or criminal proceedings, or any combination thereof, against us.

The Internal Revenue Service (IRS) routinely conducts audits of our federal income tax returns. During the fourth quarter of fiscal year 2006, we reached a settlement with the IRS with respect to federal income tax returns for the fiscal years 1997 and 1998 that were previously in appeals, and entered the appeals phase relative to audit results for fiscal years 1999 through 2001. The IRS began an audit of fiscal years 2002 through 2005 in fiscal year 2007. We also remain subject to tax authority audits in various other jurisdictions in which we operate.

We record accruals for tax positions taken or expected to be taken in a tax return in accordance with the provisions of FIN No. 48. If we were to prevail in matters for which accruals have been established, or are required to pay amounts in excess of established accruals, our effective income tax rate in a given financial statement period may be materially impacted.

11. Business Segment Information

We operate and report in three business segments: Healthcare, Life Sciences, and STERIS Isomedix Services.

Our Healthcare segment is a global provider of capital equipment and accessories used in surgical and critical care environments, emergency departments, gastrointestinal and sterile processing environments, and in infection control processes. We also manufacture and sell consumable products and provide services to this healthcare customer base.

Our Life Sciences segment manufactures and sells capital equipment, cleaning chemistries, and service solutions to pharmaceutical companies, public and private research facilities, government, military, aerospace, transportation, and food and beverage customers.

Our Isomedix Services segment operates through a network of 21 facilities located in North America. We sell a comprehensive array of contract sterilization services using Gamma Irradiation, Electron Beam Irradiation, and ethylene oxide (EO) technologies. We provide sterilization, microbial reduction, and materials modification services to companies that supply products to the healthcare, industrial, and consumer products industries.

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STERIS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

(dollars in thousands, except per share amounts)

Operating income (loss) for each segment reflects the full allocation of all distribution, corporate, and research and development expenses to the segments. These allocations are based upon variables such as segment headcount and revenues. The accounting policies for reportable segments are the same as those for the consolidated Company. Individual facilities, equipment and intellectual properties are utilized for production for multiple segments at varying levels over time. As a result, an allocation of depreciable assets is not meaningful to segment performance. For the three months ended June 30, 2007, revenues from a single customer did not represent ten percent or more of any segment s revenues. Additional information regarding our segments is included in our Annual Report on Form 10-K for the year ended March 31, 2007, filed with the SEC on May 30, 2007.

Financial information for each of our segments is presented in the following tables:

	Three Months Ended June 30, 2007	Three Months Ended June 30, 2006
Revenues:		
Healthcare	$ 195,691	$ 187,131
Life Sciences	49,781	45,381
STERIS Isomedix Services	35,472	32,555
Total revenues	$ 280,944	$ 265,067
Operating income (loss):		
Healthcare	$ 15,213	$ 21,113
Life Sciences	(850)	(1,313)
STERIS Isomedix Services	7,204	5,661
Total operating income	$ 21,567	$ 25,461

For the three months ended June 30, 2007 and 2006, operating results of the Healthcare segment include restructuring expenses of $1,391 and $1,105, respectively.

Financial information for each of our United States and international geographic areas is presented in the following tables. Revenues are based on the location of our customers. Long-lived assets are those assets that are identified within the operations in each geographic area, including property, plant, equipment, goodwill, intangibles, and other assets.

	Three Months Ended June 30, 2007	Three Months Ended June 30, 2006
Revenues:		
United States	$ 221,989	$ 210,962
International	58,955	54,105
Total revenues	$ 280,944	$ 265,067

	June 30, 2007	March 31, 2007
Long-lived assets:		
United States	$ 565,373	$ 570,851
International	155,834	153,599
Total long-lived assets	$ 721,207	$ 724,450

STERIS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

(dollars in thousands, except per share amounts)

12. Common Shares

Basic earnings per common share is calculated based upon the weighted average number of common shares outstanding. Diluted earnings per common share is calculated based upon the weighted average number of common shares outstanding plus the dilutive effect of common share equivalents calculated using the treasury stock method. The following is a summary of common shares and common share equivalents outstanding used in the calculations of basic and diluted earnings per common share:

	Three Months Ended June 30,	
	2007	2006
	(shares in thousands)	
Weighted average common shares outstanding - basic	65,017	66,197
Dilutive effect of common share equivalents.	892	466
Weighted average common shares outstanding and common share equivalents - diluted .	65,909	66,663

Options to purchase the following number of common shares at the following weighted average exercise prices were outstanding but excluded from the computation of diluted earnings per common share because the options were not vested or the exercise prices were greater than the average market price for the common shares during the periods:

	Three Months Ended June 30,	
	2007	2006
	(shares in thousands)	
Number of common share options	1,085	3,066
Weighted average exercise price	$ 26.32	$ 25.50

13. Repurchases of Common Shares

During the first three months of fiscal 2008, we repurchased 708,931 of our common shares for an aggregate of $21,235, representing an average price of $29.95 per common share. At June 30, 2007, 1,886,869 common shares remained authorized for repurchase and 5,298,118 common shares were held in treasury. We provide additional information regarding common share repurchase authorizations and common share repurchases in note 18 to our consolidated financial statements titled, Subsequent Events.

14. Share-Based Compensation

STERIS has a long-term incentive plan that makes available up to 6,600,000 common shares for grants, at the discretion of the Compensation Committee of the Board of Directors to officers, directors, and key employees in the form of stock options, restricted shares, and restricted share units, or other forms permitted by the plan. STERIS previously granted stock options under various other plans. Stock options provide the right to purchase our common shares at the market price on the date of the grant, subject to the terms of option plans and agreements. Generally, stock options granted become exercisable in 25% increments for each full year of employment following the grant date. Stock options granted generally expire 10 years after the grant date, or earlier if the option holder is no longer employed by us. Certain option agreements have provisions that provide for an adjustment to the normal vesting schedule allowing the options to vest on a prorated basis, as defined by

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STERIS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

(dollars in thousands, except per share amounts)

the agreement, in the event of employee termination. Restricted shares and restricted share units generally cliff vest over an approximately three-year period. As of June 30, 2007, 6,009,556 shares remain available for grant under the long-term incentive plan.

On April 1, 2006, we adopted SFAS No. 123R using the modified prospective transition method. We estimate the fair value of share-based awards on the date of the grant using an option pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in our Consolidated Statements of Income. The expense is classified as cost of goods sold or selling, general and administrative expenses in a manner consistent with the employee s compensation and benefits.

Under the modified prospective transition method, compensation cost recognized during the first quarter of fiscal 2008 and fiscal 2007 includes (a) compensation cost for all share-based compensation granted, but not yet vested, as of April 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, and (b) compensation cost for all share-based compensation granted on or subsequent to April 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123R. Total share based compensation expense recognized during the first quarters of fiscal 2008 and fiscal 2007 was $1,615 and $2,092, respectively, before income taxes ($992 and $1,285, respectively, net of income taxes).

We issued 468,414 and 50,860 common shares from treasury upon the exercise of stock options during the three months ended June 30, 2007 and 2006, respectively. During the three months ended June 30, 2007 and 2006, 10,241 and 55,045 shares were forfeited. No stock options were granted during the first quarter of fiscal 2008 or fiscal 2007.

During the three months ended June 30, 2007, we granted 30,000 restricted share units with a weighted average grant date fair value of $26.81. No restricted shares or restricted share units were granted during the first quarter of fiscal 2007.

As of June 30, 2007, there was a total of $8,790 in unrecognized compensation cost related to nonvested share-based compensation granted under our share-based compensation plans. We expect to recognize the cost over a weighted average period of 1.45 years.

We provide additional information regarding share-based compensation in note 18 to our consolidated financial statements titled, Subsequent Events.

15. Financial and Other Guarantees

We generally offer a limited parts and labor warranty on capital equipment. The specific terms and conditions of those warranties vary depending on the product sold and the country where we conduct business. We record a liability for the estimated cost of product warranties at the time product revenues are recognized. The amounts we expect to incur on behalf of our customers for the future estimated cost of these warranties are recorded as a current liability on the accompanying Consolidated Balance Sheets within Accrued expenses and other. Factors that affect the amount of our warranty liability include the number and type of installed units, historical and anticipated rates of product failures, and material and service costs per claim. We periodically assess the adequacy of our recorded warranty liabilities and adjust the amounts as necessary.

Changes in our warranty liability during the first three months of fiscal 2008 were as follows:

Balance, March 31, 2007	$ 5,893
Warranties issued during the period	3,187
Settlements made during the period	(2,687)
Balance, June 30, 2007	$ 6,393

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STERIS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

(dollars in thousands, except per share amounts)

We also sell product maintenance contracts to our customers. These contracts range in terms from one to five years and require us to maintain and repair the product over the maintenance contract term. We initially record amounts due from customers under these contracts as a liability for deferred service contract revenue on our accompanying Consolidated Balance Sheets within Accrued expenses and other. The liability recorded for such deferred service revenue was $17,487 and $16,751 as of June 30, 2007 and March 31, 2007, respectively. Such deferred revenue is then amortized on a straight-line basis over the contract term and recognized as service revenue on our accompanying Consolidated Statements of Income. The activity related to the liability for deferred service contract revenues is excluded from the table presented above.

16. Foreign Currency Forward Contracts

From time to time, we enter into forward contracts to hedge potential foreign currency gains and losses that arise from assets and liabilities denominated in foreign currencies, including inter-company transactions. We do not use derivative financial instruments for speculative purposes. These contracts are marked to market, with gains and losses recognized on the accompanying Consolidated Statements of Income within Selling, general, and administrative expenses. At June 30, 2007, we did not hold any foreign currency forward contracts.

17. Business Dispositions

On October 31, 2005, we sold our freeze dryer (lyophilizer) product line to GEA Group of Germany for 20.8 million euros (approximately $25,161). As a result of the sale, we recognized an after-tax gain of $7,292. The gain recognized through June 30, 2006 was preliminary because the purchase price was subject to post-closing adjustments. The freeze dryer product line, based in Cologne, Germany, was part of our Life Sciences segment. The gain from the sale of this product line, recorded in the first quarter of fiscal 2007, of $627 is presented in our financial statements as a discontinued operation, net of tax.

18. Subsequent Events

On July 26, 2007, we announced that the Company s Board of Directors had declared a quarterly cash dividend in the amount of $0.06 per common share, payable on September 12, 2007, to shareholders of record as of August 15, 2007.

On July 26, 2007, we announced that the Company s Board of Directors had authorized the purchase of up to $300,000 in shares of our common stock. This common share repurchase authorization replaced the existing authorization to repurchase up to 3,000,000 shares that was approved on July 27, 2006. This new common share repurchase authorization does not have a stated maturity date. Under this new authorization, we may purchase shares from time to time through open market purchases or privately negotiated transactions, including transactions pursuant to Rule 10b5-1 plans.

On July 27, 2007, the Company s Board of Directors awarded a total of 402,718 stock options at an exercise price of $27.68 per share and 77,136 restricted shares with a grant date fair value of $27.68 per share to directors, officers, and certain key employees of the Company.

Subsequent to June 30, 2007 and prior to August 7, 2007, we repurchased 404,800 of our common shares for an aggregate of $11,258, representing an average price of $27.81 per common share.

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Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders

STERIS Corporation

We have reviewed the consolidated balance sheet of STERIS Corporation and subsidiaries as of June 30, 2007, and the related consolidated statements of income and cash flows for the three month periods ended June 30, 2007 and 2006. These financial statements are the responsibility of the Company s management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based upon our review, we are not aware of any material modifications that should be made to the consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of STERIS Corporation and subsidiaries as of March 31, 2007 and the related consolidated statements of income, shareholders equity and cash flows for the year then ended, not presented herein, and in our report dated May 24, 2007, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of March 31, 2007, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Ernst & Young LLP

Cleveland, Ohio

August 7, 2007

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

Introduction. In Management s Discussion and Analysis of Financial Condition and Results of Operations (the MD&A), we explain the general financial condition and the results of operations for STERIS including:

- what factors affect our business;
- what our earnings and costs were in the first quarter of fiscal 2008 and 2007;
- why those earnings and costs were different from the year before;
- where our earnings came from;
- how this affects our overall financial condition; and
- where cash will come from to pay for future capital expenditures.

As you read the MD&A, it may be helpful to refer to information in our consolidated financial statements, which present the results of our operations for the first quarter of fiscal 2008 and 2007. In the MD&A, we analyze and explain the period-over-period changes in the specific line items in the Consolidated Statements of Income. Our analysis may be important to you in making decisions about your investments in STERIS.

Financial Measures. In the following sections of the MD&A, we may, at times, refer to financial measures that are not required to be presented in the consolidated financial statements under U.S. GAAP. We have used the following financial measures in the context of this report: backlog; debt to capital; and days sales outstanding. We define these financial measures as follows:

- Backlog - We define backlog as the amount of unfilled capital purchase orders at a point in time. We use this figure as a measure to assist in the projection of short-term financial results and inventory requirements.
- Debt to capital - We define debt to capital as total debt divided by the sum of total debt and shareholders equity. We use this figure as a financial liquidity measure to gauge our ability to borrow, fund growth, and measure the risk of our financial structure.
- Days sales outstanding (DSO) - We define DSO as the average collection period for accounts receivable. It is calculated as net accounts receivable divided by the trailing four quarter s revenues, multiplied by 365. We use this figure to help gauge the quality of accounts receivable and expected time to collect.

In the following sections of the MD&A, we may, at times, also refer to financial measures which are considered to be non-GAAP financial measures under the rules of the SEC. Non-GAAP financial measures we may use are as follows:

- Free cash flow - We define free cash flow as net cash flows provided by (used in) operating activities as presented in the Consolidated Statements of Cash Flows less purchases of property, plant, equipment, and intangibles, net, plus proceeds from the sale of property, plant, equipment, and intangibles, which is also presented in the Consolidated Statements of Cash Flows. We use this measure to gauge our ability to fund future growth outside of core operations, repurchase common shares, pay cash dividends, and reduce debt. The following table summarizes the calculation of our cash flow for the three months ended June 30, 2007 and 2006:

	Three Months Ended June 30,	
(dollars in thousands)	**2007**	**2006**
Net cash flows provided by (used in) operating activities	$ 19,426	$ (6,677)
Purchases of property, plant, equipment and intangibles, net	(9,691)	(12,415)
Proceeds from the sale of property, plant, equipment and intangibles	22	
Free cash flow	$ 9,757	$ (19,092)

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We may, at times, refer to our results of operations excluding certain transactions or amounts that are non-recurring or are not indicative of future results, in order to provide meaningful comparative analysis between the periods presented. For example, when discussing changes in revenues, we may, at times, exclude the impact of recently completed acquisitions and dispositions.

We have presented these financial measures because we believe that meaningful analysis of our financial performance is enhanced by an understanding of certain additional factors underlying that performance. These financial measures should not be considered alternatives to measures required by U.S. GAAP. Our calculations of these measures may be different from calculations of similar measures used by other companies and you should be careful when comparing these financial measures to those of other companies.

Revenues - Defined. As required by Regulation S-X under the Securities Exchange Act of 1934 (Regulation S-X), we separately present revenues generated as either product revenues or service revenues on our Consolidated Statements of Income for each period presented. When we discuss revenues, we may, at times, refer to revenues summarized differently than the Regulation S-X requirements. The terminology, definitions, and applications of terms that we use to describe revenues may be different from terms used by other companies. We use the following terms to describe revenues:

Revenues - Our revenues are presented net of sales returns and allowances.

Product Revenues - We define product revenues as revenues generated from sales of capital equipment, which includes steam and low temperature liquid sterilizers, washing systems, VHP® technology, water stills, and pure steam generators; surgical lights, tables and ceiling management systems; and the consumable family of products, which includes STERIS SYSTEM 1® consumables, sterility assurance products, skin care products, and cleaning consumables.

Service Revenues - We define service revenues as revenues generated from parts and labor associated with the maintenance, repair, and installation of our capital equipment, as well as revenues generated from contract sterilization offered through our Isomedix Services segment.

Capital Revenues - We define capital revenues, a subset of product revenues, as revenues generated from sales of capital equipment, which includes steam and low temperature liquid sterilizers, washing systems, VHP® technology, water stills, and pure steam generators; and surgical lights, tables and ceiling management systems.

Consumable Revenues - We define consumable revenues, a subset of product revenues, as revenues generated from sales of the consumable family of products, which includes STERIS SYSTEM 1® consumables, sterility assurance products, skin care products, and cleaning consumables.

Recurring Revenues - We define recurring revenues as revenues generated from sales of consumable products and service revenues.

General Company Overview and Executive Summary. Our mission is to provide a healthier today and safer tomorrow through knowledgeable people and innovative infection prevention, decontamination and health science technologies, products, and services. Our dedicated employees around the world work together to supply a broad range of solutions by offering a combination of equipment, consumables, and services to healthcare, pharmaceutical, industrial, and governmental customers.

We participate in industries that currently benefit from strong underlying demand, with the bulk of our revenues derived from the healthcare and pharmaceutical industries. As such, much of the growth in our markets is driven by the aging of the population throughout the world, as an increasing number of individuals are entering their prime healthcare consumption years. In addition, each of our core industries also are benefiting from specific trends that drive growth. Within the healthcare market, there is increased concern regarding the level of hospital-acquired infections around the world. The pharmaceutical industry has been impacted by increased FDA scrutiny of cleaning and validation processes, mandating that manufacturers improve their processes. In the contract sterilization industry, where our Isomedix segment competes, a trend toward the outsourcing of sterilization services continues to drive growth.

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Beyond our core markets, infection-control issues are becoming a global concern, and emerging threats have gained prominence in the news. Through the Life Sciences segment, we are actively pursuing new opportunities to adapt our proven technologies to meet the needs of emerging applications such as defense, aerospace, food and beverage, and industrial decontamination.

Fiscal 2008 first quarter revenues were $280.9 million compared to $265.1 million in the first quarter of fiscal 2007, representing an increase of $15.8 million, or 6.0%, driven by revenue growth in all three business segments. Our gross margin percentage for the first quarter of fiscal 2008 was 42.3% compared to 42.8% in the first quarter of fiscal 2007, or a decline of 50 basis points, reflecting the impact of higher freight expenses and raw material costs, particularly for stainless steel, partially offset by price increases and productivity gains.

Free cash flow was $9.8 million in the first quarter of fiscal 2008 compared to negative $19.1 million in the prior year first quarter. The fiscal 2007 first quarter negative free cash flow of $19.1 million primarily resulted from working capital changes, including payments to the IRS of taxes previously recognized. Our debt-to-capital ratio increased to 12.5% at June 30, 2007 from 11.6% at March 31, 2007, reflecting increased borrowings utilized to fund working capital changes and common share repurchases. During the first quarter of fiscal 2008, we repurchased approximately 0.7 million common shares at an average purchase price per share of $29.95. We also declared and paid quarterly cash dividends in the first quarter of fiscal 2008 of $0.05 per common share.

Additional information regarding our fiscal 2008 first quarter financial performance is included in the subsection below titled Results of Operations.

Matters Affecting Comparability

Accounting for Uncertain Tax Positions. On April 1, 2007, we adopted FIN No. 48, which provides guidance for the recognition threshold and measurement attribute for financial statement recognition and measurement of tax positions taken or expected to be taken on a tax return. In accordance with FIN No. 48, we recorded a cumulative-effect adjustment of $8.4 million, increasing our liability for unrecognized tax benefits, interest, and penalties and reducing the April 1, 2007 balance of retained earnings.

Additional information regarding our adoption of FIN No. 48 is included in note 1 titled, Nature of Operations and Summary of Significant Accounting Policies, and in note 8 titled, Income Tax Expense, of our accompanying consolidated financial statements.

Restructuring. On January 30, 2006, we announced that the manufacturing portion of our Erie, Pennsylvania operations will be transferred to Mexico to reduce production costs and improve our competitive position. Plans for other restructuring actions designed to reduce operating costs within the ongoing operations of both the Healthcare and Life Sciences segments also were approved.

During the first quarter of fiscal 2008 and 2007, we incurred pre-tax expenses of $1.9 million and $2.4 million, including $1.4 million and $1.1 million classified as restructuring expenses, respectively, primarily related to accelerated depreciation of assets, compensation and severance and termination benefits related to the transfer of our Erie, Pennsylvania manufacturing operations to Monterrey, Mexico.

Additional information regarding our restructuring actions is included in our Annual Report on Form 10-K for the year ended March 31, 2007, filed with the SEC on May 30, 2007.

Business Dispositions. On October 31, 2005, we sold our freeze dryer (lyophilizer) product line to GEA Group of Germany for 20.8 million euros (approximately $25.2 million). As a result of the sale, we recognized an after-tax gain of approximately $7.3 million. The gain recognized through June 30, 2007 remained subject to adjustment as transaction costs were finalized. The freeze dryer product line, based in Cologne, Germany, was part of our Life Sciences segment. The gain from the sale of this product line recorded in the first quarter of fiscal 2007 of $0.6 million is presented in our financial statements as a discontinued operation, net of tax.

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International Operations. Since we conduct operations outside of the United States using various foreign currencies, our operating results are impacted by foreign currency movements relative to the U.S. dollar. During the first quarter of fiscal 2008, our revenues were favorably impacted by $2.2 million, or 0.8%, and income before taxes was unfavorably impacted by $1.8 million, or 8.4%, compared with the first quarter of fiscal 2007, as a result of foreign currency movements relative to the U.S. dollar.

Results of Operations. In the following subsections, we discuss our earnings and the factors affecting them. We begin with a general overview of the results of operations of the Company and then separately discuss earnings for our operating segments.

Revenues. The following table compares our revenues for the three months ended June 30, 2007 to the three months ended June 30, 2006:

	Three Months Ended June 30,			Percent	Percent of Total Revenues	
(dollars in thousands)	2007	2006	Change	Change	2007	2006
Capital Revenues	$ 102,849	$ 100,053	$ 2,796	2.8%	36.6%	37.7%
Consumable Revenues	69,520	65,706	3,814	5.8%	24.7%	24.8%
Product Revenues	172,369	165,759	6,610	4.0%	61.4%	62.5%
Service Revenues	108,575	99,308	9,267	9.3%	38.6%	37.5%
Total Revenues	$ 280,944	$ 265,067	$ 15,877	6.0%	100.0%	100.0%
Service Revenues	$ 108,575	$ 99,308	$ 9,267	9.3%	38.6%	37.5%
Consumable Revenues	69,520	65,706	3,814	5.8%	24.7%	24.8%
Recurring Revenues	178,095	165,014	13,081	7.9%	63.4%	62.3%
Capital Revenues	102,849	100,053	2,796	2.8%	36.6%	37.7%
Total Revenues	$ 280,944	$ 265,067	$ 15,877	6.0%	100.0%	100.0%
United States	$ 221,989	$ 210,962	$ 11,027	5.2%	79.0%	79.6%
International	58,955	54,105	4,850	9.0%	21.0%	20.4%
Total Revenues	$ 280,944	$ 265,067	$ 15,877	6.0%	100.0%	100.0%

Revenues increased $15.8 million, or 6.0%, to $280.9 million for the quarter ended June 30, 2007, as compared to $265.1 million for the same prior year quarter, driven by growth in all three business segments. As compared to the first quarter of fiscal 2007, service revenues increased $9.3 million in the first quarter of fiscal 2008 primarily due to increases in revenues within the United States for all three business segments. Consumable revenues increased 5.8% for the quarter ended June 30, 2007, as compared to the same prior year quarter, primarily driven by growth in the Healthcare segment. Capital revenues increased 2.8% quarter-over-quarter primarily as a result of increases in revenues within the European markets for both the Healthcare and Life Sciences segments.

International revenues increased $4.8 million, or 9.0%, to $58.9 million for the quarter ended June 30, 2007, as compared to $54.1 million for the same prior year quarter. International revenues were positively affected by growth in capital equipment revenues within the European markets for both our Healthcare and Life Sciences segments with increases of 9.9% and 44.3% over the comparable prior year quarter, respectively. Consumable revenues within our Healthcare segment s European market also experienced 16.8% growth during the first quarter of fiscal 2008 as compared to the same prior year quarter.

United States revenues increased $11.0 million, or 5.2%, to $221.9 million for the quarter ended June 30, 2007, as compared to $210.9 million for the same prior year quarter. The increase in United States revenues was primarily driven by strong growth in recurring revenues, with increases of 3.9% and 9.7% in consumable

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and service revenues, respectively. United States capital revenues also increased for the first quarter of fiscal 2008 as compared to the prior year quarter, with 1.1% growth in our Healthcare segment, tempered by relatively flat capital revenues for our Life Sciences segment.

Revenues by segment are further discussed in the section of MD&A titled, Business Segment Results of Operations.

Gross Profit. The following table compares our gross profit for the three months ended June 30, 2007 to the three months ended June 30, 2006:

	Three Months Ended June 30,			Percent
(dollars in thousands)	2007	2006	Change	Change
Gross Profit:				
Product	$ 70,494	$ 70,466	$ 28	0.0%
Service	48,218	42,909	5,309	12.4%
Total Gross Profit	$ 118,712	$ 113,375	$ 5,337	4.7%
Gross Profit Percentage:				
Product	40.9%	42.5%		
Service	44.4%	43.2%		
Total Gross Profit Percentage	42.3%	42.8%		

Our gross profit (margin) is affected by the volume, pricing, and mix of sales of our products and services, as well as the costs associated with the products and services that are sold. Our total gross margin decreased from the first quarter of fiscal 2007, reflecting increases in raw material costs, particularly for stainless steel, and freight costs, which more than offset price increases and productivity gains in our manufacturing facilities and service organization.

Operating Expenses. The following table compares our operating expenses for the three months ended June 30, 2007 to the three months ended June 30, 2006:

	Three Months Ended June 30,			Percent
(dollars in thousands)	2007	2006	Change	Change
Operating Expenses:				
Selling, General, and Administrative	$ 86,495	$ 78,414	$ 8,081	10.3%
Research and Development	9,259	8,395	864	10.3%
Restructuring Expenses	1,391	1,105	286	25.9%
Total Operating Expenses	$ 97,145	$ 87,914	$ 9,231	10.5%

Significant components of total selling, general, and administrative expenses (SG&A) are compensation and benefit costs, fees for professional services, travel and entertainment, facilities costs, and other general and administrative expenses. As a percentage of total revenue, SG&A increased 120 basis points for the first quarter of fiscal 2008 as compared to the first quarter of fiscal 2007. The increases in SG&A and research and development expenses in the first quarter of fiscal 2008 reflect continued investments in developing new products and the related costs incurred for marketing, advertising, and supporting these new product introductions.

As a percentage of total revenues, research and development expenses were 3.3% and 3.2% for the three-month periods ended June 30, 2007 and 2006, respectively. Research and development expenses are influenced

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by the number and timing of in-process projects and labor hours and other costs associated with these projects. Our research and development initiatives continue to emphasize new product development, product improvements, and the development of new technological innovations. During the first quarter of fiscal 2008, our investments in research and development continued to be focused on, but were not limited to, enhancing capabilities of delivery systems in the defense and industrial areas, sterile processing combination technologies, surgical tables and accessories, and the areas of emerging infectious agents such as Prions and Nanobacteria.

Our operating expenses include restructuring expenses. We recognize restructuring expenses as incurred as required under the provisions of SFAS No. 146. In addition, we assessed the property, plant and equipment associated with the related facilities for impairment under SFAS No. 144. Asset impairment and accelerated depreciation expenses primarily relate to an adjustment to the carrying value of the related facilities to their estimated fair value. In addition, the remaining useful lives of other property, plant and equipment associated with the related operations were reevaluated based on the respective restructuring plan, resulting in the acceleration of depreciation and amortization of certain assets.

In the first quarter of fiscal 2008, we recorded $1.4 million in restructuring expenses, as compared to $1.1 million in the first quarter of fiscal 2007. These restructuring expenses primarily related to the previously announced transfer of the Erie, Pennsylvania manufacturing operations to Monterrey, Mexico, which was part of the Fiscal 2006 Restructuring Plan. The restructuring expenses we recorded during the first quarter of fiscal 2008 and the first quarter of fiscal 2007 are summarized in the following table:

	Fiscal 2006 Restructuring Plan Three Months Ended June 30,	
(dollars in thousands)	**2007**	**2006**
Asset impairment and accelerated depreciation	$ 1,059	$ 705
Severance, payroll and other related costs	332	390
Other		10
Total restructuring charges	$ 1,391	$ 1,105

The costs incurred during the first quarter of fiscal 2008 and fiscal 2007 are associated with our Healthcare business segment. Since the inception of the Fiscal 2006 Restructuring Plan, we have incurred restructuring expenses of $31.6 million, with restructuring expenses of $31.2 million and $0.4 million related to the Healthcare and Life Sciences segments, respectively.

We anticipate incurring approximately an additional $3.0 million in restructuring expenses during fiscal 2008 in connection with the transfer of the manufacturing operations to Mexico. Restructuring expenses to be incurred include compensation and benefits, severance, accelerated depreciation and other expenses.

Liabilities related to the Fiscal 2006 Restructuring Plan activities are recorded as current liabilities on the accompanying Consolidated Balance Sheets within Accrued expenses and other. The following table summarizes our liabilities related to these restructuring activities:

	Fiscal 2006 Restructuring Plan			
	March 31,	**Fiscal 2008**		**June 30,**
(dollars in thousands)	**2007**	**Provision**	**Payments**	**2007**
Severance and termination benefits	$ 1,799	$ 332	$ (209)	$ 1,922
Lease termination obligation	157	(13)	(144)	
Total	$ 1,956	$ 319	$ (353)	$ 1,922

During the third quarter of fiscal 2007, we adopted the European Restructuring Plan. For the three months ended June 30, 2007, we did not incur any restructuring expenses related to the European Restructuring Plan. We are continuing to evaluate our European operations for opportunities to enhance performance, but we have not committed to any additional specific restructuring actions.

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Liabilities related to the European Restructuring Plan activities are recorded as current liabilities on the accompanying Consolidated Balance Sheets within Accrued expenses and other. The following table summarizes our liabilities related to these restructuring activities:

		European Restructuring Plan		
	March 31,	Fiscal 2008		June 30,
(dollars in thousands)	2007	Provision	Payments	2007
Severance and termination benefits	$ 638	$	$ (238)	$ 400
Lease termination obligation	219		(33)	186
Fixed asset impairment	105			105
Total	$ 962	$	$ (271)	$ 691

Non-Operating Expense, Net. Non-operating expense (income), net consists of interest expense on debt, offset by interest earned on cash, cash equivalents, short-term investment balances, and other miscellaneous income. The following table compares our net non-operating expense for the three months ended June 30, 2007 and 2006:

	Three Months Ended June 30,		
(dollars in thousands)	2007	2006	Change
Non-Operating Expense, Net:			
Interest Expense	$ 1,235	$ 1,769	$ (534)
Interest and Miscellaneous Income	(462)	(679)	217
Non-Operating Expense, Net	$ 773	$ 1,090	$ (317)

Interest expense decreased $0.5 million during the first three months of fiscal 2008 compared with the same prior year period, reflecting lower average debt levels and lower average interest rates. Interest and other miscellaneous income decreased $0.2 million during the first three months of fiscal 2008 compared with the same prior year period. This decrease was due to lower cash balances in fiscal 2008, which resulted in a smaller amount of interest earnings on those balances.

Income Tax Expense. The following table compares our income tax expense and effective income tax rates for continuing operations for the three months ended June 30, 2007 to the three months ended June 30, 2006:

	Three Months Ended June 30,			Percent
(dollars in thousands)	2007	2006	Change	Change