

HAEMONETICS CORP  
Form 10-Q  
November 08, 2006

**FORM 10-Q**  
**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

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

For the quarter ended: September 30, 2006 Commission File Number: 1-10730

**HAEMONETICS CORPORATION**

(Exact name of registrant as specified in its charter)

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

**04-2882273**  
(I.R.S. Employer Identification No.)

**400 Wood Road, Braintree, MA 02184**

(Address of principal executive offices)

Registrant's telephone number, including area code: **(781) 848-7100**

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) (2.) has been subject to the filing requirements for at least the past 90 days.

Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.)

Yes  No

The number of shares of \$.01 par value common stock outstanding as of September 30, 2006:

**26,919,907**

**HAEMONETICS CORPORATION**

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## ITEM 1. FINANCIAL STATEMENTS

## HAEMONETICS CORPORATION AND SUBSIDIARIES

## CONSOLIDATED INCOME STATEMENTS

(Unaudited in thousands, except per share data)

|   | Three months ended |                     | Six Months Ended   |                     |
|---|--------------------|---------------------|--------------------|---------------------|
|   | September 30, 2006 | (1) October 1, 2005 | September 30, 2006 | (1) October 1, 2005 |
| Net revenues  | \$ 108,487         | \$ 100,488          | \$ 219,161         | \$ 203,661          |
| Cost of goods sold                                      | 53,326             | 48,723              | 106,626            | 97,372              |
| Gross profit  | 55,162             | 51,765              | 112,535            | 106,289             |
| Operating expenses:                                     |                    |                     |                    |                     |
| Research and development                                | 6,119              | 6,283               | 11,541             | 11,824              |
| Selling, general and administrative                     | 34,741             | 30,103              | 71,649             | 60,591              |
| Other unusual charges relating to acquisition (Note 16) | 73                 | 187                 | 225                | 362                 |
| In process research and development (Note 16)           | 9,073              |                     | 9,073              |                     |
| Total operating expenses                                | 50,006             | 36,573              | 92,488             | 72,777              |
| Operating income  | 5,156              | 15,192              | 20,047             | 33,512              |
| Interest expense  | (421 )             | (522 )              | (846 )             | (1,063 )            |
| Interest income   | 1,951              | 1,083               | 3,977              | 2,396               |
| Other income (expense), net                             | 425                | 481                 | 1,337              | 1,345               |
| Income before provision for income taxes                | 7,111              | 16,234              | 24,515             | 36,190              |
| Provision for income taxes                              | 5,845              | 5,476               | 12,093             | 12,723              |
| Net income  | \$ 1,266           | \$ 10,758           | \$ 12,422          | \$ 23,467           |
| <b>Basic income per common share</b>                    |                    |                     |                    |                     |
| Net income  | \$ 0.05            | \$ 0.41             | \$ 0.46            | \$ 0.89             |
| <b>Income per common share assuming dilution</b>        |                    |                     |                    |                     |
| Net income  | \$ 0.05            | \$ 0.39             | \$ 0.44            | \$ 0.86             |
| <b>Weighted average shares outstanding</b>              |                    |                     |                    |                     |
| Basic   | 27,087             | 26,395              | 26,993             | 26,338              |
| Diluted   | 27,969             | 27,354              | 27,948             | 27,279              |

(1) Reflects the adjustment to convert our investment in Arryx, Inc. to the equity method for periods prior to the acquisition. See Note #16

The accompanying notes are an integral part of these consolidated financial statements

## HAEMONETICS CORPORATION AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

(Unaudited in thousands)

|   | September 30,<br>2006 | (1) April 1,<br>2006 |
|---|-----------------------|----------------------|
| <b>ASSETS</b>   |                       |                      |
| Current assets:   |                       |                      |
| Cash and cash equivalents   | \$ 242,200            | \$ 250,667           |
| Accounts receivable, less allowance of \$1,687 at September 30, 2006 and \$1,086 at April 1, 2006                                     | 84,001                | 86,901               |
| Inventories   | 58,925                | 54,571               |
| Deferred tax asset, net   | 12,864                | 11,156               |
| Prepaid expenses and other current assets   | 15,815                | 15,109               |
| Total current assets  | 413,805               | 418,404              |
| Total Property, plant and equipment   | 300,862               | 283,475              |
| Less accumulated depreciation   | (220,105)             | (208,209)            |
| Net property, plant and equipment   | 80,757                | 75,266               |
| Other assets:   |                       |                      |
| Other Intangibles, less amortization of \$15,749 at September 30, 2006 and \$14,447 at April 1, 2006                                  | 25,915                | 22,945               |
| Goodwill, net   | 33,494                | 18,483               |
| Deferred tax asset, long term   | 3,181                 | 1,237                |
| Other long-term assets  | 4,280                 | 9,122                |
| Total other assets  | 66,870                | 51,787               |
| Total assets  | \$ 561,432            | \$ 545,457           |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>  |                       |                      |
| Current liabilities:  |                       |                      |
| Notes payable and current maturities of long-term debt  | \$ 21,922             | \$ 26,176            |
| Accounts payable  | 17,293                | 14,217               |
| Accrued payroll and related costs   | 16,000                | 18,318               |
| Accrued income taxes  | 7,602                 | 10,264               |
| Other accrued liabilities   | 25,298                | 19,141               |
| Total current liabilities   | 88,115                | 88,116               |
| Long-term debt, net of current maturities   | 12,690                | 12,977               |
| Other long-term liabilities   | 3,637                 | 3,800                |
| Commitments and contingencies (Note 12)   |                       |                      |
| Stockholders' equity:   |                       |                      |
| Common stock, \$.01 par value; Authorized 80,000,000 shares; Issued 26,919,907 at September 30, 2006 and 26,829,249 at April 1, 2006, | 269                   | 268                  |
| Additional paid-in capital  | 157,175               | 141,371              |
| Retained earnings   | 301,622               | 301,759              |
| Accumulated other comprehensive loss  | (2,076)               | (2,834)              |
| Total stockholders' equity  | 456,990               | 440,564              |
| Total liabilities and stockholders' equity  | \$ 561,432            | \$ 545,457           |

(1) Reflects the adjustment to convert our investment in Arryx, Inc. to the equity method for periods prior to the acquisition. See Note #16

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The accompanying notes are an integral part of these consolidated financial statements.

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**HAEMONETICS CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**  
(Unaudited in thousands)

|   | Common Stock<br>Shares | Amounts | Additional<br>Paid-in<br>Capital | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Loss | Total<br>Stockholders'<br>Equity | Comprehensive<br>Income |
|---|------------------------|---------|----------------------------------|----------------------|---|----------------------------------|-------------------------|
| (1) Balance, April 1,<br>2006                           | 26,829                 | \$ 268  | \$ 141,371                       | \$ 301,759           | (\$2,834)                                     | ) \$ 440,564                     |                         |
| Employee stock<br>purchase plan                         | 24                     |         | 1,012                            |                      |   | 1,012                            |                         |
| Exercise of stock<br>options and related tax<br>benefit | 372                    | 1       | 11,201                           |                      |   | 11,201                           |                         |
| Shares Repurchased                                      | (305)                  |         | (1,702)                          | (12,559)             |   | (14,261)                         |                         |
| Stock Compensation<br>Expense                           |                        |         | 5,294                            |                      |   | 5,294                            |                         |
| Net income  |                        |         |                                  | 12,422               |   | 12,422                           | \$ 12,422               |
| Foreign currency<br>translation adjustment              |                        |         |                                  |                      | 3,561   | 3,561                            | \$ 3,561                |
| Unrealized gain on<br>cash flow hedges                  |                        |         |                                  |                      | (2,803)                                       | (2,803)                          | (\$2,803)               |
| Comprehensive<br>income                                 |                        |         |                                  |                      |   |                                  | \$ 13,180               |
| Balance, September<br>30, 2006                          | 26,920                 | \$ 269  | \$ 157,175                       | \$ 301,622           | (\$2,076)                                     | ) \$ 456,990                     |                         |

(1) Reflects the adjustment to convert our investment in Arryx, Inc. to the equity method for periods prior to the acquisition. See Note #16

The accompanying notes are an integral part of these consolidated financial statements.



**HAEMONETICS CORPORATION AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Unaudited in thousands)

|  | Six Months Ended<br>September 30,<br>2006 | (1) October 1,<br>2005 |
|--|---|------------------------|
| <b>Cash Flows from Operating Activities:</b>   |   |                        |
| Net income   | \$ 12,422                                 | \$ 23,467              |
| <b>Adjustments to reconcile net income to net cash provided by operating activities:</b> |   |                        |
| <b>Non cash items:</b>   |   |                        |
| Depreciation and amortization  | 14,120                                    | 12,285                 |
| Stock Compensation Expense   | 5,294                                     |                        |
| Deferred tax expense   |   | 21                     |
| Gain on sales of plant, property and equipment   | (616 )                                    | (1,220 )               |
| Tax benefit related to exercise of stock options   |   | 1,142                  |
| Unrealized loss (gain) from hedging activities   | (2,716 )                                  | 1,319                  |
| In-process research and development/Other unusual charges (Note 16)                      | 9,298                                     | 362                    |
| <b>Change in operating assets and liabilities:</b>                                       |   |                        |
| Increase / (decrease) in accounts receivable, net  | 5,126                                     | (6,062 )               |
| Increase in inventories  | (5,441 )                                  | (7,687 )               |
| Decrease in prepaid income taxes   | 192                                       | 219                    |
| Other assets and other long-term liabilities   | (1,793 )                                  | (870 )                 |
| Decrease in accounts payable and accrued expenses  | (2,387 )                                  | (348 )                 |
| Net cash provided by operating activities  | 33,499                                    | 22,628                 |
| <b>Cash Flows from Investing Activities:</b>   |   |                        |
| Capital expenditures on property, plant and equipment                                    | (17,290 )                                 | (10,531 )              |
| Proceeds from sale of property, plant and equipment                                      | 1,754                                     | 2,918                  |
| Acquisition of Arryx, Inc., net of acquired cash   | (23,227 )                                 |                        |
| Net cash used in investing activities  | (38,763 )                                 | (7,613 )               |
| <b>Cash Flows from Financing Activities:</b>   |   |                        |
| Payments on long-term real estate mortgage   | (287 )                                    | (243 )                 |
| Net (decrease) / increase in short-term revolving credit agreements                      | (4,293 )                                  | 2,025                  |
| Employee stock purchase plan   | 1,012                                     | 680                    |
| Exercise of stock options and related excess tax benefits                                | 10,033                                    | 7,101                  |
| Stock Repurchase   | (10,629 )                                 |                        |
| Grant monies received  |   | 318                    |
| Net cash (used in) provided by financing activities                                      | (4,164 )                                  | 9,881                  |
| Effect of Exchange Rates on Cash and Cash Equivalents                                    | 961                                       | (730 )                 |
| <b>Net Increase in Cash and Cash Equivalents</b>   | (8,467 )                                  | 24,166                 |
| <b>Cash and Cash Equivalents at Beginning of Year</b>                                    | 250,667                                   | 185,815                |
| <b>Cash and Cash Equivalents at End of Period</b>  | \$ 242,200                                | \$ 209,981             |
| <b>Non-cash Investing and Financing Activities:</b>                                      |   |                        |
| Transfers from inventory to fixed assets for placements of Haemonetics equipment         | \$ 2,000                                  | \$ 1,736               |
| <b>Supplemental Disclosures of Cash Flow Information:</b>                                |   |                        |
| Interest paid  | \$ 731                                    | \$ 960                 |
| Income taxes paid  | \$ 12,938                                 | \$ 13,536              |

(1) Reflects the adjustment to convert our investment in Arrayx, Inc. to the equity method for periods prior to the acquisition. See Note #16

The accompanying notes are an integral part of these consolidated financial statements

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## 1. BASIS OF PRESENTATION

Our accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles ( GAAP ) in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of our management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. All significant intercompany transactions have been eliminated. Certain reclassifications were made to prior year balances to conform with the presentation of the financial statements for the six months ended September 30, 2006. Additionally, the FY06 amounts have been restated in accordance with Accounting Principles Board, Opinion No 18, The Equity Method of Accounting for Investments in Common Stock to reflect our investment in Arryx, Inc. for periods prior to the acquisition. (See note #16 Acquisition) Operating results for the six month period ended September 30, 2006 are not necessarily indicative of the results that may be expected for the full fiscal year ending March 31, 2007. For further information, refer to the audited consolidated financial statements and footnotes included in our annual report on Form 10-K for the fiscal year ended April 1, 2006.

Our fiscal year ends on the Saturday closest to the last day of March. Fiscal year 2007 and 2006 include 52 weeks with all four quarters including 13 weeks.

## 2. RECENT ACCOUNTING PRONOUNCEMENTS

In June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes which is an interpretation of FASB Statement 109, Accounting for Income Taxes . Interpretation No. 48 requires management to perform a two step evaluation for all tax positions, ensuring that these tax return positions meet the more-likely than not recognition threshold and can be measured with sufficient precision to determine the benefit recognized in the financial statements. This interpretation therefore provides management with a comprehensive model for how a company should recognize, measure, present, and disclose in its financial statements tax positions that the Company has taken or expects to take on their income tax returns. While additional efforts will be necessary to measure, present, and disclose this information, the Company does not believe that this will have a material impact on our results of operations. This statement is effective for our fiscal year 2008.

In September 2006, the FASB issued Statement No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans , which is an amendment of FASB Statements 87, 88, 106 and 123R. This statement requires that we:

- Recognize in our balance sheet an asset for a defined benefit postretirement plan s overfunded status or a liability for a plan s underfunded status.
- Measure our defined benefit postretirement plan s assets and obligations that determine the funded status as of the end of our fiscal year.
- Recognize changes in the funded status of our defined benefit post retirement plan in comprehensive income in the year in which the changes occur.

This statement is effective for this fiscal year end FY07. We do not expect this to have a significant effect as, of the various retirement programs the Company offers to its employees,

only two of these in our international locations are defined benefit plans covered by the pronouncement.

### 3. EARNINGS PER SHARE ( EPS )

The following table provides a reconciliation of the numerators and denominators of the basic and diluted earnings per share computations, as required by FASB Statement No. 128, Earnings Per Share. Basic EPS is computed by dividing net income by weighted average shares outstanding. Diluted EPS includes the effect of potentially dilutive common shares.

|                                 | <b>For the three months ended<br/>September 30, 2006</b> | <b>October 1, 2005</b> |
|---------------------------------|--|------------------------|
|                                 | <b>(in thousands, except per share amounts)</b>          |                        |
| <b>Basic EPS</b>                |  |                        |
| Net income                      | \$ 1,266   | \$ 10,758              |
| Weighted average shares         | 27,087   | 26,395                 |
| Basic earnings per share        | \$ 0.05  | \$ 0.41                |
| <b>Diluted EPS</b>              |  |                        |
| Net income                      | \$ 1,266   | \$ 10,758              |
| Basic weighted average shares   | 27,087   | 26,395                 |
| Effect of stock options         | 882  | 959                    |
| Diluted weighted average shares | 27,969   | 27,354                 |
| Diluted earnings per share      | \$ 0.05  | \$ 0.39                |

|                                 | <b>For the six months ended<br/>September 30, 2006</b> | <b>October 1, 2005</b> |
|---------------------------------|--|------------------------|
|                                 | <b>(in thousands, except per share amounts)</b>        |                        |
| <b>Basic EPS</b>                |  |                        |
| Net income                      | \$ 12,422  | \$ 23,467              |
| Weighted average shares         | 26,993   | 26,338                 |
| Basic earnings per share        | \$ 0.46  | \$ 0.89                |
| <b>Diluted EPS</b>              |  |                        |
| Net income                      | \$ 12,422  | \$ 23,467              |
| Basic weighted average shares   | 26,993   | 26,338                 |
| Effect of stock options         | 955  | 941                    |
| Diluted weighted average shares | 27,948   | 27,279                 |
| Diluted earnings per share      | \$ 0.44  | \$ 0.86                |

#### 4. STOCK-BASED COMPENSATION

On April 2, 2006, we adopted SFAS No. 123R, *Share-based Payment*, which requires that the cost resulting from all share-based payment transactions be recognized as compensation cost over the vesting period based on the fair value of the instrument on the date of grant. SFAS No. 123R revises SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS No. 123), which previously allowed pro forma disclosure of certain share-based compensation expense. Further, SFAS No. 123R supercedes Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, which previously allowed the intrinsic value method of accounting for stock options. Previously, we accounted for stock option grants using the intrinsic value method, and accordingly our reported net income did not include recognition of stock-based compensation expense prior to our adoption of SFAS No. 123R on April 2, 2006.

We adopted SFAS No. 123R as of April 2, 2006, using the modified prospective transition method. In accordance with the modified prospective transition method, our condensed consolidated financial statements for the prior periods have not been restated to reflect, and do not include, the impact of SFAS No. 123R. Stock-based compensation expense of \$5.3 million was recognized under SFAS No. 123R for the six months ended September 1, 2006. The related income tax benefit recognized was \$1.5 million. We recognize stock-based compensation on a straight line basis. As noted above, there was no stock-based compensation expense related to employee stock options recognized in the statement of income during the six months ended October 1, 2005.

For a more detailed description of our stock-based compensation plans, see Note 11 *Capital Stock to the Company* s consolidated financial statements included in our Annual Report on Form 10-K for the year ended April 1, 2006. Our stock-based compensation plans currently consist of stock options and an employee stock purchase plan. Options become exercisable in the manner specified by the Compensation Committee of our Board of Directors. Options granted in the six months ended September 30, 2006 vest over a four year period of time for employees and immediately for Directors and, expire not more than 7 years from the date of grant.

The following table illustrates the pro forma effect on net income and earnings per share if we had applied the fair value recognition provisions of SFAS 123 during the three and six months ended October 1, 2005.

|   | <b>Three Months Ended</b><br>(in thousands, except<br>per share amounts):<br>October 1, 2005 | <b>Six Months Ended</b><br>(in thousands, except<br>per share amounts):<br>October 1, 2005 |
|---|--|--|
| Net Income, as reported   | \$ 10,758  | 23,467   |
| Deduct: Total stock-based compensation expense determined under fair value method, net of tax | (2,127   | ) (3,182   |
| Pro forma net income  | \$ 8,631   | 20,576   |
| Basic EPS, as reported  | \$ 0.41  | 0.89   |
| Basic EPS, pro forma  | \$ 0.33  | 0.78   |
| Diluted EPS, as reported  | \$ 0.39  | 0.86   |
| Diluted EPS, pro forma  | \$ 0.32  | 0.76   |

SFAS No. 123R requires that cash flows relating to the benefits of tax deductions in excess of compensation cost recognized (in our reported or proforma results) be reported as a financing cash flow, rather than as an operating cash flow, as previously required. This excess tax benefit was \$1.4 million and \$1.7 million for the three and six months ended September 30, 2006, respectively.

A summary of information related to stock options is as follows:

| Stock Options                          | For the six months ended September 30, 2006 |  |  | Aggregate<br>Intrinsic<br>Value<br>(dollars in<br>thousands) |
|--|---|--|--|--|
|  | Shares                                      | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Life (Years) |  |
| Outstanding at April 1, 2006           | 3,709,258                                   | \$ 29.71                                 |  |  |
| Granted                                | 741,151                                     | 52.68                                    |  |  |
| Exercised                              | (153,933 )                                  | 22.69                                    |  |  |
| Lapsed (forfeited or cancelled)        | (23,001 )                                   | 42.09                                    |  |  |
| Outstanding at July 1, 2006            | 4,273,475                                   | \$ 33.88                                 |  |  |
| Granted                                | 115,695                                     | 47.53                                    |  |  |
| Exercised                              | (217,753 )                                  | 22.40                                    |  |  |
| Lapsed (forfeited or cancelled)        | (16,610 )                                   | 42.20                                    |  |  |
| Outstanding at September 30, 2006      | 4,154,807                                   | \$ 34.80                                 | 5.98   | \$ 54,336  |
| Exercisable at September 30, 2006      | 2,308,715                                   | \$ 28.63                                 | 5.52   | \$ 42,273  |
| Expected to Vest at September 30, 2006 | 3,909,998                                   | \$ 34.16                                 | 5.80   | \$ 53,249  |

The total intrinsic value of options exercised during the three and six months ending September 30, 2006 was \$5.2 million and \$9.0 million, respectively.

As of September 30, 2006, there was \$21.4 million of total unrecognized compensation cost related to non vested share-based compensation arrangements. That cost is expected to be recognized over a weighted average period of 2.0 years. The total fair value of shares fully vested during the six months ended September 30, 2006 was \$17.4 million.

The weighted average fair value for our options granted in the first six months of 2006 and 2005 was \$19.12 and \$14.50, respectively. The fair value was estimated using the Black-Scholes option-pricing model based on the weighted average of the high and low stock prices at the grant date and the weighted average assumptions specific to the underlying options. Expected volatility assumptions are based on the historical volatility of our common stock. The risk-free interest rate was selected based upon yields of US Treasury issues with a term equal to the expected life of the option being valued. The expected life of the option was estimated with reference to historical exercise patterns, the contractual term of the option and the vesting period. The assumptions utilized for option grants during the periods presented are as follows:

|   | September 30<br>2006 | October 1<br>2005 |   |
|---|----------------------|-------------------|---|
| Stock Options Black-Scholes assumptions (weighted average): |                      |                   |   |
| Volatility  | 0.31                 | 0.31              |   |
| Expected life (years)                                       | 5.0                  | 5.1               |   |
| Risk-free interest rate                                     | 5.00                 | % 4.04            | % |
| Dividend yield  | 0.00                 | % 0.00            | % |

## 5. ACCOUNTING FOR SHIPPING AND HANDLING COSTS

Shipping and handling costs are included in costs of goods sold with the exception of \$1.8 million and \$1.3 million for the three month periods ended September 30, 2006 and October 1, 2005, respectively, and \$3.3 million and \$2.6 million for the six month periods ended September 30, 2006 and October 1, 2005, respectively that are included in selling, general and administrative expenses. Freight is classified in costs of goods sold when the customer is charged for freight and in selling, general and administration when the customer is not explicitly charged for freight.

## 6. FOREIGN CURRENCY

We enter into forward exchange contracts to hedge the anticipated cash flows from forecasted foreign currency denominated revenues, principally Japanese Yen and Euro. The purpose of our hedging strategy is to lock in foreign exchange rates for twelve months to minimize, for this period of time, the unforeseen impact on our results of operations of fluctuations in foreign exchange rates. We also enter into forward contracts that settle within 35 days to hedge certain inter-company receivables denominated in foreign currencies. These derivative financial instruments are not used for trading purposes. The cash flows related to the gains and losses on these foreign currency hedges are classified in the consolidated statements of cash flows as part of cash flows from operating activities.

## 7. PRODUCT WARRANTIES

We provide a warranty on parts and labor for one year after the sale and installation of each device. We also warrant our disposable products through their use or expiration. We estimate our potential warranty expense based on our historical warranty experience, and we periodically assess the adequacy of our warranty accrual and make adjustments as necessary.

|  | For the three months ended              |                    |
|--|---|--------------------|
|  | September 30,<br>2006<br>(in thousands) | October 1,<br>2005 |
| Warranty accrual as of the beginning of the period | \$ 676                                  | \$ 699             |
| Warranty provision                                 | 586                                     | 536                |
| Warranty spending                                  | (584 )                                  | (536 )             |
| Warranty accrual as of the end of the period       | \$ 678                                  | \$ 699             |

|  | <b>For the six months ended</b> |                            |
|--|---------------------------------|----------------------------|
|  | <b>September 30,<br/>2006</b>   | <b>October 1,<br/>2005</b> |
|  | <b>(in thousands)</b>           |                            |
| Warranty accrual as of the beginning of the period | \$ 676                          | \$ 703                     |
| Warranty provision                                 | 820                             | 1,039                      |
| Warranty spending                                  | (818 )                          | (1,043 )                   |
| Warranty accrual as of the end of the period       | \$ 678                          | \$ 699                     |

**8. COMPREHENSIVE INCOME**

Comprehensive income is the total of net income and all other non-owner changes in stockholders' equity. For us, all other non-owner changes are primarily foreign currency translation, the change in our net minimum pension liability and the changes in fair value of the effective portion of our outstanding cash flow hedge contracts.

A summary of the components of other comprehensive income is as follows:

|   | <b>For the three months ended</b> |                            |
|---|-----------------------------------|----------------------------|
|   | <b>September 30,<br/>2006</b>     | <b>October 1,<br/>2005</b> |
|   | <b>(in thousands)</b>             |                            |
| Net income  | \$ 1,266                          | \$ 10,758                  |
| Other comprehensive income:   |                                   |                            |
| Foreign currency translation  | 800                               | (1,134 )                   |
| Unrealized (loss) gain on cash flow hedges, net of tax                        | (182 )                            | 1,220                      |
| Reclassifications into earnings of cash flow hedge (gains) losses, net of tax | (163 )                            | (271 )                     |
| Total comprehensive income  | \$ 1,721                          | \$ 10,573                  |



|   | <b>For the six months ended</b> |                            |
|---|---------------------------------|----------------------------|
|   | <b>September 30,<br/>2006</b>   | <b>October 1,<br/>2005</b> |
|   | <b>(in thousands)</b>           |                            |
| Net income  | \$ 12,422                       | \$ 23,467                  |
| Other comprehensive income:   |                                 |                            |
| Foreign currency translation  | 3,561                           | (4,894 )                   |
| Unrealized (loss) gain on cash flow hedges, net of tax                        | (1,903 )                        | 3,755                      |
| Reclassifications into earnings of cash flow hedge (gains) losses, net of tax | (900 )                          | 554                        |
| Minimum pension liabilities adjustment, net of tax                            |                                 | (52 )                      |
| Total comprehensive income  | \$ 13,180                       | \$ 22,830                  |

#### 9. INVENTORIES

Inventories are stated at the lower of cost or market and include the cost of material, labor and manufacturing overhead. Cost is determined on the first-in, first-out method.

Inventories consist of the following:

|                 | <b>September 30,<br/>2006</b> | <b>April 1,<br/>2006</b> |
|-----------------|-------------------------------|--------------------------|
|                 | <b>(in thousands)</b>         |                          |
| Raw materials   | \$ 16,274                     | \$ 14,683                |
| Work-in-process | 6,469                         | 5,528                    |
| Finished goods  | 36,182                        | 34,360                   |
|                 | \$ 58,925                     | \$ 54,571                |

#### 10. GOODWILL AND OTHER INTANGIBLE ASSETS

##### Goodwill

The change in the carrying amount of our goodwill during the six months ended September 30, 2006 is as follows (in thousands):

|  |           |
|--|-----------|
| Carrying amount as of April 1, 2006            | \$ 18,483 |
| Arryx (a)                                      | 14,926    |
| Effect of change in rates used for translation | 85        |
| Carrying amount as of September 30, 2006       | \$ 33,494 |

(a) See Note #16 Acquisition for a full description of the acquisition of Arryx, Inc. which occurred on July 18, 2006.

### Other Intangible Assets

| As of September 30, 2006<br>(in thousands)   | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Weighted Average<br>Useful life<br>(in years) |
|--|-----------------------------|-----------------------------|---|
| <b><u>Amortized Intangibles</u></b>          |                             |                             |   |
| Patents                                      | \$ 13,682                   | \$ 3,924                    | 13  |
| Other technology                             | 18,212                      | 8,483                       | 14  |
| Customer contracts and related relationships | 9,261                       | 3,342                       | 14  |
| Subtotal                                     | \$ 41,155                   | \$ 15,749                   | 14  |
| <b><u>Indefinite Life Intangibles</u></b>    |                             |                             |   |
| Trade name                                   | 509                         | n/a                         | Indefinite                                    |
| Total Intangibles                            | \$ 41,664                   | \$ 15,749                   |   |

| As of April 1, 2006<br>(in thousands)        | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Weighted Average<br>Useful life<br>(in years) |
|--|-----------------------------|-----------------------------|---|
| <b><u>Amortized Intangibles</u></b>          |                             |                             |   |
| Patents                                      | \$ 10,389                   | \$ 3,198                    | 13  |
| Other technology                             | 17,369                      | 8,349                       | 14  |
| Customer contracts and related relationships | 9,130                       | 2,900                       | 14  |
| Subtotal                                     | \$ 36,888                   | \$ 14,447                   | 14  |
| <b><u>Indefinite Life Intangibles</u></b>    |                             |                             |   |
| Trade name                                   | 503                         | n/a                         | Indefinite                                    |
| Total Intangibles                            | \$ 37,391                   | \$ 14,447                   |   |

Changes to the net carrying value of our intangible assets from April 1, 2006 to September 30, 2006, reflect the acquisition of Arryx, Inc. (see Note 16), amortization expense and the effect of exchange rate changes in the translation of our intangible assets held by our international subsidiaries.

Amortization expense for other amortizable intangible assets was \$0.7 million and \$0.5 million for the three months ended September 30, 2006 and October 1, 2005 and \$1.3 million and \$1.0 million for the six months ended September 30, 2006 and October 1, 2005, respectively. Annual amortization expense is expected to approximate \$2.6 million for fiscal years 2007 and 2008, \$3.1 million for fiscal year 2009, and \$3.7 million for both fiscal years 2010 and 2011.

## 11. INCOME TAXES

Our reported tax rate includes two principal components: an expected annual tax rate and discrete items that are recorded in the quarter that an event arises. Events or items that give rise to discrete recognition include: the finalization of open tax years, or a stock acquisition.

The reported tax rate was 82.2% and 49.3% for the current three and six month periods ended September 30, 2006 respectively. The reported tax rate includes:

A 35.5% expected annual tax rate which reflects higher tax exempt income than in prior periods and stock compensation expenses that are not deductible in all jurisdictions.

The reported rate also incorporates the \$9.1 million non-deductible In Process Research and Development charge (see Footnote #16 Acquisition) and the adjustment to convert our investment in Arryx, Inc. to the equity method.

The reported tax rate was 33.7% and 35.2% for the three and six months ended October 1, 2005, respectively.

We expect our annual tax rate to be approximately 35.5% for the remainder of fiscal year 2007. Future adjustments may also increase or decrease the reported tax rate.

The Federal Research and Experimentation tax credit that provides a tax benefit on certain incremental R&D expenditures expired on December 31, 2005. While legislation has been introduced to retroactively reinstate this R&E tax credit, it has not been enacted nor signed into law as of our fiscal quarter ended September 30, 2006. Accordingly, no benefit has been included in our effective tax rate for the first two quarters.

**12. COMMITMENTS AND CONTINGENCIES**

We are presently engaged in various legal actions, and although ultimate liability cannot be determined at the present time, we believe, based on consultation with counsel, that any such liability will not materially affect our consolidated financial position or our results of operations.

**13. DEFINED BENEFIT PENSION PLANS**

Two of the Company's foreign subsidiaries have defined benefit pension plans covering substantially all full time employees at those subsidiaries. Net periodic benefit costs for the plans in the aggregate include the following components:

|  | <b>For the three months ended<br/>September 30,<br/>2006<br/>(in thousands):</b> | <b>October 1,<br/>2005</b> |
|--|--|----------------------------|
| Service Cost   | \$ 159   | \$ 186                     |
| Interest cost on benefit obligation  | 47   | 44                         |
| Expected return on plan assets   | (21 )  | (16 )                      |
| Amortization of unrecognized prior service cost, unrecognized gain and unrecognized initial obligation | 2  | 7                          |
| Net periodic benefit cost  | \$ 187   | \$ 221                     |

|  | <b>For the six months ended<br/>September 30,<br/>2006<br/>(in thousands):</b> | <b>October 1,<br/>2005</b> |
|--|--|----------------------------|
| Service Cost   | \$ 324   | \$ 381                     |
| Interest cost on benefit obligation  | 96   | 91                         |
| Expected return on plan assets   | (41)   | (33)                       |
| Amortization of unrecognized prior service cost, unrecognized gain and unrecognized initial obligation | 3  | 13                         |
| Net periodic benefit cost  | \$ 382   | \$ 452                     |

**14. SEGMENT INFORMATION***Segment Definition Criteria*

We manage our business on the basis of one operating segment: the design, manufacture and marketing of automated blood processing systems. Our chief operating decision-maker uses consolidated results to make operating and strategic decisions. Manufacturing processes, as well as the regulatory environment in which we operate, are largely the same for all product lines.

*Product and Service Segmentation*

We have two families of products: (1) those that serve the blood donor and (2) those that serve the patient. Under the donor family of products we have included blood bank, red cell and plasma collection products. The patient products include autologous blood salvage products

targeting surgical patients who lose blood while in the operating room and while in recovery.

*Donor*

The blood bank products include machines, single use disposables and solutions that perform apheresis, (the separation of whole blood into its components and subsequent collection of certain components, including platelets and plasma) as well as the washing of red blood cells for certain procedures. In addition, the blood bank product line includes solutions used in apheresis applications. The main devices used for these blood component therapies are the MCS®+ mobile collection systems and the ACP® 215 automated cell processing system.

Red cell products include machines, single use disposables and solutions that perform apheresis for the collection of red blood cells. Devices used for the collection red blood cells are the MCS®+ 8150 mobile collection system.

Plasma collection products are machines, disposables and solutions that perform apheresis for the separation of whole blood components and subsequent collection of plasma. The devices used in automated plasma collection are the PCS®2 plasma collection system and the Superlite .

In 2003, Haemonetics entered into a marketing partnership with Hemosystems S.A. to market Hemosystems ScanSystem platelet bacterial detection system. Haemonetics planned to leverage its strong market share in the platelet collection market to accelerate adoption of platelet bacterial detection in Europe. Over the past three years, Haemonetics and Hemosystems have made progress in penetrating this market, but at a slower rate than hoped. Haemonetics has decided at this time not to renew its partnership with Hemosystems so that it can devote its sales resources to other projects.

*Patient*

Patient products include machines and single use disposables that perform surgical blood salvage in orthopedic and cardiovascular surgical applications. Surgical blood salvage is for higher blood loss surgeries and trauma. OrthoPAT technology is used for lower, slower blood loss procedures, typically orthopedic surgeries, where bleeding takes place during and after surgery. These technologies perform a procedure whereby shed blood is collected, cleansed and made available to be transfused back to the patient. Patient products include the OrthoPAT®, Cell Saver® and cardioPAT autologous blood recovery systems, and the Smart Suction Harmony which is a suction device designed to operate together with these blood recovery systems.

*Other*

Other revenue includes revenue generated from equipment repairs performed under preventive maintenance contracts or emergency service billings and miscellaneous sales, including revenue from our software division, 5D. 5D provides software support and collection and data management systems, principally to plasma collectors and the US Department of Defense.

## Revenues from External Customers:

|   | <b>Three months Ended</b> |                   |
|---|---------------------------|-------------------|
|   | <b>(in thousands)</b>     |                   |
|   | <b>September 30,</b>      | <b>October 1,</b> |
|   | <b>2006</b>               | <b>2005</b>       |
| <b>Disposable Revenues by Product Family</b>  |                           |                   |
| Donor:  |                           |                   |
| Plasma  | \$ 32,072                 | \$ 25,938         |
| Blood Bank                                    | 31,678                    | 32,193            |
| Red Cell                                      | 10,373                    | 8,903             |
|   | \$ 74,123                 | \$ 67,034         |
| Patient:                                      |                           |                   |
| Surgical                                      | \$ 15,108                 | \$ 15,394         |
| OrthoPAT                                      | 7,085                     | 4,536             |
|   | \$ 22,193                 | \$ 19,930         |
| Disposables Revenue                           | \$ 96,316                 | \$ 86,964         |
| Equipment                                     | 4,405                     | 6,623             |
| Other   | 7,766                     | 6,901             |
| <b>Total revenues from external customers</b> | <b>\$ 108,487</b>         | <b>\$ 100,488</b> |

|   | <b>Six months Ended</b> |                   |
|---|-------------------------|-------------------|
|   | <b>(in thousands)</b>   |                   |
|   | <b>September 30,</b>    | <b>October 1,</b> |
|   | <b>2006</b>             | <b>2005</b>       |
| <b>Disposable Revenues by Product Family</b>  |                         |                   |
| Donor:  |                         |                   |
| Plasma  | \$ 63,891               | \$ 53,241         |
| Blood Bank                                    | 63,044                  | 64,883            |
| Red Cell                                      | 20,973                  | 17,358            |
|   | \$ 147,908              | \$ 135,482        |
| Patient:                                      |                         |                   |
| Surgical                                      | \$ 32,309               | \$ 32,490         |
| OrthoPAT                                      | 14,641                  | 10,125            |
|   | \$ 46,950               | \$ 42,615         |
| Disposables Revenue                           | \$ 194,858              | \$ 178,097        |
| Equipment                                     | 10,013                  | 12,734            |
| Other   | 14,290                  | 12,830            |
| <b>Total revenues from external customers</b> | <b>\$ 219,161</b>       | <b>\$ 203,661</b> |

**15. RESTRUCTURING**

During the six months ended September 30, 2006, we began the reorganization of certain of our international sales and service organizations. The aggregate full year restructuring costs related to these actions are expected to be in the range of \$3 million to \$4 million on a pre-tax basis. The restructuring costs are expected to be incurred throughout this fiscal year. We expect to incur approximately \$3.0 million of employee related costs, including severance and certain other employee benefits, and up to approximately \$1.0 million of lease termination and related facility closure costs.

During the six months ended September 30, 2006, we recorded pre-tax restructuring costs of \$2.7 million as selling, general and administrative costs.

The following summarizes the restructuring activity for the six months ended September 30, 2006

| (Dollars in thousands) | Costs incurred | Payments | Balance at<br>September 30, 2006 |
|------------------------|----------------|----------|----------------------------------|
| Employee-related costs | \$ 2,375       | \$ 1,550 | \$ 825                           |
| Facility related costs | 292            | 25       | 267                              |
|                        | \$ 2,667       | \$ 1,575 | \$ 1,092                         |

**16. ACQUISITION**

On July 18, 2006, the Company acquired the remaining outstanding shares of Arryx, Inc. for \$26 million. We previously had a \$5 million cost method investment in Arryx, Inc. as well as a license agreement for the use of its technology in a defined field of use with a carrying value of approximately \$3 million. The results of Arryx, Inc. have been included in our consolidated financial statements for periods after the acquisition date, and we have restated our prior period financial results to record our cost method investment on the equity method of accounting in accordance with Accounting Principles Board, Opinion No 18, *The Equity Method of Accounting for Investments in Common Stock* which resulted in recognizing our 18.6% proportionate share of Arryx losses in periods prior to the current acquisition. We recorded cumulative equity method losses of \$1.3 million for periods prior to the acquisition date. We recorded an in-process research and development charge of \$9.1 million in connection with this acquisition.

***Purchase Price***

The Company has accounted for the acquisition of Arryx, Inc. as the purchase of a business under U.S. generally accepted accounting principles. Under the purchase method of accounting, the assets and liabilities of Arryx, Inc. were recorded as of the acquisition date, at their respective fair values, and consolidated with those of Haemonetics. The purchase price is based upon estimates of the fair value of assets acquired and liabilities assumed. The purchase price allocation will be finalized no later than one year from the acquisition date. The preparation of the valuation required the use of significant assumptions and estimates. Critical estimates included, but were not limited to, future expected cash flows, including product and license revenues, and the applicable discount rates. These estimates were based on assumptions that the Company believes to be reasonable. However, actual results may differ from these estimates.

The preliminary purchase price is as follows (amounts in 000 s):

| <u>Consideration for Arryx, Inc.</u>  |                  |
|---|------------------|
| Cash portion of consideration   | \$ 26,558        |
| License agreement with Arryx, Inc.  | 3,298            |
| Cost Method Investment, representing 18.6% of outstanding Arryx, Inc. Shares            | 5,000            |
| Adjust Cost Method Investment to Equity Method in accordance with Accounting Principles |                  |
| Board Opinion No 18   | (1,311 )         |
| <b>Total Consideration</b>  | <b>33,545</b>    |
| <u>Other acquisition-related costs</u>  |                  |
| Other estimated acquisition-related costs   | 447              |
| <b>Total acquisition related costs</b>  | <b>\$ 33,992</b> |

We applied the guidance under EITF 04-1, *Accounting for Preexisting Relationships between the Parties to a Business Combination*, to determine if any gain or loss was inherent in our existing license agreement with Arryx, Inc. We determined that no loss was inherent in this existing contractual relationship with Arryx, Inc., and accordingly included it at its net book value at the acquisition date in the purchase price determination.

#### *Purchase Price Allocation*

The following chart summarizes the preliminary purchase price allocation

| <b>(in thousands)</b>                     |                  |
|---|------------------|
| Cash                                      | \$ 3,900         |
| Intangible assets subject to amortization | 6,028            |
| Goodwill                                  | 14,926           |
| Other assets                              | 565              |
| Deferred Tax Asset, Long Term             | 2,696            |
| In-process research and development       | 9,073            |
| Current liabilities                       | (785 )           |
| Deferred tax liabilities                  | (2,411 )         |
| <b>Total</b>                              | <b>\$ 33,992</b> |

The deferred tax liability primarily relates to the tax impact of future amortization associated with the identified intangible assets acquired, which are not deductible for tax purposes.

The excess of the purchase price over the fair value of net tangible assets acquired was allocated to specific intangible asset categories as follows:



| (in thousands)                             | Amount<br>Assigned | Weighted<br>Average<br>Amortization<br>Period | Risk-Adjusted<br>Discount Rate used in<br>Purchase Price<br>Allocation |   |
|--|--------------------|---|--|---|
| <b>Amortizable intangible assets</b>       |                    |   |  |   |
| Technology developed                       | \$ 2,735           | 10 years                                      | 26   | % |
| Patents                                    | 3,293              | 12 years                                      | 25   | % |
|  | \$ 6,028           | 10.5 years                                    |  |   |
| <b>Goodwill</b>                            |                    |   |  |   |
|  | \$ 14,926          |   |  |   |
| <b>In-process research and development</b> |                    |   |  |   |
|  | \$ 9,073           |   | 29   | % |

The Company believes that the estimated intangible assets represent the fair value at the date of acquisition and do not exceed the amount a third party would pay for the assets. The Company used the income approach to determine the fair value of the amortizable intangible assets and purchased research and development.

Various factors contributed to the establishment of goodwill, including: the value of Arryx, Inc.'s highly trained work force as of the acquisition date, the expected business plans and associated revenue from future products and license opportunities. The goodwill acquired is not deductible for tax purposes.

The developed technology acquired represents the value associated with currently marketed product, the BioRx device. This device employs holographic optical trapping (HOT) technology, and is currently used by large research and educational institutions. The Company used the income approach to estimate the fair value of the developed technology as of the acquisition date. The Company determined that the estimated useful life of the developed technology is 10 years.

The estimated fair value of the patents was determined by using the income approach. The estimated revenues and associated cash flows attributable to the patent portfolio were discounted. The estimated useful life of the patent asset is estimated to be 12 years.

#### *In-process Research and Development*

The \$9.1 million purchased research and development that was charged to operating expenses consists of a project for the advancement and development of the technology in the blood collection and testing applications and for the purposes of licensing the technology outside of the blood collection and testing marketplace. The project includes work to reduce the size of the technology, including reducing the size of the laser, and developing mechanisms to label samples and collections.

For purposes of valuing the acquired purchased research development, the Company estimated total costs to complete the current development of the platform of approximately \$11 million. We estimate this project will be complete at the end of fiscal year 2008. For the in-process project the Company acquired in connection with the acquisition of Arryx, Inc., it used a risk-adjusted discount rate of 29% to discount the projected cash flows. The Company believes that the estimated purchased research and

development amounts so determined represent the fair value at the date of acquisition and do not exceed the amount a third party would pay for the projects.

The major risks and uncertainties associated with the timely and successful completion of the in-process research and development project include the ability to both complete the development of the platform and to establish its effectiveness for different applications for the purposes of licensing the technology outside of the blood collection and testing marketplace.

#### **17. CAPITALIZATION OF SOFTWARE DEVELOPED FOR INTERNAL USE**

The Company is implementing an Enterprise Resource Plan (ERP) system. We plan to implement the system in three phases over the next three years

The cost of software that is developed for internal use is accounted for pursuant to AICPA Statement of Position 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use ( SOP 98-1 ). Pursuant to SOP 98-1, the Company capitalizes costs incurred during the application development stage of software developed for internal use, and expenses costs incurred during the preliminary project and the post-implementation operation stages of development. During the first six month of 2006, the Company capitalized \$2.5 million in costs incurred for acquisition of the software license and related software development costs for new internal software development that was in the application stage. The total capitalized costs incurred to date include \$1.9 million for the cost of the software license and \$0.6 million in internal personnel and third party development costs.

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

This Management's Discussion and Analysis of Financial Condition and Results of Operations ( MD&A ) should be read in conjunction with both our interim consolidated financial statements and notes thereto which appear elsewhere in this Quarterly Report on Form 10-Q and the MD&A contained in our fiscal year 2006 Annual Report on Form 10-K filed with the Securities and Exchange Commission (the SEC ) on June 9, 2006. The following discussion may contain forward-looking statements and should be read in conjunction with the **Cautionary Statement Regarding Forward-Looking Information** beginning on page 38.

**Our Business**

We design, manufacture and market automated systems for the collection, processing and surgical salvage of donor and patient blood, including the single-use disposables used with our systems and related data management software. Our systems allow users to collect and process only the blood component(s) they target, plasma, platelets, or red blood cells, increasing donor and patient safety as well as collection efficiencies. Our systems consist of proprietary disposable sets that operate on our specialized equipment. Our data management systems are used by blood collectors to improve the safety and efficiency of blood collection logistics by eliminating previously manual functions at commercial plasma and not-for-profit blood banks.

We either sell our devices to customers (resulting in equipment revenue) or place our devices with customers subject to certain conditions. When the device remains our property, the customer has the right to use it for a period of time as long as the customer meets certain conditions we have established, which among other things, generally include one or more of the following:

- Purchase and consumption of a minimum level of disposable products
- Payment of monthly rental fees
- An asset utilization performance metric, such as performing a minimum level of procedures per month per device.

Our disposable revenue stream (including sales of disposables and fees for the use of our equipment) accounted for approximately 88.8% and 86.5% of our total revenues for the second quarter of fiscal year 2007 and 2006, respectively and 88.9% and 87.4% of our total revenues for the first six months of fiscal year 2007 and 2006 respectively.

## Financial Summary

|                            | For the three months ended                                     |                        |               | %<br>Increase/<br>(Decrease)<br>Q2FY07<br>vs.<br>Q2FY06 | For the six months ended |                        |               | %<br>Increase/<br>(Decrease)<br>YTDFY07<br>vs.<br>YTDFY06 |
|----------------------------|--|------------------------|---------------|---|--------------------------|------------------------|---------------|---|
|                            | September 30,<br>2006<br>(in thousands, except per share data) | October 1,<br>2005 (1) |               |   | September 30,<br>2006    | October 1,<br>2005 (1) |               |   |
| Net revenues               | \$ 108,487   | \$ 100,488             | <b>8.0</b>    | %   | \$ 219,161               | \$ 203,661             | <b>7.6</b>    | %   |
| Gross Profit               | 55,162   | 51,765                 | <b>6.6</b>    |   | 112,535                  | 106,289                | <b>5.9</b>    |   |
| <i>% of net revenues</i>   | 50.8   | % 51.5                 | %             |   | 51.3                     | % 52.2                 | %             |   |
| Operating income           | 5,156  | 15,192                 | <b>(66.1)</b> | )   | 20,047                   | 33,512                 | <b>(40.2)</b> | )   |
| <i>% of net revenues</i>   | 4.8  | % 15.1                 | %             |   | 9.1                      | % 16.5                 | %             |   |
| Provision for income tax   | 5,845  | 5,476                  | <b>6.7</b>    |   | 12,093                   | 12,723                 | <b>(5.0)</b>  | )   |
| <i>% of pre-tax income</i> | 82.2   | % 33.7                 | %             |   | 49.3                     | % 35.2                 | %             |   |
| Net income                 | \$ 1,266   | \$ 10,758              | <b>(88.2)</b> | )   | \$ 12,422                | \$ 23,467              | <b>(47.1)</b> | )   |
| <i>% of net revenues</i>   | 1.2  | % 10.7                 | %             |   | 5.7                      | % 11.5                 | %             |   |
| Earnings per share-diluted | \$ 0.045   | \$ 0.393               | <b>(88.5)</b> | )%  | \$ 0.444                 | \$ 0.860               | <b>(48.4)</b> | )%  |

(1) Reflects the adjustment to convert our investment in Arrayx, Inc. to the equity method for periods prior to the acquisition. See Note

Net revenues increased 8.0% and 7.6%, respectively for the second quarter and the first six months of fiscal year 2007 over the comparable period of fiscal year 2006. The effects of foreign exchange accounted for an increase of 0.1% and 0.2%, respectively for the second quarter and the first six months. The remaining increase of 7.9% for the quarter and 7.5% for the first six months is mainly due to increases in our disposable and software support revenues. The increase in disposable revenue for the quarter and the first six months resulted primarily from disposable unit increases in our plasma, orthopedic and red cell product lines.

Gross profit increased 6.6% and 5.9%, respectively for the second quarter and the first six months of fiscal year 2007 over the comparable period of fiscal year 2006. The unfavorable effects of foreign exchange accounted for a decrease of 1.8% for the quarter and 0.6% for the first six months. The remaining increase of 8.4% for the quarter and 6.6% for the first six months was due primarily to increased sales and cost reductions, offset partly by changes in product mix.

Operating income decreased 66.1% and 40.2%, respectively for the second quarter and the first six months of fiscal year 2007 over the comparable period of fiscal year 2006. The unfavorable effects of foreign exchange accounted for decrease of operating income of 7.5% for the quarter and 0.8% for the first six months. Without the unfavorable effects of foreign exchange operating income decreased 59.3% for the quarter and 39.8% for the first six months. Other key changes without the effects of foreign exchange were as follows:

- Gross profit improvements increased operating income by 28.6% for the quarter and 20.9% for the first six months.
- Increased operating expenses reduced operating income by 88.4% for the quarter and 58.7% for the first six months. These increased operating expenses included certain significant items that accounted for a reduction in

operating income of 81.6% for the quarter and 50.5% for the first six months. These items included:

§ An in process research and development charge of \$9.1 million was taken in the second quarter in connection with the acquisition of Arryx, Inc. This charge reduced operating income by 59.7% for the quarter and 29.0% for the first six months.

§ Stock compensation expense related to the adoption of SFAS 123R accounted for a reduction in operating income of 14.6% for the quarter and 15.5% for the first six months.

§ Restructuring costs, principally in our international operations, accounted for a reduction in operating income of 7.3% for the quarter and 8.0% for the first six months.

Net income decreased 88.2% for the second quarter of fiscal year 2007 and 47.1% for the first six months over the comparable period of fiscal year 2006. The unfavorable effects of foreign exchange accounted for decreases of 2.6% and 0.9%, respectively for the quarter and first six months of fiscal year 2007. Without the unfavorable effects of foreign exchange net income decreased 86.2% and 46.6%, respectively, for the second quarter and first six months of fiscal year 2007 over the comparable period of fiscal year 2006. The main factors that affected net income were the decreases in operating income due to the reasons mentioned above offset partly by increased interest income.

## RESULTS OF OPERATIONS

### Net Revenues

#### By Geography

| (in thousands) | For the three months ended |                 |  | % Increase/ (Decrease) Q2FY07 vs. Q2FY06 | For the six months ended |                 |  | % Increase/ (Decrease) YTD FY07 vs. YTD FY06 |
|----------------|----------------------------|-----------------|--|--|--------------------------|-----------------|--|--|
|                | September 30, 2006         | October 1, 2005 |  |  | September 30, 2006       | October 1, 2005 |  |  |
| United States  | \$ 46,811                  | \$ 37,930       |  | 23.4 %                                   | \$ 93,231                | \$ 76,153       |  | 22.4 %                                       |
| International  | 61,676                     | 62,558          |  | (1.4 )                                   | 125,930                  | 127,508         |  | (1.2 )                                       |
| Net revenues   | \$ 108,487                 | \$ 100,488      |  | 8.0 %                                    | \$ 219,161               | \$ 203,661      |  | 7.6 %  |

**International Operations and the Impact of Foreign Exchange**

Our principal operations are in the U.S., Europe, Japan and other parts of Asia. Our products are marketed in more than 50 countries around the world via a direct sales force as well as independent distributors.

Our revenues generated outside the U.S. approximated 57% and 62% of total sales for the second quarters of fiscal years 2007 and 2006, respectively and 57% and 63% for the first six months of fiscal years 2007 and 2006, respectively. Revenues in Japan accounted for approximately 21.5% and 25.9% of total revenues for the second quarter of fiscal year 2007 and 2006, respectively and 20.9% and 25.2% of total revenues for the first six months of fiscal year 2007 and 2006, respectively. Revenues in Europe accounted for approximately 26.4% and 27.6% of total revenues for the second quarters of fiscal year 2007 and 2006 and 27.9% and 29.0% of total revenues for the first six months of fiscal year 2007 and 2006, respectively. International sales are primarily conducted in local currencies, primarily the Japanese Yen and the Euro. Accordingly, our results of operations can be significantly affected by changes in the value of the Yen and the Euro relative to the U.S. dollar. The effects of foreign exchange resulted in a 0.1% increase in revenues quarter over quarter and 0.2% increase in revenues for the first six months of fiscal year 2007 over the comparable period in fiscal year 2006.

Please see section entitled "Foreign Exchange" in this discussion for a more complete explanation of how foreign currency affects our business and our strategy for managing this exposure.

***Net Revenues******By Product Type***

| (in thousands)      | For the three months ended |                   |            | % Increase/ (Decrease) Q2FY07 vs. Q2FY06 | For the six months ended |                   |            | % Increase/ (Decrease) YTDFY07 vs. YTDFY06 |
|---------------------|----------------------------|-------------------|------------|--|--------------------------|-------------------|------------|--|
|                     | September 30, 2006         | October 1, 2005   |            |  | September 30, 2006       | October 1, 2005   |            |  |
| Disposables         | \$ 96,316                  | \$ 86,964         | 10.8       | %  | \$ 194,858               | \$ 178,097        | 9.4        | %  |
| Equipment           | 4,405                      | 6,623             | (33.5)     | )  | 10,013                   | 12,734            | (21.4)     | )  |
| Misc. & service     | 7,766                      | 6,901             | 12.5       |  | 14,290                   | 12,830            | 11.4       |  |
| <b>Net revenues</b> | <b>\$ 108,487</b>          | <b>\$ 100,488</b> | <b>8.0</b> | <b>%</b>                                 | <b>\$ 219,161</b>        | <b>\$ 203,661</b> | <b>7.6</b> | <b>%</b>                                   |

*Disposables Revenues**By Product Type*

| (in thousands)                   | For the three months ended |                  |             | % Increase/ (Decrease) Q2FY07 vs. Q2FY06 | For the six months ended |                   | % Increase/ (Decrease) YTD FY07 vs. YTD FY06 |
|----------------------------------|----------------------------|------------------|-------------|--|--------------------------|-------------------|--|
|                                  | September 30, 2006         | October 1, 2005  |             |  | September 30, 2006       | October 1, 2005   |  |
| <i><u>Donor:</u></i>             |                            |                  |             |  |                          |                   |  |
| Plasma                           | \$ 32,072                  | \$ 25,938        | 23.6        | %  | \$ 63,891                | \$ 53,241         | 20.0 %                                       |
| Blood Bank                       | 31,678                     | 32,193           | (1.6)       | )  | 63,044                   | 64,883            | (2.8)  |
| Red Cell                         | 10,373                     | 8,903            | 16.5        |  | 20,973                   | 17,358            | 20.8   |
| <b>Subtotal</b>                  | <b>\$ 74,123</b>           | <b>\$ 67,034</b> | <b>10.6</b> |  | <b>\$ 147,908</b>        | <b>\$ 135,482</b> | <b>9.2 %</b>                                 |
| <i><u>Patient:</u></i>           |                            |                  |             |  |                          |                   |  |
| Surgical                         | \$ 15,108                  | \$ 15,394        | (1.9)       | )  | \$ 32,309                | \$ 32,490         | (0.6)  |
| OrthoPAT                         | 7,085                      | 4,536            | 56.2        |  | 14,641                   | 10,125            | 44.6   |
| <b>Subtotal</b>                  | <b>\$ 22,193</b>           | <b>\$ 19,930</b> | <b>11.4</b> |  | <b>\$ 46,950</b>         | <b>\$ 42,615</b>  | <b>10.2</b>                                  |
| <b>Total disposables revenue</b> | <b>\$ 96,316</b>           | <b>\$ 86,964</b> | <b>10.8</b> | <b>%</b>                                 | <b>\$ 194,858</b>        | <b>\$ 178,097</b> | <b>9.4 %</b>                                 |



## DONOR PRODUCTS

Donor products include the Plasma, Blood Bank and Red Cell product lines. Disposable revenue for donor products increased 10.6% compared to the second quarter of fiscal year 2006 and 9.2% for the first six months over the comparable period in fiscal year 2006. Foreign exchange resulted in a 0.1% increase for the second quarter and 0.2% increase in donor disposable revenue for the first six months over the comparable period in fiscal year 2006. The remaining increase was the result of increases in the Plasma and Red Cell product lines partially offset by the decreased Blood Bank product line, as discussed below.

### Plasma

Plasma disposable revenue increased 23.6% and 20%, respectively, for the second quarter and the first six months of fiscal year 2007 compared to the same periods in fiscal year 2006. Foreign exchange resulted in a 0.4% increase in plasma disposable revenue for the quarter and first six months. Of the remaining increase of 23.2% for the quarter and 19.6% for the first six months, the U.S. and Europe revenue growth combined contributed more than 100% of the increase, partially offset by a decrease in Japan of approximately 20%. The U.S. increase was due to market share growth over second quarter and first six months of fiscal year 2006 that relates largely to the conversion to Haemonetics systems by one very large customer, ZLB Plasma services ( ZLB ) that took place during fiscal year 2006 but is in full operation in fiscal year 2007. Plasma growth is also the result of increases in collections by our customers as the demand for source plasma continues to strengthen. Conversely, in Japan, fewer plasma collections were performed by our customer, the Japan Red Cross Society (JRC) as compared to the comparable period in fiscal 2006.

### Blood Bank

Blood bank disposable revenue for donor products decreased 1.6% and 2.8%, respectively, for the second quarter and the first six months of fiscal year 2007 compared to the same periods in of fiscal year 2006. Foreign exchange resulted in a 0.2% decrease in blood bank disposable revenue during the quarter and 0.3% increase in the first six months over the comparable period in fiscal year 2006.

Without the effect of currency, blood bank revenue decreased 1.4% for the quarter and 3.1% for the first six months over fiscal year 2006. In the quarter and for the first six month, Japan accounts for the majority of the decrease which is the result of lower platelet collections and comparison to a period that included a temporary increase in market share due to quality issues of a competitor in early FY06.

### Red Cell

Red Cell disposable revenue increased 17.4% compared to the second quarter of fiscal year 2006 and 21.3% compared to the first six months of fiscal year 2006. Foreign exchange accounted for increases of 0.6% and 0.3%, respectively, for the second quarter and the first six months over the comparable period in fiscal year 2006. Of the remaining increase of 16.8% for the second quarter and 21.1% for the first six months, the U.S. contributed over 90% of the increase. The increase in the U.S. is due to penetration strategies at existing customer suites and to a shift to higher priced filtered sets, which include a filter to remove white blood cells from the collected blood and an increase in units sold.

In 2003, Haemonetics entered into a marketing partnership with Hemosystems S.A. to market Hemosystems ScanSystem platelet bacterial detection system. Haemonetics planned to leverage its

strong market share in the platelet collection market to accelerate adoption of platelet bacterial detection in Europe. Over the past three years, Haemonetics and Hemosystems have made progress in penetrating this market, but at a slower rate than hoped. Haemonetics has decided at this time not to renew its partnership with Hemosystems so that it can devote its sales resources to other projects.

## PATIENT PRODUCTS

The patient product line has two major brand platforms: the Cell Saver® brand and the OrthoPAT® brand. Patient disposable revenue increased 11.4% compared to the second quarter of fiscal year 2006 and 10.2% compared to the first six months of fiscal year 2006. Foreign exchange resulted in a 0.4% increase in patient disposable revenue during the quarter and 0.3% during the first six months. Without the effects of currency, surgical disposable revenue increased 11.0% for the quarter and 9.9% for the first six months.

### Surgical

Surgical disposables revenue decreased 1.8% as compared to the second quarter of fiscal year 2006 and 0.5% as compared to the first six months of fiscal year 2006. Foreign exchange resulted in a 0.4% and 0.3% respectively, increase in surgical disposable revenue during the quarter and the first six months of fiscal year 2006. Surgical disposable revenue principally consists of Cell Saver brand products. Without the effect of currency, surgical disposable revenue decreased 2.2% for the quarter and 0.9% for the first six months. Demand is declining due to fewer open heart surgeries and due to a change in the reimbursement policies of certain European countries.

### OrthoPAT

OrthoPAT disposables revenue increased 56.2% as compared to the second quarter of fiscal year 2006 and 44.6% for the first six month of fiscal year 2006. Foreign exchange resulted in a 0.5% increase in OrthoPAT disposable revenue during the quarter and 0.2% for the first six months. Without foreign exchange, revenues increased by 55.7% and 44.4%, respectively, for the second quarter and the first six months of fiscal year 2007 compared to the same period in fiscal year 2006. Growth was largely in the U.S. The sales increase in the U.S. is attributable to higher prices realized as we transition from employing a distributor to direct selling through our Patient sales force.

## Other Revenues

|                             | For the three months ended |                  |  | For the six months ended |                 | % Increase/ (Decrease) YTD FY07 vs. YTD FY06 |
|-----------------------------|----------------------------|------------------|--|--------------------------|-----------------|--|
|                             | September 30, 2006         | October 1, 2005  | % Increase/ (Decrease) Q2FY07 vs. Q2FY06 | September 30, 2006       | October 1, 2005 |  |
| (in thousands)              |                            |                  |  |                          |                 |  |
| Equipment                   | \$ 4,405                   | \$ 6,623         | (33.5)%                                  | \$ 10,013                | \$ 12,734       | (21.4)%                                      |
| Miscellaneous & Service     | 7,766                      | 6,901            | 12.5                                     | 14,290                   | 12,830          | 11.4   |
| <b>Total other revenues</b> | <b>\$ 12,171</b>           | <b>\$ 13,524</b> | <b>(10.0)%</b>                           | <b>\$ 24,303</b>         | <b>25,564</b>   | <b>(4.9)%</b>                                |

Equipment revenue decreased 33.5% as compared to the second quarter of fiscal year 2006 and 21.4% as compared to the first six months of fiscal year 2006. Foreign exchange resulted in a 0.3% increase for the quarter and 0.3% decrease for the first six months in equipment revenue. The remaining decrease of 33.8% for the quarter consists of decreases in cell processing equipment sales in the U.S. and Cell Saver equipment sales in Japan, U.S. and Europe. The remaining decrease of 21.1% for the first six months over fiscal year 2006 consists of decreases in Cell Saver equipment sales in the U.S. and Japan, platelet equipment in Japan, and red cell and cell processing equipment sales in the U.S., partly offset by strong plasma equipment sales in Europe. Equipment sales fluctuate from period to period.

Our miscellaneous and service revenue includes revenue from repairs performed under preventive maintenance contracts or emergency service visits, spare part sales, various training programs and revenue from our software division, 5D.

Miscellaneous and Service revenue increased 12.5% as compared to the second quarter of fiscal year 2006 and 11.4% for the first six months compared to fiscal year 2006. Foreign exchange resulted in a 1.2% increase in miscellaneous and service revenue during the quarter and 1.9% decrease for the first six months. Of the remaining increase of 11.3% for the quarter and 13.3% for the first six months, the increase for the quarter and six months is largely due to increased revenues from 5D. These increased sales were principally the result of a software support contract for a military customer.

### Gross Profit

| (in thousands)           | For the three months ended |                  |          | % Increase/Decrease) Q2FY07 vs. Q2FY06 | For the six months ended |                   |          | % Increase/Decrease) YTD FY07 vs. YTD FY06 |
|--------------------------|----------------------------|------------------|----------|--|--------------------------|-------------------|----------|--|
|                          | September 30, 2006         | October 1, 2005  |          |  | September 30, 2006       | October 1, 2005   |          |  |
| <b>Gross Profit</b>      | <b>\$ 55,162</b>           | <b>\$ 51,765</b> |          | <b>6.6</b>                             | <b>\$ 112,535</b>        | <b>\$ 106,289</b> |          | <b>5.9</b>                                 |
| <i>% of net revenues</i> | <i>50.8</i>                | <i>% 51.5</i>    | <i>%</i> |  | <i>51.3</i>              | <i>% 52.2</i>     | <i>%</i> |  |

Gross profit increased 6.6% and 5.9%, respectively, as compared to the second quarter and first six months of fiscal year 2006. Foreign exchange resulted in a 1.8% decrease for the quarter and 0.6% for the first six months in gross profit as compared to fiscal year 2006. The remaining increase of 8.4% for the quarter and 6.6% for the first months was due primarily to i) the net increase in sales, and ii) improved manufacturing efficiencies as a result of more product being produced in our plants partly offset by (iii) product mix as we sold more commercial plasma product with lower gross margins (iv) an increase in equipment depreciation expense primarily as a result of additional machines placed at our US commercial plasma customers related to market share gains and collection growth and (v) a \$1.1 million reserve for equipment and components that took place in fiscal year 2006.

**Operating Expenses**

| (in thousands)                      | For the three months ended |                  |  |          | For the six months ended |                  |  |          |
|-------------------------------------|----------------------------|------------------|--|----------|--------------------------|------------------|--|----------|
|                                     | September 30, 2006         | October 1, 2005  | % Increase/ (Decrease) Q2FY07 vs. Q2FY06 |          | September 30, 2006       | October 1, 2005  | % Increase/ (Decrease) YTD FY07 vs. YTD FY06 |          |
| Research and development            | \$ 6,119                   | \$ 6,283         | (2.6)                                    | )%       | \$ 11,541                | \$ 11,824        | (2.4)  | )%       |
| <i>% of net revenues</i>            | 5.6                        | % 6.3            | %  |          | 5.3                      | % 5.8            | %  |          |
| Selling, general and administrative | 34,741                     | 30,103           | 15.4                                     | %        | 71,649                   | 60,591           | 18.3   |          |
| <i>% of net revenues</i>            | 32.0                       | % 30.0           | %  |          | 32.7                     | % 29.8           | %  |          |
| <i>In-Process R&amp;D</i>           | 9,073                      | 0                |  |          | 9,073                    | 0                |  |          |
| <i>Cost to Equity</i>               | 73                         | 187              | (61.0)                                   | )%       | 225                      | 362              | (37.8)                                       | )%       |
| <b>Total Operating Expenses</b>     | <b>\$ 50,006</b>           | <b>\$ 36,573</b> | <b>36.7</b>                              | <b>%</b> | <b>\$ 92,488</b>         | <b>\$ 72,777</b> | <b>27.1</b>                                  | <b>%</b> |
| <i>% of net revenues</i>            | <b>46.1</b>                | <b>% 36.4</b>    | <b>%</b>                                 |          | <b>42.2</b>              | <b>% 35.7</b>    | <b>%</b>                                     |          |

**Research and Development**

Research and development expenses decreased 2.6% as compared to current quarter of fiscal year 2006 and 2.4% for the first six months as compared to fiscal year 2006. Foreign exchange resulted in a 0.3% increase in research and development during the quarter and a 0.3% decrease in research and development during the first six months. The significant factor in the remaining decrease of 2.9% for the quarter and 2.1% for the first six months was lower research and development expenses primarily related to capitalization of software development costs in first and second quarter in fiscal year 2007 that we did not capitalize until third quarter of fiscal year 2006 after reaching technological feasibility. New product spending was significantly directed towards the development of our new, multi-component collection platform.

**Selling, General and Administrative**

During the second quarter of fiscal year 2007, selling, general and administrative expenses increased 15.4% and 18.3% for the first six months. Foreign exchange resulted in a 0.6% increase in selling, general and administrative during the quarter and a 0.6% decrease in selling, general and administrative during the first six months. Excluding the impact of foreign exchange, selling, general and administrative expense increased 14.9% and 19.2%, respectively for the second quarter and first six months as compared to comparable periods in fiscal year 2006. The increase for the quarter was largely

due (i) stock compensation expense related to the adoption of FAS 123R which accounted for 50.3% of the increase for the quarter and 44.8% for the first six months (ii) restructuring related costs mainly in our international operations which accounted for 25.2% of the increase for the second quarter and 23.7% for the first six months and (iii) expansion of sales and marketing staff, particularly our patient sales force and increased reserves for bad debt.

### ***In Process Research and Development***

#### *Purchased Research and Development*

The \$9.1 million purchased research and development that was charged to operating expenses consists of a project for the advancement and development of the technology in the blood collection and testing applications, and for the purposes of licensing the technology outside of the blood collection and testing marketplace. The project includes work to reduce the size of the technology, including reducing the size of the laser, and developing mechanisms to label samples and collections.

For purposes of valuing the acquired purchased research development, the Company estimated total costs to complete the current development of the platform of approximately \$11 million. For the in-process project the Company acquired in connection with the acquisition of Arrayx, Inc., it used a risk-adjusted discount rate of 29% to discount the projected cash flows. The Company believes that the estimated purchased research and development amounts so determined represent the fair value at the date of acquisition and do not exceed the amount a third party would pay for the projects.

### **Operating Income**

| (in thousands)           | For the three months ended |                      |  | For the six months ended |                      |                 | % Increase/ (Decrease) YTD FY07 vs. YTD FY06 |
|--------------------------|----------------------------|----------------------|--|--------------------------|----------------------|-----------------|--|
|                          | September 30, 2006         | October 1, 2005      | % Increase/ (Decrease) Q2FY07 vs. Q2FY06 | September 30, 2006       | October 1, 2005      | %               |  |
| <b>Operating income</b>  | <b>\$ 5,156</b>            | <b>\$ 15,192</b>     | <b>(66.1 )%</b>                          | <b>\$ 20,047</b>         | <b>\$ 33,512</b>     | <b>(40.2 )%</b> |  |
| <i>% of net revenues</i> | <b>4.8</b>                 | <i>%</i> <b>15.1</b> | <i>%</i>                                 | <b>9.1</b>               | <i>%</i> <b>16.5</b> | <i>%</i>        |  |

Operating income decreased 66.1% and 40.2%, respectively, as compared to the second quarter and first six months of fiscal year 2006. Foreign exchange resulted in a 7.5% decrease in operating income during the quarter and 0.8% decrease during the first six months. Without the effects of foreign currency, operating income decreased 59.3% for the quarter and 39.8% for the first six months primarily due to increases in operating expenses that exceeded increases in gross profit. The primary contributors to higher operating expenses were (i) in process R&D related to Arrayx, (ii) stock compensation expense related to the adoption of FAS 123R (iii) restructuring related costs mainly in our international operations, (iv) expansion of sales and marketing staff, particularly our patient sales force and (v) increased reserves for bad debt. These increases more than offset the increases in gross profit.

**Other income, net**

| (in thousands)          | For the three months ended |                    |   | For the six months ended |                    |          | %<br>Change/<br>YTD<br>FY07 vs.<br>YTD<br>FY06 |
|-------------------------|----------------------------|--------------------|---|--------------------------|--------------------|----------|--|
|                         | September 30,<br>2006      | October 1,<br>2005 | %<br>Change/<br>Q2FY07<br>vs.<br>Q2FY06 | September 30,<br>2006    | October 1,<br>2005 |          |  |
| Interest expense        | \$ (421 )                  | \$ (522 )          | (19.3 )%                                | \$ (846 )                | \$ (1,063 )        | (20.4 )% |  |
| Interest income         | 1,951                      | 1,083              | 80.1                                    | 3,977                    | 2,396              | 66.0     |  |
| Other income, net       | 425                        | 481                | (11.6 )                                 | 1,337                    | 1,345              | (0.6 )   |  |
| Total other income, net | \$ 1,955                   | \$ 1,042           | 87.6 %                                  | \$ 4,468                 | \$ 2,678           | (66.8 )% |  |
| % of net revenues       | 1.8                        | % 1.0              | %                                       | 2.0                      | % 1.3              | %        |  |

Total other income, net increased during both the second quarter and six month periods of fiscal year 2007. Interest income, net increased due to lower average debt outstanding, higher cash balances and higher interest rates. Other income, net decreased for the six month periods of fiscal year 2007, as a result of increases in hedge-points which was more than offset by a \$0.3 million insurance settlement on a property loss during the first quarter of fiscal year 2006. Hedge-points on forward contracts are amounts, either expensed or earned, based on the interest rate differential between two foreign currencies in a forward hedge contract.

**Income Taxes**

| (in thousands)                  | For the three months ended |   |                 |   | For the six months ended |   |                 |      | % Increase/ (Decrease) YTD FY07 vs. YTD FY06 |   |
|---------------------------------|----------------------------|---|-----------------|---|--------------------------|---|-----------------|------|--|---|
|                                 | September 30, 2006         |   | October 1, 2005 |   | September 30, 2006       |   | October 1, 2005 |      |  |   |
| <i>Reported Income Tax Rate</i> | 82.2                       | % | 33.7            | % | 48.5                     | % | 49.3            | 35.2 | 14.2   | % |

Our reported tax rate includes two principal components: an expected annual tax rate and discrete items that are recorded in the quarter that an event arises. Events or items that give rise to discrete recognition include: the finalization of open tax years or a stock acquisition.

The reported tax rate was 82.2% and 49.3% for the current three and six month periods ended September 30, 2006 respectively. The reported tax rate includes:

A 35.5% expected annual tax rate which reflects higher tax exempt income than in prior periods and stock compensation expenses that are not deductible in all jurisdictions.

The reported rate also incorporates the \$9.1 million non-deductible In Process Research and Development charge (see Footnote #16 Acquisition) and the adjustment to convert our investment in Arryx, Inc. to the equity method.

The reported tax rate was 33.7% and 35.2% for the three and six months ended October 1, 2005, respectively.

We expect our annual tax rate to be approximately 35.5% for the remainder of fiscal year 2007. Future adjustments may also increase or decrease the reported tax rate.

**Liquidity and Capital Resources**

The following table contains certain key performance indicators we believe depict our liquidity and cash flow position:

|   | September 30, 2006     | April 1, 2006 |
|---|------------------------|---------------|
|   | (dollars in thousands) |               |
| Cash & cash equivalents                       | \$ 242,200             | \$ 250,667    |
| Working capital                               | \$ 325,690             | \$ 330,288    |
| Current ratio                                 | 4.7                    | 4.7           |
| Net cash position (1)                         | \$ 207,588             | \$ 211,514    |
| Days sales outstanding (DSO)                  | 68                     | 71            |
| Disposables finished goods inventory turnover | 6.0                    | 6.0           |

(1) *Net cash position is the sum of cash and cash equivalents less total debt.*

Our primary sources of capital include cash and cash equivalents, internally generated cash flows, bank borrowings and option exercises. We believe these sources to be sufficient to fund our requirements, which are primarily capital expenditures and acquisitions (including the acquisition of Arryx on July 18, 2006 - See Footnote 16 Acquisition), new business and product development and working capital for at least the next twelve months.

|   | For the six months ended<br>September 30, 2006<br><i>(In thousands)</i> | October 1, 2005  | \$ Increase<br>Q2 07 vs Q2<br>06 |
|---|---|------------------|----------------------------------|
| Net cash provided by (used in):             |   |                  |                                  |
| Operating activities                        | 33,499  | 22,628           | \$ 10,871                        |
| Investing activities                        | (38,763 )   | (7,613 )         | \$ (31,150 )                     |
| Financing activities                        | (4,164 )  | 9,881            | \$ (14,045 )                     |
| Effect of exchange rate changes on cash (1) | 961   | (730 )           | \$ 1,691                         |
| Net increase in cash and cash equivalents   | <b>\$ (8,467 )</b>  | <b>\$ 24,166</b> | <b>\$ (32,633 )</b>              |

(1) The balance sheet is affected by spot exchange rates used to translate local currency amounts into US dollars. In accordance with GAAP, we have removed the effect of foreign currency throughout our cash flow statement, except for its effect on our cash and cash equivalents.

Through September 30, 2006, the Company has repurchased approximately 0.3 million shares of its common stock for an aggregate purchase price of \$14.3 million. We reflect stock repurchases in our financial statements on a trade date basis and as Authorized Unissued (Haemonetics is a Massachusetts company and under Massachusetts law repurchased shares are treated as authorized but unissued). At September 30, 2006 we had \$25.7 million remaining on the \$40.0 million share buyback expenditure limit set by the Board of Directors.



**Cash Flow Overview:**

**Six Month Comparison**

***Operating Activities:***

Net cash provided by operating activities increased \$10.9 million in the first six months of fiscal year 2007 as compared to 2006 due primarily to:

Increases from:

- \$0.5 million in net income adjusted for non-cash items
- \$11.2 million less cash used by accounts receivables due to reduced days sales outstanding partly offset by increased sales
- \$2.2 million less cash used by inventory

Partially offset by decreases from:

- \$2.9 million increase in other assets and other long-term liabilities, accounts payable and accrued expenses

***Investing Activities:***

Net cash used in investing activities increased \$31.5 million as a result of:

- \$23.3 million investment in the acquisition of Arryx, Inc. (see Note #16 Acquisition)
- \$1.1 million less proceeds from the sale of property, plant and equipment
- \$6.7 million increase in capital expenditures due to the placement of more new devices with customers, notably US Plasma, and an investment in an ERP software license.

***Financing Activities:***

Net cash used by financing activities decreased by \$14.0 million. The decrease was due primarily to:

Decreases from:

- \$10.6 million decrease which reflects shares of common stock the Company repurchased in Q2 FY07.
- \$6.3 million decrease which reflects payments made in Fiscal 2007 on the short-term revolving credit facility in our Japanese subsidiary.

Partially offset by increases from:

- \$2.9 million increase in the exercise of stock options and stock compensation expense.



### *Inflation*

We do not believe that inflation has had a significant impact on our results of operations for the periods presented, although we have observed increased resin costs associated with petroleum price increases. Historically, we believe we have been able to mitigate the effects of inflation by improving our manufacturing and purchasing efficiencies, by increasing employee productivity and by adjusting the selling prices of products.

### *Foreign Exchange*

Approximately 58% of our sales are generated outside the US in local currencies, yet our reporting currency is the US dollar. Our primary foreign currency exposures in relation to the US dollar are the Japanese Yen and the Euro. Foreign exchange risk arises because we engage in business in foreign countries in local currency. Exposure is partially mitigated by producing and sourcing product in local currency and expenses incurred by local sales offices. However, whenever the US dollar strengthens relative to the other major currencies, there is an adverse affect on our results of operations and alternatively, whenever the US dollar weakens relative to the other major currencies there is a positive effect on our results of operations.

It is our policy to minimize for a period of time, the unforeseen impact on our financial results of fluctuations in foreign exchange rates by using derivative financial instruments known as forward contracts to hedge the anticipated cash flows from forecasted foreign currency denominated sales. Hedging through the use of forward contracts does not eliminate the volatility of foreign exchange rates, but because we generally enter into forward contracts one year out, rates are fixed for a one-year period, thereby facilitating financial planning and resource allocation. We enter into forward contracts that mature one month prior to the anticipated timing of the forecasted foreign currency denominated sales. These contracts are designated as cash flow hedges and are intended to lock in the expected cash flows of forecasted foreign currency denominated sales at the available spot rate. Actual spot rate gains and losses on these contracts are recorded in sales, at the same time the underlying transactions being hedged are recorded.

We compute a composite rate index for purposes of measuring, comparatively, the change in foreign currency hedge spot rates from the hedge spot rates of the corresponding period in the prior year. The relative value of currencies in the index is weighted by sales in those currencies. The composite was set at 1.00 based upon the weighted rates at March 31, 1997. The composite rate is presented in the period corresponding to the maturity of the underlying forward contracts.

The favorable or (unfavorable) changes are in comparison to the same period of the prior year. A favorable change is presented when we will obtain relatively more US dollars for each of the underlying foreign currencies than we did in the prior period. An unfavorable change is presented when we obtain relatively fewer US dollars for each of the underlying foreign currencies than we did in the prior period. These indexed hedge rates impact sales, and as a result also gross profit, operating income and net income, in our consolidated financial statements. The final impact of currency fluctuations on the results of operations is dependent on the local currency amounts hedged and the actual local currency results.

|               |              |    | Composite Index<br>Hedge Spot Rates | Favorable / (Unfavorable)<br>Change versus Prior Year |
|---------------|--------------|----|-------------------------------------|---|
| <b>FY2003</b> |              | Q1 | 1.09                                | (8.9)%  |
|               |              | Q2 | 1.08                                | (10.3)%   |
|               |              | Q3 | 1.10                                | (8.1)%  |
|               |              | Q4 | 1.17                                | (11.0)%   |
| <b>2003</b>   | <b>Total</b> |    | <b>1.11</b>                         | <b>(9.5)%</b>   |
| <b>FY2004</b> |              | Q1 | 1.13                                | (3.6)%  |
|               |              | Q2 | 1.05                                | 3.6%  |
|               |              | Q3 | 1.06                                | 3.2%  |
|               |              | Q4 | 1.01                                | 15.9%   |
| <b>2004</b>   | <b>Total</b> |    | <b>1.06</b>                         | <b>4.9%</b>   |
| <b>FY2005</b> |              | Q1 | 0.97                                | 15.7%   |
|               |              | Q2 | 0.99                                | 5.1%  |
|               |              | Q3 | 0.92                                | 15.5%   |
|               |              | Q4 | 0.89                                | 14.1%   |
| <b>2005</b>   | <b>Total</b> |    | <b>0.94</b>                         | <b>12.7%</b>  |
| <b>FY2006</b> |              | Q1 | 0.92                                | 5.2%  |
|               |              | Q2 | 0.91                                | 9.1%  |
|               |              | Q3 | 0.87                                | 5.7%  |
|               |              | Q4 | 0.86                                | 2.8%  |
| <b>2006</b>   | <b>Total</b> |    | <b>0.89</b>                         | <b>5.1%</b>   |
| <b>FY2007</b> |              | Q1 | 0.89                                | 3.6%  |
|               |              | Q2 | 0.92                                | (1.1)%  |
|               |              | Q3 | 0.96                                | (9.4)%  |
|               |              | Q4 | 0.95                                | (9.3)%  |
| <b>2007</b>   | <b>Total</b> |    | <b>0.93</b>                         | <b>(4.2)%</b>   |
| <b>FY2008</b> |              | Q1 | 0.92                                | (3.1)%  |
|               |              | Q2 | 0.93                                | (1.0)%  |
|               |              | Q3 | 0.94*                               | 2.4%  |

**NOTE:** \* Represents hedges through November FY08 only.

#### Recent Accounting Pronouncements

In June 2006, the FASB issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes which is an interpretation of FASB Statement 109, Accounting for Income Taxes. Interpretation No. 48 requires management to perform a two step evaluation for all tax positions, ensuring that these tax return positions meet the more-likely than not recognition threshold and can be measured with sufficient precision to determine the benefit recognized in the financial statements. This interpretation therefore provides management with a comprehensive model for how a company should recognize, measure, present, and disclose in its financial statements tax positions that the Company has taken or expects to take on their tax returns. While additional efforts will be necessary to measure, present, and disclose this information, the Company does not believe that this will have a material impact on its results. This statement is effective for our fiscal year 2008.



In September 2006, the FASB issued Statement No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans*, which is an amendment of FASB Statements 87, 88, 106 and 123R. This statement requires that we:

- Recognize in our balance sheet an asset for a defined benefit postretirement plan's overfunded status or a liability for a plan's underfunded status.
- Measure our defined benefit postretirement plan's assets and obligations that determine the funded status as of the end of our fiscal year.
- Recognize changes in the funded status of our defined benefit post retirement plan in comprehensive income in the year in which the changes occur.

This statement is effective for this fiscal year end FY07. We do not expect this to have a significant effect as, of the various retirement programs the Company offers to its employees, only two of these in our international locations are defined benefit plans covered by the pronouncement.

#### **Cautionary Statement Regarding Forward-Looking Information**

Statements contained in this report, as well as oral statements we make which are prefaced with the words *may*, *will*, *expect*, *anticipate*, *continue*, *estimate*, *project*, *intend*, *designed*, and similar expressions, are intended to identify forward looking statements regarding events, conditions, and financial trends that may affect our future plans of operations, business strategy, results of operations, and financial position. These statements are based on our current expectations and estimates as to prospective events and circumstances about which we can give no firm assurance. Further, any forward-looking statement speaks only as of the date on which such statement is made, and we undertake no obligation to update any forward-looking statement to reflect events or circumstances after the date on which such statement is made. As it is not possible to predict every new factor that may emerge, forward-looking statements should not be relied upon as a prediction of our actual future financial condition or results. These forward-looking statements, like any forward-looking statements, involve risks and uncertainties that could cause actual results to differ materially from those projected or anticipated. Such risks and uncertainties include technological advances in the medical field and our standards for transfusion medicine and our ability to successfully implement products that incorporate such advances and standards, product demand and market acceptance of our products, regulatory uncertainties, the effect of economic and political conditions, the impact of competitive products and pricing, the impact of industry consolidation, foreign currency exchange rates, changes in customers ordering patterns, the effect of industry consolidation as seen in the Plasma market, the effect of communicable diseases and the effect of uncertainties in markets outside the US (including Europe and Asia) in which we operate. The foregoing list should not be construed as exhaustive.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The Company's exposures relative to market risk are due to foreign exchange risk and interest rate risk.

**FOREIGN EXCHANGE RISK**

See the section entitled Foreign Exchange for a discussion of how foreign currency affects our business. It is our policy to minimize for a period of time, the unforeseen impact on our financial results of fluctuations in foreign exchange rates by using derivative financial instruments known as forward contracts to hedge anticipated cash flows from forecasted foreign currency denominated sales. We do not use the financial instruments for speculative or trading activities. At September 30, 2006, we had the following significant foreign exchange contracts to hedge the anticipated cash flows from forecasted foreign currency denominated sales outstanding:

| Hedged Currency | (BUY) / SELL Local Currency | Weighted Spot Contract Rate |          | Weighted Forward Contract Rate |          | Fair Value  | Maturity            |
|-----------------|-----------------------------|-----------------------------|----------|--------------------------------|----------|-------------|---------------------|
| Euro            | 6,165,000                   | \$1.184                     |          | \$1.207                        |          | \$(402,291) | Oct - Nov 2006      |
| Euro            | 8,915,000                   | \$1.206                     |          | \$1.229                        |          | \$(427,600) | Dec 2006 - Feb 2007 |
| Euro            | 8,880,000                   | \$1.260                     |          | \$1.285                        |          | \$22,663    | Mar - May 2007      |
| Euro            | 8,186,000                   | \$1.272                     |          | \$1.294                        |          | \$56,935    | Jun - Aug 2007      |
| Japanese Yen    | 1,123,000,000               | 117.1                       | per US\$ | 112.2                          | per US\$ | \$402,552   | Oct - Nov 2006      |
| Japanese Yen    | 1,399,000,000               | 116.6                       | per US\$ | 111.6                          | per US\$ | \$431,052   | Dec 2006 - Feb 2007 |
| Japanese Yen    | 1,251,000,000               | 113.7                       | per US\$ | 108.6                          | per US\$ | \$552,073   | Mar - May 2007      |
| Japanese Yen    | 1,467,000,000               | 116.9                       | per US\$ | 111.7                          | per US\$ | \$151,310   | Jun - Aug 2007      |
|                 |                             |                             |          | Total:                         |          | \$786,694   |                     |

We estimate the change in the fair value of all forward contracts assuming both a 10% strengthening and weakening of the US dollar relative to all other major currencies. In the event of a 10% strengthening of the US dollar, the change in fair value of all forward contracts would result in a \$10.2 million increase in the fair value of the forward contracts; whereas a 10% weakening of the US dollar would result in a \$11.2 million decrease in the fair value of the forward contracts.

**INTEREST RATE RISK**

All of our long-term debt is at fixed rates. Accordingly, a change in interest rates has an insignificant effect on our interest expense amounts. The fair value of our long-term debt, however, does change in response to interest rate movements due to its fixed rate nature. These changes reflect the premium (when market interest rates decline below the contract fixed interest rates) or discount (when market interest rates rise above the fixed interest rate) that an investor in these long term obligations would pay in the market interest rate environment.

At September 30, 2006, the fair value of our long-term debt was approximately \$1.0 million higher than the value of the debt reflected on our financial statements. This higher fair market is entirely related to our \$5.7 million, 7.05% fixed rate senior notes and our \$7.0 million, 8.41% real estate mortgage.

At October 1, 2005, the fair value of our long-term debt was approximately \$2.1 million higher than the value of the debt reflected on our financial statements. This higher fair market is entirely related to our \$11.4 million, 7.05% fixed rate senior notes and our \$7.5 million, 8.41% real estate mortgage.

Using scenario analysis, if the interest rate on all long-term maturities changed by 10% from the rate levels that existed at September 30, 2006 the fair value of our long-term debt would change by approximately \$0.2 million.

#### **ITEM 4. CONTROLS AND PROCEDURES**

We conducted an evaluation, as of September 30, 2006, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer (the Company's principal executive officer and principal financial officer, respectively) regarding the effectiveness of the design and operation of our disclosure controls and procedures as defined in Rule 13a-15 of the Securities Exchange Act of 1934 (the Exchange Act). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective.

There was no change in our internal control over financial reporting during the three and six months ended September 30, 2006 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

#### **PART II - OTHER INFORMATION**

##### **Item 1. Legal Proceedings**

Not applicable

##### **Item 1A. Risk Factors**

In addition to the other information set forth in this report, careful consideration should be given to the factors discussed in Part 1, Item 1A. Risk Factors in the Company's Annual Report on Form 10-K for the year ended April 1, 2006, which could materially affect the Company's business, financial condition or future results. The risks described in the Company's Annual Report on Form 10-K are not the only risks facing the Company. Additional risks and uncertainties not currently known to the Company or that it currently deems to be immaterial also may materially adversely affect its business, financial condition and/or operating results.



Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Through September 30, 2006, the Company has repurchased approximately 0.3 million shares of its common stock for an aggregate purchase price of \$14.3 million. We reflect stock repurchases in our financial statements on a trade date basis and as Authorized Unissued (Haemonetics is a Massachusetts company and under Massachusetts law repurchased shares are treated as authorized but unissued). At September 30, 2006 we had \$25.7 million remaining on the \$40.0 million share buyback expenditure limit set by the Board of Directors in August 2006.

During the six months ended September 30, 2006, the Company repurchased \$14.3 million or 0.3 shares million of its Common Stock as illustrated in the table below:

| Period                                | Total Number of Shares Repurchased | Average Price Paid per Share | Total Dollar Value of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Dollar Value of Shares that May Yet be Purchased Under the Plans or Programs |
|---------------------------------------|------------------------------------|------------------------------|--|--|
| July 2, 2006 to July 29, 2006         | N/A                                | \$N/A                        | N/A  | \$N/A  |
| July 30, 2006 to August 26, 2006      | N/A                                | \$N/A                        | N/A  | \$N/A  |
| August 27, 2006 to September 30, 2006 | 305,400                            | \$46.68                      | \$14,264,159   | \$25,735,840   |
| Total                                 | 305,400                            | \$46.68                      | \$14,264,160   | \$25,735,840   |

As of September 30, 2006, the Company had 27.0 million basic shares of its Common Stock outstanding.

Item 3. Defaults upon Senior Securities

Not applicable.

Item 4. Submission of Matters to a Vote of Security Holders

On August 9, 2006, the Company held its annual meeting of stockholders. At the meeting, Ronald G. Gelbman, Ronald A. Matricaria and Brad Nutter were re-elected as Directors for a term ending in 2009. The voting results were as follows:

|                      |                |          |           |
|----------------------|----------------|----------|-----------|
| Ronald G. Gelbman    | For 23,195,580 | Withheld | 1,568,874 |
| Ronald A. Matricaria | For 24,666,625 | Withheld | 97,829    |
| Brad Nutter          | For 24,665,120 | Withheld | 99,334    |

The other members of the Board of Directors whose terms continued after the meeting were:

Serving a Term Ending in 2007 Susan Bartlett Foote, Pedro P. Granadillo and Mark W. Kroll

Serving a Term Ending in 2008 Lawrence C. Best, Richard J. Meelia and Ronald L. Merriman

At the meeting, the stockholders voted to increase the number of shares of Common Stock which the Corporation has authority to issue from 80,000,000 shares to 150,000,000 shares. The vote was as follows:

|     |            |         |           |         |        |                 |
|-----|------------|---------|-----------|---------|--------|-----------------|
| For | 18,271,553 | Against | 6,477,801 | Abstain | 15,098 | Broker Non-Vote |
|-----|------------|---------|-----------|---------|--------|-----------------|

At the meeting, the stockholders ratified the selection by the Board of Directors of Ernst & Young LLP as independent public accountants for the current fiscal year. The vote was as follows:

|     |            |         |         |         |       |                 |
|-----|------------|---------|---------|---------|-------|-----------------|
| For | 24,557,185 | Against | 197,609 | Abstain | 9,660 | Broker Non-Vote |
|-----|------------|---------|---------|---------|-------|-----------------|

On October 27, 2006 Ronald A. Matricaria notified the Board of Directors of his decision to retire as a director at the end of December 2006

Item 5. Other Information

None

Item 6. Exhibits

- 31.1 Certification pursuant to Section 302 of Sarbanes-Oxley Act of 2002, of Brad Nutter, President and Chief Executive Officer of the Company
- 31.2 Certification pursuant to Section 302 of Sarbanes-Oxley of 2002, of Ronald J. Ryan, Vice President and Chief Financial Officer of the Company
- 32.1 Certification Pursuant to 18 United States Code Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of Brad Nutter, President and Chief Executive Officer of the Company
- 32.2 Certification Pursuant to 18 United States Code Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of Ronald J. Ryan, Vice President and Chief Financial Officer of the Company

**SIGNATURES**

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

HAEMONETICS CORPORATION

Date: November 7, 2006

By: */s/ Brad Nutter*  
Brad Nutter, President and Chief Executive Officer  
(Principal Executive Officer)

Date: November 7, 2006

By: */s/ Ronald J. Ryan*  
Ronald J. Ryan, Vice President and Chief  
Financial Officer (Principal Financial Officer)

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