STERIS CORP
Form 10-Q
February 07, 2007
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D. C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended December 31, 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 1-14643

STERIS Corporation

(Exact name of registrant as specified in its charter)

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

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

(Registrant s telephone number, including area code)

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

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

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

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

The number of common shares outstanding as of January 31, 2007: 64,871,229

Table of Contents

STERIS Corporation

Form 10-Q

Index

		Page
Part I Financial Information		
Item 1.	Financial Statements	3
Item 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations	22
Item 3.	Quantitative and Qualitative Disclosures About Market Risk	39
Item 4.	Controls and Procedures	39
Part II Other Information		
Item 1.	Legal Proceedings	40
Item 1A.	Risk Factors	40
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	41
Item 6.	Exhibits	41
	Signature	42

Table of Contents

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

STERIS CORPORATION

CONSOLIDATED BALANCE SHEETS

(in thousands)

	December 31, 2006 (Unaudited)	March 31, 2006
Assets		
Current assets:		
Cash and cash equivalents	$ 39,011	$ 72,732
Accounts receivable (net of allowances of $9,369 and $9,037, respectively)	207,012	242,002
Inventories, net	147,039	112,224
Current portion of deferred income taxes, net	13,190	13,021
Prepaid expenses and other current assets	34,298	20,336
Total current assets	440,550	460,315
Property, plant, and equipment, net	390,914	401,536
Goodwill and intangibles, net	333,897	326,529
Other assets	1,571	593
Total assets	$ 1,166,932	$ 1,188,973
Liabilities and shareholders equity		
Current liabilities:		
Current portion of long-term indebtedness	$ 827	$ 1,755
Accounts payable	61,183	87,057
Accrued income taxes	6,796	19,821
Accrued payroll and other related liabilities	49,137	50,496
Accrued expenses and other	72,648	75,017
Total current liabilities	190,591	234,146
Long-term indebtedness	125,420	114,480
Deferred income taxes, net	28,807	35,135
Long-term portion of retirement benefit obligations	75,073	74,385
Total liabilities	419,891	458,146
Serial preferred shares, without par value; 3,000 shares authorized; no shares issued or outstanding		
Common shares, without par value; 300,000 shares authorized; issued and outstanding shares of 64,873 and 66,976, respectively	99,228	141,723
Retained earnings	640,717	596,878
Accumulated other comprehensive (loss) income:		
Minimum pension liability and other	(6,218)	(6,214)
Cumulative foreign currency translation adjustment	13,314	(1,560)
Total shareholders equity	747,041	730,827

Total liabilities and shareholders equity	$ 1,166,932	$ 1,188,973

See notes to consolidated financial statements.

3

Table of Contents

STERIS CORPORATION

CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share amounts)

(Unaudited)

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2006	2005	2006	2005
Revenues:				
Product	$ 192,945	$ 189,864	$ 538,079	$ 533,856
Service	106,022	97,628	309,491	295,155
Total revenues	298,967	287,492	847,570	829,011
Cost of revenues:				
Product	112,072	109,659	313,712	309,044
Service	59,194	55,737	174,021	169,112
Total cost of revenues	171,266	165,396	487,733	478,156
Gross profit	127,701	122,096	359,837	350,855
Operating expenses:				
Selling, general, and administrative	82,594	74,316	243,789	234,196
Research and development	8,078	8,726	24,756	25,564
Restructuring expenses	3,179		5,442	
Total operating expenses	93,851	83,042	273,987	259,760
Income from continuing operations	33,850	39,054	85,850	91,095
Non-operating expenses (income):				
Interest expense	1,714	1,100	5,859	3,624
Interest and miscellaneous income	(591)	(597)	(2,071)	(2,889)
Total non-operating expense, net	1,123	503	3,788	735
Income from continuing operations before income tax expense	32,727	38,551	82,062	90,360
Income tax expense	11,859	15,386	30,773	34,859
Net income from continuing operations	20,868	23,165	51,289	55,501
Discontinued operations:				
Income from discontinued operations, net of tax		(301)		1,109
Gain on the sale of discontinued operations, net of tax	431	5,225	1,058	5,225
Net income	$ 21,299	$ 28,089	$ 52,347	$ 61,835
Basic earnings per common share:				
Income from continuing operations, net of tax	$ 0.32	$ 0.34	$ 0.78	$ 0.81
Income from discontinued operations, net of tax	$ 0.01	$ 0.07	$ 0.02	$ 0.09
Net income	$ 0.33	$ 0.41	$ 0.80	$ 0.90
Diluted earnings per common share:				
Income from continuing operations, net of tax	$ 0.32	$ 0.34	$ 0.78	$ 0.80

Income from discontinued operations, net of tax	$	0.01	$	0.07	$	0.02	$	0.09
Net income	$	0.33	$	0.41	$	0.80	$	0.89
Cash dividends declared per common share outstanding	$	0.05	$	0.04	$	0.13	$	0.12

See notes to consolidated financial statements.

Table of Contents

STERIS CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	Nine Months Ended December 31,	
	2006	2005
Operating activities:		
Net income	$ 52,347	$ 61,835
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, depletion, and amortization	44,273	42,110
Deferred income taxes	(7,107)	(97)
Share based compensation	8,895	
Tax benefit from stock options exercised		2,001
Loss on the sale of property, plant, equipment, and intangibles, net	742	
Gain on the sale of discontinued operations, net of tax	(1,058)	(5,225)
Other items	(553)	(8,863)
Changes in operating assets and liabilities, excluding the effects of business acquisitions:		
Accounts receivable, net	39,095	34,588
Inventories, net	(32,338)	(20,401)
Other current assets	(16,468)	(1,278)
Accounts payable	(26,939)	(10,724)
Accruals and other, net	(19,518)	(5,020)
Assets of discontinued operations		39,047
Liabilities of discontinued operations		(28,606)
Net cash provided by operating activities	41,371	99,367
Investing activities:		
Purchases of property, plant, equipment, and intangibles, net	(33,066)	(34,122)
Purchases of property, plant, equipment, and intangibles, net for discontinued operations		(160)
Investments in businesses, net of cash acquired		(1,504)
Proceeds from the sale of property, plant, equipment, and intangibles	2,577	
Proceeds from the sale of discontinued operations	2,927	22,111
Net cash used in investing activities	(27,562)	(13,675)
Financing activities:		
Proceeds under credit facilities, net	11,440	1,720
Payments on long-term obligations and capital leases	(1,436)	(3,380)
Repurchases of common shares	(59,628)	(64,326)
Cash dividends paid to common shareholders	(8,508)	(8,229)
Deferred financing fees		(217)
Stock option and other equity transactions, net	6,746	10,385
Tax benefit from stock options exercised	1,440	
Net cash used in financing activities	(49,946)	(64,047)
Effect of exchange rate changes on cash and cash equivalents	2,416	(542)
(Decrease) increase in cash and cash equivalents	(33,721)	21,103
Cash and cash equivalents at beginning of period	72,732	23,547

Cash and cash equivalents at end of period	$ 39,011	$ 44,650

See notes to consolidated financial statements.

STERIS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

For the Three and Nine Months Ended

December 31, 2006 and 2005

(dollars in thousands, except per share amounts)

1. Nature of Operations and Summary of Significant Accounting Policies

Throughout this document, references to STERIS Corporation, STERIS, or the Company are references to STERIS Corporation and its subsidiaries, except where a different meaning is clearly required by the context. The Company s fiscal year ends on March 31. References to a particular year or year-end refer to the Company s fiscal year.

Nature of Operations

The Company develops, manufactures, and/or markets equipment, consumables, and services for healthcare, pharmaceutical, scientific, research, industrial, and governmental customers throughout the world. The Company operates in three business segments: Healthcare, Life Sciences, and STERIS Isomedix Services.

Interim Financial Statements

The accompanying unaudited consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles (U.S. GAAP) for complete financial statements. In the opinion of management, the accompanying unaudited consolidated financial statements contain all material adjustments (including normal recurring accruals and adjustments) necessary to present fairly the financial condition, results of operations, and cash flows of the Company for the periods presented.

These interim consolidated financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company s Annual Report on Form 10-K for the year ended March 31, 2006, filed with the Securities and Exchange Commission (SEC) on June 12, 2006. The Consolidated Balance Sheet at March 31, 2006 has been derived from the audited consolidated financial statements at that date, but does not include all of the information and footnotes required by U.S. GAAP for complete financial statements.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. Inter-company accounts and transactions have been eliminated upon consolidation.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions in certain circumstances that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from these estimates and, therefore, operating results for the three and nine month periods ended December 31, 2006 are not necessarily indicative of results that may be expected for the full fiscal year ending March 31, 2007.

Reclassifications

Certain prior period amounts have been reclassified to conform to the current period s presentation.

STERIS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

For the Three and Nine Months Ended

December 31, 2006 and 2005

(dollars in thousands, except per share amounts)

Share-Based Compensation

On April 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123 (revised 2004) (SFAS No. 123R), Share-Based Payment, and elected to use the modified prospective transition method (see Note 2).

New Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 158 (SFAS No. 158), Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an Amendment of FASB Statements No. 87, 88, 106, and 132(R), requiring public companies to fully recognize an asset or liability for the overfunded or underfunded status of their benefit plans and requiring the use of a measurement date that corresponds to the plan sponsor s year end. The recognition and disclosure provisions of SFAS No. 158 are effective for fiscal years ending after December 15, 2006. The measurement date provision of SFAS No. 158 is effective for fiscal years beginning after December 15, 2008. The Company currently measures plan assets and benefit obligations of its defined benefit pension and postretirement benefit plans as of its fiscal year-end balance sheet date. The Company will adopt the recognition and disclosure provisions of SFAS No. 158 as of March 31, 2007, as required. Management is currently evaluating the requirements of SFAS No. 158 and has not yet determined the impact on the Company s consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157 (SFAS No. 157), Fair Value Measurements, providing enhanced guidance on the use of fair value to measure assets and liabilities. SFAS No. 157 also provides for expanded information about the extent to which companies measure assets and liabilities at fair value, the information used to measure fair value, and the effect of fair value measurements on earnings. The standard does not expand the use of fair value, but applies whenever other standards require (or permit) assets or liabilities to be measured at fair value. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007. The Company will adopt SFAS No. 157 as of April 1, 2008, as required. Management is currently evaluating the requirements of SFAS No. 157 and has not yet determined the impact on the Company s consolidated financial statements.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108 (SAB 108), Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements, providing interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a potential current year misstatement. SAB 108 is effective for fiscal years beginning after November 15, 2006. The Company will adopt SAB 108 as of April 1, 2007, as required.

In July 2006, the FASB issued Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109, Accounting for Income Taxes, to create a single model to address accounting for uncertainty in tax positions. FIN 48 prescribes a benefit recognition model with a two-step approach: a more-likely-than-not recognition criterion and a measurement attribute that measures the position as the largest amount of tax benefit that is greater than 50% likely of being ultimately realized upon settlement. If it is not more-likely-than-not that the benefit will be sustained on its technical merits, no benefit will be recorded. FIN 48 also requires that the amount of interest expense to be recognized related to uncertain tax positions be recognized in accordance with applying the applicable statutory rate of interest to the difference between the tax position recognized in accordance with FIN 48 and the amount previously taken or expected to be taken in a tax return. The change in net assets as a result of applying this interpretation will be considered a

STERIS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

For the Three and Nine Months Ended

December 31, 2006 and 2005

(dollars in thousands, except per share amounts)

change in accounting principle with the cumulative effect of the change treated as an offsetting adjustment to the opening balance of retained earnings or goodwill, if allowed under existing accounting standards, in the period of transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company will adopt FIN 48 as of April 1, 2007, as required. Management is currently evaluating the requirements of FIN 48 and has not yet determined the impact on the Company s consolidated financial statements.

Significant Accounting Policies

A detailed description of the Company s significant and critical accounting policies, estimates, and assumptions is included in the Company s Annual Report on Form 10-K for the year ended March 31, 2006, filed with the SEC on June 12, 2006. The Company s significant and critical accounting policies, estimates, and assumptions have not changed materially from March 31, 2006, other than the adoption of SFAS No. 123R as described above.

2. Share-Based Compensation

Under the Company s long-term incentive plan, up to 6,600,000 shares of common stock have been made available for grant at the discretion of the Compensation Committee of the Board of Directors to officers, directors, and key employees in the form of stock options, restricted shares, and restricted share units. Stock options provide the right to purchase the Company s common shares at the market price on the date of grant, subject to the terms of option plans and agreements. Stock options granted generally become exercisable to the extent of one-fourth of the optioned shares for each full year of employment following the date of grant and generally expire 10 years after the date of grant, or earlier if an option holder ceases to be employed by the Company. Certain option agreements have provisions that provide for an adjustment to the normal vesting schedule whereby options vest on a prorated basis as defined by specific option agreements in the event of employment termination. Restricted shares and restricted share units cliff vest over an approximately three-year period. As of December 31, 2006, 5,977,725 shares remain available for grant under the long-term incentive plan.

Prior to April 1, 2006, the Company accounted for share-based compensation under the provisions of Accounting Principles Board Opinion No. 25 (APB No. 25), Accounting for Stock Issued to Employees, as permitted by Statement of Financial Accounting Standards No. 123 (SFAS No. 123), Accounting for Stock-Based Compensation, as amended by Statement of Financial Accounting Standards No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, and accordingly recognized no compensation expense when the exercise price equaled the market price of the stock on the date of grant.

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

Under the modified prospective transition method, compensation cost recognized in the first nine months of fiscal 2007 includes (a) compensation cost for all share-based compensation granted, but not yet vested, as of April 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, and (b) compensation cost for all share-based compensation granted on or subsequent to April 1, 2006,

Table of Contents

STERIS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

For the Three and Nine Months Ended

December 31, 2006 and 2005

(dollars in thousands, except per share amounts)

based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123R. The Company s consolidated financial statements as of and for the three and nine month periods ended December 31, 2006 reflect the impact of SFAS No. 123R. In accordance with the modified prospective transition method, the consolidated financial statements for prior periods have not been restated to reflect, and do not include the impact of SFAS No. 123R.

The adoption of SFAS No. 123R on April 1, 2006 reduced the Company s income from continuing operations before income taxes for the third quarter and first nine months of fiscal 2007 by $3,110 and $8,895, respectively, and reduced net income for the third quarter and first nine months of fiscal 2007 by $1,910 ($0.03 per basic and diluted share) and $5,462 ($0.08 per basic and diluted share), respectively. The adoption of SFAS No.123R also required the classification of the tax benefit from the exercise of stock options for the nine months ended December 31, 2006 of $1,440 as a financing activity in the cash flow statement rather than as an operating activity, as previously required. For the nine months ended December 31, 2005, the tax benefit from the exercise of stock options reported as an operating activity in the cash flow statement was $2,001.

The effect of the adoption of SFAS No. 123R on results for the first nine months of fiscal 2007 is not indicative of the effect on the remainder of fiscal 2007, as approximately $1,784 of the share-based compensation expense for the first nine months of the fiscal year was attributable to the accelerated recognition of expense for certain employees that are or will become eligible for retirement during the vesting period.

The following table contains pro forma disclosures regarding the effect on the Company s net income, earnings per basic common share, and earnings per diluted common share for the third quarter and first nine months of fiscal 2006 had the Company applied a fair value method of accounting for share-based compensation in accordance with SFAS No. 123.

	Three Months Ended December 31, 2005	Nine Months Ended December 31, 2005
Net income:		
As reported	$ 28,089	$ 61,835
Less: Stock-based compensation expense, net of income taxes, assuming the fair value method	1,383	4,257
Pro forma	$ 26,706	$ 57,578
Earnings per common share:		
Basic:		
As reported	$ 0.41	$ 0.90
Pro forma	0.39	0.84
Diluted:		
As reported	$ 0.41	$ 0.89
Pro forma	0.38	0.83

For the purpose of computing pro forma net income, the fair value of option grants was estimated at their grant date using the Black-Scholes-Merton option pricing model. This model was developed for use in estimating the fair value of traded options that have no

vesting restrictions and are fully transferable, characteristics that are not present in the Company s option grants. If the model permitted consideration of the unique characteristics of employee stock options, the resulting estimate of the fair value of the stock options could be different.

Table of Contents

STERIS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

For the Three and Nine Months Ended

December 31, 2006 and 2005

(dollars in thousands, except per share amounts)

The following weighted-average assumptions were used for all options granted during the first nine months of fiscal 2007 and fiscal 2006:

	SFAS No. 123R Expense	SFAS No. 123 Pro forma
	Fiscal 2007	Fiscal 2006
Risk-free interest rate	4.73%	3.95% - 4.40%
Expected life of options	6 years	5 years
Expected dividend yield of stock	0.65%	0.58% - 0.66%
Expected volatility of stock	34.29%	45.00%

The risk-free interest rate is based upon the U.S. Treasury yield curve at the time of grant. The expected life of options is reflective of historical experience, vesting schedules and contractual terms. The expected dividend yield of stock represents the Company s best estimate of expected future dividend yield. The expected volatility of stock is derived by referring to the Company s historical stock prices over a timeframe similar to that of the expected life of the grant. The Company has applied an estimated forfeiture rate of 2.2 percent. This rate is calculated based upon historical activity and represents an estimate of the granted options not expected to vest. If actual forfeitures differ from the expected rate, the Company may be required to make additional adjustments to compensation expense in future periods. The expected life and expected forfeiture rate used for options granted in fiscal 2007 to the Company s Chief Executive Officer (CEO) were adjusted based on the terms of the employment agreement between the Company and the CEO entered into in September 2006.

Stock option activity for the first nine months of fiscal 2007 is as follows:

	Number of Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at March 31, 2006	5,706,874	$ 21.02		
Granted	528,225	24.44		
Exercised	(414,934)	16.13		
Forfeited	(154,797)	25.57		
Outstanding at December 31, 2006	5,665,368	$ 21.55	5.91	$ 20,516
Exercisable at December 31, 2006	3,999,665	$ 20.16	4.97	$ 20,049

The total intrinsic value of stock options exercised during the first nine months of fiscal 2007 and fiscal 2006 was $3,740 and $5,266, respectively. Net cash proceeds from the exercise of stock options were $6,692 and $10,225 for the first nine months of fiscal 2007 and fiscal 2006, respectively. An income tax benefit of $1,440 and $2,001 was realized from stock option exercises during the first nine months of fiscal 2007 and fiscal 2006, respectively.

The weighted average grant date fair value of stock option grants was $9.13 and $10.49 for the first nine months of fiscal 2007 and fiscal 2006, respectively. The weighted average grant date fair value of stock options granted to the CEO was adjusted based on the terms of the employment agreement between the Company and the CEO entered into in September 2006.

Table of Contents

STERIS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

For the Three and Nine Months Ended

December 31, 2006 and 2005

(dollars in thousands, except per share amounts)

A summary of the status of the Company s nonvested shares as of December 31, 2006 and changes during the first nine months of fiscal 2007 is presented below:

	Number of Restricted Shares	Number of Restricted Share Units	Weighted-Average Grant Date Fair Value
Nonvested at March 31, 2006	2,200		$ 27.20
Granted	73,200	20,850	23.18
Vested	(2,200)		27.20
Canceled	(5,500)		23.17
Nonvested at December 31, 2006	67,700	20,850	$ 23.18

Restricted shares and restricted share units granted were valued based on the closing stock price at the grant date and are estimated to cliff vest over an approximately three-year period based upon the terms of the grants. The total intrinsic value of restricted shares that vested during the first nine months of fiscal 2007 was $50.

As of December 31, 2006, there was $13,212 of total unrecognized compensation cost related to non-vested share-based compensation granted under the Company s share-based compensation plans. The cost is expected to be recognized over a weighted average period of 1.12 years.

3. Common Shares

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

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2006	2005	2006	2005
	(shares in thousands)			
Weighted average common shares outstanding - basic	64,737	68,205	65,255	68,509
Dilutive effect of common share equivalents	603	621	541	721
Weighted average common shares outstanding and common share equivalents - diluted	65,340	68,826	65,796	69,230

Options to purchase the following number of common shares at the following weighted average exercise prices were outstanding but excluded from the computation of diluted earnings per common share because the exercise prices were greater than the average market price for the common shares during the periods:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2006	2005	2006	2005
	(shares in thousands)			
Number of common share options	1,262	2,177	2,157	1,370
Weighted average exercise price	$ 28.85	$ 26.85	$ 26.69	$ 28.26

STERIS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

For the Three and Nine Months Ended

December 31, 2006 and 2005

(dollars in thousands, except per share amounts)

4. Comprehensive Income

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

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2006	**2005**	**2006**	**2005**
Net income	$ 21,299	$ 28,089	$ 52,347	$ 61,835
Foreign currency translation adjustments	3,256	(6,453)	14,874	(16,726)
Minimum pension liability and other	(4)		(4)	
Total comprehensive income	$ 24,551	$ 21,636	$ 67,217	$ 45,109

5. Restructuring

Restructuring expenses have been recognized as incurred during fiscal 2007 as required under the provisions of Statement of Financial Accounting Standards No. 146 (SFAS No. 146), Accounting for Costs Associated with Exit or Disposal Activities. In addition, property, plant and equipment associated with the restructuring actions were assessed for impairment under Statement of Financial Accounting Standards No. 144 (SFAS No. 144), Accounting for the Impairment or Disposal of Long-Lived Assets. Asset impairment and accelerated depreciation expenses primarily relate to adjustments to the carrying value and the estimated useful lives of the assets to reflect their estimated fair value and remaining useful life.

European Restructuring Plan

During the third quarter of fiscal 2007, the Company adopted a restructuring plan related to certain of its European operations (European Restructuring Plan). As part of this plan, the Company will close its Nanterre, France and Stockholm, Sweden sales offices. In addition, the Company has taken steps to reduce the workforce in certain European support functions. These actions are intended to improve the Company s cost structure in Europe and are expected to impact approximately 40 employees in various European locations. In the three months ended December 31, 2006, the Company recorded $1,600 in restructuring expenses related to these actions.

The restructuring expenses predominately consist of severance and related benefits, with restructuring expenses of $1,384 and $216 related to the Healthcare and Life Sciences segments, respectively. The Company continues to evaluate its European operations for opportunities to enhance performance, but has not committed to any additional specific actions.

Fiscal 2006 Restructuring Plan

During the three and nine months ended December 31, 2006, the Company recorded $1,579 and $3,842, respectively, in restructuring expenses related to the previously announced transfer of the Erie, Pennsylvania manufacturing operations to Monterrey, Mexico and other actions to improve the Company s cost structure (Fiscal 2006 Restructuring Plan), exclusive of the European Restructuring Plan.

Table of Contents

STERIS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

For the Three and Nine Months Ended

December 31, 2006 and 2005

(dollars in thousands, except per share amounts)

Since the inception of the Fiscal 2006 Restructuring Plan, the Company has incurred restructuring expenses of $29,150, with restructuring expenses of $28,736 and $414 related to the Healthcare and Life Sciences segments, respectively. These charges primarily related to the transfer of the Erie, Pennsylvania manufacturing operations to Monterrey, Mexico.

The Company anticipates incurring approximately an additional $6,000 in restructuring expenses during the remainder of fiscal 2007 and fiscal 2008 in connection with the transfer of the manufacturing operations from Erie, Pennsylvania to Monterrey, Mexico, which is a lower amount than originally anticipated due to a reduction in estimated severance costs for the Erie facility. Restructuring expenses to be incurred include compensation and benefits, severance, accelerated depreciation and other expenses.

The following tables summarize the Company s total restructuring expenses incurred for the third quarter and first nine months of fiscal 2007:

Three Months Ended December 31, 2006	**European Restructuring Plan**	**Fiscal 2006 Restructuring Plan**	**Total**
Severance, payroll and other related costs	$ 1,276	$ 739	$ 2,015
Lease termination costs	219		219
Asset impairment and accelerated depreciation	105	765	870
Other		75	75
Total restructuring charges	$ 1,600	$ 1,579	$ 3,179

Nine Months Ended December 31, 2006	**European Restructuring Plan**	**Fiscal 2006 Restructuring Plan**	**Total**
Severance, payroll and other related costs	$ 1,276	$ 1,717	$ 2,993
Lease termination costs	219		219
Asset impairment and accelerated depreciation	105	2,034	2,139
Other		91	91
Total restructuring charges	$ 1,600	$ 3,842	$ 5,442

Liabilities related to restructuring activities are recorded as current liabilities on the accompanying Consolidated Balance Sheets within Accrued expenses and other. The following tables summarize the Company s liabilities related to restructuring activities:

	Fiscal 2006 Restructuring Plan			
	March 31, 2006	**Fiscal 2007 Provision**	**Fiscal 2007 Payments**	**December 31, 2006**

Severance and termination benefits	$ 1,941	$ 1,448	$ (1,695)	$ 1,694
Lease termination obligation	135		(102)	33
Total	$ 2,076	$ 1,448	$ (1,797)	$ 1,727

Table of Contents

STERIS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

For the Three and Nine Months Ended

December 31, 2006 and 2005

(dollars in thousands, except per share amounts)

	March 31, 2006	European Restructuring Plan Fiscal 2007 Provision	Payments	December 31, 2006
Severance and termination benefits	$	$ 1,276	$ (236)	$ 1,040
Lease termination obligation		219		219
Fixed asset impairment		105		105
Total	$	$ 1,600	$ (236)	$ 1,364

6. Depreciable Assets

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

	December 31, 2006	March 31, 2006
Land and land improvements (1)	$ 25,399	$ 24,611
Buildings and leasehold improvements	179,547	179,264
Machinery and equipment	264,271	259,820
Information systems	111,881	108,853
Radioisotope	129,151	125,008
Construction in progress (1)	41,617	31,554
Total property, plant, and equipment	751,866	729,110
Less: accumulated depreciation and depletion	(360,952)	(327,574)
Property, plant, and equipment, net	$ 390,914	$ 401,536

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

7. Inventories, Net

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

	December 31, 2006	March 31, 2006

Raw materials	$ 42,875	$ 32,121
Work in process	31,571	29,011
Finished goods	72,593	51,092
Inventories, net	$ 147,039	$ 112,224

Table of Contents

STERIS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

For the Three and Nine Months Ended

December 31, 2006 and 2005

(dollars in thousands, except per share amounts)

8. Debt

Indebtedness was as follows:

	December 31, 2006	March 31, 2006
Private placement	$ 100,000	$ 100,000
Credit facility	24,420	12,980
Other debt	1,827	3,255
Total	126,247	116,235
Less: current portion	827	1,755
Long-term portion	$ 125,420	$ 114,480

Additional information regarding the Company s indebtedness is included in the Company s Annual Report on Form 10-K for the year ended March 31, 2006, filed with the SEC on June 12, 2006.

9. Additional Consolidated Balance Sheets Information

Additional information related to the Company s Consolidated Balance Sheets is as follows:

	December 31, 2006	March 31, 2006
Accrued payroll and other related liabilities:		
Compensation and related items	$ 15,311	$ 14,646
Accrued vacation	12,259	12,912
Accrued bonuses	6,521	3,542
Accrued employee commissions	8,290	9,474
Retirement benefit obligations-current portion	6,756	9,922
Total accrued payroll and other related liabilities	$ 49,137	$ 50,496
Accrued expenses and other:		
Deferred revenues	$ 20,634	$ 19,408
Self-insured risk retention-Global Risk Insurance Company	18,564	16,090
Other self-insured risks	1,113	1,407
Accrued dealer commissions	5,573	6,067

Accrued warranty	5,999	7,226
Other	20,765	24,819
Total accrued expenses and other	$ 72,648	$ 75,017

15

Table of Contents

STERIS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

For the Three and Nine Months Ended

December 31, 2006 and 2005

(dollars in thousands, except per share amounts)

10. Income Tax Expense

Income tax expense includes United States federal, state and local, and foreign income taxes, and is based on reported pre-tax income. The effective income tax rates for continuing operations for the three month periods ended December 31, 2006 and 2005 were 36.2% and 39.9%, respectively. For the nine month periods ended December 31, 2006 and 2005, the effective income tax rates for continuing operations were 37.5% and 38.6%, respectively. The lower effective income tax rate for the three and nine month periods ended December 31, 2006 resulted principally from discrete item adjustments to recognize additional deferred tax assets related to foreign tax credits.

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

11. Benefit Plans

The Company provides defined benefit pension plans for certain manufacturing and plant administrative personnel throughout the world as determined by collective bargaining agreements or employee benefit standards, including two United States defined benefit pension plans. In addition to providing pension benefits to certain employees, the Company sponsors an unfunded post-retirement medical benefit plan for two groups of United States employees comprised substantially of the same employees who receive pension benefits under the United States defined benefit pension plans. Benefits under this plan include retiree life insurance and retiree medical insurance, including prescription drug coverage and Medicare supplemental coverage. Additional information regarding the Company s defined benefit pension plans and other post-retirement medical benefit plan is included in the Company s Annual Report on Form 10-K for the year ended March 31, 2006, filed with the SEC on June 12, 2006.

During the fourth quarter of fiscal 2006, the Company recorded curtailment and special termination benefit losses associated with the Fiscal 2006 Restructuring Plan. Fiscal 2007 net periodic benefit costs are reduced as a result of the recognition of these losses.

Components of the net periodic benefit cost of the Company s defined benefit pension plans and other post-retirement medical benefit plan were as follows:

	Defined Benefit Pension Plans				Other Post-	
	U.S. Qualified		International		Retirement Plan	
Three Months Ended December 31,	**2006**	**2005**	**2006**	**2005**	**2006**	**2005**
Service cost	$ (14)	$ 222	$ 109	$ 416	$	$ 272
Interest cost	693	646	80	221	1,168	1,134
Expected return on plan assets	(680)	(697)	(97)	(230)		
Net amortization and deferral	67	209			231	438
Net periodic benefit cost	$ 66	$ 380	$ 92	$ 407	$ 1,399	$ 1,844

Table of Contents

STERIS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

For the Three and Nine Months Ended

December 31, 2006 and 2005

(dollars in thousands, except per share amounts)

	Defined Benefit Pension Plans				Other Post-	
	U.S. Qualified		International		Retirement Plan	
Nine Months Ended December 31,	**2006**	**2005**	**2006**	**2005**	**2006**	**2005**
Service cost	$ 85	$ 663	$ 328	$ 570	$	$ 817
Interest cost	2,077	1,939	240	302	3,505	3,401
Expected return on plan assets	(2,039)	(2,091)	(291)	(315)		
Net amortization and deferral	200	627			691	1,315
Net periodic benefit cost	$ 323	$ 1,138	$ 277	$ 557	$ 4,196	$ 5,533

It is the Company s practice to fund amounts for the defined benefit pension plans at least sufficient to meet the minimum requirements set forth in applicable employee benefit laws and local tax laws. In September 2006, the Company contributed $3,125 to its U.S. defined benefit pension plans and as a result of making this contribution, the Company was able to reduce the third quarter service cost for its U.S. qualified defined benefit pension plans by approximately $63. Liabilities for amounts in excess of these funding levels are included on the accompanying Consolidated Balance Sheets of the Company.

12. Contingencies

The Company may be involved in various patent, product liability, consumer, environmental, tax proceedings and claims, governmental investigations, and other legal and regulatory proceedings that arise from time to time in the ordinary course of business. In accordance with Statement of Financial Accounting Standards No. 5, Accounting for Contingencies, the Company records accruals for such contingencies to the extent that the Company concludes that their occurrence is both probable and estimable. The Company considers many factors in making these assessments, including the professional judgment of experienced members of management and the Company s legal counsel. The Company has made estimates as to the likelihood of unfavorable outcomes and the amounts of such potential losses. In the opinion of management, the ultimate outcome of these proceedings and claims is not anticipated to have a material adverse effect on the Company s consolidated financial position, results of operations, or cash flows. Legal and other proceedings are inherently unpredictable and actual results could materially differ from the Company s estimates. The Company records anticipated recoveries under applicable insurance contracts when assured of recovery.

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

To the extent that management of the Company believes it is probable that a taxing authority will take a sustainable position on a matter contrary to the position taken by the Company, the Company provides tax accruals. If the Company was to prevail in matters for which accruals have been established, or is required to pay amounts in excess of established accruals, the Company s effective income tax rate in a given financial statement period may be materially impacted.

Table of Contents

STERIS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

For the Three and Nine Months Ended

December 31, 2006 and 2005

(dollars in thousands, except per share amounts)

13. Business Segment Information

The Company operates and reports in three business segments: Healthcare, Life Sciences, and STERIS Isomedix Services. Operating income (loss) for each of the Company s reportable business segments reflects the full allocation of all distribution, corporate, and research and development expenses to the reportable segments. These allocations are based upon variables such as segment headcount and revenues. The accounting policies for reportable segments are the same as those for the consolidated Company. Segment results for the three and nine months ended December 31, 2005 exclude the freeze dryer product line, which has been presented as a discontinued operation, and reflect the reallocation of corporate overhead charges to all business segments. The freeze dryer product line was previously included in the Life Sciences business segment. For the three and nine months ended December 31, 2006, revenues from a single customer did not represent ten percent or more of any segment s revenues. Additional information regarding the Company s business segments is included in the Company s Annual Report on Form 10-K for the year ended March 31, 2006, filed with the SEC on June 12, 2006.

Financial information for each of the Company s reportable business segments is presented in the following table:

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2006	2005	2006	2005
Revenues:				
Healthcare	$ 209,807	$ 203,668	$ 594,032	$ 583,420
Life Sciences	56,062	52,671	154,394	149,932
STERIS Isomedix Services	33,098	31,153	99,144	95,659
Total revenues	$ 298,967	$ 287,492	$ 847,570	$ 829,011
Operating income (loss):				
Healthcare	$ 25,598	$ 33,059	$ 67,142	$ 77,608
Life Sciences	2,534	746	1,496	(2,807)
STERIS Isomedix Services	5,718	5,249	17,212	16,294
Total operating income	$ 33,850	$ 39,054	$ 85,850	$ 91,095

Financial information for each of the Company s geographic areas is presented in the following table. Long-lived assets are those assets that are identified within the operations in each geographic area, including property, plant, equipment, goodwill, intangibles, and other assets.

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2006	2005	2006	2005
Revenues:				
United States	$ 227,792	$ 229,512	$ 662,973	$ 669,380

International	71,175	57,980	184,597	159,631
Total revenues	$ 298,967	$ 287,492	$ 847,570	$ 829,011

	December 31, 2006	**March 31, 2006**
Long-lived assets:		
United States	$ 572,246	$ 589,384
International	154,136	139,274
Total long-lived assets	$ 726,382	$ 728,658

Table of Contents

STERIS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

For the Three and Nine Months Ended

December 31, 2006 and 2005

(dollars in thousands, except per share amounts)

14. Repurchases of Common Shares

No repurchases of common shares were made by or on behalf of the Company during the third quarter of fiscal 2007. During the first nine months of fiscal 2007, the Company repurchased 2,585,300 of its common shares for $59,628, representing an average price of $23.06 per common share. At December 31, 2006, 2,617,300 common shares remained authorized for repurchase under the common share repurchase program which was approved by the Company s Board of Directors and announced on July 27, 2006. This common share repurchase authorization does not have a stated maturity date. At December 31, 2006, 5,166,123 common shares were held in treasury.

15. Financial and Other Guarantees

The Company generally offers a limited parts and labor warranty on its capital equipment. The specific terms and conditions of those warranties vary depending on the product sold and the country where the Company conducts business. The Company provides for the estimated cost of product warranties at the time product revenues are recognized. Amounts due to customers for the Company s future performance under these warranties are recorded as a current liability on the accompanying Consolidated Balance Sheets within Accrued expenses and other. Factors that affect the Company s warranty liability include the number and type of installed units, historical and anticipated rates of product failures, and material and service costs per claim. The Company periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary.

Changes in the Company s warranty liability during the first nine months of fiscal 2007 were as follows:

Balance, March 31, 2006	$ 7,226
Warranties issued during the period	6,678
Settlements made during the period	(7,905)
Balance, December 31, 2006	$ 5,999

The Company also issues product maintenance contracts to its customers that are accounted for in accordance with the requirements of FASB Technical Bulletin No. 90-1, Accounting for Separately Priced Extended Warranty and Product Maintenance Contracts. Such contracts generally range in terms from one to five years and require the Company to maintain and repair capital products over the maintenance contract term. Amounts due from customers under these contracts are initially recorded as a liability for deferred service contract revenue on the accompanying Consolidated Balance Sheets. The liability recorded for such deferred service revenue was $15,447 and $15,876 as of December 31, 2006 and March 31, 2006, respectively. Such deferred revenues are then amortized on a straight-line basis over the contract term and recognized as service revenues on the accompanying Consolidated Statements of Income. The activity related to the liability for deferred service contract revenues has been excluded from the table presented above.

16. Foreign Currency Forward Contracts

The Company enters into forward contracts to hedge potential foreign currency gains and losses that arise from assets and liabilities denominated in foreign currencies, including inter-company transactions. The Company does not use derivative financial instruments for speculative purposes. These contracts are marked to market, with gains and losses recognized on the accompanying Consolidated Statements of Income within Selling, general, and administrative expenses. At December 31, 2006, the Company held foreign currency forward contracts to

sell 11.0 million euros and buy 2.0 million British pounds sterling.

Table of Contents

STERIS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) (Continued)

For the Three and Nine Months Ended

December 31, 2006 and 2005

(dollars in thousands, except per share amounts)

17. Business Acquisitions

Pursuant to the terms of the share purchase agreement with respect to Hamo Holding AG (Hamo), the final settlement and resolution of certain indemnification claims was made during the first quarter of fiscal 2006. Amounts received by the Company amounted to approximately 2.2 million Swiss francs (approximately $1,700) and are included in Interest and miscellaneous income on the Consolidated Statements of Income. Hamo was acquired by the Company during fiscal 2004.

18. Business Dispositions

On October 31, 2005, the Company completed the sale of its freeze dryer (lyophilizer) product line to GEA Group of Germany for 20.8 million euros (approximately $25,161). The transaction resulted in an after-tax gain to the Company of $7,292 ($1,058 recognized in the first nine months of fiscal 2007, $5,225 recognized in the first nine months of fiscal 2006, and $1,009 recognized in the fourth quarter of fiscal 2006). The freeze dryer product line, based in Cologne, Germany, was part of the Company s Life Sciences segment. Goodwill of $5,571 was allocated to the freeze dryer product line in connection with its disposition. This product line is presented in the Company s financial statements as a discontinued operation. All historical financial information for this product line has been classified as a discontinued operation. Segment results for the three and nine months ended December 31, 2005 exclude the freeze dryer product line and reflect the reallocation of corporate overhead charges to all business segments. Revenues, (loss) income before income taxes, income tax (benefit) expense, and net income generated by this discontinued operation prior to its disposition were as follows:

(dollars in thousands)	Three Months Ended December 31, 2005	Nine Months Ended December 31, 2005
Revenues	$ 1,869	$ 10,624
(Loss) income before income taxes	$ (501)	$ 1,326
Income tax (benefit) expense	(200)	217
Income from discontinued operations	$ (301)	$ 1,109

19. Subsequent Events

Subsequent to December 31, 2006, foreign currency contracts to sell 11.0 million euros and to buy 2.0 million British pounds sterling matured. Subsequent to December 31, 2006, the Company entered into foreign currency forward contracts to sell 11.0 million euros and buy 2.0 million British pounds sterling.

On January 23, 2007, the Company announced that its Board of Directors had declared a quarterly cash dividend in the amount of $0.05 per common share, payable on March 13, 2007, to shareholders of record as of February 13, 2007.

Table of Contents

Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders

STERIS Corporation

We have reviewed the consolidated balance sheet of STERIS Corporation and subsidiaries as of December 31, 2006, and the related consolidated statements of income for the three-month and nine-month periods ended December 31, 2006 and 2005, and the consolidated statements of cash flows for the nine-month periods ended December 31, 2006 and 2005. These financial statements are the responsibility of the Company s management.

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

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

We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of STERIS Corporation and subsidiaries as of March 31, 2006 and the related consolidated statements of income, shareholders equity and cash flows for the year then ended, not presented herein, and in our report dated June 8, 2006, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of March 31, 2006, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Ernst & Young LLP

Cleveland, Ohio

February 6, 2007

Table of Contents

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

Financial Measures. In the following sections of Management s Discussion and Analysis of Financial Condition and Results of Operations (MD&A), the Company, at times, may refer to financial measures that are not required to be presented in the consolidated financial statements under U. S. GAAP. The Company has used the following financial measures that are not required to be presented under U. S. GAAP in the context of this report: backlog, debt to capital, and days sales outstanding. The Company defines these financial measures as follows:

Backlog - is defined by the Company as the amount of unfilled capital purchase orders at a point in time. The Company uses this figure as a measure to assist in the projection of short-term financial results and inventory requirements.

Debt to capital - is defined by the Company as total debt divided by the sum of total debt and shareholders equity. The Company uses this figure as a financial liquidity measure to gauge its ability to borrow, provide strength/protection against creditors, fund growth, develop outside of its current business operations, and measure the risk of the Company s financial structure.

Days sales outstanding (DSOs) - is defined by the Company as the average collection period for sales revenues. It is calculated as net accounts receivable divided by the trailing four quarter s revenues, multiplied by 365 days. The Company uses this figure to help gauge the quality of its accounts receivable and expected time to collect.

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

Free cash flow - is defined by the Company as net cash flows provided by operating activities as presented in the Consolidated Statements of Cash Flows less purchases of property, plant, equipment, and intangibles, net, plus proceeds from the sale of property, plant, equipment, and intangibles, which are also presented in the Consolidated Statements of Cash Flows. The Company uses this measure to gauge its ability to fund future growth opportunities, repurchase common shares, and pay cash dividends. The following table reconciles the calculations of the Company s free cash flow for the nine months ended December 31, 2006 and 2005:

	Nine Months Ended December 31,	
(dollars in thousands)	**2006**	**2005**
Cash flows from operating activities	$ 41,371	$ 99,367
Purchases of property, plant, equipment and intangibles, net	(33,066)	(34,282)
Proceeds from the sale of property, plant, equipment and intangibles	2,577	
Free cash flow	$ 10,882	$ 65,085

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

The Company has presented these financial measures because it believes that meaningful analysis of its financial performance is enhanced by an understanding of certain additional factors underlying that performance. These financial measures should not be considered alternatives to measures required by U.S. GAAP. The Company s calculations of these measures may differ from calculations of similar measures used by other companies.

Table of Contents

Revenues - Defined. As required by Regulation S-X, the Company has presented separately on its Consolidated Statements of Income, for each period presented, revenues generated as either product revenues or service revenues. In discussing revenues, the Company, at times, may refer to revenues in differing detail than that which is required by Regulation S-X. The terminology, definitions, and applications of terms that the Company uses to describe revenues may differ from terms used by other companies. The Company uses the following terms to describe revenues:

Revenues - The Company s revenues are presented net of sales returns and allowances.

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

Service Revenues - Service revenues are defined by the Company as revenues generated from parts and labor associated with the maintenance, repair, and installation of capital equipment, as well as revenues generated from contract sterilization offered through the Company s Isomedix Services segment.

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

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

Recurring Revenues - Recurring revenues are defined by the Company as the combination of consumable revenues and service revenues.

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

The Company s revenues are primarily derived from the healthcare and pharmaceutical industries. Much of the growth in its markets is driven by the aging of the population throughout the world, as an increasing number of individuals are entering their prime healthcare consumption years. In addition, each of STERIS s core industries also are benefiting from specific trends that drive growth. Within the healthcare market, there is increased concern regarding the level of hospital-acquired infections around the world. The pharmaceutical industry has been impacted by increased FDA scrutiny of cleaning and validation processes, mandating that manufacturers improve their processes. In the contract sterilization industry, where Isomedix competes, a trend toward the outsourcing of sterilization services and single use medical devices continues to drive growth.

Beyond STERIS s core markets, infection-control issues are becoming a global concern, and emerging threats have gained prominence in the news. Through STERIS s Life Sciences segment, the Company is actively pursuing new opportunities to adapt its proven technologies to meet the needs of emerging applications such as defense, aerospace, and industrial decontamination. As a result of these efforts, the Company recently announced the grant of United States Environmental Protection Agency label clearance, which will allow for the more universal application of its proprietary technologies to combat emerging decontamination needs in various environments.

During the third quarter of fiscal 2007, the Company adopted a restructuring plan related to certain of its European operations. As part of this plan, the Company will close its Nanterre, France and Stockholm, Sweden

sales offices. In addition, the Company has taken steps to reduce the workforce in certain European support functions. These restructuring actions are intended to improve the Company s cost structure in Europe and are expected to impact approximately 40 employees in various European locations.

During the third quarter of fiscal 2007, the Company recorded pre-tax expenses of $1.6 million related to the European restructuring plan, primarily related to compensation and severance costs, lease termination costs, and fixed asset impairment charges.

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

During the first nine months of fiscal 2007, the Company incurred pre-tax expenses of $8.7 million associated with the transfer of its Erie, Pennsylvania manufacturing operations to Monterrey, Mexico. Included in these expenses are $3.9 million classified as restructuring expenses, primarily related to accelerated depreciation of assets, compensation and severance and termination benefits related to the transition.

Fiscal 2007 third quarter and year to date revenues were $299.0 million and $847.6 million, respectively, representing increases of 4.0% and 2.2%, respectively, from the same prior year periods. Revenue growth in the third quarter and first nine months of fiscal 2007 was driven by increased revenues in all three business segments.

The Company s gross margin percentages were 42.7% and 42.5% for the third quarter and first nine months of fiscal 2007, respectively, representing increases of 20 basis points from the same prior year periods. Gross margins during both fiscal 2007 periods were positively impacted by price increases, reductions in freight and distribution costs, and operating efficiencies, which more than offset increases in the costs of labor and materials.

Free cash flow was $10.9 million in the first nine months of fiscal 2007 compared to $65.1 million in the same prior year period. The fiscal 2007 year to date free cash flow level was impacted by working capital changes, including approximately $30.0 million in payments to the IRS for taxes previously recognized and higher inventory levels. The Company s debt-to-capital ratio increased to 14.5% at December 31, 2006 from 13.7% at March 31, 2006, reflecting increased borrowings utilized to fund working capital changes and common share repurchases. During the first nine months of fiscal 2007, the Company repurchased approximately 2.6 million common shares at an average purchase price per share of $23.06. The Company also declared and paid quarterly cash dividends of $0.13 and $0.12 per common share in the first nine months of fiscal 2007 and fiscal 2006, respectively.

Additional information regarding the Company s fiscal 2007 third quarter and year to date financial performance is included in the subsection below titled Results of Operations.

Matters Affecting Comparability.

Accounting for Share-Based Compensation. On April 1, 2006, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004) (SFAS No. 123R), Share-Based Payment, using the modified prospective transition method. SFAS No. 123R requires the Company to estimate the fair value of share-based awards on the date of the grant using an option pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in the Company s consolidated statements of income.

The Company s consolidated financial statements as of December 31, 2006 and for the three and nine month periods then ended reflect the impact of SFAS No. 123R. In accordance with the modified prospective transition method, the consolidated financial statements for prior periods have not been restated to reflect, and do not include the impact of SFAS No. 123R. Total share-based compensation expense for the third quarter and first nine months of fiscal 2007 was $3.1 million and $8.9 million, respectively, on a pre-tax basis, or $1.9 million ($0.03 per basic and diluted share) and $5.5 million, ($0.08 per basic and diluted share), net of tax.

As of December 31, 2006, there was $13.2 million of total unrecognized compensation cost related to non-vested share-based compensation granted under the Company s stock option plans. The cost is expected to be recognized over a weighted average period of 1.12 years.

Additional information regarding the Company s adoption of SFAS No. 123R is included in notes 1 and 2 to the consolidated financial statements.

Business Dispositions. On October 31, 2005, the Company completed the sale of its freeze dryer (lyophilizer) product line to GEA Group of Germany for 20.8 million euros (approximately $25.2 million). The transaction resulted in an after-tax gain to the Company of approximately $7.3 million ($1.1 million recognized in the first nine months of fiscal 2007, $5.2 million recognized in the first nine months of fiscal 2006, and $1.0 million recognized in the fourth quarter of fiscal 2006). The freeze dryer product line, based in Cologne, Germany, was part of the Company s Life Sciences segment. All historical financial information for this product line has been classified as a discontinued operation. Segment results for the three and nine months ended December 31, 2005 exclude the freeze dryer product line and reflect the reallocation of corporate overhead charges to all business segments.

International Operations. Given the nature of the Company s global operations, it maintains an inherent exposure to fluctuations in foreign currencies. During the third quarter of fiscal 2007, the Company s revenues were favorably impacted by $3.6 million, or 1.2%, and income before taxes was favorably impacted by $0.8 million, or 2.4%, compared with the same period in fiscal 2006, as a result of foreign currency fluctuations. During the first nine months of fiscal 2007, the Company s revenues were favorably impacted by $6.9 million, or 0.8%, and income before taxes was favorably impacted by $2.5 million, or 3.1%, as compared to the same prior year period, as a result of foreign currency fluctuations.

Results of Operations. The following subsections provide information regarding the Company s results of operations for the third quarter and first nine months of fiscal 2007 compared with the same fiscal 2006 periods.

Revenues. The following table contains information regarding the Company s revenues for the third quarter and first nine months of fiscal 2007 and 2006:

	Three Months Ended December 31,			Percent	Percent of Total Revenues	
(dollars in thousands)	2006	2005	Change	Change	2006 (1)	2005 (1)
Capital Revenues	$ 127,624	$ 124,857	$ 2,767	2.2%	42.7%	43.4%
Consumable Revenues	65,321	65,007	314	0.5%	21.8%	22.6%
Product Revenues	192,945	189,864	3,081	1.6%	64.5%	66.0%
Service Revenues	106,022	97,628	8,394	8.6%	35.5%	34.0%
Total Revenues	$ 298,967	$ 287,492	$ 11,475	4.0%	100.0%	100.0%
Service Revenues	$ 106,022	$ 97,628	$ 8,394	8.6%	35.5%	34.0%
Consumable Revenues	65,321	65,007	314	0.5%	21.8%	22.6%
Recurring Revenues	171,343	162,635	8,708	5.4%	57.3%	56.6%
Capital Revenues	127,624	124,857	2,767	2.2%	42.7%	43.4%
Total Revenues	$ 298,967	$ 287,492	$ 11,475	4.0%	100.0%	100.0%
United States	$ 227,792	$ 229,512	$ (1,720)	-0.7%	76.2%	79.8%
International	71,175	57,980	13,195	22.8%	23.8%	20.2%
Total Revenues	$ 298,967	$ 287,492	$ 11,475	4.0%	100.0%	100.0%

25

Table of Contents

(dollars in thousands)	Nine Months Ended December 31, 2006	2005	Change	Percent Change	Percent of Total Revenues 2006 (1)	2005 (1)
Capital Revenues	$ 342,781	$ 340,932	$ 1,849	0.5%	40.4%	41.1%
Consumable Revenues	195,298	192,924	2,374	1.2%	23.0%	23.3%
Product Revenues	538,079	533,856	4,223	0.8%	63.5%	64.4%
Service Revenues	309,491	295,155	14,336	4.9%	36.5%	35.6%
Total Revenues	$ 847,570	$ 829,011	$ 18,559	2.2%	100.0%	100.0%
Service Revenues	$ 309,491	$ 295,155	$ 14,336	4.9%	36.5%	35.6%
Consumable Revenues	195,298	192,924	2,374	1.2%	23.0%	23.3%
Recurring Revenues	504,789	488,079	16,710	3.4%	59.6%	58.9%
Capital Revenues	342,781	340,932	1,849	0.5%	40.4%	41.1%
Total Revenues	$ 847,570	$ 829,011	$ 18,559	2.2%	100.0%	100.0%
United States	$ 662,973	$ 669,380	$ (6,407)	-1.0%	78.2%	80.7%
International	184,597	159,631	24,966	15.6%	21.8%	19.3%
Total Revenues	$ 847,570	$ 829,011	$ 18,559	2.2%	100.0%	100.0%

(1) Certain percentages may not calculate precisely due to rounding.

Quarter over Quarter Comparison

Revenues increased $11.5 million, or 4.0%, to $299.0 million for the quarter ended December 31, 2006, as compared to $287.5 million for the comparable prior year quarter. As compared to the third quarter of fiscal 2006, recurring revenues increased 5.4%, driven primarily by an increase of 8.6% in service revenues, with consumable revenues remaining relatively flat. Capital revenues increased $2.8 million quarter over quarter as revenues increased internationally to more than offset a decline in the United States.

International revenues increased $13.2 million, or 22.8%, to $71.2 million, for the quarter ended December 31, 2006, as compared to $58.0 million for the comparable prior year quarter. International revenues were positively impacted by capital equipment revenues growth within both the Healthcare and Life Sciences segments with increases of 18.9% and 69.6%, respectively, over the comparable prior year quarter. Recurring revenues also grew within both the Healthcare and Life Sciences segments with increases of 6.1% and 32.1%, respectively, over the comparable prior year quarter.

United States revenues decreased $1.7 million, or 0.7%, to $227.8 million, for the quarter ended December 31, 2006, as compared to $229.5 million for the comparable prior year quarter. United States revenues were positively impacted by recurring revenue growth in all three business segments with increases of 3.9%, 2.4%, and 6.7% in the Healthcare, Life Sciences, and Isomedix segments, respectively. The strength in recurring revenues was more than offset by a decline in capital revenues of 8.1%, reflecting declines in both the Healthcare and Life Sciences segments.

Year over Year Comparison

Revenues increased $18.6 million, or 2.2%, to $847.6 million for the first nine months of fiscal 2007, as compared to $829.0 million for the same prior year period. As compared to the first nine months of fiscal 2006, recurring revenues increased 3.4%, reflecting growth in consumable revenues and service revenues, with increases of 1.2% and 4.9%, respectively. Capital revenues were relatively flat, with an increase of 0.5%.

International revenues for the first nine months of fiscal 2007 amounted to $184.6 million, an increase of $25.0 million, or 15.6%, as compared to the first nine months of fiscal 2006. Fiscal 2007 year-to-date international revenues were positively impacted by strong capital revenue growth within both the Healthcare and Life Sciences segments, with increases of 16.8% and 46.1%, respectively.

Table of Contents

United States revenues for the first nine months of fiscal 2007 amounted to $663.0 million, a decrease of $6.4 million, or 1.0%, as compared to the first nine months of fiscal 2006. Strong underlying demand for the Company s service offerings and consumable products was offset by a decline in capital revenues in both the Healthcare and Life Sciences segments.

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

Gross Profit. The following table contains information regarding the Company s gross profit for the three and nine months ended December 31, 2006 and 2005:

	Three Months Ended December 31,			Percent
(dollars in thousands)	2006	2005	Change	Change
Gross Profit:				
Product	$ 80,873	$ 80,205	$ 668	0.8%
Service	46,828	41,891	4,937	11.8%
Total Gross Profit	$ 127,701	$ 122,096	$ 5,605	4.6%
Gross Profit Percentage:				
Product	41.9%	42.2%		
Service	44.2%	42.9%		
Total Gross Profit Percentage	42.7%	42.5%		

	Nine Months Ended December 31,			Percent
	2006	2005	Change	Change
Gross Profit:				
Product	$ 224,367	$ 224,812	$ (445)	-0.2%
Service	135,470	126,043	9,427	7.5%
Total Gross Profit	$ 359,837	$ 350,855	$ 8,982	2.6%
Gross Profit Percentage:				
Product	41.7%	42.1%		
Service	43.8%	42.7%		
Total Gross Profit Percentage	42.5%	42.3%		

Gross profit (margin) is impacted by the volume, pricing, and mix of the Company s products and services, as well as, the costs associated with the products and services that are sold. Gross margin for the third quarter of fiscal 2007 amounted to 42.7%, representing an increase of 20 basis points as compared to the same prior year period. For the first nine months of fiscal 2007, gross margin amounted to 42.5%, representing an increase of 20 basis points as compared to the same prior year period. Gross margins for both fiscal 2007 periods were positively impacted by price increases, reductions in freight and distribution costs and operating efficiencies, which more than offset increases in the costs of labor and materials. Gross margins for the third quarter and first nine months of fiscal 2007 included $0.2 million and $0.9 million, respectively, in share-based compensation expense as a result of the adoption of SFAS No. 123R.

Table of Contents

Operating Expenses. The following table contains information regarding the Company s operating expenses for the three and nine months ended December 31, 2006 and 2005:

	Three Months Ended December 31,			Percent
(dollars in thousands)	2006	2005	Change	Change
Operating Expenses:				
Selling, General, and Administrative	$ 82,594	$ 74,316	$ 8,278	11.1%
Research and Development	8,078	8,726	(648)	-7.4%
Restructuring Expense	3,179		3,179	NM
Total Operating Expenses	$ 93,851	$ 83,042	$ 10,809	13.0%

	Nine Months Ended December 31,			Percent
	2006	2005	Change	Change
Operating Expenses:				
Selling, General, and Administrative	$ 243,789	$ 234,196	$ 9,593	4.1%
Research and Development	24,756	25,564	(808)	-3.2%
Restructuring Expense	5,442		5,442	NM
Total Operating Expenses	$ 273,987	$ 259,760	$ 14,227	5.5%

NM - Not Meaningful

Significant components of total selling, general, and administrative expenses (SG&A) are compensation and benefit costs, fees for professional services, travel and entertainment, facilities costs, and other general and administrative expenses. As a percentage of total revenues, SG&A increased 180 basis points to 27.6% for the third quarter of fiscal 2007 and increased 50 basis points to 28.8% for the first nine months of fiscal 2007, as compared to the same prior year periods. SG&A in both fiscal 2007 periods were negatively impacted primarily by share-based compensation expense, increased compensation and benefit costs, and increased travel-related expenses.

As a percentage of total revenues, research and development expenses were 2.7% and 2.9% for the three and nine month periods ended December 31, 2006, respectively, as compared to 3.0% and 3.1%, respectively, for the same prior year periods. For the three and nine month periods ended December 31, 2006, research and development expenses decreased 7.4% and 3.2% to $8.1 million and $24.8 million, respectively, as compared to $8.7 million and $25.6 million, respectively, during the same prior year periods. Research and development expenses are influenced by the number and timing of in-process projects and labor hours and other costs associated with these projects. The Company continues to focus research and development efforts on product development, product improvements, and the development of new technological innovations. Research and development efforts are concentrated in the defense and industrial areas, sterile processing combination technologies, and the area of prions, or infectious proteins.

SG&A and research and development expenses for the third quarter and first nine months of fiscal 2007 included $2.9 million and $8.0 million, respectively, in share-based compensation expense as a result of the adoption of SFAS No. 123R.

Operating expenses include restructuring expenses, which have been recognized as incurred during fiscal 2007, as required under the provisions of SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities. In addition, the property, plant and equipment associated with the restructuring actions were assessed for impairment under Statement of Financial Accounting Standards No. 144 (SFAS No. 144), Accounting for the Impairment or Disposal of Long-Lived Assets. Asset impairment and accelerated depreciation expenses primarily result from the reevaluation of the remaining useful lives of property, plant and equipment based on the transfer plans. The Company did not incur restructuring expenses in the third quarter or first nine months of fiscal 2006.

28

Table of Contents

During the third quarter of fiscal 2007, the Company recorded $1.6 million in restructuring expenses related to the closing of its Nanterre, France and Stockholm, Sweden sales offices and the rationalization of certain European support functions. The restructuring expenses predominately consist of severance and related benefits, with restructuring expenses of $1.4 million and $0.2 million related to the Healthcare and Life Sciences segments, respectively. The Company continues to evaluate its European operations for opportunities to enhance performance, but has not committed to any additional specific actions.

In the third quarter and first nine months of fiscal 2007, the Company recorded $3.0 million and $8.7 million, respectively, in expenses related to the transfer of its Erie, Pennsylvania manufacturing operations to Monterrey, Mexico. Included in these expenses are $1.7 million and $3.9 million classified as Fiscal 2006 Restructuring Plan expenses in the respective periods. These costs are associated with the Healthcare business segment. Since the inception of the Fiscal 2006 Restructuring Plan, the Company has incurred restructuring expenses of $29.1 million, with restructuring expenses of $28.7 million and $0.4 million related to the Healthcare and Life Sciences segments, respectively.

The Company anticipates incurring approximately an additional $6.0 million in restructuring expenses during the remainder of fiscal 2007 and fiscal 2008 in connection with the transfer of the manufacturing operations from Erie, Pennsylvania to Monterrey, Mexico, which is a lower amount than originally anticipated due to a reduction in estimated severance costs for the Erie facility. Restructuring expenses to be incurred include compensation and benefits, severance, accelerated depreciation and other expenses.

The following tables summarize the restructuring expenses the Company incurred for the third quarter and first nine months of fiscal 2007:

Three Months Ended December 31, 2006	**European Restructuring Plan**	**Fiscal 2006 Restructuring Plan**	**Total**
Severance, payroll and other related costs	$ 1,276	$ 739	$ 2,015
Lease termination costs	219		219
Asset impairment and accelerated depreciation	105	765	870
Other		75	75
Total restructuring charges	$ 1,600	$ 1,579	$ 3,179

Nine Months Ended December 31, 2006	**European Restructuring Plan**	**Fiscal 2006 Restructuring Plan**	**Total**
Severance, payroll and other related costs	$ 1,276	$ 1,717	$ 2,993
Lease termination costs	219		219
Asset impairment and accelerated depreciation	105	2,034	2,139
Other		91	91
Total restructuring charges	$ 1,600	$ 3,842	$ 5,442

Liabilities related to restructuring activities are recorded as current liabilities on the accompanying Consolidated Balance Sheets within Accrued expenses and other. The following tables summarize the Company s liabilities related to restructuring activities:

	Fiscal 2006 Restructuring Plan			
	March 31, 2006	**Fiscal 2007 Provision**	**Fiscal 2007 Payments**	**December 31, 2006**
Severance and termination benefits	$ 1,941	$ 1,448	$ (1,695)	$ 1,694
Lease termination obligation	135		(102)	33
Total	$ 2,076	$ 1,448	$ (1,797)	$ 1,727

29

Table of Contents

	March 31, 2006	European Restructuring Plan Fiscal 2007 Provision	Payments	December 31, 2006
Severance and termination benefits	$	$ 1,276	$ (236)	$ 1,040
Lease termination obligation		219		219
Fixed asset impairment		105		105
Total	$	$ 1,600	$ (236)	$ 1,364

Non-Operating Expense, Net. The following table contains information regarding the Company s non-operating (income) expense, net for the three and nine months ended December 31, 2006 and 2005:

(dollars in thousands)	Three Months Ended December 31, 2006	2005	Change
Non-Operating Expense, Net:			
Interest Expense	$ 1,714	$ 1,100	$ 614
Interest and Miscellaneous Income	(591)	(597)	6
Total Non-Operating Expense, Net	$ 1,123	$ 503	$ 620

	Nine Months Ended December 31, 2006	2005	Change
Non-Operating Expense, Net:			
Interest Expense	$ 5,859	$ 3,624	$ 2,235
Interest and Miscellaneous Income	(2,071)	(2,889)	818
Total Non-Operating Expense, Net	$ 3,788	$ 735	$ 3,053

Non-operating expense, net consists of interest expense on debt, offset by interest earned on cash, cash equivalents, short-term investment balances, and other miscellaneous income. Interest expense increased $0.6 million and $2.2 million during the third quarter and first nine months of fiscal 2007, respectively, as compared to the prior year periods as a result of higher average debt levels and higher average interest rates during both fiscal 2007 periods. Interest and miscellaneous income was relatively flat for the third quarter of fiscal 2007 as compared to the third quarter of fiscal 2006. For the first nine months of fiscal 2007, interest and miscellaneous income decreased $0.8 million. This reduction primarily reflects the first quarter fiscal 2006 settlement in the amount of $1.7 million in miscellaneous income due to the resolution of certain indemnification claims pursuant to the terms of the share purchase agreement with respect to Hamo, which was acquired by the Company in fiscal 2004, partially offset by interest earned on higher average cash balances in the first half of fiscal 2007.

Income Tax Expense. The following table contains information regarding the Company s income tax expense and effective income tax rates for the three and nine months ended December 31, 2006 and 2005:

(dollars in thousands)	Three Months Ended December 31, 2006	2005	Change	Percent Change
Income Tax Expense	$ 11,859	$ 15,386	$ (3,527)	-22.9%
Effective Income Tax Rate	36.2%	39.9%		

	Nine Months Ended December 31, 2006	2005	Change	Percent Change

Income Tax Expense	$ 30,773	$ 34,859	$ (4,086)	-11.7%
Effective Income Tax Rate	37.5%	38.6%		

Table of Contents

Income tax expense includes United States federal, state and local, and foreign income taxes, and is based on reported pre-tax income. The effective income tax rates for continuing operations for the three and nine month periods ended December 31, 2006 were 36.2% and 37.5%, respectively, as compared to 39.9% and 38.6%, respectively, for the same prior year periods. The lower effective income tax rate for the three and nine month periods ended December 31, 2006 resulted principally from discrete item adjustments to recognize additional deferred tax assets related to foreign tax credits.

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

Business Segment Results of Operations. Segment results for the three and nine months ended December 31, 2005 exclude the freeze dryer product line, which was sold in October 2005, and reflect the reallocation of corporate overhead charges to all business segments. Information presented in the following tables and related discussion regarding segment revenues and operating results reflect these changes.

The Company operates and reports in three business segments: Healthcare, Life Sciences, and STERIS Isomedix Services. Additional information regarding the Company s business segments is included in the Company s Annual Report on Form 10-K for the year ended March 31, 2006, filed with the SEC on June 12, 2006. The following table contains information regarding business segment revenues for the three and nine months ended December 31, 2006 and 2005:

	Three Months Ended December 31,			Percent
(dollars in thousands)	2006	2005	Change	Change
Revenues:				
Healthcare	$ 209,807	$ 203,668	$ 6,139	3.0%
Life Sciences	56,062	52,671	3,391	6.4%
STERIS Isomedix Services	33,098	31,153	1,945	6.2%
Total Revenues	$ 298,967	$ 287,492	$ 11,475	4.0%

	Nine Months Ended December 31,			Percent
	2006	2005	Change	Change
Revenues:				
Healthcare	$ 594,032	$ 583,420	$ 10,612	1.8%
Life Sciences	154,394	149,932	4,462	3.0%
STERIS Isomedix Services	99,144	95,659	3,485	3.6%
Total Revenues	$ 847,570	$ 829,011	$ 18,559	2.2%

Healthcare Segment

Healthcare segment revenues represented 70.2% of total Company revenues for the third quarter of fiscal 2007 compared with 70.8% for the same prior year period. Healthcare revenues increased $6.1 million, or 3.0%, to $209.8 million for the quarter ended December 31, 2006, compared with $203.7 million for the third quarter of fiscal 2006. The increase in Healthcare revenues was driven by strong international capital revenues and a 10.5% increase in global service revenues. Tempering the Healthcare segment s revenue growth was a decline in consumable revenues of 1.2% and a decline in United States capital revenues of 3.4% as a result of soft demand levels in North America. At December 31, 2006, the Healthcare segment s backlog amounted to $88.1 million, representing an increase of $5.9 million, or 6.8%, compared to the September 30, 2006 level and an increase of $15.5 million, or 21.3%, compared to the December 31, 2005 level.

Healthcare segment revenues represented 70.1% of total Company revenues for the first nine months of fiscal 2007 compared with 70.4% for the same prior year period. Healthcare revenues increased $10.6 million, or 1.8%, to $594.0 million for the nine months ended December 31, 2006, as compared to $583.4 million for the same prior year period. The increase is attributable to service revenue growth of 6.6% globally, with growth of 5.5% within the United States and 12.8% internationally.

Life Sciences Segment

Life Sciences segment revenues represented 18.8% of total Company revenues for the third quarter of fiscal 2007 as compared to 18.3% for the comparable prior year quarter. Life Sciences revenues increased $3.4 million, or 6.4%, to $56.1 million for the quarter ended December 31, 2006, as compared to $52.7 million for the third quarter of fiscal 2006. The increase in Life Sciences revenues was driven by increases in capital revenues, consumable revenues, and service revenues of 4.6%, 8.8%, and 7.5%, respectively. Capital revenues reflect substantial increases in the Canadian and European markets. This growth was partially offset by a decline in the United States market, resulting from a competitive environment in the United States research equipment business. The growth in consumable revenues reflects increases of 5.0% and 34.0% in the United States and European markets, respectively. The increase in service revenues is primarily attributable to increases in the European and Asian markets. At December 31, 2006, the Life Sciences segment s backlog amounted to $44.9 million, increasing $0.6 million, or 1.4%, compared to the backlog of $44.3 million at September 30, 2006 and decreasing $1.2 million, or 2.7%, compared to the December 31, 2005 level.

Life Sciences segment revenues represented 18.2% of total Company revenues for the first nine months of fiscal 2007 as compared to 18.1% for the comparable prior year period. Life Sciences revenues increased $4.5 million, or 3.0%, to $154.4 million for the first nine months of fiscal 2007, as compared to $149.9 million for the same prior year period. The increase in Life Sciences revenues was driven by a 5.4% increase in recurring revenues. Overall, Life Sciences capital revenues were flat, primarily due to the competitive environment in the United States research equipment business.

STERIS Isomedix Services Segment

STERIS Isomedix Services segment revenues represented 11.1% of total Company revenues for the third quarter of fiscal 2007 as compared to 10.8% for the comparable prior year quarter. The segment s revenues increased $1.9 million, or 6.2%, to $33.1 million during the third quarter of fiscal 2007, as compared to $31.2 million during the comparable prior year quarter. The increase in Isomedix revenues resulted from increased demand from medical device customers and routine price increases.

STERIS Isomedix Services segment revenues represented 11.7% of total Company revenues for the first nine months of fiscal 2007 as compared to 11.5% for the comparable prior year period. The segment experienced revenue growth of $3.4 million, or 3.6%, to $99.1 million during the first nine months of fiscal 2007 as compared to $95.7 million for the same prior year period. The increase in revenues was primarily driven by increased demand from medical device customers and routine price increases.

The following table contains information regarding business segment operating income (loss) for the three and nine months ended December 31, 2006 and 2005:

	Three Months Ended December 31,			Percent
(dollars in thousands)	**2006**	**2005**	**Change**	**Change**
Operating Income (Loss):				
Healthcare	$ 25,598	$ 33,059	$ (7,461)	-22.6%
Life Sciences	2,534	746	1,788	239.7%
STERIS Isomedix Services	5,718	5,249	469	8.9%
Total Operating Income	$ 33,850	$ 39,054	$ (5,204)	-13.3%

Table of Contents

	Nine Months Ended December 31,			Percent
(dollars in thousands)	2006	2005	Change	Change
Operating Income (Loss):				
Healthcare	$ 67,142	$ 77,608	$ (10,466)	-13.5%
Life Sciences	1,496	(2,807)	4,303	NM
STERIS Isomedix Services	17,212	16,294	918	5.6%
Total Operating Income	$ 85,850	$ 91,095	$ (5,245)	-5.8%

NM - Not meaningful

To determine segment operating income (loss), the Company reduces the respective segment s gross profit by direct expenses and indirect cost allocations, which reflect the full allocation of all distribution, corporate, and research and development expenses. Corporate cost allocations are based on each segment s portion of revenues, headcount, or other variables in relation to the total Company.

Healthcare Segment

Healthcare segment operating income decreased $7.5 million and $10.5 million for the third quarter and first nine months of fiscal 2007, respectively, as compared to the same prior year periods. The segment s operating margins were 12.2% and 11.3% for the third quarter and first nine months of fiscal 2007, respectively, representing decreases of 400 basis points and 200 basis points, respectively, as compared to the same prior year periods. Operating margins for the third quarter and first nine months of fiscal 2007 were impacted by increased material costs, expenses associated with the transfer of manufacturing operations from Erie, Pennsylvania to Monterrey, Mexico of $3.0 million and $8.7 million, respectively, including $1.7 million and $3.9 million classified as restructuring, respectively, and expenses of $1.4 million associated with the European Restructuring Plan. The Healthcare segment also incurred share-based compensation expense of $2.2 million and $6.0 million, respectively, during the third quarter and first nine months of fiscal 2007, as a result of the adoption of SFAS No. 123R.

Life Sciences Segment

Life Sciences segment had operating income of $2.5 million and $1.5 million for the third quarter and first nine months of fiscal 2007, respectively, as compared to operating income of $0.7 million and an operating loss of $2.8 million for the same prior year periods. The improvement in operating performance reflects higher gross margins resulting from a shift in revenue mix, higher volumes, and productivity enhancements. Results also reflect improved leverage of operating expenses offset by share-based compensation expense of $0.6 million and $1.8 million in the third quarter and first nine months of fiscal 2007, respectively, as a result of the adoption of SFAS No. 123R.

STERIS Isomedix Services Segment

STERIS Isomedix Services segment operating income increased $0.5 million and $0.9 million for the third quarter and first nine months of fiscal 2007, respectively, as compared to the same prior year periods. The segment s operating margins were 17.3% and 17.4% for the third quarter and first nine months of fiscal 2007, respectively, representing increases of 50 basis points and 40 basis points, respectively, over the comparable prior year periods. The segment s margins reflect pricing and volumes on a relatively fixed cost base. Operating results for the third quarter and first nine months of fiscal 2007 included share-based compensation expense of $0.3 million and $1.1 million, respectively, as a result of the adoption of SFAS No. 123R.

Table of Contents

Liquidity and Capital Resources. The following table summarizes significant components of the Company s cash flows for the nine months ended December 31, 2006 and 2005:

Cash Flows

(dollars in thousands)	Nine Months Ended December 31, 2006	Nine Months Ended December 31, 2005
Operating activities:		
Net income	$ 52,347	$ 61,835
Gain on the sale of discontinued operations, net of tax	(1,058)	(5,225)
Loss on the sale of property, plant and equipment	742	
Non-cash items	45,508	35,151
Changes in assets and liabilities of discontinued operations		10,441
Changes in operating assets and liabilities, excluding the effects of business acquisitions	(56,168)	(2,835)
Net cash provided by operating activities	$ 41,371	$ 99,367
Investing activities:		
Purchases of property, plant, equipment, and intangibles, net	$ (33,066)	$ (34,282)
Investments in businesses, net of cash acquired		(1,504)
Proceeds from the sale of property, plant and equipment	2,577	
Proceeds from the sale of discontinued operations	2,927	22,111
Net cash used in investing activities	$ (27,562)	$ (13,675)
Financing activities:		
Proceeds under credit facilities, net	$ 11,440	$ 1,720
Payments on long-term obligations and capital leases, net	(1,436)	(3,380)
Repurchases of common shares	(59,628)	(64,326)
Cash dividends paid to common shareholders	(8,508)	(8,229)
Deferred financing fees		(217)
Stock option and other equity transactions, net	8,186	10,385
Net cash used in financing activities	$ (49,946)	$ (64,047)
Debt-to-captial ratio	14.5%	12.7%