

MERIT MEDICAL SYSTEMS INC  
Form 10-Q  
August 08, 2006

# SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

## FORM 10-Q

- QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2006.**  
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 0-18592

## MERIT MEDICAL SYSTEMS, INC.

(Exact name of Registrant as specified in its charter)

**Utah**  
(State or other jurisdiction  
of incorporation or organization)

**87-0447695**  
(I.R.S. Identification No.)

**1600 West Merit Parkway, South Jordan, UT, 84095**  
(Address of Principal Executive Offices)  
**(801) 253-1600**  
(Registrant's telephone number, including area code)

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

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

Large Accelerated  Filer 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

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

| <b>Title or class</b> | <b>Number of Shares<br/>Outstanding at August 4, 2006</b> |
|-----------------------|---|
| Common Stock          | 27,349,540  |



**MERIT MEDICAL SYSTEMS, INC.**

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**MERIT MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
**JUNE 30, 2006 AND DECEMBER 31, 2005**  
(In Thousands - Unaudited)

|  | <b>June 30,<br/>2006</b> | <b>December 31,<br/>2005</b> |
|--|--------------------------|------------------------------|
| <b>ASSETS</b>  |                          |                              |
| <b>CURRENT ASSETS:</b>   |                          |                              |
| Cash and cash equivalents  | \$ 7,644                 | \$ 4,645                     |
| Trade receivables - less allowances of \$442 and \$767, respectively                   | 23,150                   | 25,433                       |
| Employee receivables   | 160                      | 116                          |
| Other receivables  | 553                      | 108                          |
| Inventories  | 35,756                   | 32,080                       |
| Prepaid expenses and other assets  | 1,695                    | 1,023                        |
| Deferred income tax assets   | 28                       | 28                           |
| Income tax refunds receivable  | 46                       | 977                          |
| <b>Total current assets</b>  | <b>69,032</b>            | <b>64,410</b>                |
| <b>PROPERTY AND EQUIPMENT:</b>   |                          |                              |
| Land and land improvements   | 7,885                    | 6,232                        |
| Building   | 42,533                   | 42,283                       |
| Manufacturing equipment  | 50,218                   | 46,457                       |
| Furniture and fixtures   | 16,941                   | 16,255                       |
| Leasehold improvements   | 6,630                    | 6,658                        |
| Construction-in-progress   | 8,431                    | 7,374                        |
| <b>Total</b>   | <b>132,638</b>           | <b>125,259</b>               |
| Less accumulated depreciation and amortization   | (42,651)                 | (39,641)                     |
| <b>Property and equipment net</b>  | <b>89,987</b>            | <b>85,618</b>                |
| <b>OTHER ASSETS:</b>   |                          |                              |
| Other intangibles - less accumulated amortization of \$1,634 and \$1,483, respectively | 3,595                    | 3,342                        |
| Goodwill   | 7,579                    | 6,415                        |
| Other assets   | 2,424                    | 2,363                        |
| Deferred income tax assets   | 4                        |                              |
| Deposits   | 99                       | 99                           |
| <b>Total other assets</b>  | <b>13,701</b>            | <b>12,219</b>                |
| <b>TOTAL ASSETS</b>  | <b>\$ 172,720</b>        | <b>\$ 162,247</b>            |

See notes to consolidated financial statements.

**MERIT MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
**JUNE 30, 2006 AND DECEMBER 31, 2005**  
(In Thousands - Unaudited)

|  | June 30,<br>2006  | December 31,<br>2005 |
|--|-------------------|----------------------|
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>   |                   |                      |
| <b>CURRENT LIABILITIES:</b>  |                   |                      |
| Current portion of long-term debt  | \$ 1              | \$ 2                 |
| Trade payables   | 10,758            | 10,254               |
| Accrued expenses   | 9,853             | 8,549                |
| Advances from employees  | 273               | 316                  |
| Deferred income tax liabilities  | 720               | 1,141                |
| Income taxes payable   | 1,448             | 455                  |
| <b>Total current liabilities</b>   | <b>23,053</b>     | <b>20,717</b>        |
| <b>DEFERRED INCOME TAX LIABILITIES</b>   | <b>4,144</b>      | <b>4,166</b>         |
| <b>LONG-TERM DEBT</b>  | <b>3</b>          | <b>2</b>             |
| <b>DEFERRED COMPENSATION PAYABLE</b>   | <b>2,586</b>      | <b>2,363</b>         |
| <b>DEFERRED CREDITS</b>  | <b>2,325</b>      | <b>2,415</b>         |
| <b>OTHER LONG-TERM OBLIGATION</b>  | <b>75</b>         | <b>100</b>           |
| <b>Total liabilities</b>   | <b>32,186</b>     | <b>29,763</b>        |
| <b>STOCKHOLDERS EQUITY:</b>  |                   |                      |
| Preferred stock 5,000 shares authorized as of<br>June 30, 2006, no shares issued   |                   |                      |
| Common stock no par value; 50,000 shares<br>authorized; 27,308 and 27,163 shares issued<br>at June 30, 2006 and December 31 2005, respectively | 50,179            | 48,198               |
| Retained earnings  | 90,591            | 84,668               |
| Accumulated other comprehensive loss   | (236              | ) (382 )             |
| <b>Total stockholders equity</b>   | <b>140,534</b>    | <b>132,484</b>       |
| <b>TOTAL LIABILITIES AND STOCKHOLDERS EQUITY</b>   | <b>\$ 172,720</b> | <b>\$ 162,247</b>    |

See notes to consolidated financial statements.

**MERIT MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2006 AND 2005**  
(In Thousands Except Share Data and Unaudited)

|                                      | Three Months Ended<br>June 30, |            | Six Months Ended<br>June 30, |            |
|--------------------------------------|--------------------------------|------------|------------------------------|------------|
|                                      | 2006                           | 2005       | 2006                         | 2005       |
| NET SALES                            | \$ 48,121                      | \$ 42,405  | \$ 93,161                    | \$ 82,679  |
| COST OF SALES                        | 29,125                         | 24,145     | 57,114                       | 46,957     |
| GROSS PROFIT                         | 18,996                         | 18,260     | 36,047                       | 35,722     |
| <b>OPERATING EXPENSES:</b>           |                                |            |                              |            |
| Selling, general, and administrative | 11,301                         | 9,326      | 22,539                       | 19,033     |
| Research and development             | 2,023                          | 1,747      | 4,102                        | 3,294      |
| Impairment                           | 196                            |            | 225                          |            |
| Total operating expenses             | 13,520                         | 11,073     | 26,866                       | 22,327     |
| INCOME FROM OPERATIONS               | 5,476                          | 7,187      | 9,181                        | 13,395     |
| <b>OTHER INCOME (EXPENSE):</b>       |                                |            |                              |            |
| Interest income                      | 64                             | 143        | 110                          | 325        |
| Other (expense)                      | (67)                           | (20)       | (65)                         | (41)       |
| Other income (expense) - net         | (3)                            | 123        | 45                           | 284        |
| INCOME BEFORE INCOME TAXES           | 5,473                          | 7,310      | 9,226                        | 13,679     |
| INCOME TAX EXPENSE                   | 1,951                          | 2,629      | 3,303                        | 4,923      |
| NET INCOME                           | \$ 3,522                       | \$ 4,681   | \$ 5,923                     | \$ 8,756   |
| <b>EARNINGS PER COMMON SHARE:</b>    |                                |            |                              |            |
| Basic                                | \$ .13                         | \$ .18     | \$ .22                       | \$ .33     |
| Diluted                              | \$ .13                         | \$ .17     | \$ .21                       | \$ .32     |
| <b>AVERAGE COMMON SHARES:</b>        |                                |            |                              |            |
| Basic                                | 27,260,928                     | 26,725,684 | 27,228,481                   | 26,616,813 |
| Diluted                              | 27,966,729                     | 27,726,579 | 28,029,595                   | 27,658,419 |

See notes to consolidated financial statements.

**MERIT MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE SIX MONTHS ENDED JUNE 30, 2006 AND 2005**  
(In Thousands and Unaudited)

|   | <b>Six Months Ended</b> |             |
|---|-------------------------|-------------|
|   | <b>June 30,</b>         | <b>2005</b> |
|   | <b>2006</b>             | <b>2005</b> |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>  |                         |             |
| Net income  | \$ 5,923                | \$ 8,756    |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: |                         |             |
| Depreciation and amortization   | 3,998                   | 2,486       |
| Losses (gains) on sales of property and equipment   | 169                     | (1 )        |
| Bad debt expense  | 24                      | 24          |
| Write-off of certain patents and trademarks   | 40                      | 29          |
| Amortization of deferred credits  | (90 )                   | (105 )      |
| Deferred income taxes   | (448 )                  | 76          |
| Stock-based compensation  | 764                     |             |
| Excess tax benefits for stock-based compensation  |                         | 1,894       |
| Changes in operating assets and liabilities net of effects from acquisitions:               |                         |             |
| Trade receivables   | 2,500                   | (1,498 )    |
| Employee receivables  | (44 )                   | (19 )       |
| Other receivables   | (424 )                  | (190 )      |
| Inventories   | (3,153 )                | (3,452 )    |
| Prepaid expenses and other assets   | (655 )                  | (446 )      |
| Income tax refund receivables   | 932                     |             |
| Deposits  | (1 )                    | (20 )       |
| Trade payables  | 371                     | 78          |
| Accrued expenses  | 720                     | (507 )      |
| Advances from employees   | (50 )                   | 53          |
| Income taxes payable  | 962                     | (695 )      |
| Other liabilities   | (25 )                   | 125         |
| Total adjustments   | 5,590                   | (2,168 )    |
| Net cash provided by operating activities   | 11,513                  | 6,588       |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>  |                         |             |
| Capital expenditures for:   |                         |             |
| Property and equipment  | (8,032 )                | (21,874 )   |
| Patents and trademarks  | (205 )                  | (133 )      |
| Increase in cash surrender value of life insurance contracts                                | (61 )                   | (158 )      |
| Proceeds from the sale of property and equipment  | 14                      | 4           |
| Cash paid in acquisitions   | (1,800 )                | (86 )       |
| Net cash used in investing activities   | (10,084 )               | (22,247 )   |

See notes to consolidated financial statements.





**MERIT MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE SIX MONTHS ENDED JUNE 30, 2006 AND 2005**  
(In Thousands and Unaudited)

|   | <b>Six Months Ended</b> |                  |
|---|-------------------------|------------------|
|   | <b>June 30,</b>         | <b>2005</b>      |
|   | <b>2006</b>             |                  |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>                |                         |                  |
| Proceeds from issuance of common stock                      | \$ 856                  | \$ 1,265         |
| Principal payments on long-term debt                        |                         | (4 )             |
| Increase in deferred compensation payable                   | 223                     | 362              |
| Excess tax benefits from stock-based compensation           | 361                     |                  |
| Net cash provided by financing activities                   | 1,440                   | 1,623            |
| <b>EFFECT OF EXCHANGE RATES ON CASH</b>                     | <b>130</b>              | <b>(166 )</b>    |
| <b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b> | <b>2,999</b>            | <b>(14,202 )</b> |
| <b>CASH AND CASH EQUIVALENTS:</b>                           |                         |                  |
| Beginning of period   | 4,645                   | 33,037           |
| End of period   | \$ 7,644                | \$ 18,835        |
| <b>SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION</b>    |                         |                  |
| Cash paid during the period for:                            |                         |                  |
| Interest  | \$ 5                    | \$ 5             |
| Income taxes  | \$ 1,464                | \$ 3,648         |

**SUPPLEMENTAL DISCLOSURES OF NON-CASH INVESTING AND FINANCING ACTIVITIES:**

During the six months ended June 30, 2006, we acquired certain assets and other intangibles (Customer Relationships) of Hypoguard USA, Inc. in a purchase transaction for \$790,077. The purchase price was preliminarily allocated between fixed assets for \$178,573, inventory for \$149,821, other intangible for \$300,000 and goodwill for \$161,683.

|   |            |
|---|------------|
| Fair value of assets acquired (including goodwill of \$161,683) | \$ 790,077 |
| Cash paid   | (790,777 ) |
| Liabilities assumed   | NONE       |

See notes to consolidated financial statements.

**MERIT MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOW**  
**FOR THE SIX MONTHS ENDED JUNE 30, 2006 AND 2005**  
(In Thousands and Unaudited)

SUPPLEMENTAL DISCLOSURES OF NON-CASH INVESTING AND FINANCING ACTIVITIES (Continued):

During the six months ended June 30, 2006, we acquired certain assets of Millimed A/S in a purchase transaction for \$1,510,122. The purchase price was preliminarily allocated between fixed assets for \$135,590, inventory for \$461,790 and goodwill for \$912,742. We have accrued for the additional purchase price payment of \$500,000 in accrued expenses.

|   |              |
|---|--------------|
| Fair value of assets acquired (including goodwill of \$912,742) | \$ 1,510,122 |
| Cash paid   | (1,010,122 ) |
| Accrued purchase price  | (500,000 )   |
| Liabilities assumed   | NONE         |

As of June 30, 2006 and 2005, \$1.5 million and \$6.3 million, respectively, of additions to plant, equipment, and other asset purchases were accrued as accounts payable.

See notes to consolidated financial statements.

**MERIT MEDICAL SYSTEMS, INC. AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(Unaudited)

**1. Basis of Presentation.** The interim consolidated financial statements of Merit Medical Systems, Inc. ( Merit, we or us ) for the three and six-month periods ended June 30, 2006 and 2005 are not audited. Our consolidated financial statements are prepared in accordance with the requirements for unaudited interim periods, and consequently, do not include all disclosures required to be in conformity with accounting principles generally accepted in the United States of America. In the opinion of management, the accompanying consolidated financial statements contain all adjustments, consisting of normal recurring accruals, necessary for a fair presentation of our financial position as of June 30, 2006, and our results of operations and cash flows for the three and six-month periods ended June 30, 2006 and 2005. The results of operations for the three and six-month period ended June 30, 2006 are not necessarily indicative of the results for a full-year period. These interim consolidated financial statements should be read in conjunction with the financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2005 filed with the Securities and Exchange Commission (the SEC ).

Reclassifications. Certain other amounts have been reclassified in the prior year s financial statements to conform with the current year s presentation.

**2. Inventories.** Inventories are stated at the lower of cost or market. Inventories at June 30, 2006 and December 31, 2005 consisted of the following (in thousands):

|                 | June 30,<br>2006 | December 31,<br>2005 |
|-----------------|------------------|----------------------|
| Finished goods  | \$ 18,093        | \$ 16,259            |
| Work-in-process | 5,717            | 3,832                |
| Raw materials   | 11,946           | 11,989               |
| Total           | \$ 35,756        | \$ 32,080            |

**3. Reporting Comprehensive Income.** Comprehensive income for the three and six-month periods ended June 30, 2006 and 2005 consisted of net income and foreign currency translation adjustments. As of June 30, 2006 and December 31, 2005, the cumulative effect of such adjustments reduced stockholders equity by \$236,320 and \$381,784, respectively. Comprehensive income for the three and six-month periods ended June 30, 2006 and 2005 has been computed as follows (in thousands):

|                              | Three Months Ended |          | Six Months Ended |          |
|------------------------------|--------------------|----------|------------------|----------|
|                              | June 30,<br>2006   | 2005     | June 30,<br>2006 | 2005     |
| Net income                   | \$ 3,522           | \$ 4,681 | \$ 5,923         | \$ 8,756 |
| Foreign currency translation | 109                | 20       | 145              | 9        |
| Comprehensive income         | \$ 3,631           | \$ 4,701 | \$ 6,068         | \$ 8,765 |

**4. Stock-based Compensation.** Effective January 1, 2006, we adopted Statement of Financial Accounting Standards (SFAS) No. 123R, *Share-Based Payment*, ( SFAS No. 123R ). We adopted the fair value recognition provisions of SFAS No. 123R using the modified prospective transition method. Under this transition method, stock-based compensation cost recognized beginning January 1, 2006 includes compensation cost for all share-based payments not yet vested as of January 1, 2006 based on the grant date fair value estimated had we adopted the provisions of SFAS No. 123. In addition, this transition method requires any share-based payments granted after January 1, 2006, be accounted in accordance with the provisions of SFAS No. 123R.

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In the six-month period ended June 30, 2006, the adoption of SFAS No. 123R resulted in incremental stock-based compensation expense of \$764,000 (\$225,000 in cost of goods sold, \$90,000 in research and development and

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\$449,000 in selling, general and administrative expense). We recognize stock-based compensation expense (net of a forfeiture rate) for those awards which are expected to vest on a straight-line basis over the requisite service period. We estimated the forfeiture rate based on our historical experience and expectations about future forfeitures. The stock-based compensation expense associated with our adoption of SFAS No. 123R reduced net operating income for the three months ended June 30, 2006 by \$374,000, decreased net income by \$239,000, and reduced basic earnings per share by \$.01 per share. The diluted earnings per share calculation for the second quarter of 2006, was affected by stock-based compensation; however, the effect was less than \$.01 per share. For the six-month period ended June 30, 2006, stock-based compensation expense associated with our adoption of SFAS No. 123R reduced net operating income by \$764,000, decreased net income by \$489,000, reduced basic earnings per share by \$.01 per share and reduced diluted earnings per share by \$.02. As of June 30, 2006, the total remaining unrecognized compensation cost related to non-vested stock options, net of forfeitures, was approximately \$2.1 million and is expected to be recognized over a weighted average period of 1.1 years. The total income tax benefit related to share-based compensation for the six month period ended June 30, 2006 which is recorded in capital in excess of par value was \$361,000 and was shown as a cash flow from financing activities in our cash flow statement.

Our stock-based compensation primarily consists of the following plans:

**Employee Stock Purchase Plan:** Prior to January 1, 2006, the Merit Medical Systems, Inc. 1996 Employee Stock Purchase Plan ( ESPP ) permitted participants to purchase shares on a quarterly basis at the lesser of 85% of the market value on the offering commencement date or offering termination date. In October 2005, our Board of Directors amended the ESPP, effective January 1, 2006, adjusting the per-share price that participants pay for shares of common stock purchased under the ESPP to be equal to 95% of the market price of the common stock at the end of the applicable offering period. This amendment was adopted in response to the adoption of SFAS No. 123R in an effort to eliminate our stock-based compensation expense related to ESPP grants.

**Stock Option Incentive Plans:**

Stock Incentive Plan

Since 1999, we have operated the Merit Medical Systems, Inc. Stock Incentive Plan (formerly the 1999 Omnibus Stock Incentive Plan), which provides for the issuance of incentive stock options, non-statutory stock options and certain corresponding stock appreciation rights (the Stock Incentive Plan ). Options may be granted to directors, officers, outside consultants and key employees and may be granted upon such terms and such conditions as the compensation committee of our Board of Directors in their sole discretion shall determine. Options typically vest 20% per year over either a 4.5 or 5 year life with contractual lives of 5 and 10 years, respectively. The Plan also provides for options that vest 100% upon grant with contractual lives of 10 years. In no event, however, may the exercise price be less than the fair market value on the date of grant. Under a provision of our stock incentive plan, participants are allowed to surrender mature shares of our common stock for the payment of the option price and minimum statutory taxes associated with the exercise of options. The shares surrendered must be shares the participant has held for more than six months. The value of the mature shares surrendered is based on the closing price of our common stock on the date of exercise by the participant. As of June 30, 2006 a total of 95,402 shares remained available to be issued under the Stock Incentive Plan.

2006 Long-Term Incentive Plan

Merit's Board of Directors adopted and our shareholders approved the Merit Medical Systems, Inc. 2006 Long-Term Incentive Plan (the 2006 Incentive Plan ) in May of 2006. The 2006 Incentive Plan provides for the granting of stock options, stock appreciation rights, restricted stock, stock units (including restricted stock units) and performance awards. Options may be granted to directors, officers, outside consultants and key employees and may be granted upon such terms and such conditions as the compensation committee of our Board of Directors shall determine. Options will typically vest over a 3 or 5 year life (or 1 year if performance based) with contractual lives of 7 years. A total of 1.5 million shares of common stock was approved to be granted under the 2006 Long-Term Incentive Plan. As of June 30, 2006 a total of 1,395,000 shares remained available to be issued under the 2006 Long-Term Incentive Plan.

Prior to January 1, 2006, we accounted for stock-based compensation arrangements under the intrinsic value method outlined in Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, (APB Opinion No. 25). Accordingly, no compensation cost has been recognized for our stock-based compensation arrangements in our consolidated financial statements. If the compensation cost for our stock-based compensation plans had been determined consistent with SFAS No. 123R, our net income and earnings per common share and common share equivalent would have changed to the pro forma amounts indicated below (in thousands, except per share data):

|  | <b>Three Months Ended<br/>June 30,<br/>2005</b> | <b>Six Months Ended<br/>June 30,<br/>2005</b> |
|--|---|---|
| Net income, as reported  | \$ 4,681  | \$ 8,756                                      |
| Compensation cost under fair value-based accounting method, net of tax | 599   | 2,980   |
| Net income, pro forma  | \$ 4,082  | \$ 5,776                                      |
| Net income per common share:   |   |   |
| Basic:   |   |   |
| As reported  | \$ 0.18   | \$ 0.33                                       |
| Pro forma  | 0.15  | 0.22  |
| Diluted:   |   |   |
| As reported  | 0.17  | 0.32  |
| Pro forma  | 0.15  | 0.21  |

In applying the Black-Scholes methodology to the option grants, we used the following assumptions:

|                           | <b>Six Months<br/>Ended June 30,<br/>2006</b> |   | <b>2005</b> |   |
|---------------------------|---|---|-------------|---|
| Risk-free interest rate   | 4.98  | % | 3.13-3.65   | % |
| Expected option life      | 6.08  |   | 2.5         |   |
| Expected price volatility | 41.90   | % | 46.28       | % |

The average risk-free interest rate is determined using the U.S. Treasury rate in effect as of the date of grant, based on the expected term of the stock option. We determined the expected term of the stock options using historical data. The expected price volatility was determined using a weighted average of daily historical volatility of our stock price over the corresponding expected option life and implied volatility based on recent trends of our daily historical volatility. For options with a vesting period, compensation expense is recognized on a ratable basis over the service period which corresponds to the vesting period. Compensation expense is recognized immediately for options that are fully vested on the date of grant. On February 3, 2005, Merit accelerated the vesting of 427,448 options with an exercise price of \$21.67, which was in excess of the current market price. The acceleration of these options increased the pro-forma compensation for the three months ended March 31, 2005 by approximately \$1.9 million, net of tax. During the second quarter of 2006, 105,000 stock-based compensation grants were made for a total fair value of approximately \$541,000, net of an estimated forfeiture rate.

The weighted-average estimated fair value of stock options granted during the quarter ended June 30, 2006 and 2005 was \$5.58 and \$4.52, respectively.

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The table below presents information related to stock option activity for the six months ended June 30, 2006 and 2005 (in thousands):

|  | <b>Six Months Ended<br/>June 30,</b> |             |
|--|--------------------------------------|-------------|
|  | <b>2006</b>                          | <b>2005</b> |
| Total intrinsic value of stock options exercised           | \$ 962                               | \$ 4,996    |
| Cash received from stock option exercises                  | 667                                  | 875         |
| Net income tax benefit from the exercises of stock options | 361                                  | 1,894       |

A summary of stock option activity for the six months ended June 30, 2006 is as follows:

|                                  | <b>Number of<br/>Shares<br/>(In thousands)</b> | <b>Weighted<br/>Average<br/>Exercise<br/>Price</b> | <b>Wtd. Avg<br/>Remaining<br/>Contractual<br/>Term (years)</b> | <b>Aggregate<br/>Intrinsic<br/>Value<br/>(In thousands)</b> |
|----------------------------------|--|--|--|---|
| Outstanding at December 31, 2005 | 4,288  | \$ 10.67   |  |   |
| Granted                          | 105  | 11.52  |  |   |
| Exercised                        | (136 )   | 5.52   |  |   |
| Forfeited or expired             | (106 )   | 10.87  |  |   |
| Outstanding at June 30, 2006     | 4,151  | 10.85  | 6.99   | \$ 16,160   |
| Exercisable                      | 3,615  | 11.05  | 7.09   | \$ 13,857   |

A summary of warrant activity for the six months ended June 30, 2006 is as follows:

|                                  | <b>Number of<br/>Shares<br/>(In thousands)</b> | <b>Weighted<br/>Average<br/>Exercise<br/>Price</b> | <b>Wtd. Avg<br/>Remaining<br/>Contractual<br/>Term (years)</b> | <b>Aggregate<br/>Intrinsic<br/>Value<br/>(In thousands)</b> |
|----------------------------------|--|--|--|---|
| Outstanding at December 31, 2005 | 100  | \$ 10.13   |  |   |
| Granted                          |  |  |  |   |
| Exercised                        |  |  |  |   |
| Forfeited or expired             |  |  |  |   |
| Outstanding at June 30, 2006     | 100  | \$ 10.13   | 3.38   | \$ 363  |
| Exercisable                      | 100  | \$ 10.13   | 3.38   | \$ 363  |

**5. Shares Used in Computing Net Income Per Share.** The following table sets forth the computation of the number of shares used in calculating basic and diluted net income per share (in thousands):

|   | <b>June 30,<br/>2006</b> | <b>2005</b> | <b>June 30,<br/>2006</b> | <b>2005</b> |
|---|--------------------------|-------------|--------------------------|-------------|
| Weighted-average shares outstanding used for calculation of net income per share-basic  | 27,261                   | 26,726      | 27,228                   | 26,617      |
| Common stock equivalents  | 706                      | 1,001       | 802                      | 1,041       |
| Total shares used for calculation of net income per share-diluted   | 27,967                   | 27,727      | 28,030                   | 27,658      |
| Weighted-average shares under stock options excluded from the calculation of common stock equivalents as the impact was anti-dilutive | 2,051                    | 1,054       | 1,366                    | 1,275       |

**6. 2006 Acquisitions.** On March 31, 2006, Merit entered into an Asset Purchase Agreement with Millimed A/S, a Danish Company, to purchase certain assets for the manufacture and sale of a hemostasis valve, for a purchase





price including legal fees of \$1,510,122. Merit made an initial payment on April 3, 2006 of \$1.0 million to Millimed A/S, with additional payment of \$500,000 due upon the first to occur of: (a) the date of six months following the closing date; or (b) the successful transfer of the production of the product to Merit's facility in Galway, Ireland. In accordance with SFAS No. 141, *Business Combination*, paragraph 26 and 27, we have recorded the additional \$500,000 in accrued expenses in the financial statements as it is certain beyond a reasonable doubt that the payment will occur through the passage of time. The additional future payment has been included in the initial purchase price allocation. The purchase price was preliminarily allocated between fixed assets for \$135,590, inventory for \$461,790 and goodwill for \$912,742. Merit is the market leader in hemostasis valves. This hemostasis device minimizes blood loss during an interventional procedure. With the purchase of this hemostasis valve product line, Merit will be able to broaden its hemostasis product offerings as well as compete against other competitors which have similar devices. We plan to finalize the purchase price allocation in 2006.

On April 7, 2006, Merit entered into an Asset Purchase Agreement with Hypoguard USA, Inc, a Delaware corporation, to purchase certain assets for the manufacturing and sale of auto-retractable safety scalpels, for a purchase price including legal fees and freights costs to transport fixed assets of \$790,077. Merit made an initial payment of \$750,000 to Hypoguard USA, Inc, with a potential earn-out payment of \$500,000 due upon reaching certain sales milestones. In accordance with SFAS No. 141, *Business Combination*, paragraph 26 and 27, we have not recorded the additional earn out contingent consideration as it is not certain beyond a reasonable doubt. If the earn-out payment occurs it will be included in the initial purchase price. The purchase price was preliminarily allocated between fixed assets for \$178,573, inventory for \$149,821, other intangible (Customer Relationships) for \$300,000 and goodwill for \$161,683. Customer Relationships will be amortized on an accelerated basis over 4 years. Disposable safety scalpels are used in various medical procedures for the purpose of minimizing accidents to health care workers. Merit intends to use scalpel product line and technology to broaden product offerings related to customs kits, procedure trays and OEM business. We plan to finalize the purchase price allocation in 2006

All of the acquisitions discussed above have been accounted for as a purchase in accordance with SFAS No. 141, *Business Combinations*. The amount allocated to goodwill for each of the acquisitions will be reviewed annually for impairment or more frequently if impairment indicators arise, in accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*.

**7. Recently Adopted/Issued Accounting Standards.** In May 2005, the Financial Accounting Standard Board (the FASB ) issued SFAS No. 154, *Accounting Changes and Error Corrections*, a replacement of APB Opinion No. 20 and FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements*. FASB No. 154 requires retrospective application for reporting a change in accounting principles unless such application is impracticable or unless transition requirements specific to a newly adopted accounting principle require otherwise. SFAS No. 154 also requires the reporting of a correction of an error by restating previously issued financial statements. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 31, 2005. On January 1, 2006 we adopted the provisions of SFAS No. 154. The adoption of this pronouncement did not have a material impact on Merit's consolidated financial statements for the six months ended June 30, 2006.

In November 2004, the FASB issued SFAS No. 151, *Inventory Costs*, an amendment of ARB No. 43, Chapter 4, *Inventory Pricing*, ( SFAS No. 151 ) to clarify that abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage), should be expensed as incurred and not included in overhead. In addition, SFAS No. 151 requires the allocation of fixed production overhead expenses to the costs of conversion be based on the normal capacity of the production facilities. The provisions in SFAS No. 151 are effective for inventory costs incurred during fiscal years beginning after June 15, 2005. We elected early adoption of the provisions of SFAS No. 151 during the fourth quarter of 2005 and recorded additional expenses to cost of sales of \$415,000, research and development expense of \$83,000 and selling, general and administrative expense of \$37,000.

In July 2006, the FASB issued Interpretation No. 48 ( FIN 48 ), *Accounting for Uncertainty in Income Taxes*, which clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. FIN 48 provides guidance on the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosures, and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. We are currently evaluating the impact of FIN 48 on our consolidated financial statements.

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

### Disclosure Regarding Forward-Looking Statements

This Report includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). All statements, other than statements of historical fact, are forward-looking statements for purposes of these provisions, including any projections of earnings, revenues or other financial items, any statements of the plans and objectives of management for future operations, any statements concerning proposed new products or services, any statements regarding future economic conditions or performance, and any statements of assumptions underlying any of the foregoing. All forward-looking statements included in this Report are made as of the date hereof and are based on information available to us as of such date. We assume no obligation to update any forward-looking statement. In some cases, forward-looking statements can be identified by the use of terminology such as may, will, expects, plans, anticipates, intends, believes, estimates, potential, or continue, or the negative or comparable terminology. Although we believe that the expectations reflected in the forward-looking statements contained herein are reasonable, there can be no assurance that any such expectations or any forward-looking statement will prove to be correct. Our actual results will vary, and may vary materially, from those projected or assumed in the forward-looking statements. Our future financial condition and results of operations, as well as any forward-looking statements, are subject to inherent risks and uncertainties, including, without limitation, market acceptance of our products, product introductions, potential product recalls, delays in obtaining regulatory approvals, or the failure to maintain such approvals, cost increases, fluctuations in and obsolescence of inventory, price and product competition, availability of labor and materials, development of new products and technology that could render our products obsolete, product liability claims, modification or limitation of governmental or private insurance reimbursement procedures, infringement of our technology or the assertion that our technology infringes the rights of other parties, foreign currency fluctuations, challenges associated with our growth strategy, changes in healthcare markets related to healthcare reform initiatives, and other factors referred to in our press releases and reports filed with the SEC, including our Annual Report on Form 10-K for the year ended December 31, 2005. All subsequent forward-looking statements attributable to Merit or persons acting on our behalf are expressly qualified in their entirety by these cautionary statements. Additional factors that may have a direct bearing on our operating results are described under Risk Factors beginning on page 16 below.

### Overview

For the quarter ended June 30, 2006 we reported record revenues of \$48.1 million, up 13% from the three months ended June 30, 2005 of \$42.4 million. Revenues for the six months ended June 30, 2006 were a record \$93.2 million, compared with \$82.7 million for the same six months in 2005, a gain of 13%.

Gross margins were down to 39.5% and 38.7% of sales for the three and six-month periods ended June 30, 2006, respectively, when compared to 43.1% and 43.2% of sales for the three and six-month periods ended June 30, 2005, respectively. This decline resulted primarily from additions made during the second half of 2005 for new facilities and related costs (i.e. utilities, maintenance, cleaning and taxes) and equipment, additional headcount to support production lines, increased cost of direct labor, and new product launches. The decline in gross margin was also affected by an increase in procedure tray business at lower gross margins. Sales of procedure trays contributed 4.8% and 4.7%, respectively, to our total sales for the three and six-month periods ended June 30, 2006, compared to 1.8% and 1.6%, respectively, to sales for the three and six-month period ended June 30, 2005. Absent the procedure tray business gross margins for the three and six-month periods ended June 30, 2006 would have been 41.6% and 40.7%, respectively, compared to 44.4% for the three and six-month periods ended June 30, 2005.

Net income decreased for the three months ended June 30, 2006 to \$3.5 million, compared to \$4.7 million for the prior year's period. For the six-month period ended June 30, 2006 net income decreased to \$5.9 million, compared to \$8.8 million for the prior year's period. Net income for the three and six-month periods ended June 30, 2006 was positively affected by increased sales volumes, and negatively affected by lower gross margins, increased selling, general and administrative expenses, higher research and development spending and increased fixed asset impairment losses, when compared to the prior year's periods.

Merit made significant investments during 2005, including for the completion of new facilities to meet production demands for anticipated future sales growth; the purchase of a new facility in Chester, Virginia for our newly acquired procedure tray business, 17 new sales representatives added to our U.S. domestic sales force; and additional research and development staff to support anticipated product launches. All of these investments affected our performance for the three and six-month periods ended June 30, 2006. Management believes that, despite the temporary effects of these investments on earnings, they improve our position for potential growth and earnings. Management has already seen some improvement in gross margins during the second quarter of 2006 to 39.5% of sales, compared to 37.9% of sales for the first quarter of 2006. The improvement in gross margins for second quarter was the first in eight quarters, which our management believes can be attributed primarily to increased sales and the absorption of relatively fixed overhead created by the expansion of facilities and the hiring of personnel to develop new molding and production facilities.

### Results of Operations

The following table sets forth certain operational data as a percentage of sales for the three and six-month periods ended June 30, 2006 and 2005:

|  | Three Months Ended<br>June 30, |       | Six Months Ended<br>June 30, |       |
|--|--------------------------------|-------|------------------------------|-------|
|  | 2006                           | 2005  | 2006                         | 2005  |
| Sales  | 100.0                          | 100.0 | 100.0                        | 100.0 |
| Gross profit                                 | 39.5                           | 43.1  | 38.7                         | 43.2  |
| Selling, general and administrative expenses | 23.5                           | 22.0  | 24.2                         | 23.0  |
| Research and development expenses            | 4.2                            | 4.1   | 4.4                          | 4.0   |
| Income from operations                       | 11.8                           | 16.9  | 10.1                         | 16.2  |
| Other income                                 | -0.4                           | 0.3   | -0.2                         | 0.3   |
| Net income                                   | 7.3                            | 11.0  | 6.4                          | 10.6  |

**Sales.** Sales for the three months ended June 30, 2006 increased by 13%, or approximately \$5.7 million, compared to the same period of 2005. Sales for the six months ended June 30, 2006 increased by 13%, or approximately \$10.5 million, compared to the same period of 2005. We currently report sales in four product categories. Listed below are the sales relating to these product categories for the three and six-month periods ended June 30, 2006 and 2005. In order to track Merit's changing business more clearly, management has decided to combine the custom kit and procedure tray sales, which we reported separately until December 31, 2005, into a single category.

|                                 | Three Months Ended<br>June 30, |           |           | Six Months Ended<br>June 30, |           |           |
|---------------------------------|--------------------------------|-----------|-----------|------------------------------|-----------|-----------|
|                                 | % Change                       | 2006      | 2005      | % Change                     | 2006      | 2005      |
| Inflation devices               | 5%                             | \$ 14,307 | \$ 13,639 | 9%                           | \$ 28,165 | \$ 25,848 |
| Custom kits and procedure trays | 17%                            | 14,228    | 12,159    | 12%                          | 27,510    | 24,539    |
| Stand-alone devices             | 20%                            | 14,330    | 11,974    | 14%                          | 26,953    | 23,580    |
| Catheters                       | 13%                            | 5,256     | 4,633     | 21%                          | 10,533    | 8,712     |
| Total                           | 13%                            | \$ 48,121 | \$ 42,405 | 13%                          | \$ 93,161 | \$ 82,679 |

Sales growth for the three and six-month periods ended June 30, 2006, when compared to the prior year periods, was favorably affected by an approximate five percent increase due to the introduction of new products, a five percent and four percent, respectively, increase due to new procedure tray business acquired from MedSource in the fourth quarter of 2004, and the remainder resulting primarily from procedural growth and market share gains. Substantially all of the increase in revenues was attributable to increased unit sales as the markets for many of our products are experiencing slight pricing declines.

**Gross Profit.** Gross margins were down to 39.5% and 38.7% of sales for the three and six-month periods ended June 30, 2006, respectively, when compared to 43.1% and 43.2% of sales for the three and six-month periods ended June 30, 2005, respectively. This decline resulted primarily from additions made during the second half of



2005 for new facilities and related costs (i.e. utilities, maintenance, cleaning and taxes) and equipment, additional headcount to support production lines, increased cost of direct labor, and new product launches. The decline in gross margin was also affected by an increase in procedure tray business at lower gross margins. Sales of procedure trays contributed 4.8% and 4.7%, respectively, to our total sales for the three and six-month periods ended June 30, 2006, compared to 1.8% and 1.6%, respectively, to sales for the three and six-month periods ended June 30, 2005.

Operating Expenses. Selling, general and administrative expenses increased to 23.5% of sales for the three months ended June 30, 2006, compared with 22.0% of sales for the three months ended June 30, 2005. For the six months ended June 30, 2006, selling, general and administrative expenses increased to 24.2% compared with 23.0% of sales for the six months ended June 30, 2005. The increase in selling, general and administrative expenses as a percentage of sales during the three and six-month periods ended June 30, 2006, when compared to the prior periods, was due primarily to the hiring of 17 additional sales people during the second half of 2005 and the effect of stock-based compensation expense resulting from our adoption of SFAS No. 123R effective January 1, 2006. Research and development expenses increased to 4.2% and 4.4% of sales for the three and six-month periods ended June 30, 2006, respectively, compared to 4.1% and 4.0% of sales for the three and six-month periods ended June 30, 2005, respectively. This increase was primarily attributable to additional headcount and indirect costs, to support an increase in the number of new products launched. Impairment costs of \$196,000 and \$225,000 for the three and six-month periods ended June 30, 2006, respectively, related to losses on long-lived assets that were disposed of during 2006. Most of the long-lived asset losses related to molding equipment and leasehold improvements abandoned after the movement of Merit's molding department to its new facility.

Other Income (Expense). Other expense for the second quarter of 2006 was approximately (\$3,000), compared to other income of approximately \$123,000 for the same period in 2005. Other income for the six months ended June 30, 2006 was approximately \$45,000, compared to other income of approximately \$284,000 for the same period in 2005. The net change from other income for the three and six-month periods ended June 30, 2006 when compared to the same periods in 2005 was primarily the result of a decrease in interest income as the result of the decrease in our cash balance.

Income Taxes. Our effective tax rate for the three months ended June 30, 2006 was 35.7%, compared to 36.0% for the same period of 2005. For the six months ended June 30, 2006, our effective tax rate was 35.8%, compared to 36.0% for the same period in 2005.

Income. During the second quarter of 2006, we reported income from operations of \$5.5 million, a decrease of 24% from \$7.2 million for the comparable period in 2005. For the six months ended June 30, 2006, we reported income from operations of \$9.2 million, a decrease of 31% from \$13.4 million for the comparable period in 2005. When compared to the prior year periods, income from operations was positively affected by increased sales volumes, and negatively affected by lower gross margins, increased selling, general and administrative expenses, higher research and development spending and increased asset impairment losses. These factors contributed to lower net income of \$3.5 and \$5.9 million for the three and six-month periods ended June 30, 2006, respectively, compared to net income of \$4.7 million and \$8.8 million for the same periods of 2005.

#### **Liquidity and Capital Resources**

Our working capital as of June 30, 2006 and December 31, 2005 was \$46.0 million and \$43.7 million, respectively. The increase in working capital was, in part, the result of less cash needed to fund construction of our new facilities in South Jordan, Utah and an improvement from year end in our days sales outstanding (DSO) from 47 DSO at year end to 44 DSO at June 30, 2006. As of June 30, 2006, we had a current ratio of 3 to 1. We had \$0 outstanding under our line of credit at June 30, 2006. We generated cash from operations for the six months ended June 30, 2006, in the amount of \$11.5 million, an increase of \$4.9 million over the comparable period of 2005. We maintain a long-term revolving credit facility (the Facility) with a bank, which currently enables us to borrow funds at variable interest rates. We voluntarily reduced the Facility to \$500,000 in August 2002. The Facility expired on June 30, 2006. We are currently working with the bank to extend this \$500,000 credit facility. We are currently in discussions with a different bank for a line of credit for \$30 million, subject to a favorable credit review.

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Historically, we have incurred significant expenses in connection with product development and introduction of new products. We have also used substantial capital to finance the increase in our receivables and inventories associated with our increased sales. Our principal source of funding for these and other expenses has historically

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been cash generated from operations, sales of equity, cash from loans on equipment, and bank lines of credit. We currently believe that our present sources of liquidity and capital are adequate to conduct our current operations for the foreseeable future.

### **Critical Accounting Policies and Estimates**

The SEC has requested that all registrants address their most critical accounting policies. The SEC has indicated that a critical accounting policy is one which is both important to the representation of the registrant's financial condition and results and requires management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. We base our estimates on past experience and on various other assumptions our management believes to be reasonable under the circumstances, the results of which form the basis for making judgments about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results will differ, and may differ materially from these estimates under different assumptions or conditions. Additionally, changes in accounting estimates could occur in the future from period to period. Our management has discussed the development, and selection of our most critical financial estimates with the audit committee of our Board of Directors. The following paragraphs identify our most critical accounting policies:

**Inventory Obsolescence Reserve:** Our management reviews on a regular basis inventory quantities on hand for unmarketable and/or slow moving products that may expire prior to being sold. This review of inventory quantities for unmarketable and/or slow moving products is based on estimates of forecasted product demand prior to projected product expiration dates. If market conditions become less favorable than those projected by our management, additional inventory write-downs may be required. We believe that the amount included in our obsolescence reserve has historically been an accurate estimate of the unmarketable and/or slow moving products that may expire prior to being sold. Our obsolescence reserve was approximately \$1.9 million as of June 30, 2006.

**Allowance for Doubtful Accounts:** A majority of our receivables are with hospitals, which over our history, have demonstrated favorable collection rates. Therefore, we have experienced relatively minimal bad debts from hospital customers. In limited circumstances we have written off bad debts as the result of the termination of foreign distributors. The most significant write-offs over our history have been attributed to receivables associated with sales to U.S. packers who bundle our products in surgical trays.

We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. The allowance is based upon historical experience and a review of individual customer balances. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. Our bad debt reserve was \$441,856 at June 30, 2006, which is in line with our historical collection experience.

**Stock-Based Compensation:** Effective January 1, 2006, we adopted SFAS No.123R. We adopted the fair value recognition provisions of SFAS No. 123R using the modified prospective transition method. Under this transition method, stock-based compensation cost recognized beginning January 1, 2006 includes compensation cost for all share-based payments not yet vested as of January 1, 2006, based on the grant date fair value estimated had we adopted the provisions of SFAS No. 123. In addition, this transition method requires any share-based payments granted after January 1, 2006, be accounted in accordance with the provisions of SFAS No. 123R.

We recognize compensation cost net of a forfeiture rate and recognize the associated compensation expense for only those awards expected to vest on a straight-line basis over the requisite service period. During the second quarter of 2006, 105,000 stock-based compensation grants were made for a total fair value of approximately \$541,000, net of an estimated forfeiture rate.

If we continue to grant share-based payments, reasonable judgment will be required in the determination of the fair value of share-based payment on the date of grant using an option-pricing model with assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to, the expected term of the awards, the expected stock price volatility over the term of the awards, the expected dividends of the awards, the risk-free interest rate of the awards and an estimate of the amount of awards that are expected to be forfeited.





If factors change and we employ different assumptions in the application of SFAS No. 123R in future periods, the stock-based compensation expense recorded under SFAS No. 123R may differ significantly from what was recorded in the current period.

### **ITEM 3: QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Our principal market risk relates to changes in the value of the Euro and Great Britain Pound ( GBP ) relative to the value of the U.S. Dollar. Our consolidated financial statements are denominated in, and our principal currency is, the U.S. Dollar. A portion of our revenues (\$5.1 million, representing approximately 10.5% of aggregate revenues), for the quarter ended June 30, 2006 was attributable to sales that were denominated in Euros and GBPs. Certain of our expenses are also denominated in Euros and GBPs, which partially offsets risks associated with fluctuations of exchanges rates between the Euro and GBP on the one hand, and the U.S. Dollar on the other hand. Because of our Euro and GBP-denominated revenues and expenses, in a year in which our Euro and GBP-denominated revenues exceed our Euro and GBP-based expenses, the value of such Euro and GBP-denominated net income increases if the value of the Euro and GBP increase relative to the value of the U.S. Dollar, and decreases if the value of the Euro and GBP decrease relative to the value of the U. S. Dollar. During the quarter ended June 30, 2006, the exchange rate between the Euro and GBP against the U.S. Dollar resulted in a decrease of our gross revenues of approximately \$115,000 and 0.24% in gross profit.

At June 30, 2006, we had a net exposure representing the difference between Euro and GBP denominated receivables and Euro and GBP denominated payables of approximately 1.1 million and £308,000, respectively. In order to partially offset such risks, at May 31, 2006, we entered into a 30-day forward contract for Euro and GBP. We generally enter into similar economic transactions at various times during the year to partially offset exchange rate risks we bear throughout the year. We do not purchase or hold derivative financial instruments for speculative or trading purposes. During the three and six-month periods ended June 30, 2006, we experienced a net loss of approximately \$66,000 and \$62,000, respectively, on hedging transactions we executed during the three and six-month periods ended June 30, 2006 in an effort to limit our exposure to fluctuations in the Euro and GBP against the U.S. Dollar exchange rate.

As of June 30, 2006, we had no variable rate debt. As long as we do not have variable rate debt, our interest expense would not be affected by changes in interest rates.

### **ITEM 4: CONTROLS AND PROCEDURES**

An evaluation was performed under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of our disclosure controls and procedures, as of June 30, 2006. Based on that evaluation, our management, including our Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed by Merit in reports filed or submitted by Merit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported as specified in the SEC's rules and forms. There was no change in our internal control over financial reporting during the quarter ended June 30, 2006 that materially affected, or that we believe is reasonably likely to materially affect, our internal control over financial reporting.

## **PART II - OTHER INFORMATION**

### **ITEM 1A. RISK FACTORS**

In addition to other information set forth in this Report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2005, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing Merit. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

On May 25, 2006 we held our 2006 Annual Meeting of Shareholders at which our shareholders considered and voted as follows on the items described below:

1. The shareholders considered whether to elect the following persons as directors, each to serve for a term of one, two or three years, as indicated below, or until his respective successor shall have been duly elected and shall qualify:

|                              | <b>Term<br/>in Years</b> | <b>Votes<br/>Received</b> | <b>Withheld</b> |
|------------------------------|--------------------------|---------------------------|-----------------|
| Michael E. Stillabower, M.D. | 1                        | 24,424,563                | 223,679         |
| Kent W. Stanger              | 2                        | 23,347,470                | 1,300,722       |
| Fred P. Lampropoulos         | 3                        | 23,785,990                | 862,252         |
| Franklin J. Miller, M.D.     | 3                        | 24,437,579                | 210,663         |

In addition to the four individuals named above, Rex C. Bean, Richard W. Edelman, and James J. Ellis shall continue to serve as directors.

2. Our shareholders also considered a proposal to amend the Merit Medical Systems, Inc. 1996 Employee Stock Purchase Plan and the Merit Services Non-qualified Employee Stock Purchase Plan. There were 20,808,024 votes cast in favor of the proposal, 215,940 votes cast against the proposal, and 203,427 votes abstained.

3. Our shareholders also considered a proposal to approve the Merit Medical Systems, Inc. 2006 Long-Term Incentive Plan. There were 17,464,391 votes cast in favor of the proposal, 3,578,724 votes cast against the proposal, and 198,376 votes abstained.

4. Our shareholders also considered a proposal to ratify the appointment by the Audit Committee of our Board of Directors of Deloitte & Touche, LLP as our auditors for the fiscal year ending December 31, 2006. There were 24,490,440 votes cast in favor of the proposal, 137,664 votes cast against the proposal, and 20,138 votes abstained.

**ITEM 6: EXHIBITS**

| <b>Exhibit<br/>No.</b> | <b>Description</b>   |
|------------------------|--|
| 31.1                   | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2                   | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32.1                   | Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2                   | Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

SIGNATURES

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

MERIT MEDICAL SYSTEMS, INC.  
REGISTRANT

Date: August 8, 2006

/s/ FRED P. LAMPROPOULOS  
FRED P. LAMPROPOULOS  
PRESIDENT AND CHIEF EXECUTIVE  
OFFICER

Date: August 8, 2006

/s/ KENT W. STANGER  
KENT W. STANGER  
SECRETARY AND CHIEF FINANCIAL  
OFFICER