Throughout this discussion, references are made to the following financial measures: "constant currency," "adjusted net earnings from continuing operations," "adjusted basic net earnings per share from continuing operations" and "adjusted diluted net earnings per share from continuing operations." These financial measures are an alternative representation of Stryker Corporation's (the Company or Stryker) past and potential future operational performance and do not replace the presentation of the Company's reported financial results under U.S. generally accepted accounting principles (GAAP). The Company has provided these supplemental non-GAAP financial measures because they provide meaningful information regarding the Company's results on a consistent and comparable basis for the periods presented. Management uses these non-GAAP financial measures for reviewing the operating results of its business segments, for analyzing potential future business trends in connection with its budget process and bases certain annual bonus plans on these non-GAAP financial measures. In order to measure the Company's sales performance on a constant currency basis, it is necessary to remove the impact of changes in foreign currency exchange rates which affects the comparability and trend of sales. Constant currency results are calculated by translating current year results at prior year average foreign currency exchange rates. In order to measure earnings performance on a consistent and comparable basis, the Company excludes the restructuring charges recorded in 2008, the intangible asset impairment charge recorded in 2007 and the purchased in-process research and development charge recorded in 2006, each of which affects the comparability of operating results and the trend of earnings. Additional details regarding the nature, determination and financial statement impact of these items are included in *Results of Operations*. In addition, the Company believes investors will utilize this information to evaluate period-to-period results on a comparable basis and to better understand potential future operating results. The Company encourages investors and other users of these financial statements to review its Consolidated Financial Statements and other publicly filed reports in their entirety and not to rely solely on any single financial measure.

Executive Level Overview

Stryker is one of the world's leading medical technology companies with the most broadly based range of products in orthopaedics and a significant presence in other medical specialties. Stryker works with respected medical professionals to help people lead more active and more satisfying lives. The Company's products include implants used in joint replacement, trauma, craniomaxillofacial and spinal surgeries; biologics; surgical, neurologic, ear, nose & throat and interventional pain equipment; endoscopic, surgical navigation, communications and digital imaging systems; as well as patient handling and emergency medical equipment.

Domestic sales accounted for 64% of total revenues in 2008. Most of the Company's products are marketed directly to doctors, hospitals and other healthcare facilities by approximately 3,900 sales and marketing personnel in the United States. 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 2008. The Company's products are sold in more than 100 countries through Company-owned sales subsidiaries and branches as well as 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.

During the fourth quarter of 2008, the general economic slowdown in the United States resulted in a significant and rapid contraction in hospital capital budgets that depressed demand for certain MedSurg Equipment products. The unprecedented weakening of the economy caused the Company's hospital customers to reduce capital purchases to a degree not previously experienced in prior recessionary periods.

During 2008 the Company repurchased 17.4 million shares of common stock in the open market at a cost of $1,000.0 million pursuant to the repurchase programs authorized by the Company's Board of Directors. Shares repurchased under the share repurchase programs are available for general corporate purposes, including offsetting dilution associated with stock option and other equity-based employee benefit plans.

In 2008 the Company decided to simplify the structure of its Japanese distribution business and to substantially reduce development efforts associated with the product technologies acquired from Sightline Technologies Ltd. (Sightline). In 2006 the Company acquired all of the outstanding stock of Sightline, a private, development-stage company, for an upfront payment of $50.0 million in cash plus certain transaction costs and the assumption of certain liabilities. Terms of the transaction also included milestone payments of up to an additional $90.0 million upon the achievement of certain operational and financial targets related to Sightline's products. Unanticipated issues have arisen that continue to delay the regulatory approval and commercialization efforts of new products associated with the product technologies acquired in the Sightline acquisition. However, the Company believes that the technologies acquired in the Sightline acquisition may result in the introduction of new products and additional sales in future periods. Additional details, including the financial statement impact resulting from these restructurings and the acquisition of Sightline, are included in *Results of Operations.*

In 2008 the Company adopted the provisions of Financial Accounting Standard Board (FASB) Statement No. 157, *Fair Value Measurements,* for financial assets and liabilities measured on a recurring basis. This Statement applies to all financial assets and financial liabilities that are being measured and reported on a fair value basis, establishes a framework for measuring fair value of assets and liabilities and expands disclosures about fair value measurements. There was no impact to the Consolidated Financial Statements as a result of the adoption of this Statement. The additional disclosure requirements regarding fair value measurements are included in Note 2 to the Consolidated Financial Statements.

In 2008 the Company adopted the provisions of FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities.* This Statement allows companies the option to measure eligible financial instruments at fair value. Such election, which may be applied on an instrument by instrument basis, is typically irrevocable once elected. The Company has elected to apply the fair value option to its Auction Rate Securities Rights agreement, as more fully described in *Liquidity and Capital Resources.*

In 2007 the Company sold its outpatient physical therapy business, Physiotherapy Associates, for $150.0 million in cash less certain indebtedness. Physiotherapy Associates' operating results are reported as discontinued operations for the years ended December 31, 2007 and 2006. Additional details, including the financial statement impact resulting from this divestiture, are included in *Results of Operations.*

In 2007 the Company adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes.* This Interpretation clarifies the accounting for income taxes by prescribing the minimum recognition threshold an income tax position is required to meet before being recognized in the Company's Consolidated Financial Statements. The Interpretation also provides guidance for the measurement and classification of income tax positions, interest and penalties, and requires additional disclosure on an annual basis. Additional details, including the financial statement impact resulting from this adoption, are included in *Results of Operations.*

Outlook for 2009

The Company continues to face depressed demand for certain MedSurg Equipment products due to the general economic slowdown. In addition, the Company anticipates that a slowdown in elective procedures for certain of its Orthopaedic Implants products may occur. The Company projects that diluted net earnings per share for 2009 will be in the range of $3.12 to $3.22, an increase of 10% to 14% over adjusted diluted net earnings per share from continuing operations of $2.83 in 2008. The financial forecast for 2009 anticipates a constant currency net sales increase in the range of 6% to 9%. If foreign currency exchange rates hold near January 31, 2009 levels, the Company anticipates an unfavorable impact on net sales of approximately 4.0% to 4.5% in the first quarter of 2009 and an unfavorable impact on net sales of approximately 3.5% to 4.5% for the full year of 2009.

Results of Operations

The table below outlines the components of net earnings from continuing operations from the Consolidated Statements of Earnings as a percentage of net sales and the year-to-year percentage change in dollar amounts:

	Percentage of Net Sales			Percentage Change	
	2008	*2007*	*2006*	*2008/2007*	*2007/2006*
Net sales	100.0%	100.0%	100.0%	12%	17%
Cost of sales	31.7	31.1	31.4	14	15
Gross profit	68.3	68.9	68.6	11	17
Research, development and engineering expenses	5.5	6.3	6.3	(2)	16
Selling, general and administrative expenses	39.1	39.9	39.8	10	17
Intangibles amortization	0.6	0.7	0.8	(3)	(3)
Restructuring charges	0.5	–	–	–	–
Intangible asset impairment	–	0.3	–	(100)	–
Purchased in-process research and development	–	–	1.0	–	(100)
Operating income	22.6	21.8	20.7	16	23
Other income (expense)	0.9	1.0	0.6	(3)	108
Earnings from continuing operations before income taxes	23.5	22.8	21.3	15	25
Income taxes	6.4	6.4	6.3	13	19
Net earnings from continuing operations	17.1%	16.4%	15.0%	16	28

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, craniomaxillofacial and spinal implant systems; bone cement; and the bone growth factor OP-1. The MedSurg Equipment segment sells surgical equipment; surgical navigation systems; endoscopic, communications and digital imaging systems; as well as patient handling and emergency medical equipment.

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

	Net Sales			Percentage Change			
	2008	*2007*	*2006*	*2008/2007*		*2007/2006*	
				Reported	Constant Currency	Reported	Constant Currency
Domestic/international sales:							
Domestic	$4,282.2	$3,850.3	$3,298.4	11%	11%	17%	17%
International	2,436.0	2,150.2	1,848.8	13	9	16	9
Total net sales	$6,718.2	$6,000.5	$5,147.2	12	11	17	14
Product line sales:							
Orthopaedic Implants	$3,967.5	$3,587.3	$3,122.8	11	9	15	12
MedSurg Equipment	2,750.7	2,413.2	2,024.4	14	13	19	17
Total net sales	$6,718.2	$6,000.5	$5,147.2	12	11	17	14

The tables below set forth additional geographical sales growth information for significant products within the Company's Orthopaedic Implants and MedSurg Equipment segments on both a reported basis and a constant currency basis:

	Year Ended December 31, 2008				
	Percentage Change				
	Domestic	International		Total	
	Reported	Reported	Constant Currency	Reported	Constant Currency
Orthopaedic Implants sales:					
Hips	2	3	0	3	1
Knees	15	13	10	14	13
Trauma	20	17	10	18	14
Spine	22	14	8	19	18
Craniomaxillofacial	21	6	3	16	15
Total Orthopaedic Implants	11	10	6	11	9
MedSurg Equipment sales:					
Surgical equipment and surgical navigation systems	16	18	14	17	15
Endoscopic, communications and digital imaging systems	6	18	15	9	8
Patient handling and emergency medical equipment	13	43	41	18	17
Total MedSurg Equipment	11	22	18	14	13

	Year Ended December 31, 2007				
	Percentage Change				
	Domestic	International		Total	
	Reported	Reported	Constant Currency	Reported	Constant Currency
Orthopaedic Implants sales:					
Hips	7	12	5	9	6
Knees	15	16	9	16	13
Trauma	29	12	6	19	15
Spine	29	16	10	25	23
Craniomaxillofacial	24	6	0	17	14
Total Orthopaedic Implants	16	13	7	15	12
MedSurg Equipment sales:					
Surgical equipment and surgical navigation systems	17	26	18	20	17
Endoscopic, communications and digital imaging systems	18	30	21	21	19
Patient handling and emergency medical equipment	18	7	3	16	15
Total MedSurg Equipment	18	24	17	19	17

2008 Compared with 2007

The Company's net sales increased 12% in 2008 to $6,718.2 million from $6,000.5 million in 2007. Net sales grew by 11% as a result of increased unit volume and changes in product mix and by 1% due to favorable changes in foreign currency exchange rates.

The Company's domestic sales were $4,282.2 million for 2008, representing an increase of 11%, as a result of higher shipments of Orthopaedic Implants and MedSurg Equipment. International sales were $2,436.0 million for 2008, representing an increase of 13%. The impact of foreign currency comparisons to the dollar value of international sales was favorable by $84.7 million for 2008. On a constant currency basis, international sales increased 9% in 2008 as a result of higher shipments of Orthopaedic Implants and MedSurg Equipment.

Worldwide sales of Orthopaedic Implants were $3,967.5 million for 2008, representing an increase of 11%. On a constant currency basis, sales of Orthopaedic Implants increased 9% in 2008 as a result of higher shipments of reconstructive, trauma, spinal and craniomaxillofacial implant systems and bone cement.

Hip Implant Systems: Sales of hip implant systems increased 3% in 2008 (1% on a constant currency basis). In the United States, sales growth was driven by increased sales of the Cormet Hip Resurfacing product and sales growth in X3 Polyethylene and Accolade cementless hip products, partially offset by declines in other hip systems. Sales growth in several hip systems, including Accolade, X3 Polyethylene and ABG II, in Europe and Secur-Fit in Japan and the Pacific region also contributed to the Company's constant currency sales growth in 2008.

Knee Implant Systems: Sales of knee implant systems increased 14% in 2008 (13% on a constant currency basis) due to strong sales growth in the Triathlon Knee System in the United States, Europe, Canada and the Pacific region and solid sales growth in the Scorpio Knee System in Japan and the Latin America region.

Trauma Implant Systems: Sales of trauma implant systems increased 18% in 2008 (14% on a constant currency basis) as a result of strong worldwide sales growth in the Gamma3 Hip Fracture System and the SPS Calcaneal Foot Plating System and strong sales growth in the Company's T2 Nailing System in the United States, Canada and the Pacific region. Strong sales growth in the HydroSet injectable bone substitute product in the United States and the Pacific region also contributed to the Company's constant currency sales growth in 2008.

Spinal Implant Systems: Sales of spinal implant systems increased 19% in 2008 (18% on a constant currency basis). The increase was driven by strong worldwide sales growth of thoracolumbar implant systems, interbody devices and cervical implants.

Craniomaxillofacial Implant Systems: Sales of craniomaxillofacial implant systems increased 16% in 2008 (15% on a constant currency basis) primarily due to strong sales growth of products for neurological indications and craniomaxillofacial implants and the HydroSet injectable bone substitute product in the United States and the Pacific region.

Worldwide sales of MedSurg Equipment were $2,750.7 million for 2008, representing an increase of 14%. On a constant currency basis, sales of MedSurg Equipment increased 13% in 2008 as a result of higher shipments of surgical equipment and surgical navigation systems; endoscopic, communications and digital imaging systems; as well as patient handling and emergency medical equipment.

Surgical Equipment and Surgical Navigation Systems: Sales of surgical equipment and surgical navigation systems increased 17% in 2008 (15% on a constant currency basis) due to strong worldwide sales growth in powered surgical and operating room equipment as well as solid sales growth in interventional pain products in the United States and the Pacific region.

Endoscopic, Communications and Digital Imaging Systems: Sales of endoscopic, communications and digital imaging systems increased 9% in 2008 (8% on a constant currency basis) as a result of strong worldwide sales growth in arthroscopy and general surgery as well as strong international sales growth of medical video imaging equipment, led by the 1188 HD camera and complimentary products, partially offset by lower sales of medical video imaging equipment in the United States. Strong sales growth in communication products, led by the SwitchPoint Infinity 2, in the United States and Canada also contributed to the Company's constant currency sales growth.

Patient Handling and Emergency Medical Equipment: Sales of patient handling and emergency medical equipment increased 18% in 2008 (17% on a constant currency basis) due to strong sales growth of hospital bed products in the United States and the Latin America region and stretchers and emergency medical equipment in the United States and Europe.

Cost of sales represented 31.7% of sales in 2008 compared with 31.1% in 2007. The increase in the cost of sales percentage is primarily due to increased compliance initiative spending and higher commodity and freight costs.

Research, development and engineering expenses represented 5.5% of sales in 2008 compared with 6.3% in 2007. As anticipated, the spending level in 2008 decreased by 2% to $367.8 million as the Company implemented a more normalized level of spending for these costs compared to prior periods as well as the Company's focus of research and development resources on compliance initiatives, which has slowed down some research and development projects and reduced outside contractor spending on certain projects. New product introductions in 2008 for the Orthopaedic Implants segment included the Tritanium Primary Hip System; the Triathlon TS Revision Knee System; the Triathlon Partial Knee Resurfacing System; the Asnis Screw System; the VariAx Hand and Foot Trauma Systems; and the Xia III Thoracolumbar Spinal System. Within the MedSurg Equipment segment, new product introductions in 2008 included the S3 Med/Surg Hospital Bed and the Neptune 2 Waste Management System.

Selling, general and administrative expenses increased 10% in 2008 and represented 39.1% of sales compared with 39.9% in 2007. The decrease in selling, general and administrative expenses as a percent of sales in 2008 is due to tight control of discretionary spending in the second half of 2008 partially offset by increases in sales-related costs and costs associated with compliance activities.

In 2008 the Company recorded $34.9 million ($21.7 million net of income taxes) in restructuring charges related to the decisions to simplify the structure of the Company's Japanese distribution business and to substantially reduce development efforts associated with Sightline product technologies acquired in 2006. In 2007 the Company recorded a $19.8 million charge ($12.7 million net of income taxes) to write off patents associated with intervertebral body fusion cage products. The impairment followed a U.S. Food and Drug Administration (FDA) decision to downgrade certain intervertebral body fusion products to class II devices, along with a weak market for sales of these specific products. As a result, the Company performed a discounted cash flow analysis over the remaining life of the patented technologies and determined that the charge was required.

Interest and marketable securities income, which is included in other income (expense), increased to $97.7 million in 2008 from $85.5 million in 2007 primarily as a result of increased average cash and cash equivalents and marketable securities balances in 2008 compared to 2007. Interest expense, which is included in other income (expense), increased to $30.5 million in 2008 from $22.2 million in 2007, primarily as a result of interest expense associated with unresolved income tax positions.

The Company's effective income tax rate on earnings from continuing operations for the year ended December 31, 2008 was 27.4% compared to an effective income tax rate for the year ended December 31, 2007 of 28.0%. The effective income tax rate for the year ended December 31, 2008 reflects the impact of the restructuring charges of $21.7 million (net of $13.2 million income tax benefits). The effective income tax rate for the year ended December 31, 2007 reflects the impact of the intangible asset impairment charge of $12.7 million (net of $7.1 million income tax benefit). In addition to these factors, the Company's reported effective income tax rates for the years ended December 31, 2008 and 2007 are lower than the U.S. statutory income tax rate primarily as a result of manufacturing in lower income tax jurisdictions.

Net earnings from continuing operations increased 16% in 2008 to $1,147.8 million from $986.7 million in 2007. Basic net earnings per share from continuing operations increased 17% in 2008 to $2.81 from $2.41 in 2007, and diluted net earnings per share from continuing operations increased 17% in 2008 to $2.78 from $2.37 in 2007.

Excluding the impact of the restructuring charges recorded in 2008 and the charge to reflect the intangible asset impairment in 2007, adjusted net earnings from continuing operations increased 17% in 2008 to $1,169.5 million from $999.4 million in 2007. Adjusted basic net earnings per share from continuing operations increased 18% in 2008 to $2.87 from $2.44 in 2007, and adjusted diluted net earnings per share from continuing operations increased 18% in 2008 to $2.83 from $2.40 in 2007.

The reconciliations of these non-GAAP financial measures are as follows (in millions, except per share amounts):

	2008	*2007*	*Percentage Change*
Reported net earnings from continuing operations	$1,147.8	$986.7	16
Restructuring charges	21.7	–	–
Intangible asset impairment	–	12.7	(100)
Adjusted net earnings from continuing operations	$1,169.5	$999.4	17
Basic net earnings per share of common stock from continuing operations:			
Reported basic net earnings per share from continuing operations	$ 2.81	$ 2.41	17
Restructuring charges	$ 0.05	–	–
Intangible asset impairment	–	$ 0.03	(100)
Adjusted basic net earnings per share from continuing operations	$ 2.87	$ 2.44	18
Weighted-average basic shares outstanding	408.1	409.7	
Diluted net earnings per share of common stock from continuing operations:			
Reported diluted net earnings per share from continuing operations	$ 2.78	$ 2.37	17
Restructuring charges	$ 0.05	–	–
Intangible asset impairment	–	$ 0.03	(100)
Adjusted diluted net earnings per share from continuing operations	$ 2.83	$ 2.40	18
Weighted-average diluted shares outstanding	413.6	417.2	

The weighted-average basic and diluted shares outstanding used in the calculation of these non-GAAP financial measures are the same as the weighted-average shares outstanding used in the calculation of the reported per share amounts.

Net earnings for the year ended December 31, 2007 included a gain of $25.7 million (net of income taxes), or $0.06 per diluted share, to reflect the divestiture of the Company's outpatient physical therapy business, Physiotherapy Associates, and net earnings from discontinued operations of $5.0 million, or $0.01 per diluted share.

Net earnings increased 13% in 2008 to $1,147.8 million from $1,017.4 million in 2007. Basic net earnings per share increased 13% in 2008 to $2.81 from $2.48 in 2007, and diluted net earnings per share increased 14% in 2008 to $2.78 from $2.44 in 2007.

2007 Compared with 2006

The Company's net sales increased 17% in 2007 to $6,000.5 million from $5,147.2 million in 2006. Net sales grew by 14% as a result of increased unit volume and changes in product mix and by 3% due to favorable changes in foreign currency exchange rates.

The Company's domestic sales were $3,850.3 million for 2007, representing an increase of 17% as a result of higher shipments of Orthopaedic Implants and MedSurg Equipment. International sales were $2,150.2 million for 2007, representing an increase of 16%. The impact of foreign currency comparisons to the dollar value of international sales was favorable by $131.5 million for 2007. On a constant currency basis, international sales increased 9% in 2007 as a result of higher shipments of Orthopaedic Implants and MedSurg Equipment.

Worldwide sales of Orthopaedic Implants were $3,587.3 million for 2007, representing an increase of 15%. On a constant currency basis, sales of Orthopaedic Implants increased 12% in 2007 as a result of higher shipments of reconstructive, trauma, spinal and craniomaxillofacial implant systems; bone cement; and the bone growth factor OP-1.

Hip Implant Systems: Sales of hip implant systems increased 9% in 2007 (6% on a constant currency basis). In the United States, sales growth was driven by sales of X3 polyethylene and Accolade cementless hip products, partially offset by declines in other hip systems. Solid sales growth in the Exeter, Trident, X3 polyethylene and Accolade hip products in Europe, the Pacific region and the Latin America region also contributed to the Company's constant currency sales growth for 2007.

Knee Implant Systems: Sales of knee implant systems increased 16% in 2007 (13% on a constant currency basis) due to strong sales growth in the Triathlon Knee System in the United States, Europe, Canada and the Pacific region and solid sales growth in the Scorpio Knee System in Europe, the Pacific region and the Latin America region.

Trauma Implant Systems: Sales of trauma implant systems increased 19% in 2007 (15% on a constant currency basis) as a result of strong sales growth in the Gamma3 Hip Fracture System in the United States, Europe, Canada and the Pacific region as well as solid sales growth in the Company's T2 Nailing System in the United States and Europe, partially offset by a sales decline in Japan as a result of government-imposed price cuts.

Spinal Implant Systems: Sales of spinal implant systems increased 25% in 2007 (23% on a constant currency basis). The increase was driven by strong worldwide sales growth of thoracolumbar implant systems, interbody devices and cervical implants.

Craniomaxillofacial Implant Systems: Sales of craniomaxillofacial implant systems increased 17% in 2007 (14% on a constant currency basis) primarily due to strong sales growth of products for neurological indications and craniomaxillofacial implants in the United States, Europe and the Pacific region.

Worldwide sales of MedSurg Equipment were $2,413.2 million for 2007, representing an increase of 19%. On a constant currency basis, sales of MedSurg Equipment increased 17% in 2007 as a result of higher shipments of surgical equipment; surgical navigation systems; endoscopic, communications and digital imaging systems; as well as patient handling and emergency medical equipment.

Surgical Equipment and Surgical Navigation Systems: Sales of surgical equipment and surgical navigation systems increased 20% in 2007 (17% on a constant currency basis) due to strong sales growth in powered surgical and operating room equipment in the United States, Europe and the Pacific region. Solid sales growth in interventional pain products in Europe also contributed to the Company's constant currency sales growth.

Endoscopic, Communications and Digital Imaging Systems: Sales of endoscopic, communications and digital imaging systems increased 21% in 2007 (19% on a constant currency basis) as a result of strong worldwide sales growth of medical video imaging equipment led by the 1188 HD Camera and complementary products such as the X8000 Lightsource and Vision Elect Monitor. Strong sales growth in arthroscopy and communication products in the United States, Europe and the Pacific region also contributed to the Company's constant currency sales growth.

Patient Handling and Emergency Medical Equipment: Sales of patient handling and emergency medical equipment increased 16% in 2007 (15% on a constant currency basis) due to strong sales growth of stretchers and emergency medical equipment in the United States and Europe. In addition, constant currency sales growth was aided by strong sales growth in hospital beds in the United States as well as strong sales growth in maternity beds in the United States, Canada, Europe and the Latin America region.

Cost of sales represented 31.1% of sales in 2007 compared with 31.4% in 2006. The cost of sales percentage in 2007 was favorably impacted by efficiencies gained within manufacturing plants and product distribution channels.

Research, development and engineering expenses represented 6.3% of sales for both 2007 and 2006. These expenses increased 16% in 2007 to $375.3 million. The higher spending level was the result of the Company's continued focus on new product development for anticipated future product launches and continued investments in new technologies. New product introductions in 2007 for the Orthopaedic Implants segment included the condylar stabilizing (CS) ultra-congruent insert for the Triathlon Knee System; the Scorpio NRG with X3 advanced bearing technology; and the Omega3 Compression Hip Screw System. Within the MedSurg Equipment segment, new product introductions in 2007 included InTouch, a high-acuity care bed; the SDC Ultra, an all-in-one medical imaging information management system; the CORE Sumex drill, designed for use in ENT procedures; and the 45L PneumoSure insufflator.

Selling, general and administrative expenses increased 17% in 2007 and represented 39.9% of sales compared with 39.8% in 2006. The slight increase in selling, general and administrative expenses as a percent of sales in 2007 was due to higher sales-related costs, primarily compensation and increased regulatory compliance-related costs, partially offset by decreases in insurance costs and slower growth in discretionary spending.

As previously described, in 2007 the Company recorded a $19.8 million charge ($12.7 million net of income taxes) to write off patents associated with intervertebral body fusion cage products.

The purchased in-process research and development charge of $52.7 million recorded in 2006 related to the acquisition of Sightline. At the date of the acquisition, the flexible endoscope technologies acquired had not yet reached technological feasibility. The upfront payment of $50.0 million, plus certain transaction costs and the assumption of certain liabilities, was allocated to assets acquired, purchased in-process research and development and liabilities assumed based on their estimated fair value at the date of acquisition. The amount written off as purchased in-process research and development was not deductible for income tax purposes in the United States.

Interest and marketable securities income, which is included in other income (expense), increased to $85.5 million in 2007 from $41.4 million in 2006 primarily as a result of increased cash and cash equivalents and marketable securities balances in 2007 compared to 2006. Interest expense, which is included in other income (expense), increased to $22.2 million in 2007 from $9.5 million in 2006, primarily as a result of interest expense associated with unresolved income tax positions.

The Company's effective income tax rate on earnings from continuing operations for the year ended December 31, 2007 was 28.0% compared to an effective income tax rate for the year ended December 31, 2006 of 29.5%. The effective income tax rate for the year ended December 31, 2007 reflects the impact of the intangible asset impairment charge of $12.7 million (net of $7.1 million income tax benefit). The effective income tax rate for the year ended December 31, 2006 reflects the impact of the nondeductibility for income tax purposes of the purchased in-process research and development charge associated with the acquisition of Sightline. In addition to these factors, the Company's reported effective income tax rates for the years ended December 31, 2007 and 2006 are lower than the U.S. statutory income tax rate primarily as a result of manufacturing in lower income tax jurisdictions.

Upon adoption of FASB Interpretation No. 48, the Company recognized an increase in the interest expense accrual associated with unresolved income tax positions, which was accounted for by reducing the January 1, 2007 balance of retained earnings by $7.6 million (net of income taxes). In addition, the Company reclassified $179.2 million from the current income taxes liability to non-current liabilities to match the anticipated timing of future income tax payments.

Net earnings from continuing operations increased 28% in 2007 to $986.7 million from $771.4 million in 2006. Basic net earnings per share from continuing operations increased 27% in 2007 to $2.41 from $1.90 in 2006, and diluted net earnings per share from continuing operations increased 27% in 2007 to $2.37 from $1.87 in 2006.

Excluding the impact of the charges to reflect the intangible asset impairment in 2007 and to write off purchased in-process research and development recorded in 2006, adjusted net earnings from continuing operations increased 21% in 2007 to $999.4 million from $824.1 million in 2006. Adjusted basic net earnings per share from continuing operations increased 20% in 2007 to $2.44 from $2.03 in 2006, and adjusted diluted net earnings per share from continuing operations increased 20% in 2007 to $2.40 from $2.00 in 2006.

The reconciliations of these non-GAAP financial measures are as follows (in millions except per share amounts):

	2007	*2006*	*Percentage Change*
Reported net earnings from continuing operations	$986.7	$771.4	28
Intangible asset impairment	12.7	–	–
Purchased in-process research and development	–	52.7	(100)
Adjusted net earnings from continuing operations	$999.4	$824.1	21
Basic net earnings per share of common stock:			
Reported basic net earnings per share from continuing operations	$ 2.41	$ 1.90	27
Intangible asset impairment	$ 0.03	–	–
Purchased in-process research and development	–	$ 0.13	(100)
Adjusted basic net earnings per share from continuing operations	$ 2.44	$ 2.03	20
Weighted-average basic shares outstanding	409.7	406.5	
Diluted net earnings per share of common stock:			
Reported diluted net earnings per share from continuing operations	$ 2.37	$ 1.87	27
Intangible asset impairment	$ 0.03	–	–
Purchased in-process research and development	–	$ 0.13	(100)
Adjusted diluted net earnings per share from continuing operations	$ 2.40	$ 2.00	20
Weighted-average diluted shares outstanding	417.2	411.8	

The weighted-average basic and diluted shares outstanding used in the calculation of these non-GAAP financial measures are the same as the weighted-average shares outstanding used in the calculation of the reported per share amounts.

The sale of Physiotherapy Associates resulted in a gain on sale of discontinued operations of $25.7 million (net of income taxes), or $0.06 per diluted share in 2007. Net earnings from discontinued operations for the year ended December 31, 2007 were $5.0 million, or $0.01 per diluted share and net earnings from discontinued operations were $6.3 million, or $0.02 per diluted share, for the year ended December 31, 2006.

Net earnings increased 31% in 2007 to $1,017.4 million from $777.7 million in 2006. Basic net earnings per share increased 30% in 2007 to $2.48 from $1.91 in 2006, and diluted net earnings per share increased 29% in 2007 to $2.44 from $1.89 in 2006.

Liquidity and Capital Resources

The Company's working capital at December 31, 2008 decreased $54.7 million to $3,517.2 million from $3,571.9 million at December 31, 2007. The decrease in working capital resulted from the use of cash to complete the $1,000.0 million share repurchase programs partially offset by increases in accounts receivable, inventories and prepaid expenses. The decrease in working capital is also due to the reclassification of certain marketable securities from current assets to non-current assets within the Consolidated Balance Sheet at December 31, 2008, as more fully described below. Accounts receivable days sales outstanding was 59 days at December 31, 2008 and 56 days at December 31, 2007. Days sales in inventory increased by 18 days to 155 days at December 31, 2008 from 137 days at December 31, 2007 in support of recent and future anticipated product launches.

The Company generated cash of $1,175.9 million from operations in 2008 compared with $1,028.3 million in 2007. The increase in cash from operations in 2008 is primarily due to increased earnings partially offset by increased inventory levels.

In 2008 the Company used cash of $155.2 million for capital expenditures, including $33.2 million for facility expansions. In addition, the Company used cash of $135.6 million for the payment of dividends and $1,000.0 million of cash to repurchase 17.4 million shares of common stock. The Company also purchased and sold marketable securities, which are classified as available-for-sale investments in accordance with the provisions of FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities,* and related interpretations.

The Company had $701.1 million in cash and cash equivalents and $1,494.5 million in current marketable securities at December 31, 2008. The Company had outstanding borrowings totaling $20.5 million at that date, all of which were classified as current obligations. 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; loaner instrumentation for surgical implants in support of new product launches; required debt repayments and the payment of dividends.

Should additional funds be required, the Company had $1,079.4 million of additional borrowing capacity available under all of its existing credit facilities, including the Company's $1,000.0 million 5-year nonamortizing, revolving Unsecured Credit Facility that expires in November 2010. In addition, the Company had the entire $100.0 million accounts receivable securitization facility available at December 31, 2008.

The Company's additional borrowing capacity, along with the expected expiration period of the commitments, is summarized as follows (in millions):

		Amount of Commitment Expiration Per Period	
	Total Amount Committed	Less Than 1 Year	In Excess of 1 Year
Unsecured Credit Facility and other lines of credit	$1,079.4	$ 0.2	$1,079.2

The Company reviews declines in the fair value of its investments classified as available-for-sale for impairment in accordance with SFAS No. 115 in order to determine whether the decline in fair value is an other-than-temporary impairment. Other-than-temporary impairments of available-for-sale marketable securities are recorded in earnings. The primary factors considered by the Company to recognize declines in the fair value of its investments as other-than-temporary impairments are the intent and ability of the Company to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in market value, the length of time and the extent to which the market value of the investment has been less than cost and the financial condition and near-term prospects of the issuer based on publicly available financial information.

Beginning in February 2008, liquidity issues in the global credit markets resulted in the failure of auctions for all of the auction-rate securities (ARS) investments held by the Company, as the amount of securities submitted for sale in those auctions exceeded the amount of purchase bids. To date the Company has collected all interest receivable on outstanding ARS when due and expects to continue to do so in the future. Due to current market conditions the ARS investments have continued to experience failed auctions. These failed auctions result in a lack of liquidity in the securities but do not affect the underlying collateral of the securities. The Company does not anticipate that the lack of liquidity in its ARS, even for an extended period of time, will affect its ability to finance its operations, including its expansion programs and planned capital expenditures. The Company continues to monitor efforts by the financial markets to find alternative means for restoring the liquidity of these investments. These investments will be classified as non-current assets until liquidity is restored in the market.

As of December 31, 2008, the Company held $166.8 million, at par value, of ARS investments. In 2008 the Company entered into an ARS Rights agreement (Rights) with UBS Financial Services Inc. (UBS), one of its investment providers, whereby the Company received the right to sell its ARS at par value to UBS at any time during the period June 30, 2010 through July 2, 2012. These Rights are nontransferable securities registered with the U.S. Securities and Exchange Commission. As a result of accepting the Rights, the Company has released UBS and its employees/agents from all claims except claims for consequential damages directly or indirectly relating to UBS's marketing and sale of ARS and agreed not to serve as a class representative or receive benefits under any class action settlement or investor fund.

The Company elected to measure the value of the Rights under the fair value option of FASB Statement No. 159, and recorded a gain of $28.0 million in other income (expense), and a corresponding non-current asset. Simultaneously, the Company transferred its ARS investments, at their fair value of $138.8 million, from available-for-sale to trading marketable securities. As a result of this transfer, the Company recognized a loss of $28.0 million in other income (expense), reflecting a reversal of the related temporary valuation allowance that was previously recorded within accumulated other comprehensive gain (loss) in shareholders' equity. The Company anticipates that any future changes in the fair value of the Rights will be offset by the changes in the fair value of the related ARS, both of which will be adjusted to fair value on an ongoing basis.

The Company's future contractual obligations for agreements with initial terms greater than 1 year, including agreements to purchase materials in the normal course of business, are summarized as follows (in millions):

	Payment Period						
	2009	*2010*	*2011*	*2012*	*2013*	*After 2013*	*Total*
Long-term debt	$ 20.5	$ –	$ –	$ –	$ –	$ –	$ 20.5
Operating leases	47.7	37.7	26.5	15.7	12.2	27.1	166.9
Unconditional purchase obligations	475.6	40.2	24.5	13.0	2.0	12.6	567.9
Contribution to defined benefits plans	21.5	–	–	–	–	–	21.5
Other	2.0	2.3	2.0	1.5	1.5	12.6	21.9
	$567.3	$ 80.2	$ 53.0	$ 30.2	$ 15.7	$ 52.3	$ 798.7

As further described in Note 11 to the Consolidated Financial Statements, as of December 31, 2008, the Company's defined benefit pension plans are in an underfunded status of $101.6 million. Due to the rules affecting tax-deductible contributions in the jurisdictions in which the plans are offered and the impact of future plan asset performance, changes in interest rates and the potential for changes in legislation in the United States and other foreign jurisdictions, the Company is not able to reasonably estimate the future periods, beyond 2009, in which contributions to fund defined benefit pension plans will be made. As further described in Note 12 to the Consolidated Financial Statements, as of December 31, 2008, the Company has recorded a liability for unresolved income tax positions of $277.1 million. Due to uncertainties regarding the ultimate resolution of income tax audits, the Company is not able to reasonably estimate the amount or the future periods in which income tax payments to settle these unresolved income tax positions will be made.

Critical Accounting Policies and Estimates

The preparation of the Company's Consolidated Financial Statements requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Management evaluates these estimates and assumptions on an ongoing basis. Estimates are based on historical experience, when available, and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Management believes that, of its significant accounting policies (see Note 1 to the Consolidated Financial Statements), an understanding of the following critical accounting policies is important in obtaining an overall understanding of the Consolidated Financial Statements.

Allowance for Doubtful Accounts: The Company maintains an allowance for doubtful accounts for estimated losses in the collection of accounts receivable. The Company makes estimates regarding the future ability of its customers to make required payments based on historical credit experience and expected future trends. If actual customer financial conditions are less favorable than projected by management, additional accounts receivable write offs may be necessary, which could unfavorably affect future operating results.

Inventory Reserves: The Company maintains reserves for excess and obsolete inventory resulting from the potential inability to sell its products at prices in excess of current carrying costs. The markets in which the Company operates are highly competitive and new products and surgical procedures are introduced on an ongoing basis. Such marketplace changes may cause some of the Company's products to become obsolete. The Company makes estimates regarding the future recoverability of the costs of these products and records a provision for excess and obsolete inventories based on historical experience, expiration of sterilization dates and expected future trends. If actual product life cycles, product demand or acceptance of new product introductions are less favorable than projected by management, additional inventory write downs may be required, which could unfavorably affect future operating results.

Income Taxes: The Company operates in multiple income tax jurisdictions both inside and outside the United States. Accordingly, management must determine the appropriate allocation of income to each of these jurisdictions. Income tax audits associated with the allocation of this income and other complex issues, including inventory transfer pricing and cost sharing and product royalty arrangements, may require an extended period of time to resolve and may result in income tax adjustments if changes to the income allocation are required between jurisdictions with different income tax rates. Because income tax adjustments in certain jurisdictions can be significant, the Company records accruals representing management's best estimate of the probable resolution of these matters. To the extent additional information becomes available, such accruals are adjusted to reflect the revised estimated probable outcome.

Other Matters

The Company distributes its products throughout the world. As a result, the Company's financial results could be significantly affected by factors such as weak economic conditions or changes in foreign currency exchange rates. The Company's operating results are primarily exposed to changes in exchange rates among the U.S. dollar, European currencies, in particular the euro and the British pound, the Japanese yen, the Australian dollar and the Canadian dollar. When the U.S. dollar weakens against foreign currencies, the dollar value of sales denominated in foreign currencies increases. When the U.S. dollar strengthens, the opposite situation occurs. The Company manufactures its products in the United States, France, Germany, Ireland, Switzerland, Canada and Puerto Rico and incurs the costs to manufacture in the applicable local currencies. This worldwide deployment of factories serves to partially mitigate the impact of currency exchange rate changes on the Company's cost of sales.

The Company enters into forward currency exchange contracts to mitigate the impact of currency fluctuations on transactions denominated in nonfunctional currencies, thereby limiting risk to the Company that would otherwise result from changes in exchange rates. These nonfunctional currency exposures principally relate to intercompany receivables and payables arising from intercompany purchases of manufactured products. The periods of the forward currency exchange contracts correspond to the periods of the exposed transactions, with realized gains and losses included in the measurement and recording of transactions denominated in the nonfunctional currencies. All forward currency exchange contracts are recorded at their fair value each period, with resulting gains (losses) included in other income (expense) in the Consolidated Statements of Earnings.

At December 31, 2008, the Company had outstanding forward currency exchange contracts to purchase $412.5 million and sell $288.4 million of various currencies (principally U.S. dollars and euros) with maturities ranging from 2 to 110 days. At December 31, 2007, the Company had outstanding forward currency exchange contracts to purchase $427.9 million and sell $257.7 million of various currencies (principally U.S. dollars and euros) with maturities ranging from 4 to 101 days. The estimated fair value of forward currency exchange contracts represents the measurement of the contracts at month-end spot rates as adjusted by current forward points. A hypothetical 10% change in foreign currencies relative to the U.S. dollar would change the December 31, 2008 fair value by approximately $20.7 million. The Company is exposed to credit loss in the event of nonperformance by counterparties on its outstanding forward currency exchange contracts but does not anticipate nonperformance by any of the counterparties.

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 currency exchange rates. For the year ended December 31, 2008, the weakening of foreign currencies relative to the U.S. dollar decreased the value of these investments in net assets, and the related foreign currency translation adjustment gain in shareholders' equity, by $68.6 million to $203.7 million from $272.3 million at December 31, 2007.

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

In 2008 the Company and certain current and former employees received subpoenas from the U.S. Department of Justice Office, Criminal Division, of the United States Attorney in Massachusetts requesting documents related to (i) false Institutional Review Board approvals; (ii) the amount of sales of OP-1 under one of the Company's Humanitarian Device Exemptions; and (iii) the off-label promotion of Calstrux in combination with OP-1. The Company is in the process of responding to the U.S. Department of Justice regarding this matter.

In 2008 the Company received a warning letter from the U.S. Food and Drug Administration (FDA) related to quality systems and compliance issues at its OP-1 implant manufacturing facility in Hopkinton, Massachusetts. In 2007 the Company received two warning letters from the FDA regarding compliance with certain quality system specifications at its reconstructive implant manufacturing facilities: one letter for its facility in Cork, Ireland and another for its facility in Mahwah, New Jersey. The Company takes these matters very seriously and has been fully cooperating with the FDA to address their observations.

In 2007 the Company announced that it reached a resolution with the U.S. Attorney's office for the District of New Jersey in connection with a previously announced investigation 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 resolution is in the form of a non-prosecution agreement for an 18-month period ending on March 27, 2009. During the term of the agreement, the Company's Orthopaedics subsidiary is subject to oversight by a federal monitor, as appointed by the U.S. Attorney, regarding compliance with certain standards and procedures in connection with the retention and payment of orthopaedic surgeon consultants related to reconstructive products and the provision of certain benefits to such surgeons. Subsequent to entering into the non-prosecution agreement, the U.S. Department of Health and Human Services, Office of Inspector General (HHS) issued a civil subpoena to the Company in seeking to determine whether the Company violated various laws by paying consulting fees and providing other things of value to orthopedic surgeons and healthcare and educational institutions as inducements to use Stryker's orthopedic medical devices in procedures paid for in whole or in part by Medicare. The Company produced numerous documents and other materials to HHS in response to the subpoena and had been working with HHS to attempt to narrow the scope of the requested production. In 2008 the U.S. Department of Justice and the HHS sought judicial enforcement of the subpoena and a court agreed to enforce it in January 2009. At the same time, the U.S. District Court for the District of New Jersey dismissed the Company's complaint which had asked the court to quash the subpoena and sought other appropriate relief on the grounds that the subpoena is overbroad and oppressive.

In 2007 the Company disclosed that the U.S. Securities and Exchange Commission made an informal inquiry of the Company regarding possible violations of the Foreign Corrupt Practices Act in connection with the sale of medical devices in certain foreign countries. Subsequently, in 2008, the Company received a subpoena from the U.S. Department of Justice, Criminal Division, requesting certain documents for the period since January 1, 2000 in connection with the U.S. Securities and Exchange Commission inquiry. The Company is fully cooperating with the U.S. Department of Justice and the U.S. Securities and Exchange Commission regarding these matters.

In 2006 the Company announced that it received a subpoena from the U.S. Department of Justice, Antitrust Division, requesting documents for the period since January 2001 regarding possible violations of federal criminal law, including possible violation of the antitrust laws, relating to the manufacture and sale of orthopaedic implant devices. In 2008 the Company was advised by the U.S. Department of Justice, Antitrust Division, that the Department had closed its grand jury investigation of antitrust and related offenses in the orthopaedic implants industry.

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

To the Board of Directors and Shareholders of Stryker Corporation:

The management of Stryker Corporation is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 13a-15(f). Stryker Corporation's internal control system was designed to provide reasonable assurance to the Company's management and Board of Directors regarding the preparation and fair presentation of published financial statements.

Stryker Corporation's management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2008. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in *Internal Control—Integrated Framework*. Based on that assessment, management believes that, as of December 31, 2008, the Company's internal control over financial reporting is effective.

Stryker Corporation's independent registered public accounting firm, Ernst & Young LLP, has issued an attestation report on the effectiveness of the Company's internal control over financial reporting. This report appears on the following page.