

BIOMET INC  
Form 10-Q  
June 04, 2007  
Table of Contents

---

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

---

**FORM 10-Q**

---

(Mark One)

**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the quarterly period ended February 28, 2007

OR

**Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 0-12515

---

**BIOMET, INC.**

(Exact name of registrant as specified in its charter)

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

**35-1418342**  
(I.R.S. Employer I.D. No.)

**56 East Bell Drive Warsaw, Indiana**  
(Address of principal executive offices)

**46582**  
(Zip Code)

**(574) 267-6639**

Edgar Filing: BIOMET INC - Form 10-Q

(Registrant's telephone number, including area code)

**Not Applicable**

(Former name, former address and former fiscal year, if changed since last report)

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  No

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

Large accelerated filer  Accelerated filer  Non-Accelerated filer

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

As of February 28, 2007, the registrant had 245,491,635 common shares outstanding.

---

**Table of Contents**

**EXPLANATORY NOTE**

As described in further detail below, Biomet, Inc. ( *Biomet* or the *Company* ) has amended its annual report on Form 10-K for the fiscal year ended May 31, 2006 and quarterly report on Form 10-Q for the fiscal period ended August 31, 2006. The Company has not amended and does not intend to amend any of its previously filed annual reports on Form 10-K or quarterly reports on Form 10-Q for the periods affected by the restatement other than the Company's quarterly report on Form 10-Q for the fiscal period ended August 31, 2006 and the Company's annual report on Form 10-K for the fiscal year ended May 31, 2006. This quarterly report on Form 10-Q for the fiscal period ended February 28, 2007 supersedes in its entirety the Company's preliminary results furnished in Exhibit 99.1 to the Company's current report on Form 8-K filed with the Securities and Exchange Commission (the *SEC* ) on April 23, 2007 (the *Preliminary Results* ). Accordingly, the Preliminary Results should not be relied upon.

For a discussion of the restatement to the previously furnished preliminary results see Note 2 (Restatement of Previously Furnished Preliminary Financial Statements).

Following the publication of an analyst report suggesting that certain historical grants of stock options by the Company took place on dates where Biomet's stock price was trading at relatively low prices and the filing of two shareholder derivative lawsuits alleging improper backdating of stock options, the Company's Board of Directors (the *Board* ) formed a special committee (the *Special Committee* ) to conduct an independent investigation of the Company's stock option grants for the period from March 1996 to May 2006 and to determine whether the Company had any claims arising out of any inappropriate stock option backdating and, if so, whether it was in the best interest of the Company and its stakeholders to pursue any such claim. The Special Committee retained independent counsel to advise it in connection with and to conduct its investigation. Counsel to the Special Committee also hired independent accountants to assist in the investigation.

On December 18, 2006 and March 30, 2007, the Company announced preliminary reports from the Special Committee presented by counsel to the Special Committee and the independent accountants retained by counsel to the Special Committee. On May 25, 2007, the Board received and discussed the updated findings contained in the Special Committee's final report. The Special Committee's review did not cover any periods subsequent to May 31, 2006. As a result, stock option awards granted during the Company's nine-month period ended February 28, 2007 were not examined by the Special Committee.

This quarterly report on Form 10-Q should be read in conjunction with the Company's other filings with the SEC, such as the Company's current reports on Form 8-K, the Company's amended annual report on Form 10-K/A for the fiscal year ended May 31, 2006, the Company's amended quarterly report on Form 10-Q/A for the period ended August 31, 2006 and the Company's definitive proxy statement on Schedule 14A filed with the SEC on April 24, 2007, and any amendments to these filings.

**Amended Annual Report on Form 10-K/A**

On May 29, 2007 the Company filed with the SEC an amended annual report on Form 10-K/A for its fiscal year ended May 31, 2006 which contains additional information concerning the Special Committee's investigation and the impact of the Special Committee's findings on certain of the Company's historical financial statements. For further information concerning the Special Committee's investigation and the impact of the Special Committee's findings on certain of the Company's historical financial statements see the Company's amended annual report on Form 10-K/A for the fiscal year ended May 31, 2006 filed with the SEC on May 29, 2007.

**Table of Contents****FORWARD-LOOKING STATEMENTS**

*This report contains forward-looking statements within the meaning of federal securities laws. Those statements are often indicated by the use of words such as will, intend, anticipate, estimate, expect, plan and similar expressions, and include, but are not limited to, statements related to the timing and number of planned new product introductions; the effect of anticipated changes in the size, health and activities of population on demand for the Company's products; assumptions and estimates regarding the size and growth of certain market segments; the Company's ability and intent to expand in key international markets; the timing and anticipated outcome of clinical studies; assumptions concerning anticipated product developments and emerging technologies; the future availability of raw materials; the anticipated adequacy of the Company's capital resources to meet the needs of its business; the Company's continued investment in new products and technologies; the ultimate marketability of products currently being developed; the ability to successfully implement new technologies; future declarations of cash dividends; the Company's ability to sustain sales and earnings growth; the Company's goals for sales and earnings growth; the future value of the Company's common stock; the ultimate effect of the Company's share repurchase programs; the Company's success in achieving timely approval or clearance of its products with domestic and foreign regulatory entities; the stability of certain foreign economic markets; the impact of anticipated changes in the musculoskeletal industry and the ability of the Company to react to and capitalize on those changes; the ability of the Company to successfully implement its desired organizational changes; the impact of the Company's managerial changes; the Company's inability to satisfy the conditions to closing the proposed merger with the private equity consortium (including obtaining shareholder approval) and the costs and consequences of not closing the merger; the effect of the pending merger with the private equity consortium on the Company's business and its relationship with customers, distributors, employees and suppliers; the results and related outcomes of the review by the Special Committee, including: the impact of the restatement of the Company's financial statements or other actions that may be taken or required as a result of the Special Committee's review including the restatement of the Company's financial statements announced on March 30, 2007; the impact of the inability of the Company to timely file reports with the Securities and Exchange Commission and distribute such reports or statements to its shareholders; the impact of any tax consequences, including any determination that Biomet's filed tax returns were not true, correct and complete; the impact of any determination that some of the Company's options may not have been validly issued under the stock option plans; the impact of the determination that certain of Biomet's financial statements were not prepared in accordance with GAAP and/or the required reporting under the applicable securities rules and regulations; developments related to the Company's internal controls over financial reporting disclosure controls and procedures; and the impact of any determination that some of Biomet's insurance policies may not be in full force and effect and/or that Biomet may not be in compliance with the terms and conditions of the policies; litigation and governmental investigations or proceedings which may arise out of Biomet's stock option granting practices or the restatement of Biomet's financial statements; and the inability to meet NASDAQ requirements for continued listing. Readers of this report are cautioned that reliance on any forward-looking statement involves risks and uncertainties. Although the Company believes that the assumptions on which the forward-looking statements contained herein are based are reasonable, any of those assumptions could prove to be inaccurate given the inherent uncertainties as to the occurrence or nonoccurrence of future events. Any of the assumptions on which forward-looking statements were made could be inaccurate given the inherent uncertainties on which these forward-looking statements were made. There can be no assurance as to the accuracy of forward-looking statements contained in this report. The inclusion of a forward-looking statement herein should not be regarded as a representation by the Company that the Company's objectives will be achieved. Readers of this report should carefully read the factors set forth under Part II, Item 1A Risk Factors of this report and Part I, Item 1A Risk Factors of the Company's amended annual report on Form 10-K/A for the fiscal year ended May 31, 2006 filed with the SEC on May 29, 2007 for a description of certain risks that could, among other things, cause actual results to differ from those contained in forward-looking statements made in this report and presented elsewhere by management from time to time. Such factors, among others, may have a material adverse effect upon the Company's business, financial condition and results of operations. The Company undertakes no obligation to update publicly or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Accordingly, the reader is cautioned not to place undue reliance on forward-looking statements which speak only as of the date on which they were made.*

---

**Table of Contents**

**QUARTERLY REPORT FOR THE PERIOD**

**ENDED FEBRUARY 28, 2007**

	<b>Page</b>
Part I. <u>Financial Information</u>	
Item 1. <u>Financial Statements:</u>	
<u>Consolidated Balance Sheets</u>	1
<u>Consolidated Statements of Income</u>	2
<u>Consolidated Statements of Cash Flows</u>	3
<u>Notes to Consolidated Financial Statements</u>	4
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	20
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risks</u>	22
Item 4. <u>Controls and Procedures</u>	23
Part II. <u>Other Information</u>	
Item 1. <u>Legal Proceedings</u>	24
Item 1A. <u>Risk Factors</u>	24
Item 2. <u>Unregistered Sale of Equity Securities and Use of Proceeds</u>	25
Item 6. <u>Exhibits</u>	25
<u>Signatures</u>	26
<u>Index to Exhibits</u>	27

**Table of Contents****Part I. Financial Information****Item 1. Financial Statements****BIOMET, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

at February 28, 2007 and May 31, 2006

(in thousands)

	February 28, 2007 As Restated(1) (Unaudited)	May 31, 2006 As Restated(1)
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 128,507	\$ 160,963
Investments	5,527	6,380
Accounts and notes receivable, net	544,801	507,883
Inventories	550,731	534,515
Refundable income taxes	18,474	16,880
Deferred income taxes	77,430	75,190
Prepaid expenses and other	47,072	32,342
Total current assets	1,372,542	1,334,153
Property, plant and equipment, at cost	734,348	655,432
Less, Accumulated depreciation	341,451	297,800
Property, plant and equipment, net	392,897	357,632
Investments	56,489	58,128
Goodwill	443,491	441,397
Intangible assets, net	75,969	79,498
Other assets	16,326	11,839
Total assets	\$ 2,357,714	\$ 2,282,647
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Current liabilities:		
Short-term borrowings	\$ 100,316	\$ 276,561
Accounts payable	52,323	62,276
Accrued wages and commissions	82,038	84,665
Other accrued expenses	111,194	111,960
Total current liabilities	345,871	535,462
Long-term liabilities:		
Deferred income taxes	28,241	26,991

Edgar Filing: BIOMET INC - Form 10-Q

Total liabilities	374,112	562,453
<b>Contingencies (Note 8)</b>		
Shareholders' equity:		
Common shares	223,603	206,633
Additional paid-in capital	128,025	116,528
Retained earnings	1,593,218	1,379,303
Accumulated other comprehensive income	38,756	17,730
<b>Total shareholders' equity</b>	<b>1,983,602</b>	<b>1,720,194</b>
Total liabilities and shareholders' equity	\$ 2,357,714	\$ 2,282,647

(1) See Note 2 (Restatement of Previously Furnished Preliminary Financial Statements) in the notes to the consolidated financial statements. The accompanying notes are a part of the consolidated financial statements.

**Table of Contents****BIOMET, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME**

for the nine-and three-months ended February 28, 2007 and 2006

(Unaudited, in thousands, except per share data)

	Nine-Months Ended February 28,		Three-Months Ended February 28,	
	2007 As Restated(1)	2006 As Restated(1)	2007 As Restated(1)	2006 As Restated(1)
Net Sales	\$ 1,558,021	\$ 1,485,847	\$ 529,530	\$ 506,254
Cost of sales	453,735	417,463	163,759	143,158
Gross profit	1,104,286	1,068,384	365,771	363,096
Selling, general and administrative expenses	598,077	546,827	217,601	185,805
Research and development expense	71,080	63,775	23,890	21,256
Operating income	435,129	457,782	124,280	156,035
Other income, net	8,286	2,283	4,429	2,165
Income before income taxes	443,415	460,066	128,709	158,200
Provision for income taxes	149,013	154,525	43,454	52,820
Net income	\$ 294,402	\$ 305,541	\$ 85,255	\$ 105,380
Earnings per share:				
Basic	\$ 1.20	\$ 1.23	\$ 0.35	\$ 0.42
Diluted	\$ 1.20	\$ 1.23	\$ 0.35	\$ 0.42
Shares used in the computation of earnings per share:				
Basic	245,113	248,270	245,390	246,859
Diluted	245,113	249,202	245,390	247,772
Cash dividends per common share	\$ 0.30	\$ 0.25	\$	\$

(1) See Note 2 (Restatement of Previously Furnished Preliminary Financial Statements) in the notes to the consolidated financial statements. The accompanying notes are a part of the consolidated financial statements.



**Table of Contents**

**BIOMET, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**for the nine-months ended February 28, 2007 and 2006**  
**(Unaudited, in thousands)**

	<b>2007</b>	<b>2006</b>
	<b>As Restated(1)</b>	<b>As Restated(1)</b>
<b>Cash flows from (used in) operating activities:</b>		
Net income	\$ 294,402	\$ 305,541
<b>Adjustments to reconcile net income to net cash from operating activities:</b>		
Depreciation	63,604	51,062
Amortization	5,713	8,044
Share-based expense	11,390	1,500
Loss (Gain) on sale of investments, net	(921)	1,166
Deferred income taxes	(1,706)	(4,965)
Tax benefit from exercise of stock options	(2,061)	(3,065)
<b>Changes in current assets and liabilities:</b>		
Accounts and notes receivable, net	(32,003)	(29,654)
Inventories	(8,774)	(66,287)
Accounts payable	(6,633)	4,430
Accrued income taxes	(5,411)	(156)
Other	(23,245)	10,322
<b>Net cash provided by operating activities</b>	<b>294,355</b>	<b>277,938</b>
<b>Cash flows from (used in) investing activities:</b>		
Proceeds from sales and maturities of investments	17,067	48,209
Purchases of investments	(10,192)	(41,679)
Capital expenditures	(89,034)	(75,259)
Other	(5,660)	305
<b>Net cash used in investing activities</b>	<b>(87,819)</b>	<b>(68,424)</b>
<b>Cash flows from (used in) financing activities:</b>		
Decrease in short-term borrowings, net	(177,233)	(4,680)
Issuance of common shares	17,146	12,598
Cash dividends	(73,526)	(62,473)
Purchase of common shares	(7,268)	(159,122)
Tax benefit from exercise of stock options	2,061	
<b>Net cash used in financing activities</b>	<b>(238,820)</b>	<b>(213,677)</b>
Effect of exchange rate changes on cash	(172)	2,000
Decrease in cash and cash equivalents	(32,456)	(2,163)
Cash and cash equivalents, beginning of year	160,963	104,706
<b>Cash and cash equivalents, end of period</b>	<b>\$ 128,507</b>	<b>\$ 102,543</b>

## Edgar Filing: BIOMET INC - Form 10-Q

- (1) See Note 2 (Restatement of Previously Furnished Preliminary Financial Statements) in the notes to the consolidated financial statements. The accompanying notes are a part of the consolidated financial statements.

**Table of Contents****BIOMET, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****Note 1: Basis of Presentation.**

The accompanying consolidated financial statements include the accounts of Biomet, Inc. and its subsidiaries (individually and collectively referred to as "Biomet" or the "Company"). The unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included.

Operating results for the nine-month period ended February 28, 2007 are not necessarily indicative of the results that may be expected for the fiscal year ending May 31, 2007. For further information, refer to the consolidated financial statements and notes thereto included in the Company's amended annual report on Form 10-K/A for the fiscal year ended May 31, 2006.

The accompanying consolidated balance sheet at May 31, 2006, has been derived from the audited Consolidated Financial Statements at that date, but does not include all disclosures required by accounting principles generally accepted in the United States.

The Company operates in one business segment, musculoskeletal products, which includes the designing, manufacturing and marketing of reconstructive products, fixation devices, spinal products and other products. Other products consist primarily of softgoods and bracing products produced by EBI L.P., now operating as Biomet Trauma & Biomet Spine ("BTBS"), Biomet sports medicine's arthroscopy products, general instruments and operating room supplies. The Company manages its business segment primarily on a geographic basis. These geographic markets are comprised of the United States, Europe and the Rest of World. Major markets included in the Rest of World geographic market are Canada, South America, Mexico, Japan and the Pacific Rim.

Net sales of musculoskeletal products by product category and geographic segment are as follows for the nine- and three-month periods ended February 28, 2007 and 2006:

	Nine-Months Ended February 28, 2007		Three-Months Ended February 28, 2006	
	(in thousands)			
Net Sales by Product Category:				
Reconstructive Products	\$ 1,100,984	\$ 1,006,764	\$ 381,169	\$ 346,610
Fixation Devices	174,326	187,192	54,645	62,338
Spinal Products	154,036	164,267	51,253	53,914
Other Products	128,675	127,624	42,463	43,392
Total	\$ 1,558,021	\$ 1,485,847	\$ 529,530	\$ 506,254

	Nine-Months Ended February 28, 2007		Three-Months Ended February 28, 2006	
	(in thousands)			
Net Sales by Geographic Segment:				
United States	\$ 980,285	\$ 975,604	\$ 321,312	\$ 332,677
Europe	429,777	371,654	157,850	123,484
Rest of World	147,959	138,589	50,368	50,093

Edgar Filing: BIOMET INC - Form 10-Q

Total	\$ 1,558,021	\$ 1,485,847	\$ 529,530	\$ 506,254
-------	--------------	--------------	------------	------------

Table of Contents**BIOMET, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

	Nine-Months Ended February 28,		Three-Months Ended February 28,	
	2007 As Restated	2006 As Restated	2007 As Restated	2006 As Restated
(in thousands)				
<b>Operating Income by Geographic Segment:</b>				
United States	\$ 362,053	\$ 397,290	\$ 95,348	\$ 135,326
Europe	60,381	55,486	25,592	18,637
Rest of World	12,695	5,006	3,340	2,072
<b>Total</b>	<b>\$ 435,129</b>	<b>\$ 457,782</b>	<b>\$ 124,280</b>	<b>\$ 156,035</b>

The Company adopted SFAS No. 123(R), Share-Based Payment, ( SFAS 123(R) ) on June 1, 2006 using the modified prospective method. SFAS 123(R) requires all share-based payments to employees, including stock options, to be expensed based on their fair value over the required award service period. The Company uses the straight line method to recognize compensation expense related to share based payments. In the prior year, the Company followed Accounting Principles Board No. 25, Accounting for Stock Issued to Employees, in accounting for its stock option awards to employees and recorded share-based compensation expense for awards that were issued at strike prices less than fair value at date of grant. See Note 2 (Restatement of Previously Furnished Preliminary Financial Statements) in the notes to the consolidated financial statements. For the Company's non-employee distributors, share-based expense will continue to be recorded in accordance with Emerging Issues Task Force No. 96-18, Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquisition, or in Conjunction with Selling, Goods or Services.

Under the modified prospective method, the provisions of SFAS 123(R) apply to all share-based compensation awards granted or modified on or after the Company's date of adoption of SFAS 123(R), June 1, 2006. Prior period results are not restated under the modified prospective method. For share-based compensation awards granted prior to the date of adoption, the unrecognized expense related to the unvested portion at the date of adoption will be recognized in net income under the grant date fair value provisions under SFAS 123. The Company uses the Black-Scholes option-pricing model to determine the fair value of its employee stock options. Total compensation expense, as restated, recognized for the nine-month period ended February 28, 2007 was \$10,908,000 offset by \$2,709,000 of tax benefit, which is \$0.03 per share. Compensation expense, as restated, recognized in the three-month period ended February 28, 2007 was \$3,869,000 offset by \$819,000 of tax benefit, which is \$0.01 per share. The amount of pre-tax compensation cost related to nonvested stock options not yet recognized was \$109.8 million at February 28, 2007, which is expected to be amortized through 2015.

**Table of Contents****BIOMET, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

If compensation expense for the Company's employee stock options had been determined based on the fair value method of accounting, pro forma net income and earnings per share for the three- and nine-months ended February 28, 2006 would have been as follows:

	Nine-Months Ended			Three-Months Ended		
	As Reported	Adjustments	As Restated	As Reported	Adjustments	As Restated
Net income as reported (in thousands)	\$ 307,642	\$ (2,101)	\$ 305,541	\$ 106,065	\$ (685)	\$ 105,380
Total share-based compensation expense included in the determination of net income (in thousands)		1,207	1,207		397	397
Deduct: Total share-based employee compensation expense determined under the fair value method for all awards, net of related tax effects (in thousands)	(6,812)	(530)	(7,342)	(2,362)	(129)	(2,491)
Pro forma net income (in thousands)	\$ 300,830	\$ (1,424)	\$ 299,406	\$ 103,703	\$ (417)	\$ 103,286
<b>Earnings per share:</b>						
Basic, as reported	\$ 1.24	\$ (0.01)	\$ 1.23	\$ 0.43	\$ (0.01)	\$ 0.42
Basic, pro forma	\$ 1.21	\$ (0.01)	\$ 1.20	\$ 0.42	\$ (0.00)	\$ 0.42
Diluted, as reported	\$ 1.24	\$ (0.01)	\$ 1.23	\$ 0.43	\$ (0.01)	\$ 0.42
Diluted, pro forma	\$ 1.21	\$ (0.01)	\$ 1.20	\$ 0.42	\$ (0.00)	\$ 0.42

The Company uses the Black-Scholes option-pricing model to determine the fair value of options. For stock options granted during the nine-month period ended February 28, 2007, expected volatility was derived based on historical volatility of the Company's common stock. The expected term of the stock option was derived from historical employee exercise behavior. The risk-free interest rate is determined using the implied yield currently available for zero-coupon U.S. Government issues with a remaining term equal to the expected life of the options. A dividend yield is derived based on the historical dividend yield of the Company's common stock.

The weighted-average fair value of the options granted in the nine-month periods ended February 28, 2007 and 2006 were \$11.37 and \$13.85 per option, respectively, determined using the following assumptions: (1) expected life of option of 5.41 and 5.42 years; (2) dividend yield of 0.90% and 0.72%; (3) expected volatility of 32% and 32%; and (4) risk-free interest rate of 4.56% and 5.21%, respectively. The total intrinsic value of stock options exercised during the nine-month periods ended February 28, 2007 and 2006 were \$8.5 million and \$10.9 million, respectively. The following table summarizes stock option activity for the nine-month period ended February 28, 2007:

	Stock Options	Weighted Average Exercise Price
Outstanding, June 1, 2006	9,162,956	\$ 33.84
Granted	2,820,376	33.37
Exercised	(737,524)	25.31
Terminated	(1,068,671)	34.77
Outstanding, February 28, 2007	10,177,137	\$ 34.28

Table of Contents**BIOMET, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table summarizes information about outstanding stock options as of February 28, 2007, that are vested and those that are expected to vest, and that are currently exercisable:

	<b>Outstanding Stock Options</b>	<b>Options</b>
	<b>Already Vested and</b>	<b>that are</b>
	<b>Expected to Vest</b>	<b>Exercisable</b>
Number of outstanding options	8,391,000	2,119,000
Weighted average remaining contractual life	7.2 years	1 year
Weighted average exercise price per share	\$ 34.28	\$ 33.64
Intrinsic value	\$ 67,548,000	\$ 18,415,000

**Note 2: Restatement of Previously Furnished Preliminary Financial Statements.**

In accordance with FASB Statement No. 154, Accounting Changes and Error Corrections, the consolidated statements of income for the three- and nine-months ended February 28, 2007 and 2006, the consolidated statement of cash flows for the nine-months ended February 28, 2007 and 2006, and the consolidated balance sheets at February 28, 2007 and May 31, 2006 have been restated for certain errors related to the measurement of share-based compensation expense, distributor stock option expense and related payroll and withholding taxes, penalties and interest. The consolidated three- and nine-month statements of income, and nine-month statement of cash flows reflected herein for the periods ended February 28, 2007 and the consolidated balance sheet at February 28, 2007 supersede in their entirety the Company's preliminary results furnished in Exhibit 99.1 to the Company's current report on Form 8-K filed with the Securities and Exchange Commission on April 23, 2007 (the *Preliminary Results*). The restatement of amounts as of May 31, 2006 and the period ended February 28, 2006 were previously reported in the Company's form 10K/A filed on May 29, 2007. In addition to this Note 2 (Restatement of Previously Furnished Preliminary Financial Statements), Notes 1 (Basis of Presentation), 3 (Comprehensive Income), 8 (Contingencies) and 9 (Subsequent Events) have been revised in connection with the restatement of Preliminary Results.

The Company's decision to restate its financial results described in the Company's amended annual report on Form 10-K/A was based on the results of an independent investigation of the Company's stock option grants for the period from March 1996 through May 2006 by a special committee (the *Special Committee*) formed by the Company's Board of Directors (the *Board*) following the publication of an analyst report suggesting that certain historical stock option grants took place on dates where the Company's stock price was trading at relatively low prices and the filing of two shareholder derivative lawsuits alleging improper backdating of stock options. The Special Committee retained independent counsel to advise it in connection with and to conduct its investigation. Counsel to the Special Committee also hired independent accountants to assist in the investigation.

During the period from March 1996 to May 2006, the Company granted stock option awards to purchase approximately 17,000,000 Biomet common shares. The Special Committee's review did not cover any periods subsequent to May 31, 2006. As a result, stock option awards granted during the nine-months ended February 28, 2007 were not examined by the Special Committee.

In light of the Special Committee's findings relating to the Company's historical stock option practices over the 11-year period ending May 31, 2006, the Company performed a review of stock option awards granted during the nine-months ended February 28, 2007. During the nine-month period ended February 28, 2007, the Company granted stock option awards to purchase approximately 2.8 million Biomet common shares, including stock option awards to purchase 33,000 Biomet common shares with exercise prices which did not equal the fair

**Table of Contents**

**BIOMET, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

market value of the Company's common shares on the measurement date applicable to the award. The total intrinsic value of these mispriced awards to purchase 33,000 Biomet common shares was less than \$70,000 during the nine-months ended February 28, 2007. There were stock option awards to purchase 305,000 Biomet common shares granted to Section 16 officers during the nine-months ended February 28, 2007. There were no stock option awards granted to directors during the nine-months ended February 28, 2007.

The accounting guidance for determining share-based compensation expense applicable to the Company's stock option awards (other than grants to non-employee distributors as discussed below) prior to June 1, 2006 was Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, or APB No. 25. APB No. 25 defines the measurement date of a stock option award as the first date on which are known both (1) the number of shares that an individual employee is entitled to receive and (2) the option or purchase price. Under APB No. 25 a measurement date is required to be selected for each stock option award and compensation expense must be recognized ratably over the vesting period of the option award for the excess, if any, of the quoted market price of the stock on the measurement date over the stated exercise price of the award. In many instances the Company selected option grant dates and corresponding option exercise prices with respect to awards accounted for under APB No. 25 that were before the date that both the number of shares that an individual was entitled to receive and the exercise price for the award had been finalized. The Company also deemed the stated grant date to be the measurement date resulting in no compensation expense for those options in the financial statements as previously reported. For purposes of establishing the measurement date for accounting purposes, the practice of using the stated grant date rather than the date that the number of shares that an individual is entitled to receive and exercise price were finalized resulted in incorrect measurement dates and financial statement errors. In connection with the restatement previously reported in the Company's amended annual report on Form 10-K/A for the fiscal year ended May 31, 2006 and the Company's amended quarterly report on Form 10-Q/A for the period ended August 31, 2006, the Company has selected alternative measurement dates for awards accounted for under APB No. 25 during the 11-year period under investigation to correct for those errors.

On June 1, 2006, the Company adopted SFAS No. 123(R) Share-Based Payment (SFAS 123(R)). SFAS 123(R) requires stock options to be expensed based on their fair value over the required award service period. For stock options granted prior to June 1, 2006, the unrecognized expense related to the unvested portion of a stock option award at the date of adoption is to be recognized based on original grant date fair values for the award. Using the stated grant date to determine those fair values rather than the date that the option grants were finalized resulted in financial statement errors subsequent to May 31, 2006. In addition, for stock options granted prior to June 1, 2006 in determining expense during the nine-months ended February 28, 2007 the Company did not estimate forfeitures as required by SFAS 123(R) in the Preliminary Results. In connection with the preparation of the Company's financial statements described in this quarterly report on Form 10-Q, the Company has revised its fair value and forfeitures calculations to correct for these errors. For stock options granted subsequent to May 31, 2006 no adjustments were deemed necessary related to fair value or forfeitures because any differences were inconsequential.

The accounting guidance for determining share-based expense applicable to awards made to the Company's non-employee distributors is based on Emerging Issues Task Force 96-18, Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquisition, or in Conjunction with Selling, Goods or Services, or EITF 96-18. Under EITF 96-18, additional share-based expense is evaluated based on the fair value of the distributor award at the date of grant and then remeasured at each subsequent reporting period over the vesting period of the award. Prior to fiscal 2003, the Company did not record expense for stock options to non-employee distributors. In fiscal 2003 and subsequently, the Company began recording expense based upon EITF 96-18.



---

**Table of Contents**

**BIOMET, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Additional information concerning the impact of the adjustments resulting from these errors is provided in the tables contained within this Note 2 (Restatement of Previously Furnished Preliminary Financial Statements) below.

There are various negative tax consequences to employees as a result of the Company's historical stock option granting practices. As was recommended by the Special Committee, the Company is considering alternatives to potentially address some or all of these consequences.

The payroll and withholding tax treatment of a stock option granted to a U.S. employee or other service provider depends on whether the stock option qualifies as an Incentive Stock Option ( *ISO* ) or a Non-Qualified Stock Option ( *NQO* ). An ISO is a stock option that satisfies certain requirements set forth in Internal Revenue Code Section 422, including a requirement that the exercise price of the stock option may not be less than the fair market value of the underlying shares on the date of grant. An NQO is any stock option that does not satisfy the requirements to be treated as an ISO.

Upon exercise of an NQO, the Company is required, to the extent applicable, to (1) withhold the optionholder's share of social security, Medicare and other employment taxes (collectively referred to as payroll taxes ) and any federal, state or local income tax and (2) pay Biomet's share of payroll taxes. However, upon exercise of an ISO, the Company is not required to withhold any income taxes nor is the Company required to withhold or pay any payroll taxes.

The Company's stock options granted during the 11-year period were generally intended to qualify as ISOs and accordingly, except for federal withholding in certain instances with respect to same day sales, we did not withhold federal income taxes, state income taxes or the employee's share of social security, Medicare and other employment taxes upon exercise of these options, nor did the Company pay the employer's share of social security, Medicare and other employment taxes. However, as described above, approximately eighty percent of the Company's stock options granted during this period were subject to revised measurement dates. Any stock option that was granted with an exercise price less than the fair market value of the underlying shares on the revised measurement date would not have qualified as an ISO and should have been treated as an NQO for payroll and withholding tax purposes. In these cases, the Company has accrued payroll and withholding taxes, penalties and interest for stock options and included these amounts in the restated financial statements.

In preparing the restatement described in the Company's amended annual report on Form 10-K/A the Company has assumed a normal statute of limitations on the assessment of payroll and withholding taxes. Thus, the Company has reversed expense recorded in prior periods and as a result recognized a benefit in the period in which the statute of limitations for the respective options exercise expires in an aggregate amount of \$14.3 million. However, the statute of limitations may not apply in the case of a false or fraudulent return with the intent to evade tax or in the case of a willful attempt in any manner to defeat or evade any employment or withholding tax. If the statute of limitations were determined not to have expired the benefit which the Company has recognized could be deemed to be payable. The Company believes there was no intent to evade paying taxes. During the nine-months ended February 28, 2007 the Company did not reverse any expenses as a result of the expiration of the statute of limitations applicable to payroll and withholding taxes.

In most instances, ISOs which were exercised as a same-day sale were properly treated as a disqualifying disposition and the income was reported on the individuals' Form W-2. In these situations, the Company accrued payroll taxes, penalties and interest but did not accrue federal or state income taxes as the income from the disqualifying disposition of stock options was included on the employee's Form W-2 and applicable state and federal income taxes were paid by the employee. For certain ISOs which subsequently converted to a NQO stock

**Table of Contents****BIOMET, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

option, the Company accrued federal and state income taxes, payroll taxes, penalties and interest at the applicable rates, if the income was not reported on the individuals Form W-2.

The combination of taxes, penalties and interest resulted in a net compensation charge of \$1.1 million and 1.7 million, respectively, for the nine-month periods ended February 28, 2007 and 2006.

The Company believes that the unpaid employee portion of taxes represents a joint and several obligation of both the Company and its employees. However, the change of status of employee option awards from an ISO to NQO was a result of flaws in the Company's stock option granting practices as discussed above. The Company believes that the employees would likely have a valid claim against us in the event the Company attempted to recover a portion of the additional taxes, penalties and interest from its employees. Accordingly, the Company believes it is appropriate to accrue both the employee and the employer portions of these taxes. In addition, the Company believes such additional taxes, penalties and interest should be recorded in the respective years in which the underlying in-the-money options were exercised.

The increase (decrease) in net income resulting from the above errors are presented below:

		<b>Additional</b>							
	<b>Net Income as previously Reported</b>	<b>Additional Share-Based Compensation Expense (Pre-Tax)(1)</b>	<b>Distributor Stock Options Expense (Pre-Tax)(2)</b>	<b>Payroll and Withholding Taxes (Pre-Tax)</b>	<b>Total Additional Expense (Pre-Tax)</b>	<b>Income Tax Benefit(3)</b>	<b>Total Adjustments</b>	<b>Net Income as Restated</b>	
<b>Three-Months Ended</b>									
<b>February 28,</b>									
2007	\$ 84,389	\$ 641	\$ 142	\$ (399)	\$ 384	\$ 482	\$ 866	\$ 85,255	
2006	106,065	(608)	117	(564)	(1,055)	370	(685)	105,380	
<b>Nine-Months Ended</b>									
<b>February 28,</b>									
2007	\$ 290,391	\$ 3,014	\$ 504	\$ (1,096)	\$ 2,422	\$ 1,589	\$ 4,011	\$ 294,402	
2006	307,642	(1,849)	349	(1,735)	(3,235)	1,134	(2,101)	305,541	

- (1) Share-based compensation expense for the three- and nine-months ended February 28, 2007 is based upon SFAS 123(R). Share-based compensation expense for the three- and nine-months ended February 28, 2006 is based upon APB No. 25. For the three- and nine-months ended February 28, 2007 the benefit recorded was primarily due to the understatement of forfeitures in the Preliminary Results.
- (2) Distributor stock options expense or benefit is based upon EITF 96-18. The Company is recording a benefit in for the three- and nine-months ended February 28, 2007 and 2006 due to an overstatement in the computation of expense in the Preliminary Results.
- (3) The Company is recording a tax benefit in the three- and nine-months ended February 28, 2007 and 2006 due largely to the recharacterization of ISO's to NQO's.

**Table of Contents****BIOMET, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The impact of the adjustments resulting from the above errors on the Company's consolidated balance sheets as of February 28, 2007 and May 31, 2006 and the Company's three- and nine-month consolidated statements of income and nine-month consolidated statements of cash flows for the periods ended February 28, 2007 and 2006 are presented below. The restatement amounts as of May 31, 2006 and the three months ended February 28, 2006 were previously reported in the Company's amended annual report on Form 10K/A filed on May 29, 2007.

	February 28, 2007 (unaudited)			May 31, 2006		
	As Reported	Adjustments	As Restated	As Reported	Adjustments	As Restated
<b>Current assets:</b>						
Cash and cash equivalents	\$ 128,507	\$	\$ 128,507	\$ 160,963	\$	\$ 160,963
Investments	5,527		5,527	6,380		6,380
Accounts and notes receivable, net	544,801		544,801	507,883		507,883
Inventories	550,731		550,731	534,515		534,515
Refundable income taxes		18,474	18,474		16,880	16,880
Deferred income taxes	75,123	2,307	77,430	73,345	1,845	75,190
Prepaid expenses and other	47,072		47,072	32,342		32,342
<b>Total current assets</b>	<b>1,351,761</b>	<b>20,781</b>	<b>1,372,542</b>	<b>1,315,428</b>	<b>18,725</b>	<b>1,334,153</b>
Property, plant and equipment, at cost	734,348		734,348	655,432		655,432
Less, accumulated depreciation	341,451		341,451	297,800		297,800
Property, plant and equipment, net	392,897		392,897	357,632		357,632
Investments	56,489		56,489	58,128		58,128
Goodwill	443,491		443,491	441,397		441,397
Intangible assets, net	75,969		75,969	79,498		79,498
Other assets	16,326		16,326	11,839		11,839
<b>Total assets</b>	<b>\$ 2,336,933</b>	<b>\$ 20,781</b>	<b>\$ 2,357,714</b>	<b>\$ 2,263,922</b>	<b>\$ 18,725</b>	<b>\$ 2,282,647</b>
<b>Current liabilities:</b>						
Short-term borrowings	\$ 100,316	\$	\$ 100,316	\$ 276,561	\$	\$ 276,561
Accounts payable	52,323		52,323	62,276		62,276
Accrued income taxes	4,597	(4,597)		6,356	(6,356)	
Accrued wages and commissions	59,556	22,482	82,038	63,279	21,386	84,665
Other accrued expenses	111,194		111,194	111,960		111,960
<b>Total current liabilities</b>	<b>327,986</b>	<b>17,885</b>	<b>345,871</b>	<b>520,432</b>	<b>15,030</b>	<b>535,462</b>
<b>Long-term liabilities:</b>						
Deferred income taxes	28,241		28,241	26,991		26,991
<b>Total liabilities</b>	<b>356,227</b>	<b>17,885</b>	<b>374,112</b>	<b>547,423</b>	<b>15,030</b>	<b>562,453</b>
<b>Shareholders' equity:</b>						
Common shares	223,603		223,603	206,633		206,633

Edgar Filing: BIOMET INC - Form 10-Q

Additional paid-in capital	89,146	38,879	128,025	72,839	43,689	116,528
Retained earnings	1,629,201	(35,983)	1,593,218	1,419,297	(39,994)	1,379,303
Accumulated other comprehensive income	38,756		38,756	17,730		17,730
<b>Total shareholders equity</b>	<b>1,980,706</b>	<b>2,896</b>	<b>1,983,602</b>	<b>1,716,499</b>	<b>3,695</b>	<b>1,720,194</b>
Total liabilities and shareholders equity	\$ 2,336,933	\$ 20,781	\$ 2,357,714	\$ 2,263,922	\$ 18,725	\$ 2,282,647

**Table of Contents****BIOMET, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

	Nine-Months Ended February 28, 2007			Nine-Months Ended February 28, 2006		
	As Reported	Adjustments	As Restated	As Reported	Adjustments	As Restated
Net sales	\$ 1,558,021	\$	\$ 1,558,021	\$ 1,485,847	\$	\$ 1,485,847
Cost of sales	453,911	(176)	453,735	417,167	296	417,463
Gross profit	1,104,110	176	1,104,286	1,068,680	(296)	1,068,384
Selling, general and administrative expenses	600,013	(1,936)	598,077	544,772	2,055	546,827
Research and development expense	71,432	(352)	71,080	63,182	593	63,775
Operating income	432,665	2,464	435,129	460,726	(2,944)	457,782
Other income, net	8,328	(42)	8,286	2,575	(292)	2,283
Income before income taxes	440,993	2,422	443,415	463,301	(3,235)	460,066
Provision for taxes	150,602	(1,589)	149,013	155,659	(1,134)	154,525
Net income	\$ 290,391	\$ 4,011	\$ 294,402	\$ 307,642	\$ (2,101)	\$ 305,541
<b>Earnings per share:</b>						
Basic	\$ 1.18	\$ .02	\$ 1.20	\$ 1.24	\$ (.01)	\$ 1.23
Diluted	\$ 1.18	\$ .02	\$ 1.20	\$ 1.24	\$ (.01)	\$ 1.23
Shares used in the computation of earnings per share:						
Basic	245,113		245,113	248,270		248,270
Diluted	245,113		245,113	249,202		249,202
Cash dividends per share	\$ 0.30	\$	\$ 0.30	\$ 0.25	\$	\$ 0.25

	Three-Months Ended February 28, 2007			Three-Months Ended February 28, 2006		
	As Reported	Adjustments	As Restated	As Reported	Adjustments	As Restated
Net sales	\$ 529,530	\$	\$ 529,530	\$ 506,254	\$	\$ 506,254
Cost of sales	163,782	(23)	163,759	143,061	97	143,158
Gross profit	365,748	23	365,771	363,193	(97)	363,096
Selling, general and administrative expenses	217,930	(329)	217,601	185,137	668	185,805
Research and development expense	23,936	(46)	23,890	21,063	193	21,256
Operating income	123,882	398	124,280	156,993	(958)	156,035
Other income, net	4,443	(14)	4,429	2,262	(97)	2,165
Income before income taxes	128,325	384	128,709	159,255	(1,055)	158,200
Provision for taxes	43,936	(482)	43,454	53,190	(370)	52,820
Net income	\$ 84,389	\$ 866	\$ 85,255	\$ 106,065	\$ (685)	\$ 105,380
<b>Earnings per share:</b>						
Basic	\$ 0.34	\$ .01	\$ 0.35	\$ 0.43	\$ (0.01)	\$ 0.42
Diluted	\$ 0.34	\$ .01	\$ 0.35	\$ 0.43	\$ (0.01)	\$ 0.42

## Edgar Filing: BIOMET INC - Form 10-Q

Shares used in the computation of earnings per share:

Basic	245,390	245,390	246,859	246,859
Diluted	245,390	245,390	247,772	247,772

**Table of Contents****BIOMET, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

	Nine-Months Ended			Nine-Months Ended		
	February 28, 2007			February 28, 2006		
	As Reported	Adjustments	As Restated	As Reported	Adjustments	As Restated
<b>Cash flows from (used in) operating activities:</b>						
Net income	\$ 290,391	\$ 4,011	\$ 294,402	\$ 307,642	\$ (2,101)	\$ 305,541
Adjustments to reconcile net income to net cash from operating activities:						
Depreciation	63,604		63,604	51,062		51,062
Amortization	5,713		5,713	8,044		8,044
Share-based expense	12,589	(1,199)	11,390		1,500	1,500
(Gain) loss on sale of investments, net	(921)		(921)	1,166		1,166
Deferred income taxes	(1,244)	(462)	(1,706)	(5,368)	403	(4,965)
Tax benefit from exercise of stock options		(2,061)	(2,061)		(3,065)	(3,065)
Changes in current assets and liabilities:						
Accounts and notes receivable	(32,003)		(32,003)	(29,654)		(29,654)
Inventories	(8,774)		(8,774)	(66,287)		(66,287)
Accounts payable	(6,633)		(6,633)	4,430		4,430
Accrued income taxes	(1,965)	(3,446)	(5,411)	(1,685)	(1,529)	(156)
Other	(24,341)	1,096	(23,245)	8,588	1,734	10,322
Net cash provided by operating activities	296,416	(2,061)	294,355	277,938		277,938
<b>Cash flows from (used in) investing activities:</b>						
Proceeds from sales and maturities of investments	17,067		17,067	48,209		48,209
Purchases of investments	(10,192)		(10,192)	(41,679)		(41,679)
Capital expenditures	(89,034)		(89,034)	(75,259)		(75,259)
Other	(5,660)		(5,660)	305		305
Net cash used in investing activities:	(87,819)		(87,819)	(68,424)		(68,424)
<b>Cash flows from (used in) financing activities:</b>						
Decrease in short-term borrowings, net	(177,233)		(177,233)	(4,680)		(4,680)
Issuance of common shares	17,146		17,146	12,598		12,598
Cash dividends	(73,526)		(73,526)	(62,473)		(62,473)
Purchase of common shares	(7,268)		(7,268)	(159,122)		(159,122)
Tax benefit from exercise of stock options		2,061	2,061			
Net cash used in financing activities	(240,881)	2,061	(238,820)	(213,677)		(213,677)
Effect of exchange rate changes on cash	(172)		(172)	2,000		2,000
Decrease in cash and cash equivalents	(32,456)		(32,456)	(2,163)		(2,163)
Cash and cash equivalents, beginning of year	160,963		160,963	104,706		104,706
Cash and cash equivalents, end of period	\$ 128,507	\$	\$ 128,507	\$ 102,543	\$	\$ 102,543





**Table of Contents****BIOMET, INC. AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Note 3: Comprehensive Income.**

Other comprehensive income includes foreign currency translation adjustments and unrealized appreciation of available-for-sale securities, net of taxes. Other comprehensive income for the three-months ended February 28, 2007 and 2006 was \$10,744,000 and \$7,701,000, respectively. Other comprehensive income (loss) for the nine-months ended February 28, 2007 and 2006 was \$21,026,000 and \$(21,223,000), respectively. Total comprehensive income combines reported net income and other comprehensive income. Total comprehensive income, as restated, for the three-months ended February 28, 2007 and 2006 was \$95,999,000 and \$113,081,000, respectively. Total comprehensive income, as restated, for the nine-months ended February 28, 2007 and 2006 was \$315,428,000 and \$284,318,000, respectively.

**Note 4: Inventories.**

Inventories at February 28, 2007 and May 31, 2006 are as follows:

	February 28, 2007	May 31, 2006
	(in thousands)	
Raw Materials	\$ 81,795	\$ 71,126
Work-in-process	66,018	48,416
Finished goods	237,280	225,997
Consigned distributor	165,638	188,976
	\$ 550,731	\$ 534,515

**Note 5: Common Shares.**

During the nine-months ended February 28, 2007, the Company issued 725,722 common shares upon the exercise of outstanding stock options for proceeds aggregating \$17,146,000. Purchases of common shares pursuant to the common share repurchase programs aggregated 210,000 shares for \$7,268,000 during the nine-months ended February 28, 2007.

**Note 6: Earnings Per Share.**

Earnings per common share amounts ( basic EPS ) are computed by dividing net income by the weighted average number of common shares outstanding and excludes any potential dilution. Earnings per common share amounts assuming dilution ( diluted EPS ) are computed by reflecting potential dilution from the exercise of stock options.

**Note 7: Income Taxes.**

The difference between the reported provision for income taxes and a provision computed by applying the federal statutory rate to pre-tax accounting income is primarily attributable to state income taxes, tax benefits relating to operations in Puerto Rico, tax-exempt income, tax credits and lack of a tax benefit associated with Incentive Stock Options under share-based payment expense. For additional information concerning the income tax effect related to the Company's restatement of certain historical financial statements see Note 2 (Restatement of Previously Furnished Preliminary Financial Statements).



**Table of Contents**

**BIOMET, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Note 8: Contingencies.**

**Medical Insurance Plan** The Company maintains a self-insurance program for covered medical expenses for all Team Members within the continental U.S. The Company is liable for claims up to \$200,000 per insured annually, as well as an additional annual aggregate of \$60,000. Self-insurance costs are accrued based upon the aggregate of the liability for reported claims and a management-determined estimated liability for claims incurred but not reported.

**Liability Insurance** Since 1989, the Company has self-insured against product liability risks, with excess coverage on a claims-made basis from various insurance carriers in excess of the self-insured amounts and subject to certain policy limits. Self-insurance costs are accrued based on reserves set in consultation with the insurance carrier for reported claims and a management-determined estimated liability for claims incurred but not reported. Based on historical experience, management does not anticipate that incurred but unreported claims would have a material impact on the Company's consolidated financial position.

**Litigation** On March 30, 2005 the Company announced that it had received a subpoena from the U.S. Department of Justice through the U.S. Attorney for the District of New Jersey requesting documents related to any consulting and professional service agreements with orthopedic surgeons using or considering the use of Biomet's hip or knee implants for the period January 2002 through March 29, 2005. The Company is aware that similar inquiries were directed to other companies in the orthopedics industry. On July 19, 2006 Biomet received a letter from the U.S. Department of Justice through the U.S. Attorney for the District of New Jersey requesting additional documents further to the subpoena issued in March 2005. This letter requested additional documents related to consulting and service agreements for the time period January 1998 through the present, as well as research and other grant agreements for that same time period. Further, the letter requested that the Company provide copies of the agreements identified in the supplemental request on an on-going basis. In addition, the requested information related to Company-sponsored training events, the selection process used by the Company to identify consultants and researchers, the Company's product design process for hip and knee implants and information on the Company's orthopedic sales force. The Company has subsequently received additional requests for information, both informally and by subpoena, and the investigation continues to be active. The Company has cooperated and intends to continue to fully cooperate with the Department of Justice inquiry. The results of this inquiry may not be known for several years.

In February 2006, SDGI Holdings, Inc. and Medtronic Sofamor Danek, Inc. (collectively referred to herein as "Medtronic") brought an action against BTBS and Biomet alleging infringement of seven patents. Specifically, Medtronic alleges that the patents are infringed by certain components of the Company's Vuelock Anterior Cervical Plate System, as well as instruments and surgical implantation methods associated with the Company's Arra Spinal System. Medtronic's complaint did not seek a specific amount of damages, but does seek to enjoin the Company from manufacturing, selling and/or distributing the allegedly infringing products. The Company has filed a counterclaim seeking a finding of noninfringement of the patents at issue and a finding that certain of the patents are invalid and unenforceable. The litigation is in the early stages of discovery. The Company is vigorously defending this matter and intends to continue to do so.

On June 26, 2006 the Company announced that it had received a federal grand jury subpoena issued at the request of the U.S. Department of Justice, Antitrust Division, requesting documents regarding possible violations of federal criminal law, including possible violations of the antitrust laws, relating to the manufacture and sale of orthopedic implant devices (the "Subpoena"). The Subpoena requests documents from January 1, 2001 through the present date. The Company is aware of similar subpoenas directed to other companies in the orthopedics industry. The Company has cooperated and intends to continue to fully cooperate with the Department of Justice investigation. The result of this investigation may not be known for several years. However, the scope of the

**Table of Contents**

**BIOMET, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Subpoena has currently been narrowed to a specific geographic region and specific product lines. It is the Company's belief that the other orthopedic companies that received similar subpoenas have received similar guidance. It is the Company's belief that the investigation was prompted by an unsolicited e-mail sent by a representative of one of the Company's competitors that proposed a common pricing strategy in connection with a particular hospital. This e-mail was received by an independent sales representative of an independent distributor for Biomet Orthopedics, but it was never transmitted to the Company. Neither the Company, its independent distributor, nor its independent sales representative took any action in response to the e-mail, and the Company believes that no anticompetitive activity took place as a result of it. The Company requires compliance by its employees and its independent distributors with its Code of Business Conduct and Ethics and with applicable antitrust laws. The information provided herein is limited to the information available to the Company at the present time and the Company cannot offer any assurances as to the scope and final outcome of this investigation.

On an issue related to the subpoena received from the Antitrust Division of the U.S. Department of Justice, the Company has received two complaints in Class Action lawsuits alleging violations of the Sherman Antitrust Act. In addition, the Company is aware of other complaints that have been filed, but not served on the Company. The complaints also named various other companies in the orthopedics industry as defendants. The Company intends to vigorously defend this matter and believes that it has meritorious defenses to the claims being asserted.

On September 21, 2006, two shareholder-derivative complaints were filed against certain of Biomet's current and former directors and officers in Kosciusko Superior Court I in Kosciusko County, in the State of Indiana. The complaints, captioned Long v. Hann, et al., and Thorson v. Hann, et al., alleged violations of state law relating to the issuance of certain stock option grants by the Company dating back to 1996. Both complaints sought unspecified money damages as well as other equitable and injunctive relief. These two cases were consolidated under the caption In re Biomet, Inc. Derivative Litigation, and on January 19, 2007, plaintiffs filed an amended complaint that made additional allegations based on the Company's December 18, 2006 disclosures related to stock option grants, including allegations that the defendants sought to sell the company in order to escape liability for their conduct, and that they did so at a devalued price, thus further breaching their fiduciary duties to shareholders. On February 16, 2007, defendants filed a motion to dismiss plaintiffs' amended complaint, which is currently pending with the court.

On December 11, 2006, a third shareholder-derivative complaint captioned International Brotherhood of Electrical Workers Local 98 Pension Fund v. Hann, et al., No. 06 CV 14312, was filed in federal court in the Southern District of New York. The IBEW case makes allegations and claims similar to those made in the Indiana litigation, in addition to purporting to state three derivative claims for violations of the federal securities laws. On February 15, 2007, defendants filed a motion to dismiss the plaintiff's complaint. On April 2, 2007, plaintiffs filed a motion for partial summary judgment claiming that the disclosures in the Company's April 2, 2007 8-K filing and press release regarding the Company's historical stock options granting practices constitute admissions sufficient to establish defendants' liability on certain of plaintiffs' claims. Both motions are currently pending with the court.

Pursuant to Indiana law and provisions of our articles of incorporation, the Company is advancing reasonable expenses, including attorneys' fees, incurred by the current and former Biomet directors and officers in defending these lawsuits.

On May 25, 2007, the Board received and discussed an updated report from its Special Committee which concluded that pursuing these three shareholder-derivative complaints was not in the best interests of the Company. Under Indiana law, the Special Committee's determination may be binding on the pending shareholder-derivative claims and result in the dismissal of these complaints.

---

**Table of Contents**

**BIOMET, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Proposed Merger with the Private Equity Consortium** On December 18, 2006, the Company entered into an Agreement and Plan of Merger with LVB Acquisition, LLC, a Delaware limited liability company ( *Parent* ), and LVB Acquisition Merger Sub, Inc., an Indiana corporation and a wholly-owned subsidiary of Parent ( *Merger Sub* ). Under the terms of the merger agreement, Merger Sub will be merged with and into Biomet, with Biomet continuing as the surviving corporation and a wholly-owned subsidiary of Parent (the *merger* ). Parent is controlled by a consortium of private equity funds: Blackstone Capital Partners V L.P., Goldman Sachs Investments Ltd., KKR 2006 Fund L.P. and Texas Pacific Group.

At the effective time of the merger, each share of Biomet's common stock issued and outstanding immediately before the effective time of the merger (other than those shares owned by Parent, Merger Sub or any other direct or indirect wholly-owned subsidiary of Parent and shares owned by Biomet or any direct or indirect wholly-owned subsidiary of Biomet) will be converted into the right to receive \$44.00 per share in cash, less any required withholding taxes and without interest.

Consummation of the merger is not subject to a financing condition, but is subject to various other conditions, including approval of the merger by our shareholders. On February 15, 2007, the parties were granted early termination of the waiting period under the HSR Act for the proposed merger agreement and related transactions. Although the terms of the merger agreement also require that the parties receive the approval of the antitrust authorities in the European Union, no such approval is required by the parties in connection with the proposed merger.

As previously disclosed in Biomet's definitive proxy statement filed with the Securities and Exchange Commission on April 24, 2007 (the *Proxy Statement* ), on December 20, 2006, a purported class-action lawsuit captioned Long, et al. v. Hann, et al., was filed in Indiana State court in the County of Kosciusko. The lawsuit names as defendants each member of the Biomet board of directors at the time, Dane Miller, Ph.D. and Blackstone Capital Partners V L.P., KKR 2006 Fund L.P., Goldman Sachs Investments Ltd. and TPG Partners V, L.P. The complaint alleges, among other things, that the defendants breached, or aided and abetted the breach of, fiduciary duties owed to Biomet shareholders by Biomet's directors in connection with, among other things, Biomet's entry into the merger agreement. The complaint seeks, among other relief, class certification of the lawsuit, a declaration that the merger agreement was entered into in breach of the fiduciary duties of the defendants, an injunction preventing the defendants from proceeding with the merger unless and until the defendants implement procedures to obtain the highest possible sale price, an order directing the defendants to exercise their fiduciary duties to obtain a transaction which is in the best interests of Biomet's shareholders until the process for a sale of Biomet is completed and the highest price is obtained, an order directing the defendants to exercise their fiduciary duty to disclose all material information in their possession concerning the merger prior to the shareholder vote, including Biomet's fiscal year 2007 second quarter financial results, imposition of a constructive trust upon any benefits improperly received by the defendants, an award of attorneys' fees and expenses and such other relief as the court might find just and proper. On March 29 and 30, 2007, the defendants filed motions to dismiss the plaintiffs' complaint, and these motions are currently pending before the court.

On January 2, 2007, a purported class action lawsuit captioned Gervasio v. Biomet, Inc., et al., was filed in the Supreme Court for the State of New York, New York County. A virtually identical action was filed on January 9, 2007, captioned Corry v. Biomet, Inc., et al., in the same court. Both of these lawsuits named as defendants Biomet, each member of its board of directors at the time, Dane Miller, Ph.D., The Blackstone Group L.P., Kohlberg Kravis Roberts & Co., Goldman Sachs Capital Partners and Texas Pacific Group. The lawsuits made essentially the same claims and sought the same relief as in the Long action described above. On January 29, 2007, defendants filed a joint motion to dismiss Gervasio. On February 14, 2007, the plaintiff in Corry voluntarily discontinued his lawsuit and informed defendants that he intended to intervene in Gervasio. On March 26, 2007, the court granted defendants' motion to dismiss Gervasio.

---

**Table of Contents**

**BIOMET, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

On May 31, 2007, Biomet entered into a memorandum of understanding regarding the settlement of class action lawsuits that were filed on behalf of Biomet's shareholders following the announcement of the proposed merger. Each of Biomet and the other defendants denies all of the allegations in these lawsuits, including any allegation that its current disclosures with regard to the pending merger are false, misleading or incomplete in any way. Nevertheless, without admitting any liability or wrongdoing, Biomet and other defendants in these cases have agreed in principle to settle them in order to avoid the potential cost and distraction of continued litigation and to eliminate any risk of any delay to the closing of the merger posed by these lawsuits. Such settlement is subject to execution and delivery of definitive documentation, the closing of the merger and court approval. If the settlement becomes effective, the lawsuits will be dismissed with prejudice.

Pursuant to the terms of the settlement, Biomet has agreed to make available meaningful additional information, including financial information, to its shareholders. Such additional information is contained in Biomet's current report on Form 8-K filed on May 31, 2007 and should be read in conjunction with the Proxy Statement. In return, the plaintiffs agreed to the dismissal of the actions. In addition, the consortium of private equity funds that control Parent have agreed to cause Biomet (or its successors) to pay the legal fees and expenses of plaintiffs' counsel, in an amount of \$600,000 in the aggregate, subject to the approval by the court and the closing of the merger. This payment will not affect the amount of merger consideration to be paid in the merger. The details of the settlement will be set forth in a notice to be sent to Biomet's shareholders prior to a hearing before the court to consider the settlement.

The settlement will not affect the merger consideration to be paid to shareholders of Biomet in connection with the proposed merger between Biomet and Parent or the timing of the special meeting of shareholders of Biomet scheduled for Friday, June 8, 2007, beginning at 10:30 a.m., local time, in the Indiana Room, Aon Center, 200 East Randolph Drive, Chicago, Illinois 60601 to vote upon a proposal to approve the merger agreement.

**Nasdaq Delisting Proceedings** The Company's common shares are currently traded on the NASDAQ Global Select Market under the symbol BMET. On January 9, 2007, the Company filed a Form 12b-25 with the SEC stating that it did not anticipate filing its quarterly report on Form 10-Q for the second quarter of fiscal year 2007 on or before the fifth calendar day following the prescribed due date. On January 11, 2007, the Company received a Staff Determination letter from The Nasdaq Stock Market indicating that the Company is not in compliance with the filing requirements for continued listing under Marketplace Rule 4310(c)(14). The letter was issued in accordance with NASDAQ procedures due to the Company's inability to file its quarterly report on Form 10-Q for the second quarter of fiscal year 2007 by the prescribed due date.

A hearing was held on March 1, 2007, at which the Company requested an exception within which to regain compliance with the NASDAQ's filing requirements. On April 11, 2007, a NASDAQ Listing Qualifications Panel (the *Panel*) granted the Company's request for an exception and continued listing on the NASDAQ Global Select Market, notwithstanding the Company's inability to timely file its quarterly report on Form 10-Q for the second quarter of fiscal 2007. On May 22, 2007, the Company requested an extension of the May 29, 2007 deadline until June 12, 2007.

On April 12, 2007, the Company announced that it received an additional notice of non-compliance from The Nasdaq Stock Market, pursuant to Marketplace Rule 4310(c)(14), due to the previously announced delay in filing its quarterly report on Form 10-Q for the third quarter of fiscal 2007. In the notice, the Company was invited to make an additional submission to the Panel addressing its plans for making the third quarter filing. On April 19, 2007, the Company requested an exception until June 12, 2007 to file its quarterly report on Form 10-Q for the third quarter of fiscal 2007.

**Table of Contents**

**BIOMET, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

On May 29, 2007, the Panel made a determination with respect to the Company's April 19, 2007 and May 22, 2007 requests. In its May 29, 2007 determination, the Panel granted the Company's request to extend the time to file the Company's reports on Form 10-Q for the second and third quarters of fiscal 2007, and to complete all required restatements, to on or before July 11, 2007. The Panel added that notwithstanding this extension it expects the Company to comply with the terms of the exception by the June 12, 2007 date referenced in the Company's April 19, 2007 and May 22, 2007 requests. In the event the Company does not fully comply with the terms of the Panel's exception, the Panel will issue a final determination to delist the Company's securities and, absent a stay by the Nasdaq Listing and Hearings Review Council, will suspend trading of the Company's shares on The Nasdaq Stock Market effective on the second business day from the date of final determination. In addition, the Panel reserved the right to consider the terms of its exception based on any event, condition or circumstance that would, in the Panel's opinion, make continued listing of the Company's securities on The Nasdaq Stock Market inadvisable or unwarranted.

There are various other claims, lawsuits, disputes with third parties, investigations and pending actions involving various allegations against the Company incident to the operation of its business, principally product liability and intellectual property cases. Each of these matters is subject to various uncertainties, and it is possible that some of these matters may be resolved unfavorably to the Company. The Company establishes accruals for losses that are deemed to be probable and subject to reasonable estimate. Based on the advice of counsel to the Company in these matters, management believes that the ultimate outcome of these matters and any liabilities in excess of amounts provided will not have a material adverse impact on the Company's consolidated financial statements taken as a whole.

Information with respect to certain other contingencies can be found in Note 9 (Subsequent Events) to the Consolidated Financial Statements.

**Note 9. Subsequent Events.**

**U.S. Department of Justice Subpoena** The Company recently received a subpoena in May 2007 from the U.S. Department of Justice through the U.S. Attorney for the Southern District of West Virginia requesting documents generally relating to a limited number of products currently manufactured, marketed, and sold by BTBS for the time period of January 1999 through the present. The Company intends to fully cooperate with the request of the Department of Justice. Further, the Company can make no assurances as to the time or resources that will need to be devoted to this inquiry or its final outcome.

Information with respect to certain other subsequent events can be found in Note 8 (Contingencies) to the consolidated financial statements.

**Table of Contents****ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations  
FINANCIAL CONDITION AS OF FEBRUARY 28, 2007**

This discussion should be read in conjunction with the Company's consolidated financial statements and the corresponding notes contained herein. The Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward looking statements that are subject to certain risk factors, as discussed elsewhere in this report under the caption Risk Factors. The Company's cash and investments decreased \$34,948,000 to \$190,523,000 at February 28, 2007. This decrease resulted from positive cash flow from operations offset by the \$73,526,000 dividend paid during the first quarter, the \$7,268,000 used to purchase shares pursuant to the Company's share repurchase programs and payment of \$177,233,000 on short-term debt during the first nine-months.

Cash flows provided by operating activities were \$294,355,000 for the first nine-months of fiscal 2007 compared to \$277,938,000 in 2006. The primary sources of fiscal year 2007 cash flows from operating activities were net income and depreciation. The primary use was an increase in accounts receivable and inventories. The Company's major cash collection day is Monday, and as the Company's quarter end moves further away from a Monday, accounts receivable ending balances increase. In addition, as sales increase, outstanding accounts receivable increase. Inventories increased primarily in three areas: EBI L.P., now operating as Biomet Trauma & Biomet Spine, ( BTBS ), where the Company is bringing the manufacturing of spinal products in-house and built inventory from vendors to smooth the transition; 3i, where the Company is launching the nano-tite dental implant system; and Japan, where the Company is launching the Bi-metric XR and the Vanguard RP. Accounts and notes receivable and inventory balances increased during the nine-month period by \$4.9 million and \$7.4 million, respectively, due to currency exchange rates.

Cash flows used in investing activities were \$87,819,000 for the first nine-months of fiscal 2007 compared to \$68,424,000 in 2006. The primary use of cash flows from investing activities in fiscal 2007 was capital expenditures. The Company continues to upgrade its instruments used in various international markets and to support the new implant systems being launched.

Cash flows used in financing activities were \$238,820,000 for the first nine-months of fiscal 2007 compared to \$213,677,000 in 2006. The primary uses were the cash dividend paid, the share repurchase programs and a decrease in short-term borrowings. In July 2006, the Company's Board of Directors declared a cash dividend of thirty cents (\$0.30) per share payable to shareholders of record at the close of business on July 15, 2006. Over the last twenty-one quarters, the Company has used \$1,064,000,000 to purchase its common stock. The Company currently has no share repurchase programs authorized.

Currently available funds, together with anticipated cash flows generated from future operations are believed to be adequate to cover the Company's anticipated cash requirements, including capital expenditures, research and development costs and short-term debt payments.

**RESULTS OF OPERATIONS FOR THE NINE-MONTHS ENDED FEBRUARY 28, 2007 AS COMPARED TO THE NINE-MONTHS ENDED FEBRUARY 28, 2006**

Net sales increased 5% to \$1,558,021,000 for the nine-months ended February 28, 2007, from \$1,485,847,000 for the same period last year. Excluding the positive impact of foreign currency, net sales growth for the period was 3%. The Company's U.S.-based revenue increased less than 1% to \$980,285,000 during the first nine-months of fiscal 2007, while foreign sales increased 13% (9% currency adjusted) to \$577,736,000.

The Company's worldwide sales of reconstructive products during the first nine-months of fiscal 2007 were \$1,100,984,000, representing a 9% increase compared to the first nine-months of last year. This increase came through balanced growth in all of the reconstructive product categories.



**Table of Contents**

Sales of fixation products were \$174,326,000 for the first nine-months of fiscal 2007, representing a 7% decrease as compared to the same period in 2006. Sales of spinal products were \$154,036,000 for the first nine-months of fiscal 2007, representing a 6% decrease as compared to the same period in 2006. BTBS has continued to underperform management's objectives. During the nine-months, the Company has continued to make numerous managerial changes at BTBS. The Company is also making significant progress with the implementation of a new computer system, sales support system, the in-sourcing of the manufacture of spinal hardware products and expanding the research and development team. The Company believes that the new management team and infrastructure changes at BTBS will allow the Company to provide greater focus on the spine and trauma markets and our customers.

The Company's sales of other products totaled \$128,675,000, representing a 1% increase over the first nine-months of fiscal year 2006.

Cost of sales increased as a percentage of net sales to 29.1% for the first nine-months of fiscal 2007 from 28.1% for the same period last year. During the third quarter, the Company continued its review of inventory levels at BTBS and determined that they were in excess of that required to support the current level of sales. In addition, the Company will be introducing several new products, which may negatively affect sales of existing products. The Company continues verifying its field inventory and the expected results have been considered in establishing inventory reserves. The Company recorded an \$11 million charge to cost of sales during the third quarter to increase its inventory reserves at BTBS. This increased cost of sales as a percentage of net sales by 0.7%. The remaining increase in cost of sales was primarily a result of higher growth rates in international markets where gross margins are lower. Selling, general and administrative expenses as a percentage of net sales increased to 38.4% compared to 36.8% for the first nine-months last year. Three major expense categories are causing this increase: 1) the Company incurred approximately \$6.2 million in expenses related to the proposed Merger Agreement during the third quarter of fiscal 2007; 2) the adoption of SFAS 123(R) share-based payment increased selling, general and administrative expenses by \$7.9 million; and 3) the Company incurred approximately \$15.7 million in additional legal and distribution expenses compared to past period. The legal costs relate to the derivative lawsuits as previously mentioned and investigative expenses in determining alternative measurement dates of stock option awards issued during the 11-year period. The distribution expenses were incurred in efforts to re-negotiate distribution agreements with existing distributors. Research and development expenditures increased 11.5% during the first nine-months to \$71,080,000 reflecting the Company's continued emphasis on new product introductions and the aforementioned Share-Based payment expense of \$2.2 million. Operating income decreased 5% from \$457,782,000 for the first nine-months of fiscal 2006, to \$435,129,000 for the first nine-months of fiscal 2007.

Other income increased from \$2,283,000 last year to \$8,286,000 this year. Other income has been positively impacted by an increase in investment interest rates, lower short-term debt and a net gain arising from legal settlements.

The effective income tax rate for the nine-months ended in fiscal 2007 and 2006 was 33.6%.

These factors resulted in a 4% decrease in net income to \$294,402,000 for the first nine-months of fiscal 2007 as compared to \$305,541,000 for the same period in fiscal 2006, while basic and diluted earnings per share decreased 2%, from \$1.23 to \$1.20 for the periods presented.

**RESULTS OF OPERATIONS FOR THE THREE-MONTHS ENDED FEBRUARY 28, 2007 AS COMPARED TO THE THREE-MONTHS ENDED FEBRUARY 28, 2006**

Net sales increased 5% to \$529,530,000 for the third quarter ended February 28, 2007, from \$506,254,000 for the same period last year. Excluding the positive impact of foreign currency, net sales growth for the third quarter of fiscal 2007 was 2%. The Company's U.S.-based revenue decreased 3% to \$321,312,000 during the third quarter of fiscal 2007, while foreign sales increased 20% (12% currency adjusted) to \$208,218,000.

---

**Table of Contents**

The Company's worldwide sales of reconstructive products during the third quarter of fiscal 2007 were \$381,169,000, representing a 10% increase compared to the third quarter of last year. This increase came through balanced growth in all of the reconstructive product categories.

Sales of fixation products were \$54,645,000 for the third quarter of fiscal 2007, representing a 12% decrease as compared to the same period in fiscal 2006. Sales of spinal products were \$51,253,000 for the third quarter of fiscal 2007, representing a 5% decrease as compared to the same period in fiscal 2006. BTBS has continued to underperform management's objectives. During this fiscal quarter, the Company has continued to make numerous managerial changes at BTBS. The Company is also continuing to progress with the implementation of a new computer system, sales support system, the in-sourcing of the manufacture of spinal hardware products and expanding the research and development team. The Company believes that the new management team and infrastructure changes at BTBS will allow the Company to provide greater focus on the spine and trauma markets and to our customers.

The Company's sales of other products totaled \$42,463,000 for the third quarter of fiscal 2007, representing a 2% decrease when compared to the third quarter of fiscal 2006.

Cost of sales increased as a percentage of net sales to 30.9% for the third quarter of fiscal 2007 from 28.3% for the same period last year. During the quarter, the Company continued its review of inventory levels at BTBS and determined that they were in excess of that required to support the current level of sales. In addition, the Company will be introducing several new products, which will negatively affect sales of existing products. The Company continues verifying its field inventory and the expected results have been considered in establishing inventory reserves. The Company recorded an \$11 million charge to cost of sales during the third quarter to increase its inventory reserves at BTBS. This increased cost of sales as a percentage of net sales by 2.1%. The remaining increase in cost of sales was primarily a result of higher growth rates in international markets where gross margins are lower. Selling, general and administrative expenses, as a percentage of net sales, increased to 41.1% compared to 36.7% for the third quarter last year. Three major expense categories are causing this increase: 1) the Company incurred approximately \$6.2 million in expenses related to the proposed Merger Agreement during the third quarter of fiscal 2007; 2) the adoption of SFAS 123(R) Share-Based payment increased cost of sales and selling, general and administrative expenses by \$2.8 million; and 3) the Company incurred approximately \$15.7 million in additional legal and distribution expenses compared to the third quarter last year. The legal costs relate to the derivative lawsuits as previously mentioned and investigative expenses in determining alternative measurement dates of stock option awards issued during the 11-year period. The distribution expenses were incurred in efforts to re-negotiate distribution agreements with existing distributors. Research and development expenditures increased 12% during the third quarter to \$23,890,000 reflecting the Company's continued emphasis on new product introductions and the aforementioned Share-Based payment expense. Operating income decreased 20% from \$156,035,000 for the third quarter of fiscal 2006, to \$124,280,000 for the third quarter of fiscal 2007.

Other income increased from \$2,165,000 last year to \$4,429,000 this year. Other income has been positively impacted by an increase in investment interest rates and lower short-term debt.

The effective income tax rate remained relatively flat at 33.8% from 33.4%.

These factors resulted in a 19% decrease in net income to \$85,255,000 for the third quarter of fiscal 2007 as compared to \$105,380,000 for the same period in fiscal 2006, while basic and diluted earnings per share decreased 17%, from \$0.42 to \$0.35 for the periods presented.

**ITEM 3. Quantitative and Qualitative Disclosures about Market Risks**

There have been no material changes from the information provided in the Company's amended annual report on Form 10-K/A for the year ended May 31, 2006.

---

**Table of Contents****ITEM 4. Controls and Procedures**

*(a) Evaluation of Disclosure Controls and Procedures.* In connection with the matters discussed in the Explanatory Note immediately preceding Part I, Item 1 of this quarterly report on Form 10-Q and Note 2 (Restatement of Previously Furnished Preliminary Financial Statements) to the consolidated financial statements included herein, the Company evaluated, under the supervision and with the participation of its management, the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934) as of February 28, 2007 and, based on this evaluation, the Company's current Chief Executive Officer and Interim Chief Financial Officer concluded that, as a result of the material weakness in the Company's internal control over financial reporting discussed below and the restatement, the Company's disclosure controls and procedures were not effective as of February 28, 2007.

As described in more detail in Part II, Item 9A Controls and Procedures of the Company's amended annual report on Form 10-K/A filed with the SEC on May 29, 2007, as of May 31, 2006 the Company did not have an effective control designed and in place over the establishment of the appropriate grant date or the measurement date for determining share-based expense. These deficiencies resulted in the misstatement of the Company's share-based expense, payroll and other employee taxes, additional paid-in capital accounts, related income tax accounts, retained earnings, related financial disclosures and other accounts and resulted in the restatements discussed in Note 2 (Restatement of Previously Furnished Preliminary Financial Statements) to this quarterly report on Form 10-Q. As a result of these deficiencies, the Company's current management concluded that the Company had a material weakness as of May 31, 2006 and, therefore, the Company's internal control over financial reporting was not effective as of such date.

For additional information about the material weakness and the Company's remedial measures related thereto, see Part II, Item 9A Controls and Procedures of the Company's amended annual report on Form 10-K/A filed with the SEC on May 29, 2007.

*(b) Changes in Internal Control.* During the third quarter of fiscal 2007, there were no changes in the Company's internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting. However, beginning in September 2006, the Company began implementing a new computer system at one of the Company's subsidiaries, BTBS. This initiative was taken in order to improve the effectiveness and efficiency of the operations at BTBS, and was not in response to any identified weakness or deficiency in the Company's internal control over financial reporting. In connection with the implementation of this system, the Company is in the process of updating its internal control over financial reporting at BTBS, as necessary, to accommodate modifications to the business processes and accounting procedures at BTBS. Management has yet to complete testing the effectiveness of the new system's impact on the Company's internal control environment. As such, there is the risk that the new system may have deficiencies that could constitute a material weakness in the Company's internal control over financial reporting. Management continues to test the new system as part of its ongoing testing of the Company's internal controls. Until the new system is fully operational, management continues to perform other procedures and analysis related to the financial closing and inventory processes at BTBS to ensure the Company's financial statements are materially correct.

In addition, to begin addressing the material weakness described in paragraph (a) above, subsequent to February 28, 2007, the Company's management has taken actions that are reasonably likely to materially affect the Company's internal control over financial reporting. These changes are described in detail in Part II, Item 9A Controls and Procedures of the Company's amended Annual Report on Form 10-K/A filed with the SEC on May 29, 2007.

---

**Table of Contents**

**PART II. Other Information**

**ITEM 1. Legal Proceedings**

Information with respect to legal proceedings can be found in Notes 8 (Contingencies) and 9 (Subsequent Events) to the consolidated financial statements contained in Part I, Item 1 of this report. Except as discussed in Notes 8 (Contingencies) and 9 (Subsequent Events) to the financial statements contained in Part I, Item 1 of this report as of February 28, 2007 there were no material developments in the legal proceedings disclosed by the Company in Part 1, Item 3 of the Company's amended Annual Report on Form 10-K/A filed with the Securities and Exchange Commission on May 29, 2007.

**ITEM 1A. Risk Factors**

As of February 28, 2007, there were no material changes in the Company's risk factors from those disclosed in Part I, Item 1A to our amended Annual Report on Form 10-K/A for the fiscal year ended May 31, 2006 other than the inclusion of the risk factors listed below. The risk factors disclosed in our amended Annual Report on Form 10-K/A, as amended in this report, in addition to the other information set forth in this report, could materially affect our business, financial condition or results. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may, in the future, materially adversely affect our business, financial condition or results.

**Failure or a delay in completing the Company's proposed merger with the private equity consortium could negatively impact the Company's stock price and future business and financial results because of, among other things, the market disruption that would occur as a result of uncertainties relating to the delay or failure to complete the merger.**

Although the Company has agreed, subject to conditions set forth in the merger agreement, to use the Company's reasonable best efforts to take such actions as are reasonably necessary, proper or advisable to consummate the proposed merger, there is no assurance that the merger agreement will be approved by the Company's shareholders or that the Company will satisfy the other conditions to the completion of the merger. If the merger is not completed for any reason, the Company will be subject to several risks, including having had management focused on completing the Merger, as well as the Company's core business and other opportunities beneficial to Biomet. In addition, the Company would not realize any of the expected benefits of having completed the merger and, under certain circumstances, would be required to pay the private equity consortium a termination fee of \$272.5 million and reimburse the private equity consortium for up to \$40.0 million of certain expenses incurred by them in connection with the proposed merger.

To the extent that the current market price of the Company's common shares reflect a market assumption that the merger will be completed, the price of the Company's common shares may decline if the merger is not completed. In addition, the Company's business may be harmed, and the price of the Company's stock may decline as a result, to the extent that the Company's customers, employees, distributors, suppliers and others are uncertain about the Company's future prospects in the absence of the merger. Furthermore, if the merger is not completed and the Company's board of directors determines to seek another merger or business combination, there can be no assurance that a transaction creating shareholder value comparable to the value perceived to be created by the merger will be available to the Company.

If the merger is not completed, the Company cannot assure the Company's shareholders that these risks will not materialize or materially adversely affect the Company's business, financial results, financial condition and stock price.

---

**Table of Contents**

**Increased costs of retaining the existing sales force that represents the Company's orthopedic reconstructive products have negatively affected its results of operations, and if the Company fails to retain its existing relationships with this sales force or fail to establish relationships with different individuals, the Company's results of operations may be negatively impacted in the future.**

In the reconstructive market segment, the Company's revenues and profitability depend largely on the ability of its independent commissioned sales representatives, whom the Company refer to as distributors, and their sales representatives to sell our products to customers. Typically, these distributors and sales representatives develop long-standing relationships with the Company's customers and provide them with the necessary service and support relating to the Company's products. Following the announcement of the Merger Agreement, in an attempt to exploit the uncertainty related to the pending transaction, the Company's direct competitors approached its distributors who represent the Company's orthopedic reconstructive products and offered them significant financial incentives to discontinue their existing relationships with the Company. In an effort to ensure the continuity of its relationships with these distributors, the Company incurred significant costs in the third quarter of fiscal year 2007, which negatively affected its results of operations in the third quarter of fiscal year 2007. The Company has continued to incur expenses related to these matters in the fourth quarter of fiscal year 2007. If it fails to maintain its existing relationships with its orthopedic reconstructive sales force, or fail to establish relationships with different individuals, the Company's future results of operations may be negatively impacted.

**Loss of the Company's key management and other personnel, or an inability to attract such management and other personnel, could impact the Company's business.**

The Company depends on its senior managers and other key personnel to run its business and on technical experts to develop new products and technologies. The loss of any of these senior managers or other key personnel could adversely affect its operations. Competition for qualified employees is intense, and the loss of qualified employees or an inability to attract, retain and motivate additional highly-skilled employees could hinder the management, operation and expansion of the Company's business.

**ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

(c) Stock Repurchases. During the nine-months ended February 28, 2007, the Company had two publicly-announced share repurchase programs outstanding. The first, announced June 30, 2005, approved the purchase of 2,500,000 shares to be automatically purchased daily in equal increments over a twelve-month period. The remaining shares available under this plan were purchased during the three-months ended August 31, 2006. The second, announced December 21, 2005, approved the purchase of shares up to \$100 million in open market or privately negotiated transactions expiring December 20, 2006. The Company did not repurchase any shares during the quarter ended February 28, 2007. When the plan expired on December 31, 2006 \$45,861,743 remained available to purchase additional shares under the December 21, 2005 share repurchase plan.

**ITEM 6. Exhibits.**

(a) Exhibits. See Index to Exhibits.

**Table of Contents**

**Signatures**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this Form 10-Q to be signed on its behalf by the undersigned, thereunto duly authorized.

**BIOMET, INC.**

Date: June 4, 2007

By:

/s/ JEFFREY R. BINDER  
**Jeffrey R. Binder**

**President and Chief Executive Officer**

**Table of Contents**

**BIOMET, INC.**

**FORM 10-Q**

**INDEX TO EXHIBITS**

<b>Exhibit No.</b>	<b>Description</b>
31.1	Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Interim Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Written Statement of Chief Executive Officer and Interim Chief Financial Officer Pursuant to Sections 906 of the Sarbanes-Oxley Act of 2002