

STERIS CORP  
Form 10-Q  
February 08, 2012  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D. C. 20549

FORM 10-Q  
(Mark One)

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

x

For the quarterly period ended December 31, 2011

or

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

o

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

Commission File Number 1-14643

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STERIS Corporation  
(Exact name of registrant as specified in its charter)

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Ohio  
(State or other jurisdiction of  
incorporation or organization)

34-1482024  
(IRS Employer  
Identification No.)

5960 Heisley Road,  
Mentor, Ohio  
(Address of principal executive offices)  
440-354-2600

44060-1834  
(Zip code)

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer

Smaller Reporting Company

(Do not check if a smaller reporting company)

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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 common shares outstanding as of January 31, 2012: 57,640,053

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## PART 1—FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

## STERIS CORPORATION AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

(in thousands)

	December 31, 2011 (Unaudited)	March 31, 2011
Assets		
Current assets:		
Cash and cash equivalents	\$143,787	\$193,016
Accounts receivable (net of allowances of \$10,229 and \$9,085, respectively)	251,427	272,248
Inventories, net	169,412	167,344
Deferred income taxes, net	43,881	56,715
Prepaid expenses and other current assets	23,447	16,483
Total current assets	631,954	705,806
Property, plant, and equipment, net	378,165	370,402
Goodwill and intangibles, net	333,819	318,810
Other assets	32,472	31,667
Total assets	\$1,376,410	\$1,426,685
Liabilities and equity		
Current liabilities:		
Accounts payable	\$70,075	\$90,981
Accrued payroll and other related liabilities	34,257	52,251
Accrued SYSTEM 1 Rebate Program and class action settlement	100,234	127,683
Accrued expenses and other	90,729	73,831
Total current liabilities	295,295	344,746
Long-term indebtedness	210,000	210,000
Deferred income taxes, net	36,144	26,662
Other liabilities	54,566	56,612
Total liabilities	\$596,005	\$638,020
Commitments and contingencies (see note 10)		
Serial preferred shares, without par value; 3,000 shares authorized; no shares issued or outstanding	—	—
Common shares, without par value; 300,000 shares authorized; 70,040 shares issued; 57,639 and 59,122 shares outstanding, respectively	241,787	241,343
Common shares held in treasury, 12,401 and 10,918 shares, respectively	(353,042	) (305,808
Retained earnings	880,039	816,846
Accumulated other comprehensive income	10,481	35,188
Total shareholders' equity	779,265	787,569
Noncontrolling interest	1,140	1,096
Total equity	780,405	788,665
Total liabilities and equity	\$1,376,410	\$1,426,685
See notes to consolidated financial statements.		



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CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share amounts)

(Unaudited)

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2011	2010	2011	2010
Revenues:				
Product	\$239,403	\$212,622	\$664,918	\$486,986
Service	115,812	115,661	351,643	342,702
Total revenues	355,215	328,283	1,016,561	829,688
Cost of revenues:				
Product	145,976	123,381	402,214	340,693
Service	71,233	67,888	210,107	198,860
Total cost of revenues	217,209	191,269	612,321	539,553
Gross profit	138,006	137,014	404,240	290,135
Operating expenses:				
Selling, general, and administrative	73,922	93,467	227,583	237,583
Research and development	9,196	7,739	26,867	24,391
Restructuring expenses	1,164	(23)	1,522	423
Total operating expenses	84,282	101,183	255,972	262,397
Income from operations	53,724	35,831	148,268	27,738
Non-operating expenses, net:				
Interest expense	3,005	3,049	9,083	9,052
Interest income and miscellaneous expense	(373)	(321)	(948)	(671)
Total non-operating expenses, net	2,632	2,728	8,135	8,381
Income before income tax expense	51,092	33,103	140,133	19,357
Income tax expense	17,443	11,338	48,189	7,091
Net income	\$33,649	\$21,765	\$91,944	\$12,266
Net income per common share				
Basic	\$0.58	\$0.37	\$1.57	\$0.21
Diluted	\$0.58	\$0.36	\$1.55	\$0.20
Cash dividends declared per common share outstanding	\$0.17	\$0.15	\$0.49	\$0.41

See notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	Nine Months Ended December 31,	
	2011	2010
Operating activities:		
Net income	\$91,944	\$12,266
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation, depletion, and amortization	46,288	39,739
Deferred income taxes	22,758	(52,652)
Share-based compensation expense	5,799	8,489
Loss on the disposal of property, plant, equipment, and intangibles, net	376	1,217
Other items	(1,595)	) 3,637
Changes in operating assets and liabilities, net of effects of acquisitions:		
Accounts receivable, net	20,019	2,205
Inventories, net	(2,404)	) (44,855)
Other current assets	(6,954)	) 4,188
Accounts payable	(21,127)	) 7,414
Accrued SYSTEM 1 Rebate Program and class action settlement	(27,449)	) 128,770
Accruals and other, net	(14,816)	) (27,021)
Net cash provided by operating activities	112,839	83,397
Investing activities:		
Purchases of property, plant, equipment, and intangibles, net	(54,238)	) (56,390)
Proceeds from the sale of property, plant, equipment, and intangibles	—	1,298
Equity investment in joint venture	—	(16,900)
Acquisition of business, net of cash acquired	(22,269)	) (4,000)
Net cash used in investing activities	(76,507)	) (75,992)
Financing activities:		
Repurchases of common shares	(56,751)	) (19,900)
Cash dividends paid to common shareholders	(28,751)	) (24,344)
Stock option transactions, net	3,749	10,813
Tax benefit from stock options exercised	816	2,197
Net cash used in financing activities	(80,937)	) (31,234)
Effect of exchange rate changes on cash and cash equivalents	(4,624)	) 1,146
Decrease in cash and cash equivalents	(49,229)	) (22,683)
Cash and cash equivalents at beginning of period	193,016	214,971
Cash and cash equivalents at end of period	\$143,787	\$192,288

See notes to consolidated financial statements.

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STERIS CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

For the Three and Nine Months Ended December 31, 2011 and 2010

(dollars in thousands, except per share amounts)

1. Nature of Operations and Summary of Significant Accounting Policies

Nature of Operations

STERIS Corporation, an Ohio corporation, develops, manufactures and markets infection prevention, contamination control, microbial reduction, and surgical and critical care support products and services for healthcare, pharmaceutical, scientific, research, industrial, and governmental Customers throughout the world. As used in this Quarterly Report, STERIS Corporation and its subsidiaries together are called “STERIS,” the “Company,” “we,” “us,” or “our,” unless otherwise noted.

We operate in three reportable business segments: Healthcare, Life Sciences, and STERIS Isomedix Services (“Isomedix”). We describe our business segments in note 11 to our consolidated financial statements titled, “Business Segment Information.” Our fiscal year ends on March 31. References in this Quarterly Report to a particular “year” or “year-end” mean our fiscal year. The significant accounting policies applied in preparing the accompanying consolidated financial statements of the Company are summarized below:

Interim Financial Statements

We prepared the accompanying unaudited consolidated financial statements of the Company according to accounting principles generally accepted in the United States (“U.S. GAAP”) for interim financial information and the instructions to the Quarterly Report on Form 10-Q and Rule 10-01 of Regulation S-X. This means that they do not include all of the information and footnotes required by U.S. GAAP for complete financial statements. Our unaudited interim consolidated financial statements contain all material adjustments (consisting of normal recurring accruals and adjustments) management believes are necessary to fairly state our financial condition, results of operations, and cash flows for the periods presented.

These interim consolidated financial statements should be read together with the consolidated financial statements and related notes included in our Annual Report on Form 10-K for the year ended March 31, 2011, filed with the Securities and Exchange Commission (“SEC”) on May 27, 2011. The Consolidated Balance Sheet at March 31, 2011 was derived from the audited consolidated financial statements at that date, but does not include all of the information and footnotes required by U.S. GAAP for complete financial statements.

Principles of Consolidation

We use the consolidation method to report our investment in our subsidiaries. Therefore, the accompanying consolidated financial statements include the accounts of the Company and its wholly-owned and majority-owned subsidiaries. We eliminate inter-company accounts and transactions when we consolidate these accounts.

Use of Estimates

We make certain estimates and assumptions when preparing financial statements according to U.S. GAAP that affect the reported amounts of assets and liabilities at the financial statement dates and the reported amounts of revenues and expenses during the periods presented. These estimates and assumptions involve judgments with respect to many factors that are difficult to predict and are beyond our control. Actual results could be materially different from these



estimates. We revise the estimates and assumptions as new information becomes available. This means that operating results for the three and nine month periods ended December 31, 2011 are not necessarily indicative of results that may be expected for future quarters or for the full fiscal year ending March 31, 2012.

#### Recently Adopted Accounting Pronouncements

In September 2011, the FASB issued an accounting standard update titled “Testing Goodwill for Impairment,” which allows an entity the option of performing a qualitative assessment to determine whether it is necessary to perform the current two-step annual impairment test. The guidance permits an entity to assess qualitative factors to determine if it is more-likely-than-not that the fair value of the reporting unit exceeds the carrying amount to determine if the two-step impairment test is required. The guidance does not change how goodwill is calculated or the requirement to test goodwill annually for

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STERIS CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)—(Continued)

For the Three and Nine Months Ended December 31, 2011 and 2010

(dollars in thousands, except per share amounts)

impairment. The new guidance is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. The early adoption of this standard did not have an impact on our consolidated financial position, results of operations or cash flows.

In June 2011, the FASB issued new guidance titled "Comprehensive Income," which altered the presentation of comprehensive income. More specifically, the updated guidance permits an entity to present components of net income and other comprehensive income in either one continuous statement, referred to as the statement of comprehensive income, or in two separate, but consecutive statements. The guidance now eliminates the current option to report other comprehensive income and its components in the statement of changes in equity. These changes to the presentation of comprehensive income do not change the components that are recognized in net income or other comprehensive income under current accounting guidance. This guidance is effective for fiscal years and interim periods beginning after December 15, 2011 and will become effective for us at the beginning of our first quarter of fiscal 2013. The adoption of this standard will not have an impact on our consolidated financial position, results of operations or cash flows.

In April 2011, the FASB issued new guidance titled "Fair Value Measurement," intended to achieve common fair value measurement and disclosure requirements between GAAP and International Financial Reporting Standards. This new guidance amends current fair value measurement and disclosure guidance to include increased transparency regarding valuation inputs and investment categorization. This new guidance is effective for annual and interim periods beginning after December 15, 2011 and will become effective for us at the beginning of our first quarter of fiscal 2013. The adoption of this standard will not have an impact on our consolidated financial position, results of operations or cash flows.

In December 2010, the FASB issued an accounting standard update titled "When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts," amending Accounting Standards Codification (ASC) Topic 350, "Intangibles - Goodwill and Other." This guidance amends the ASC requiring entities that have a reporting unit with zero or negative carrying value to assess whether qualitative factors indicate that it is more likely than not that an impairment of goodwill exists. If the entity concludes that it is more likely than not that an impairment exists, the entity must then measure the goodwill impairment. The new guidance, amending the ASC is effective for fiscal 2012 and was applied during our annual goodwill impairment testing in the third quarter of fiscal 2012 and did not impact our results.

In October 2009, the FASB issued an accounting standard update titled "Multiple-Deliverable Revenue Arrangements," amending Accounting Standards Codification (ASC) Topic 605, "Revenue Recognition." This guidance amends the ASC requiring entities to eliminate the residual method of allocation for multiple-deliverable revenue arrangements, requiring arrangement consideration be allocated at the inception of an arrangement to all deliverables using the relative selling price method. The guidance also established a selling price hierarchy for determining the selling price of a deliverable, which includes: (1) vendor-specific objective evidence if available, (2) third-party evidence if vendor-specific objective evidence is not available, and (3) estimated selling price if neither vendor-specific nor third-party evidence is available. The guidance was adopted and applied prospectively for multiple element revenue arrangements that are new or materially modified beginning on or after April 1, 2011. The adoption of this guidance did not impact our financial position or results of operations.

## Significant Accounting Policies

A detailed description of our significant and critical accounting policies, estimates, and assumptions is included in our consolidated financial statements included in our Annual Report on Form 10-K for the year ended March 31, 2011, filed with the SEC on May 27, 2011. Our significant and critical accounting policies, estimates, and assumptions have not changed materially from March 31, 2011.

The Accrued SYSTEM 1 Rebate Program (the "Rebate Program"), initially recognized during the first quarter of fiscal 2011, is based upon the quantity of SYSTEM 1 processors eligible for rebates and the estimated value of rebates to be provided upon their return. Rebates of \$102,313 were recognized as contra-revenue consistent with other returns and allowances offered to Customers. The estimated cost of \$7,691 to facilitate the disposal of the returned SYSTEM 1 processors has been recognized as cost of revenues. Both components are recorded as current liabilities. The key assumptions involved in the estimates associated with the Rebate Program include: the number and age of SYSTEM 1 processors eligible for rebates under the Rebate Program, the number of Customers that will elect to participate in the Rebate Program, the proportion of Customers that will choose each rebate option, and the estimated per unit costs of disposal.

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## STERIS CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)—(Continued)

For the Three and Nine Months Ended December 31, 2011 and 2010

(dollars in thousands, except per share amounts)

The number and age of SYSTEM 1 processors has been estimated based on our historical sales and service records and we have assumed that 100% of eligible Customers will elect to participate in the Rebate Program. In order to estimate the portion of Customers that will choose each available rebate option, we first assessed trends in sales of the proprietary consumable products utilized in the SYSTEM 1 processor. We noted a decline of approximately 19% in shipments of SYSTEM 1 consumables during the period between the notice by FDA to healthcare facility administrators and infection control practitioners and the announcement of the Rebate Program, which indicated that a portion of our Customers had already transitioned away from the SYSTEM 1 technology during that period. The remaining 81% provided the best available indication of the portion of Customers projected to elect the rebate for the SYSTEM 1E processor. Order and quote data for fiscal 2011 provided indications of the proportion of Customers that are expected to choose each of the other rebate options. The per unit costs associated with disposal were estimated based on the service hours involved and quotes from our vendors using existing freight and disposal contracts.

## 2. Restructuring

The following summarizes our restructuring plans announced in prior fiscal years. We recognize restructuring expenses as incurred. In addition, we assess the property, plant and equipment associated with the related facilities for impairment. Additional information regarding our restructuring plans is included in our Annual Report on Form 10-K for the year ended March 31, 2011, filed with the SEC on May 27, 2011.

## Fiscal 2010 Restructuring Plan

During the fourth quarter of fiscal 2010 we adopted a restructuring plan primarily related to the transfer of the remaining operations in our Erie, Pennsylvania facility to the U.S. headquarters in Mentor, Ohio and the consolidation of our European Healthcare manufacturing operations into two central locations within Europe (the “Fiscal 2010 Restructuring Plan”). In addition, we rationalized certain products and eliminated certain positions.

Since the inception of the Fiscal 2010 Restructuring Plan, we have incurred pre-tax expenses totaling \$9,541 related to these actions, of which \$8,512 was recorded as restructuring expenses and \$1,029 was recorded in cost of revenues. We also expect to incur an additional \$1,100 by the end of fiscal 2012. These actions are intended to enhance profitability and improve efficiencies.

Production has ceased in our Switzerland manufacturing facility. We recognized an impairment loss with regard to this facility based on the value of an offer to purchase that was received during the fiscal 2012 third quarter. The following tables summarize our total pre-tax restructuring expenses for the third quarter and first nine months of fiscal 2012 and fiscal 2011:

Three Months Ended December 31, 2011	Fiscal 2010 Restructuring Plan (1)
Severance, payroll, and other related costs	\$7
Asset impairment and accelerated depreciation	1,157
Lease termination obligation and other	3

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Total restructuring charges \$1,167  
 (1) Includes \$3 in charges recorded in cost of revenues on Consolidated Statements of Income.

Three Months Ended December 31, 2010	Fiscal 2010 Restructuring Plan (1)	Fiscal 2008 Restructuring Plan	Total
Severance, payroll, and other related costs	\$489	\$—	\$489
Asset impairment and accelerated depreciation	—	(289	)(289
Other	7	—	7
Total restructuring charges	\$496	\$(289	)\$207

(1) Includes \$230 in charges recorded in cost of revenues on Consolidated Statements of Income.

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## STERIS CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)—(Continued)

For the Three and Nine Months Ended December 31, 2011 and 2010

(dollars in thousands, except per share amounts)

Nine Months Ended December 31, 2011	Fiscal 2010	Fiscal 2008	Total
	Restructuring Plan (1)	Restructuring Plan	
Severance, payroll, and other related costs	\$(73	)\$—	\$(73 )
Product rationalization	335	—	335
Asset impairment and accelerated depreciation	1,341	—	1,341
Lease termination obligation and other	3	(152	)(149 )
Total restructuring charges	\$1,606	\$(152	)\$1,454

(1)Includes \$(68) in charges recorded in cost of revenues on Consolidated Statements of Income.

Nine Months Ended December 31, 2010	Fiscal 2010	Fiscal 2008	Total
	Restructuring Plan (1)	Restructuring Plan	
Severance, payroll, and other related costs	\$498	\$—	\$498
Asset impairment and accelerated depreciation	356	(289	)67
Other	88	—	88
Total restructuring charges	\$942	\$(289	)\$653

(1)Includes \$230 in charges recorded in cost of revenues on Consolidated Statements of Income.

Liabilities related to restructuring activities are recorded as current liabilities on the accompanying Consolidated Balance Sheets within “Accrued payroll and other related liabilities” and “Accrued expenses and other.” The following table summarizes our liabilities related to these restructuring activities:

	Fiscal 2010 Restructuring Plan			
	March 31, 2011	Fiscal 2012 Provision	Payments/ Impairments (1)	December 31, 2011
Severance and termination benefits	\$1,993	\$(73 )	\$(863 )	\$1,057
Product rationalization	—	335	(335	) —
Asset impairments	—	1,341	(1,341	) —
Lease termination obligations	1,790	—	152	1,942
Other	193	3	(107	) 89
Total	\$3,976	\$1,606	\$(2,494	) \$3,088

(1) Certain amounts reported include the impact of foreign currency movements relative to the U.S. dollar.

## 3. Comprehensive Income

Comprehensive income includes net income as currently reported under U.S. GAAP and other comprehensive income. Other comprehensive income considers the effects of additional economic events that are not required to be recorded in determining net income, but rather are reported as a separate component of shareholders' equity. The following table illustrates the components of our comprehensive income:

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## STERIS CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)—(Continued)

For the Three and Nine Months Ended December 31, 2011 and 2010

(dollars in thousands, except per share amounts)

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2011	2010	2011	2010
Net income	\$33,649	\$21,765	\$91,944	\$12,266
Change in cumulative foreign currency translation adjustment	(9,823	) 793	(23,776	) 8,935
Amortization of pension and postretirement benefit plans costs, net of taxes	(269	) (277	) (809	) (828
Unrealized gain (loss) on available for sale securities	132	109	(122	) 118
Total comprehensive income	\$23,689	\$22,390	\$67,237	\$20,491

## 4. Property, Plant and Equipment

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

	December 31, 2011	March 31, 2011
Land and land improvements (1)	\$32,629	\$30,194
Buildings and leasehold improvements	221,249	201,883
Machinery and equipment	302,210	286,103
Information systems	107,477	101,934
Radioisotope	206,470	194,882
Construction in progress (1)	26,478	40,665
Total property, plant, and equipment	896,513	855,661
Less: accumulated depreciation and depletion	(518,348	) (485,259
Property, plant, and equipment, net	\$378,165	\$370,402

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

## 5. Inventories, Net

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

	December 31, 2011	March 31, 2011
Raw materials	\$58,249	\$58,375
Work in process	23,989	16,928
Finished goods	87,174	92,041
Inventories, net	\$169,412	\$167,344

## 6. Debt



Indebtedness was as follows:

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## STERIS CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)—(Continued)

For the Three and Nine Months Ended December 31, 2011 and 2010

(dollars in thousands, except per share amounts)

	December 31, 2011	March 31, 2011
Private Placement	\$210,000	\$210,000
Credit facility	—	—
Total long term debt	\$210,000	\$210,000

Additional information regarding our indebtedness is included in the notes to our consolidated financial statements included in our Annual Report on Form 10-K for the year ended March 31, 2011, filed with the SEC on May 27, 2011.

## 7. Additional Consolidated Balance Sheets Information

Additional information related to our Consolidated Balance Sheets is as follows:

	December 31, 2011	March 31, 2011
Accrued payroll and other related liabilities:		
Compensation and related items	\$13,629	\$16,160
Accrued vacation/paid time off	7,638	6,379
Accrued bonuses	413	13,925
Accrued employee commissions	8,823	11,985
Other postretirement benefit obligations-current portion	3,274	3,274
Other employee benefit plans' obligations-current portion	480	528
Total accrued payroll and other related liabilities	\$34,257	\$52,251
Accrued expenses and other:		
Deferred revenues	\$46,938	\$34,396
Self-insured risk reserves-current portion	3,074	3,610
Accrued dealer commissions	8,773	7,354
Accrued warranty	10,234	7,509
Other	21,710	20,962
Total accrued expenses and other	\$90,729	\$73,831
Other liabilities:		
Self-insured risk reserves-long-term portion	\$10,233	\$10,233
Other postretirement benefit obligations-long-term portion	18,603	20,526
Defined benefit pension plans obligations-long-term portion	5,595	8,006
Other employee benefit plans obligations-long-term portion	4,061	3,897
Accrued long-term income taxes	6,432	9,140
Other	9,642	4,810
Total other liabilities	\$54,566	\$56,612

## 8. Income Tax Expense

Income tax expense includes United States federal, state and local, and foreign income taxes, and is based on reported pre-tax income. The effective income tax rates for the three month periods ended December 31, 2011 and 2010 were 34.1% and 34.3%, respectively. The effective income tax rates for the nine month periods ended December 31, 2011 and 2010 were 34.4% and 36.6%, respectively.

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

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## STERIS CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)—(Continued)

For the Three and Nine Months Ended December 31, 2011 and 2010

(dollars in thousands, except per share amounts)

As of March 31, 2011, we had \$9,594 in unrecognized tax benefits, of which \$4,975 would favorably impact the effective tax rate if recognized. As of December 31, 2011, we had \$6,019 in unrecognized tax benefits, of which \$1,400 would favorably impact the effective tax rate if recognized. The decrease in unrecognized tax benefits for the nine months ended December 31, 2011 is primarily due to a decrease in unrecognized tax benefits relating to prior years. We believe that it is reasonably possible that unrecognized tax benefits could decrease by up to \$877 within 12 months of December 31, 2011, primarily as a result of settlements with tax authorities. As of December 31, 2011, we have recognized a liability for interest of \$946 and penalties of \$81.

We operate in numerous taxing jurisdictions and are subject to regular examinations by various United States federal, state, and local, as well as foreign, jurisdictions. We are no longer subject to United States federal examinations for years before fiscal 2010 and, with limited exceptions, we are no longer subject to United States state and local, or non-United States, income tax examinations by tax authorities for years before fiscal 2007. We do not expect the results of these examinations to have a material adverse affect on our consolidated financial statements.

## 9. Benefit Plans

We provide defined benefit pension plans for certain current and former manufacturing and plant administrative personnel throughout the world as determined by collective bargaining agreements or employee benefit standards set at the time of acquisition of certain businesses. In addition to providing pension benefits to certain employees, we sponsor an unfunded postretirement welfare benefits plan for certain United States former employees, including the same former employees who receive pension benefits under the United States defined benefit pension plan. Benefits under this plan include retiree life insurance and retiree medical coverage, including prescription drug coverage. Additional information regarding our defined benefit pension plans and other postretirement benefits plan is included in our consolidated financial statements included in our Annual Report on Form 10-K for the year ended March 31, 2011, filed with the SEC on May 27, 2011.

Components of the net periodic benefit cost for our defined benefit pension plans and other postretirement medical benefits plan were as follows:

	Defined Benefit Pension Plans				Other	
	U.S. Qualified		International		Postretirement	
	2011	2010	2011	2010	2011	2010
Three Months Ended December 31,						
Service cost	\$51	\$47	\$114	\$135	\$—	\$—
Interest cost	609	654	66	88	248	292
Expected return on plan assets	(821 )	(758 )	(67 )	(95 )	—	—
Recognized losses	267	267	—	—	106	97
Amortization of prior service cost	—	—	—	—	(816 )	(816 )
Net periodic benefit cost (income)	\$106	\$210	\$113	\$128	\$(462 )	\$(427 )
	Defined Benefit Pension Plans				Other	
	U.S. Qualified		International		Postretirement	

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Nine Months Ended December 31,	2011	2010	2011	2010	2011	2010
Service cost	\$154	\$142	\$341	\$406	\$—	\$—
Interest cost	1,828	1,963	198	262	743	876
Expected return on plan assets	(2,463 )	(2,275 )	(201 )	(285 )	—	—
Recognized losses	799	801	—	—	319	291
Amortization of prior service cost	—	—	—	—	(2,447 )	(2,447 )
Net periodic benefit cost (income)	\$318	\$631	\$338	\$383	\$(1,385 )	\$(1,280 )

We contribute amounts to the defined benefit pension plans at least sufficient to meet the minimum requirements as stated in applicable employee benefit laws and local tax laws. We record liabilities for the difference between the fair value of the plan assets and the benefit obligation (the projected benefit obligation for pension plans and the accumulated postretirement benefit

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obligation for other postretirement benefits plans) on our accompanying Consolidated Balance Sheets.

10. Contingencies

We are, and will likely continue to be, involved in a number of legal proceedings, government investigations, and claims, which we believe generally arise in the course of our business, given our size, history, complexity, and the nature of our business, products, Customers, regulatory environment, and industries in which we participate. These legal proceedings, investigations and claims generally involve a variety of legal theories and allegations, including, without limitation, personal injury (e.g., slip and falls, burns, vehicle accidents), product liability or regulation (e.g., based on product operation or claimed malfunction, failure to warn, failure to meet specification, or failure to comply with regulatory requirements), product exposure (e.g., claimed exposure to chemicals, asbestos, contaminants, radiation), property damage (e.g., claimed damage due to leaking equipment, fire, vehicles, chemicals), commercial claims (e.g., breach of contract, economic loss, warranty, misrepresentation), financial (e.g., taxes, reporting), employment (e.g., wrongful termination, discrimination, benefits matters), and other claims for damage and relief. We believe we have adequately reserved for our current litigation and claims that are probable and estimable, and further believe that the ultimate outcome of these pending lawsuits and claims will not have a material adverse affect on our consolidated financial position or results of operations taken as a whole. Due to their inherent uncertainty, however, there can be no assurance of the ultimate outcome or effect of current or future litigation, investigations, claims or other proceedings (including without limitation the matters discussed below). For certain types of claims, we presently maintain insurance coverage for personal injury and property damage and other liability coverages in amounts and with deductibles that we believe are prudent, but there can be no assurance that these coverages will be applicable or adequate to cover adverse outcomes of claims or legal proceedings against us.

As previously disclosed, we received a warning letter (the “warning letter”) from the FDA on May 16, 2008 regarding our SYSTEM 1® sterile processor and the STERIS 20 sterilant used with the processor (sometimes referred to collectively in the FDA letter and in this note 10 as the “device”). Among other matters, the warning letter included the FDA's assertion that significant changes or modifications had been made in the design, components, method of manufacture, or intended use of the device beyond the FDA's 1988 clearance, such that the FDA believed a new premarket notification submission (known within FDA regulations as a 510(k) submission) should have been made, and the assertion that our failure to make such a submission resulted in violations of applicable law. On July 30, 2008 (with an Addendum on October 9, 2008), we provided a detailed response contending that the assertions in the warning letter were not correct. On November 4, 2008, we received a letter from the FDA (dated November 3, 2008) in which the FDA stated without elaboration that, after reviewing our response, it disagreed with our position and that a new premarket notification submission was required. After discussions with the FDA regarding the November 3rd letter, we received an additional letter on November 6, 2008 from the FDA. The November 6th letter stated that the intent of the November 3rd letter was to inform us of the FDA's preliminary disagreement with our response to the warning letter and, before finalizing a position, the FDA reiterated that it wanted to meet with us to discuss the Company's response, issues related to the warning letter and next steps to resolve any differences between the Company and the FDA. We thereafter met with the FDA and, on January 20, 2009, we announced that we had submitted to the FDA a new liquid chemical sterilant processing system for 510(k) clearance, and we communicated to Customers that we would continue supporting the existing SYSTEM 1 installed base in the U.S. for at least a two year period from that date.

On December 3, 2009, the FDA provided a notice (“notice”) to healthcare facility administrators and infection control practitioners describing FDA's “concerns about the SYSTEM 1 Processor, components and accessories, and FDA

recommendations.” In the notice, among other things, FDA stated its belief that the SYSTEM 1 device had been significantly modified, that FDA had not cleared or approved the modified device, and that FDA had not determined whether the SYSTEM 1 was safe or effective for its labeled claims. The notice further stated that use of a device that does not properly sterilize or disinfect a medical or surgical device poses risks to patients and users, including the transmission of pathogens, exposure to hazardous chemicals and affect the quality and functionality of reprocessed instruments. The notice stated that FDA was aware of reports of malfunctions of the SYSTEM 1 that had the potential to cause or contribute to serious injuries to patients, such as infections, or injuries to healthcare staff, such as burns. Included in FDA's December 3, 2009 notice was a recommendation from FDA that if users had acceptable alternatives to meet sterilization and disinfection needs, they should transition to that alternative as soon as possible. After its December 3, 2009 notice, we engaged in extensive discussions with the FDA regarding a comprehensive resolution of this matter. On February 2, 2010, the FDA notified healthcare facility administrators and infection control practitioners that FDA's total recommended time period for transitioning from SYSTEM 1 in the U.S. was 18 months from that date.

On April 5, 2010, we received FDA clearance of the new liquid chemical sterilant processing system (SYSTEM 1E). Also

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in April 2010 we reached agreement with the FDA on the terms of a consent decree (“Consent Decree”). On April 19, 2010, a Complaint and Consent Decree were filed in the U.S. District Court for the Northern District of Ohio, and on April 20, 2010, the Court approved the Consent Decree. In general, the Consent Decree addresses regulatory matters regarding SYSTEM 1, restricts further sales of SYSTEM 1 processors in the U.S., defines certain documentation and other requirements for continued service and support of SYSTEM 1 in the U.S., prohibits the sale of liquid chemical sterilization or disinfection products in the U.S. that do not have FDA clearance, describes various process and compliance matters, and defines penalties in the event of violation of the Consent Decree.

The Consent Decree also provides that we may continue to support our Customers' use of SYSTEM 1 in the U.S., including the sale of consumables, parts and accessories and service for a transition period, not to extend beyond August 2, 2011 (later extended by FDA to August 2, 2012), subject to compliance with requirements for documentation of the Customer's need for continued support and other conditions and limitations (the “Transition Plan”). Our Transition Plan includes the “SYSTEM 1 Rebate Program” (the “Rebate Program”). In April 2010, we began to offer rebates to qualifying Customers. Generally, U.S. Customers that purchased SYSTEM 1 processors directly from us or who were users of SYSTEM 1 at the time the Rebate Program was introduced and who return their units have the option of either a pro-rated cash rebate or a rebate toward the future purchase of new STERIS capital equipment (including SYSTEM 1E) or consumable products. In addition, we provide credits for the return of SYSTEM 1 consumables in unbroken packaging and within shelf life and for the unused portion of SYSTEM 1 service contracts. As a result, we recorded a pre-tax liability of \$110,004 related to the SYSTEM 1 Rebate Program during the first quarter of fiscal 2011. Of the \$110,004, \$102,313 is attributable to the Customer Rebate portion of the Program and was recorded as a reduction of revenues, and \$7,691 is attributable to the disposal liability of the SYSTEM 1 units to be returned and was recorded as an increase in cost of revenues. This also resulted in a \$110,004 reduction in operating income.

Recording the obligations associated with the Rebate Program requires the use of estimates and assumptions. The use of estimates and assumptions involves judgments with respect to factors that may impact the ultimate outcome and may be beyond management's control. The amount recognized during the first quarter of fiscal 2011 is based upon the quantity of SYSTEM 1 processors eligible for rebates and the estimated value of rebates to be provided upon their return. Rebates of \$102,313 were recognized as contra-revenue consistent with other returns and allowances offered to Customers. The estimated cost of \$7,691 to facilitate the return and disposal of the processors has been recognized as cost of revenues. Both components are recorded as current liabilities. The key assumptions involved in the estimates associated with the Rebate Program include: the number and age of SYSTEM 1 processors eligible for rebates under the Rebate Program, the number of Customers that will elect to participate in the Rebate Program, the proportion of Customers that will choose each rebate option, and the estimated per unit costs of disposal.

The number and age of SYSTEM 1 processors has been estimated based on our historical sales and service records and we have assumed that 100% of eligible Customers will elect to participate in the Rebate Program. In order to estimate the portion of Customers that will choose each available rebate option, we first assessed trends in sales of the proprietary consumable products utilized in the SYSTEM 1 processor. We noted a decline of approximately 19% in shipments of SYSTEM 1 consumables during the period between the notice by FDA to healthcare facility administrators and infection control practitioners and the announcement of the Rebate Program, which indicated that a portion of our Customers had already transitioned away from the SYSTEM 1 technology during that period. The remaining 81% provided the best available indication of the portion of Customers projected to elect the rebate for the SYSTEM 1E processor. Order and quote data for fiscal 2011 provided indications of the proportion of Customers that were expected to choose each of the other cash and rebate options. The per unit costs associated with disposal were estimated based on the service hours involved and quotes from our vendors using exiting freight and disposal



contracts.

Our assumptions regarding the response of our Customers to the Rebate Program could be wrong and actual results could be different from these estimates. Through December 31, 2011, Customers have utilized or committed to utilize rebates totaling approximately \$54,385 on orders placed since the initiation of the Rebate Program. If all eligible Customers holding the remaining outstanding SYSTEM 1 units elect the maximum incentive rebate associated with the SYSTEM 1E processor rebate, the total estimated rebate cost of \$102,313 would increase to approximately \$105,000. Conversely, if all eligible Customers holding the remaining outstanding SYSTEM 1 units elect the cash rebate option, the total estimated rebate cost would decrease to approximately \$77,000.

The Consent Decree has defined the resolution of a number of issues regarding SYSTEM 1, and we believe our actions with respect to SYSTEM 1, including the Transition Plan, were and are not recalls, corrections or removals under FDA regulations. However, there is no assurance that these or other claims will not be brought or that judicial, regulatory, administrative or other legal or enforcement actions, notices or remedies will not be pursued, or that action will not be taken in

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respect of the Consent Decree, the Transition Plan, SYSTEM 1, or otherwise with respect to regulatory or compliance matters, as described in this note 10 or in various portions of Item 1A. of Part I contained in our Annual Report on Form 10-K for the year ended March 31, 2011, filed with the SEC on May 27, 2011.

In December of 2010, we began shipping SYSTEM 1E units, after having received FDA clearance for the SYSTEM 1E chemical indicator, which is used in conjunction with the SYSTEM 1E. We also submitted a 510(k) to FDA for an optional spore-based indicator strip for use with SYSTEM 1E. Thereafter, as a result of discussions with FDA, we filed a de novo submission requesting classification of this strip in accordance with Section 513(f)(2) of the Federal Food Drug & Cosmetic Act. The de novo process is part of the initial classification for new devices. This spore-based monitoring strip is an optional accessory and is not required for the proper use of SYSTEM 1E. These actions do not affect the prior clearance of the SYSTEM 1E processor or the SYSTEM 1E chemical indicator. There is no assurance regarding the outcome or timing of the de novo submission.

On February 5, 2010, a complaint was filed by a Customer that claimed to have purchased two SYSTEM 1 devices from STERIS, Physicians of Winter Haven LLC d/b/a Day Surgery Center v. STERIS Corp., Case No. 1:1-cv-00264-CAB (N.D. Ohio). The complaint alleged statutory violations, breaches of various warranties, negligence, failure to warn, and unjust enrichment and Plaintiff sought class certification, damages, and other legal and equitable relief including, without limitation, attorneys' fees and an order requiring STERIS to replace, recall or adequately repair the product and/or to take appropriate regulatory action. On February 7, 2011 we entered into a settlement agreement in which we agreed, among other things, to provide various categories of economic relief for members of the settlement class and not object to plaintiff's counsel's application to the court for attorneys' fees and expenses up to a specified amount. Certification of a settlement class was approved and final approval of the settlement was given by the court in the first quarter of fiscal 2012. During the third quarter of fiscal 2011, we recorded in operating expenses a pre-tax charge of approximately \$19,796 related to the settlement of these proceedings. The assumptions regarding the amount of this charge included, among others, the portion of class members participating in the settlement and their choice of the categories of economic relief available for such members. These assumptions may be incorrect and the costs of the settlement may be higher or lower than the charge recorded. Estimates of the actual settlement range from as low as \$7,000 and as high as \$22,000 depending on the options selected by the class members.

Other civil, criminal, regulatory or other proceedings involving our products or services also could possibly result in judgments, settlements or administrative or judicial decrees requiring us, among other actions, to pay damages or fines or effect recalls, or be subject to other governmental, Customer or other third party claims or remedies, which could materially affect our business, performance, prospects, value, financial condition, and results of operations.

For additional information regarding these matters, see the following portions of our Annual Report on Form 10-K for the fiscal year ended March 31, 2011: "Business - Information with respect to our Business in General - Government Regulation", and the "Risk Factor" titled: "We may be adversely affected by product liability claims or other legal actions or regulatory or compliance matters, including the Warning Letter and Consent Decree.", the "Risk Factor" titled: "Our business may be adversely affected as a result of the U.S. Food and Drug Administration notices to healthcare administrators and device manufacturers, and related matters," and the "Risk Factor" titled "Compliance with the Consent Decree may be more costly and burdensome than anticipated."

From time to time, STERIS is also involved in legal proceedings as a plaintiff involving contract, patent protection, and other claims asserted by us. Gains, if any, from these proceedings are recognized when they are realized.

We are subject to taxation from United States federal, state, and local, and foreign jurisdictions. Tax positions are settled primarily through the completion of audits within each individual jurisdiction or the closing of statute of limitation. Changes in applicable tax law or other events may also require us to revise past estimates.

We describe income taxes further in Note 8 to our consolidated financial statements titled, "Income Tax Expense", and in our Annual Report on Form 10-K for the year ended March 31, 2011 filed with the SEC on May 27, 2011.

#### 11. Business Segment Information

We operate and report in three business segments: Healthcare, Life Sciences, and Isomedix. "Corporate and other," which is presented separately, contains the Defense and Industrial business unit plus costs that are associated with being a publicly traded company and certain other corporate costs.

Our Healthcare segment manufactures and sells infrastructure capital equipment, accessory, consumable, information support and service solutions to healthcare providers, including acute care hospitals and surgery and gastrointestinal centers.

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These solutions aid our Customers in improving the safety, quality, productivity and utility consumption of their surgical, sterile processing, gastrointestinal, and emergency environments.

In May 2011, we acquired the stock of a privately held company with operations located near Sao Paulo, Brazil for approximately \$30,000, including cash of \$22,269 and contingent consideration that is expected to be paid over the next three years. The acquired company designs and manufactures small, medium, and large sterilizers used by public hospitals, clinics, dental offices and industrial companies (e.g., research laboratories and pharmaceutical research and production companies) and will be integrated into our Healthcare segment. The total purchase price has been allocated to net assets and intangible assets based on the valuation of assets acquired and liabilities assumed. Intangibles, including Customer relationships, technology, trademarks and tradename, and non-compete arrangements total approximately \$8,000. The residual purchase price, after allocations to net assets and intangibles, of approximately \$11,000 has been allocated to goodwill. The allocation of the purchase price for this acquisition is not final and may be subsequently adjusted.

Our Life Sciences segment manufactures and sells a broad range of capital equipment, formulated cleaning chemistries, and service solutions to pharmaceutical companies, and private and public research facilities around the globe.

Our Isomedix segment operates through a network of facilities located in North America. We sell a comprehensive array of contract sterilization services using gamma irradiation and ethylene oxide (“EO”) technologies. We offer microbial reduction services based on Customer specifications to companies that supply products to the healthcare, industrial, and consumer products industries.

Financial information for each of our segments is presented in the following table. Operating income (loss) for each segment is calculated as the segment’s gross profit less direct expenses and indirect cost allocations, which results in the full allocation of all distribution and research and development expenses, and the partial allocation of corporate costs. These allocations are based upon variables such as segment headcount and revenues. In addition, the Healthcare segment is responsible for the management of all but one manufacturing facility and uses standard cost to sell products to the Life Sciences segment. “Corporate and other” includes the gross profit and direct expense of the Defense and Industrial business unit, as well as certain unallocated corporate costs related to being a publicly traded company and legacy pension and post-retirement benefits.

The accounting policies for reportable segments are the same as those for the consolidated Company. For the three and nine month periods ended December 31, 2011, revenues from a single Customer did not represent ten percent or more of any reportable segment’s revenues. Additional information regarding our segments is included in our consolidated financial statements included in our Annual Report on Form 10-K for the year ended March 31, 2011, filed with the SEC on May 27, 2011.

Financial information for each of our segments is presented in the following tables:

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	Three Months Ended December 31,		Nine Months Ended December 31,	
	2011	2010	2011	2010
Revenues:				
Healthcare (1)	\$259,055	\$237,843	\$725,455	\$561,723
Life Sciences	55,892	51,247	167,675	151,374
Isomedix	39,615	38,081	121,617	113,721
Total reportable segments	354,562	327,171	1,014,747	826,818
Corporate and other	653	1,112	1,814	2,870
Total revenues	\$355,215	\$328,283	\$1,016,561	\$829,688
Operating income (loss):				
Healthcare (2) (3)	\$33,951	\$20,389	\$88,213	\$(19,460)
Life Sciences	10,297	7,345	30,820	23,075
Isomedix	11,750	10,250	35,924	30,858
Total reportable segments	55,998	37,984	154,957	34,473
Corporate and other	(2,274)	(2,153)	(6,689)	(6,735)
Total operating income (loss)	\$53,724	\$35,831	\$148,268	\$27,738

(1) Includes a reduction of \$102,313 resulting from the SYSTEM 1 Rebate Program in the nine months ended December 31, 2010.

(2) Includes a reduction of \$110,004 resulting from the SYSTEM 1 Rebate Program in the nine months ended December 31, 2010.

(3) Includes a reduction of \$19,796 resulting from a class action settlement in the three and nine month periods ended December 31, 2010.

## 12. Common Shares

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

	Three Months Ended December 31,		Nine Months Ended December 31,	
	2011	2010	2011	2010
Denominator (shares in thousands):				
Weighted average common shares outstanding—basic	57,782	59,233	58,594	59,329
Dilutive effect of common share equivalents	455	943	646	832
Weighted average common shares outstanding and common share equivalents—diluted	58,237	60,176	59,240	60,161

Options to purchase the following number of common shares were outstanding but excluded from the computation of diluted earnings per share because the combined exercise prices, unamortized fair values, and assumed tax benefits upon exercise were greater than the average market price for the common shares during the periods, so including these options would be anti-dilutive:

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	Three Months Ended		Nine Months Ended	
	December 31,		December 31,	
	2011	2010	2011	2010
	(shares in thousands)		(shares in thousands)	
Number of common share options	1,040	370	644	437

## 13. Repurchases of Common Shares

During the first nine months of fiscal 2012, we repurchased 1,851,510 of our common shares for an aggregate amount of \$55,942, representing an average price of \$30.21 per common share. We also obtained 22,927 of our common shares during the first nine months of fiscal 2012 in connection with stock based compensation award programs. At December 31, 2011, \$118,460 of STERIS common shares remained authorized for repurchase pursuant to a March 2008 Board Authorization. Also, 12,400,503 common shares were held in treasury at December 31, 2011.

## 14. Share-Based Compensation

We maintain a long-term incentive plan that makes available common shares for grants, at the discretion of the Compensation Committee of the Board of Directors to officers, directors, and key employees in the form of stock options, restricted shares, restricted share units, and stock appreciation rights. Stock options provide the right to purchase our common shares at the market price on the date of grant, subject to the terms of the option plans and agreements. Generally, one-fourth of the stock options granted become exercisable for each full year of employment following the grant date. Stock options granted generally expire 10 years after the grant date, or earlier if the option holder is no longer employed by us. Restricted shares and restricted share units may cliff vest after three or four year periods or vest in installments after the grant date. As of December 31, 2011, 4,568,661 shares remained available for grant under the long-term incentive plan.

The fair value of share-based compensation awards was estimated at their grant date using the Black-Scholes-Merton option pricing model. This model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable, characteristics that are not present in our option grants. If the model permitted consideration of the unique characteristics of employee stock options, the resulting estimate of the fair value of the stock options could be different. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in our Consolidated Statements of Income. The expense is classified as cost of goods sold, selling, general and administrative expenses or research and development expenses in a manner consistent with the employee's compensation and benefits.

The following weighted-average assumptions were used for options granted during the first nine months of fiscal 2012 and fiscal 2011:

	Fiscal 2012		Fiscal 2011	
Risk-free interest rate	2.41	%	2.68	%
Expected life of options	5.65	years	5.65	years
Expected dividend yield of stock	1.78	%	1.59	%
Expected volatility of stock	29.78	%	30.13	%

The risk-free interest rate is based upon the U.S. Treasury yield curve. The expected life of options is reflective of historical experience, vesting schedules and contractual terms. The expected dividend yield of stock represents our best estimate of the expected future dividend yield. The expected volatility of stock is derived by referring to our historical stock prices over a time frame similar to that of the expected life of the grant. An estimated forfeiture rate of 2.08% percent and 2.27% percent was applied in fiscal 2012 and 2011, respectively. This rate is calculated based upon historical activity and represents an estimate of the granted options not expected to vest. If actual forfeitures differ from this calculated rate, we may be required to make additional adjustments to compensation expense in future periods. The assumptions used above are reviewed at the time of each significant option grant, or at least annually.

A summary of share option activity is as follows:

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## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)—(Continued)

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	Number of Options	Weighted Average Exercise Price	Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at March 31, 2011	3,274,395	\$25.95		
Granted	325,051	35.62		
Exercised	(172,592 )	22.38		
Forfeited	(11,084 )	27.25		
Canceled	(23,240 )	22.93		
Outstanding at December 31, 2011	3,392,530	\$27.07	5.40	\$12,354
Exercisable at December 31, 2011	2,505,105	\$25.91	4.41	\$10,464

We estimate that 874,261 of the non-vested stock options outstanding at December 31, 2011 will ultimately vest.

The aggregate intrinsic value in the table above represents the total pre-tax difference between the \$29.82 closing price of our common shares on December 31, 2011 over the exercise price of the stock option, multiplied by the number of options outstanding or outstanding and exercisable, as applicable. The aggregate intrinsic value is not recorded for financial accounting purposes and the value changes daily based on the daily changes in the fair market value of our common shares.

The total intrinsic value of stock options exercised during the first nine months of fiscal 2012 and fiscal 2011 was \$2,111 and \$5,655, respectively. Net cash proceeds from the exercise of stock options were \$3,749 and \$10,813 for the nine months of fiscal 2012 and fiscal 2011, respectively. The tax benefit from stock option exercises was \$816 and \$2,197 for the first nine months of fiscal 2012 and fiscal 2011, respectively.

The weighted average grant date fair value of stock option grants was \$9.31 and \$8.80 for the first nine months of fiscal 2012 and fiscal 2011, respectively.

Stock appreciation rights (“SARS”) carry generally the same terms and vesting requirements as stock options except that they are settled in cash upon exercise and therefore, are classified as liabilities. The fair value of the outstanding SARS as of December 31, 2011 and 2010 was \$763 and \$1,111, respectively. The fair value of each outstanding SAR is revalued at each reporting date and the related liability and expense are adjusted appropriately.

A summary of the non-vested restricted share activity is presented below:

	Number of Restricted Shares	Weighted-Average Grant Date Fair Value
Non-vested at March 31, 2011	400,951	\$29.70
Granted	231,215	35.70
Vested	(76,743 )	30.33
Canceled	(11,910 )	33.06

Non-vested at December 31, 2011	543,513	\$32.09
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Restricted shares granted are valued based on the closing stock price at the grant date. The value of restricted shares that vested during the first nine months of fiscal 2012 was \$2,328.

Cash settled restricted share units carry generally the same terms and vesting requirements as stock settled restricted share units except that they are settled in cash upon vesting and therefore, are classified as liabilities. The fair value of outstanding cash-settled restricted share units as of December 31, 2011 and 2010 was \$1,244 and \$1,282, respectively. The fair value of each cash-settled restricted share unit is revalued at each reporting date and the related liability and expense are adjusted appropriately.

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As of December 31, 2011, there was a total of \$13,115 in unrecognized compensation cost related to non-vested share-based compensation granted under our share-based compensation plans. We expect to recognize the cost over a weighted average period of 2.42 years.

## 15. Financial and Other Guarantees

We generally offer a limited parts and labor warranty on capital equipment. The specific terms and conditions of those warranties vary depending on the product sold and the countries where we conduct business. We record a liability for the estimated cost of product warranties at the time product revenues are recognized. The amounts we expect to incur on behalf of our Customers for the future estimated cost of these warranties are recorded as a current liability on the accompanying Consolidated Balance Sheets. Factors that affect the amount of our warranty liability include the number and type of installed units, historical and anticipated rates of product failures, and material and service costs per claim. We periodically assess the adequacy of our recorded warranty liabilities and adjust the amounts as necessary.

Changes in our warranty liability during the first nine months of fiscal 2012 were as follows:

	Fiscal 2012	
Balance, March 31, 2011	\$7,509	
Warranties issued during the period	5,624	
Settlements made during the period	(2,899	)
Balance, December 31, 2011	\$10,234	

We also sell product maintenance contracts to our Customers. These contracts range in terms from one to five years and require us to maintain and repair the product over the maintenance contract term. We initially record amounts due from Customers under these contracts as a liability for deferred service contract revenue on the accompanying Consolidated Balance Sheets within "Accrued expenses and other." The liability recorded for such deferred service revenue was \$37,200 and \$24,655 as of December 31, 2011 and March 31, 2011, respectively. Such deferred revenue is then amortized on a straight-line basis over the contract term and recognized as service revenue on our accompanying Consolidated Statements of Income. The activity related to the liability for deferred service contract revenues is excluded from the table presented above.

## 16. Forward and Swap Contracts

From time to time, we enter into forward contracts to hedge potential foreign currency gains and losses that arise from transactions denominated in foreign currencies, including inter-company transactions. We also enter into commodity swap contracts to hedge price changes in commodities that impact raw materials included in our cost of revenues. We do not use derivative financial instruments for speculative purposes. These contracts are not designated as hedging instruments and do not receive hedge accounting treatment; therefore, changes in their fair value are not deferred but are recognized immediately in the Consolidated Statements of Income.

	Asset Derivatives		Liability Derivatives	
Balance Sheet	Fair Value at	Fair Value at	Fair Value at	Fair Value at

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Location	December 31, 2011	March 31, 2011	December 31, 2011	March 31, 2011
Prepaid & Other	\$126	\$1,483	\$—	\$—
Accrued expenses and other	\$—	\$—	\$2,198	\$41

The following table presents the impact of derivative instruments and their location within the Consolidated Statements of Income:

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## STERIS CORPORATION AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)—(Continued)

For the Three and Nine Months Ended December 31, 2011 and 2010

(dollars in thousands, except per share amounts)

	Location of gain (loss) recognized in income	Amount of gain (loss) recognized in income	
		Nine Months Ended December 31, 2011	2010
Foreign currency forward contracts	Selling, general and administrative	\$(2,122	) \$943
Commodity swap contracts	Cost of revenues	\$(1,371	) \$59

## 17. Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or that would be paid to transfer a liability in an orderly transaction between market participants at the measurement date. We estimate the fair value of financial assets and liabilities using available market information and generally accepted valuation methodologies. The inputs used to measure fair value are classified into three tiers. These tiers include Level 1, defined as observable inputs such as quoted prices in active markets; Level 2, defined as inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, defined as unobservable inputs in which little or no market data exists, therefore requiring the entity to develop its own assumptions. The following table shows the fair value of our financial assets and liabilities at December 31, 2011:

	Carrying Value	Fair Value Measurements at December 31, 2011 Using		
		Quoted Prices	Significant Other	Significant
		in Active Markets	Observable Inputs	Unobservable
	December 31, 2011	Level 1	Level 2	Level 3
Assets:				
Cash and cash equivalents	\$ 143,787	\$ 143,787	\$—	\$—
Forward and swap contracts (1)	126	—	126	—
Investments (2)	2,823	2,823	—	—
Liabilities:				
Forward and swap contracts (1)	\$ 2,198	\$—	\$ 2,198	\$—
Deferred compensation plans (2)	2,823	2,823	—	—
Long term debt (3)	210,000	—	249,795	—
Contingent consideration obligations (4)	9,195	—	—	9,195

- (1) The fair values of forward and swap contracts are based on period-end forward rates and reflect the value of the amount that we would pay or receive for the contracts involving the same notional amounts and maturity dates.
- (2) We provide a domestic non-qualified deferred compensation plan covering certain employees, which allows for the deferral of compensation for an employee-specified term or until retirement or termination. Amounts deferred can be allocated to various hypothetical investment options. The Plan has been amended to disallow deferral elections in respect fiscal year 2013 and subsequent periods. We hold investments, primarily comprised of mutual funds, to

satisfy the future obligations of the plan. Changes in the value of the investment accounts are recognized each period based on the fair value of the underlying investments. Employees making deferrals are entitled to receive distributions of their hypothetical account balances (amounts deferred, together with earnings (losses)).

- (3) We estimate the fair value of our long-term debt using discounted cash flow analysis, based on our current incremental borrowing rates for similar types of borrowing arrangements.

Contingent consideration obligations arise from prior business acquisitions. The fair values are based on discounted cash flow analyzes reflecting the possible achievement of specified performance measures or events

- (4) and captures the contractual nature of the contingencies, commercial risk, and the time value of money. Contingent consideration obligations are classified in the consolidated balance sheets as accrued expense (short-term) and other liabilities (long-term), as appropriate based on the contractual payment dates.

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STERIS CORPORATION AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)—(Continued)

For the Three and Nine Months Ended December 31, 2011 and 2010

(dollars in thousands, except per share amounts)

18. Subsequent Events

We have evaluated subsequent events through the date the financial statements were filed with the SEC, noting no events that require adjustment of, or disclosure in, the consolidated financial statements for the period ended December 31, 2011. These financial statements should be read in conjunction with the consolidated financial statements and related notes included in the 2011 Annual Report on Form 10-K.

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Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders

STERIS Corporation

We have reviewed the consolidated balance sheet of STERIS Corporation and subsidiaries, as of December 31, 2011, the related consolidated statements of income for the three-month and nine-month periods ended December 31, 2011 and 2010, and consolidated statements of cash flows for the nine-month periods ended December 31, 2011 and 2010. These financial statements are the responsibility of the Company's management.

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

Based on our review, we are not aware of any material modifications that should be made to the consolidated interim financial statements referred to above for them to be in conformity with US generally accepted accounting principles. We have previously audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of STERIS Corporation and subsidiaries as of March 31, 2011, and the related consolidated statements of income, shareholders' equity, and cash flows for the year then ended, not presented herein, and in our report dated May 27, 2011, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying consolidated balance sheet as of March 31, 2011 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ Ernst & Young LLP

Cleveland, Ohio

February 8, 2012



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

Introduction

In Management's Discussion and Analysis of Financial Condition and Results of Operations (the "MD&A"), we explain the general financial condition and the results of operations for STERIS including:

- what factors affect our business;
- what our earnings and costs were in each period presented;
- why those earnings and costs were different from prior periods;
- where our earnings came from;
- how this affects our overall financial condition;
- what our expenditures for capital projects were; and
- where cash will come from to fund future debt principal repayments, growth outside of core operations, repurchase common shares, pay cash dividends and fund future working capital needs.

As you read the MD&A, it may be helpful to refer to information in our consolidated financial statements, which present the results of our operations for the third quarter and the first nine months of fiscal 2012 and fiscal 2011. It may also be helpful to read the MD&A in our Annual Report on Form 10-K for the year ended March 31, 2011, filed with the SEC on May 27, 2011. In the MD&A, we analyze and explain the period-over-period changes in the specific line items in the Consolidated Statements of Income. Our analysis may be important to you in making decisions about your investments in STERIS.

Financial Measures

In the following sections of the MD&A, we may, at times, refer to financial measures that are not required to be presented in the consolidated financial statements under U.S. GAAP. We sometimes use the following financial measures in the context of this report: backlog; debt-to-total capital; net debt-to-total capital; and days sales outstanding. We define these financial measures as follows:

• **Backlog** – We define backlog as the amount of unfilled capital equipment purchase orders at a point in time. We use this figure as a measure to assist in the projection of short-term financial results and inventory requirements.

• **Debt-to-total capital** – We define debt-to-total capital as total debt divided by the sum of total debt and shareholders' equity. We use this figure as a financial liquidity measure to gauge our ability to borrow and fund growth.

• **Net debt-to-total capital** – We define net debt-to-total capital as total debt less cash ("net debt") divided by the sum of net debt and shareholders' equity. We also use this figure as a financial liquidity measure to gauge our ability to borrow and fund growth.

• **Days sales outstanding ("DSO")** – We define DSO as the average collection period for accounts receivable. It is calculated as net accounts receivable divided by the trailing four quarters' revenues, multiplied by 365 days. We use this figure to help gauge the quality of accounts receivable and expected time to collect.

We, at times, may also refer to financial measures which are considered to be "non-GAAP financial measures" under SEC rules. We have presented these financial measures because we believe that meaningful analysis of our financial performance is enhanced by an understanding of certain additional factors underlying that performance. These financial measures should not be considered an alternative to measures required by accounting principles generally accepted in the United States. Our calculations of these measures may differ from calculations of similar measures used by other companies and you should be careful when comparing these financial measures to those of other

companies. Additional information regarding these financial measures, including reconciliations of each non- GAAP financial measure, is available in the subsection of MD&A titled, "Non-GAAP Financial Measures."

#### Revenues – Defined

As required by Regulation S-X, we separately present revenues generated as either product revenues or service revenues on our Consolidated Statements of Income for each period presented. When we discuss revenues, we may, at times, refer to revenues summarized differently than the Regulation S-X requirements. The terminology, definitions, and applications of terms that we use to describe revenues may be different from terms used by other companies. We use the following terms to describe revenues:

Revenues – Our revenues are presented net of sales returns and allowances.

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**Product Revenues** – We define product revenues as revenues generated from sales of capital equipment, which includes steam sterilizers, low temperature liquid chemical sterilant processing systems, washing systems, VHP® technology, water stills, and pure steam generators; integrated OR; surgical lights and tables; and the consumable family of products, which includes SYSTEM 1 and SYSTEM 1E consumables, sterility assurance products, skin care products, and cleaning consumables.

**Service Revenues** – We define service revenues as revenues generated from parts and labor associated with the maintenance, repair, and installation of our capital equipment, as well as revenues generated from contract sterilization offered through our Isomedix segment.

**Capital Equipment Revenues** – We define capital equipment revenues as revenues generated from sales of capital equipment, which includes steam sterilizers, low temperature liquid chemical sterilant processing systems, including SYSTEM 1 and SYSTEM 1E, washing systems, VHP® technology, water stills, and pure steam generators; surgical lights and tables; and integrated OR.

**Consumable Revenues** – We define consumable revenues as revenues generated from sales of the consumable family of products, which includes SYSTEM 1 and SYSTEM 1E consumables, sterility assurance products, skin care products, and cleaning consumables.

**Recurring Revenues** – We define recurring revenues as revenues generated from sales of consumable products and service revenues.

**Acquired Revenues** – We define acquired revenues as base revenues generated from acquired businesses or assets and additional volumes driven through acquired businesses or assets. We will use such measure for up to a year after acquisition.

## General Company Overview and Executive Summary

Our mission is to provide a healthier today and safer tomorrow through knowledgeable people and innovative infection prevention, decontamination and health science technologies, products, and services. Our dedicated employees around the world work together to supply a broad range of solutions by offering a combination of capital equipment, consumables, and services to healthcare, pharmaceutical, industrial, and governmental Customers. The bulk of our revenues are derived from the healthcare and pharmaceutical industries. Much of the growth in these industries is driven by the aging of the population throughout the world, as an increasing number of individuals are entering their prime healthcare consumption years, and is dependent upon advancement in healthcare delivery, acceptance of new technologies, government policies, and general economic conditions. In addition, each of our core industries is experiencing specific trends that could increase demand. Within healthcare, there is increased concern regarding the level of hospital-acquired infections around the world. The pharmaceutical industry has been impacted by increased FDA scrutiny of cleaning and validation processes, mandating that manufacturers improve their processes. The aging population increases the demand for medical procedures, which increases the consumption of single use medical devices and surgical kits processed by our Isomedix segment.

Beyond our core markets, infection-control issues are a growing global concern, and emerging threats are prominent in the news. We are actively pursuing new opportunities to adapt our proven technologies to meet the changing needs of the global marketplace.

In May 2011, we acquired the stock of a privately held company with operations located near Sao Paulo, Brazil for approximately \$30 million, including contingent consideration obligations that are expected to be paid over the next three years. The acquired company designs and manufactures small, medium, and large sterilizers used by public hospitals, clinics, dental offices and industrial companies (e.g., research laboratories and pharmaceutical research and production companies).

During the first quarter of fiscal 2011, we recorded a pre-tax liability related to the SYSTEM 1 Rebate Program. The Rebate Program reduced Healthcare revenues by \$102.3 million, increased Healthcare cost of revenues by \$7.7 million, and decreased gross margin and operating margin by \$110.0 million. The accrual of these estimated rebates and costs increased current liabilities by \$110.0 million and did not have a material impact on free cash flow during

that period.

Fiscal 2011 third quarter operating expenses include a pre-tax charge of \$19.8 million related to the settlement of SYSTEM 1 class action litigation. After tax, the impact of the charge was a reduction in net income of \$13.1 million, or \$0.22 per diluted share.

Fiscal 2012 third quarter revenues were \$355.2 million representing an increase of 8.2% over prior year reflecting increases in the all three reportable business segments. Our gross margin percentage for the fiscal 2012 third quarter decreased to 38.9%, or 280 basis points (bps), from 41.7% in the fiscal 2011 third quarter. The decline in gross margin is primarily due to the reduction in SYSTEM 1 consumable volumes, a shift in mix toward capital equipment revenues, a decline in pricing, and

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an inventory write-off relating to our European consolidation efforts.

Fiscal 2012 first nine months revenues were \$1,016.6 million representing an increase of 22.5% over the prior year period. The fiscal 2011 period was negatively impacted by the SYSTEM 1 Rebate Program. When compared to adjusted revenues in the prior year period, excluding the \$102,313 negative impact of the SYSTEM 1 Rebate Program, fiscal 2012 first nine months revenues represent an increase of 9.1% (see subsection of MD&A titled "Non-GAAP Financial Measures" for additional information and related reconciliation of non-GAAP financial measures to the most comparable GAAP measures). Our gross margin percentage for the fiscal 2012 first nine months was 39.8%. The fiscal 2011 first nine months gross margin percentage of 35.0% was negatively impacted by the SYSTEM 1 Rebate Program. Adjusted gross margin percentage for the fiscal 2011 first nine months was 42.9% (see subsection of MD&A titled "Non-GAAP Financial Measures" for additional information and related reconciliation of non-GAAP financial measures to the most comparable GAAP measures). Compared to the adjusted gross margin percentage for the fiscal 2011 period, the 310 bps decrease was driven primarily by a shift in mix toward capital equipment, lower SYSTEM 1 consumable volume, a decline in pricing, unfavorable foreign currency fluctuations, and an inventory write-off relating to our European consolidation efforts.

Fiscal 2012 third quarter operating income was \$53.7 million compared with \$35.8 million for the fiscal 2011 third quarter. The prior year period was negatively impacted by the SYSTEM 1 class action settlement. Fiscal 2012 first nine months operating income was \$148.3 million compared with \$27.7 million for the first nine months of fiscal 2011. The prior year period was negatively impacted by the recording of the SYSTEM 1 Rebate Program liability and class action settlement.

Free cash flow was \$58.6 million in the first nine months of fiscal 2012 compared to \$28.3 million in the prior year first nine months, reflecting higher cash from operations resulting primarily from higher cash collections on accounts receivable and a decline in cash used for inventory purchases partially offset by the funding of the SYSTEM 1 Rebate Program (see subsection of MD&A titled "Non-GAAP Financial Measures" for additional information and related reconciliation of non-GAAP financial measures to the most comparable GAAP measures). Our debt-to-total capital ratio was 21.2% at December 31, 2011 and 21.1% at March 31, 2011. During the first nine months of fiscal 2012, we declared and paid cash dividends in the aggregate amount of \$0.49 per common share.

Inventory was \$169.4 million at December 31, 2011 which reflects an increase from the March 31, 2011 balance of \$167.3 million. The higher inventory level is primarily driven by inventory held in support of the SYSTEM 1 Transition Plan. Inventory has declined \$15.8 million during the third quarter of fiscal 2012 when compared to September 30, 2011.

Additional information regarding our fiscal 2012 third quarter and first nine months financial performance is included in the subsection below titled "Results of Operations."

**Matters Affecting Comparability**

SYSTEM 1 Rebate Program and class action settlement. In April 2010, we introduced the SYSTEM 1 Rebate Program ("Rebate Program") to Customers as a component of our Transition Plan for SYSTEM 1. Generally, U.S. Customers that purchased SYSTEM 1 processors directly from us or who were users of SYSTEM 1 at the time the rebate program was introduced and who return their units have the option of either a pro-rated cash value or rebate toward the future purchase of new STERIS capital equipment or consumable products. In addition, we provide credits for SYSTEM 1 consumables in unbroken packaging and within shelf life and for the unused portion of prepaid SYSTEM 1 services contracts.

During the first quarter of fiscal 2011, we recorded a pre-tax liability related to the SYSTEM 1 Rebate Program. Of the \$110.0 million recorded, \$102.3 million was attributable to the Customer Rebate portion of the Program and was recorded as a reduction to revenue, and \$7.7 million was attributable to the disposal liability of the SYSTEM 1 units to be returned and was recorded in cost of revenues.

Fiscal 2011 third quarter operating expenses include a pre-tax charge of \$19.8 million related to the settlement of SYSTEM 1 class action litigation. After tax, the impact of the charge was a reduction in net income of \$13.1 million, or \$0.22 per diluted share.

International Operations. Since we conduct operations outside of the United States using various foreign currencies, our operating results are impacted by foreign currency movements relative to the U.S. dollar. During the third quarter of fiscal 2012, our revenues were unfavorably impacted by \$0.1 million, or 0.1%, and income before taxes was favorably impacted by \$1.9 million, or 3.9%, as a result of foreign currency movements relative to the U.S. dollar. During the first nine months of fiscal 2012, our revenues were favorably impacted by \$7.7 million, or 0.8%, and income before taxes was unfavorably impacted by \$2.6 million, or 1.8%, as a result of foreign currency movements relative to the U.S. dollar.

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## NON-GAAP FINANCIAL MEASURES

We, at times, refer to financial measures which are considered to be “non-GAAP financial measures” under SEC rules. We, at times, also refer to our results of operations excluding certain transactions or amounts that are non-recurring or are not indicative of future results, in order to provide meaningful comparisons between the periods presented.

These non-GAAP financial measures are not intended to be, and should not be, considered separately from or as an alternative to the most directly comparable GAAP financial measures.

These non-GAAP financial measures are presented with the intent of providing greater transparency to supplemental financial information used by management and the Board of Directors in their financial analysis and operational decision-making. These amounts are disclosed so that the reader has the same financial data that management uses with the belief that it will assist investors and other readers in making comparisons to our historical operating results and analyzing the underlying performance of our operations for the periods presented.

We believe that the presentation of these non-GAAP financial measures, when considered along with our GAAP financial measures and the reconciliation to the corresponding GAAP financial measures, provide the reader with a more complete understanding of the factors and trends affecting our business than could be obtained absent this disclosure. It is important for the reader to note that the non-GAAP financial measure used may be calculated differently from, and therefore may not be comparable to, a similarly titled measure used by other companies.

We define free cash flow as net cash provided by operating activities as presented in the Consolidated Statements of Cash Flows less purchases of property, plant, equipment, and intangibles plus proceeds from the sale of property, plant, equipment, and intangibles, which are also presented in the Consolidated Statements of Cash Flows. We use this as a measure to gauge our ability to fund future debt principal repayments, growth outside of core operations, repurchase common shares, and pay cash dividends. The following table summarizes the calculation of our free cash flow for the nine month periods ended December 31, 2011 and 2010:

(dollars in thousands)	Nine Months Ended December 31,	
	2011	2010
Net cash flows provided by operating activities	\$112,839	\$83,397
Purchases of property, plant, equipment and intangibles, net	(54,238 )	(56,390 )
Proceeds from the sale of property, plant, equipment and intangibles	—	1,298
Free cash flow	\$58,601	\$28,305

To supplement our financial results presented in accordance with U.S. GAAP, we have sometimes referred to certain measures of revenues, gross profit, income tax expense, and the Healthcare segment results of operations in the section of MD&A titled, "Results of Operations" excluding the impact of the SYSTEM 1 Rebate Program recorded in the first quarter of fiscal 2011 and the SYSTEM 1 class action settlement recorded in the third quarter of fiscal 2011. These items had a significant impact on the fiscal 2011 first nine months measures and the corresponding trend in each of these measures. We provide adjusted measures to give the reader a more complete understanding of the factors and trends affecting our business than could be obtained absent this disclosure. These measures are used by management and the Board of Directors in making comparisons to our historical operating results and analyzing the underlying performance of our operations. The tables below provide a reconciliation of each of these measures to its most directly comparable GAAP financial measure.

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(dollars in thousands)	Nine Months Ended December 31, 2010	
Reported revenues	\$829,688	
Impact of the SYSTEM 1 Rebate Program	102,313	
Adjusted revenues	\$932,001	
Reported capital revenues	256,368	
Impact of the SYSTEM 1 Rebate Program	102,313	
Adjusted capital revenues	\$358,681	
Reported United States revenues	\$601,703	
Impact of the SYSTEM 1 Rebate Program	102,313	
Adjusted United States Revenues	\$704,016	
Reported Healthcare revenues	\$561,723	
Impact of the SYSTEM 1 Rebate Program	102,313	
Adjusted Healthcare revenues	\$664,036	
Reported gross profit	\$290,135	
Impact of the SYSTEM 1 Rebate Program	110,004	
Adjusted gross profit	\$400,139	
Reported gross profit percentage	35.0	%
Impact of the SYSTEM 1 Rebate Program	7.9	%
Adjusted gross profit percentage	42.9	%
Reported operating income	\$27,738	
Impact of the SYSTEM 1 Rebate Program and class action settlement	129,800	
Adjusted operating income	\$157,538	
Reported Healthcare operating (loss)	\$(19,460	)
Impact of the SYSTEM 1 Rebate Program and class action settlement	129,800	
Adjusted Healthcare operating income	\$110,340	
Reported income tax expense	\$7,091	
Impact of the SYSTEM 1 Rebate Program and class action settlement	47,164	
Adjusted income tax expense	\$54,255	
Reported effective income tax rate	36.6	%
Impact of the SYSTEM 1 Rebate Program and class action settlement	(0.2	)%
Adjusted effective income tax rate	36.4	%

## Results of Operations

In the following subsections, we discuss our earnings and the factors affecting them for the third quarter and first nine months of fiscal 2012 compared with the same fiscal 2011 periods. We begin with a general overview of our operating results and then separately discuss earnings for our operating segments.





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Revenues. The following table compares our revenues for the three and nine months ended December 31, 2011 to the revenues for the three and nine months ended December 31, 2010:

(dollars in thousands)	Three Months Ended December 31,		Change	Percent Change	
	2011	2010			
Total revenues	\$355,215	\$328,283	\$26,932	8.2	%
Revenues by type:					
Capital equipment revenues	165,290	135,121	30,169	22.3	%
Consumable revenues	74,113	77,501	(3,388)	(4.4)	%
Service revenues	115,812	115,661	151	0.1	%
Revenues by geography:					
United States revenues	263,540	239,975	23,565	9.8	%
International revenues	91,675	88,308	3,367	3.8	%

(dollars in thousands)	Nine Months Ended December 31,		Change	Percent Change	
	2011	2010			
Total revenues	\$1,016,561	\$829,688	\$186,873	22.5	%
Revenues by type:					
Capital equipment revenues	439,134	256,368	182,766	71.3	%
Consumable revenues	225,784	230,618	(4,834)	(2.1)	%
Service revenues	351,643	342,702	8,941	2.6	%
Revenues by geography:					
United States revenues	766,011	601,703	164,308	27.3	%
International revenues	250,550	227,985	22,565	9.9	%

#### Quarter over Quarter Comparison

Revenues increased \$26.9 million, or 8.2%, to \$355.2 million for the quarter ended December 31, 2011, as compared to \$328.3 million for the same prior year quarter. Capital equipment revenues increased \$30.2 million, or 22.3%, in the third quarter of fiscal 2012, as compared to the third quarter of fiscal 2011. Capital equipment revenues increased in both the Healthcare and Life Sciences segments. Within Healthcare, the increase was primarily attributable to shipments of SYSTEM 1E units. Consumable revenues declined \$3.4 million, or 4.4%, for the quarter ended December 31, 2011, as compared to the prior year quarter, attributable to reductions in SYSTEM 1 consumables within the Healthcare segment which were partially offset by growth in consumables within the Life Sciences segment. Service revenues increased \$0.2 million, or 0.1%, in the third quarter of fiscal 2012 reflecting growth in Isomedix offset by declines in Healthcare and Life Sciences.

International revenues increased \$3.4 million, or 3.8%, to \$91.7 million for the quarter ended December 31, 2011, as compared to \$88.3 million for the same prior year quarter. International revenues were favorably impacted by increases in



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capital equipment revenues which increased 2.1% primarily due to increases within Latin America and Canada. International recurring revenues increased during the third quarter of fiscal 2012 by 6.1%, led primarily by increases in consumable revenues in Europe and Latin America.

United States revenues increased \$23.6 million, or 9.8%, to \$263.5 million for the quarter ended December 31, 2011, as compared to \$240.0 million for the same prior year quarter. Higher capital equipment revenues in both the Healthcare and Life Sciences business segments combined with growth in Isomedix service revenues drove the increase. These increases were partially offset by a decline in consumable and service revenues driven by the SYSTEM 1 transition.

#### First Nine Months over First Nine Months Comparison

Revenues increased \$186.9 million, or 22.5%, to \$1,016.6 million for the first nine months of fiscal 2012. The first nine months of fiscal 2011 was negatively impacted by the SYSTEM 1 Rebate Program. Adjusted revenues, excluding the impact of the SYSTEM 1 Rebate Program, for the first nine months of fiscal 2011 were \$932.0 million (see subsection of MD&A titled "Non-GAAP Financial Measures" for additional information and related reconciliation of non-GAAP financial measures to the most comparable GAAP measures). Capital equipment revenues increased \$182.8 million or 71.3%. The prior year period was negatively impacted by the SYSTEM 1 Rebate Program. Capital equipment revenues increased 22.5% when compared to adjusted capital equipment revenues for the first nine months of fiscal 2011 of \$358.7 million (see subsection of MD&A titled "Non-GAAP Financial Measures" for additional information and related reconciliation of non-GAAP financial measures to the most comparable GAAP measures). The increase was driven by improved demand within all geographies -- North America, Europe, Asia Pacific and Latin America. Recurring revenues increased \$4.1 million or 0.7% for the first nine months of fiscal 2012 as a result of weaker demand in the United States for SYSTEM 1 consumables partially offset the impact of growth internationally in consumables and service.

International revenues for the first nine months of fiscal 2012 were \$250.6 million, an increase of \$22.6 million, or 9.9%, as compared to the first nine months of fiscal 2011. Fiscal 2012 year-to-date international revenues were favorably impacted by an 11.0% increase in capital equipment revenue and an 8.6% increase in recurring revenues, reflecting increases in both consumable and service revenues of 9.4% and 7.8%, respectively.

United States revenues for the first nine months of fiscal 2012 increased \$164.3 million, or 27.3%, as compared to the first nine months of fiscal 2011. United States revenues in the prior year first nine months were negatively impacted by the SYSTEM 1 Rebate Program. Adjusted United States revenues for the first nine months of fiscal 2011 were \$704.0 million. United States revenues for the first nine months of fiscal 2012 increased \$62.0 million, or 8.8%, when compared to adjusted United States revenues for the first nine months of fiscal 2011 (see subsection of MD&A titled "Non-GAAP Financial Measures" for additional information and related reconciliation of non-GAAP financial measures to the most comparable GAAP measures). The fiscal 2012 year-to-date increase in United States revenues was driven by increases in capital equipment revenues, including those derived from SYSTEM 1E, and service revenues generated by our Isomedix segment. These increases were partially offset by a 5.6% decrease in consumable revenues.

Revenues by segment are further discussed in the section of MD&A titled, "Business Segment Results of Operations."

Gross Profit. The following table compares our gross profit for the three and nine months ended December 31, 2011 to the three and nine months ended December 31, 2010:

(dollars in thousands)	Three Months Ended December 31,		Change	Percent Change
	2011	2010		
Gross Profit:				

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Product	\$93,427	\$89,241	\$4,186	4.7	%
Service	44,579	47,773	(3,194)	(6.7)	)%
Total Gross Profit	\$138,006	\$137,014	\$992	0.7	%
Gross Profit Percentage:					
Product	39.0	% 42.0			%
Service	38.5	% 41.3			%
Total Gross Profit Percentage	38.9	% 41.7			%

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(dollars in thousands)	Nine Months Ended		Change	Percent Change	
	December 31, 2011	2010			
Gross Profit:					
Product	\$262,704	\$146,293	\$116,411	79.6	%
Service	141,536	143,842	(2,306)	(1.6)	)%
Total Gross Profit	\$404,240	\$290,135	\$114,105	39.3	%
Gross Profit Percentage:					
Product	39.5	% 30.0	%		
Service	40.2	% 42.0	%		
Total Gross Profit Percentage	39.8	% 35.0	%		

Our gross profit percentage is affected by the volume, pricing, and mix of sales of our products and services, as well as the costs associated with the products and services that are sold. Gross profit percentage for the third quarter of fiscal 2012 compared to the third quarter of fiscal 2011 decreased 280 bps to 38.9% from 41.7%. The fiscal 2012 period was negatively impacted by the SYSTEM 1 transition (approximately 140 bps) primarily reflecting the decline in SYSTEM 1 consumable volumes, a shift in mix toward capital equipment revenues, a decline in pricing (approximately 30 bps), and an inventory write-off of \$1.1 million relating to our European consolidation efforts.

Gross profit percentage for the first nine months of fiscal 2012 was 39.8%. The fiscal 2011 first nine month period gross profit percentage of 35.0% was negatively impacted by the SYSTEM 1 Rebate Program. Excluding the impact of the SYSTEM 1 Rebate Program, adjusted gross profit percentage for the first nine months of fiscal 2011 period was 42.9% (see subsection of MD&A titled "Non-GAAP Financial Measures" for additional information and related reconciliation of non-GAAP financial measures to the most comparable GAAP measures). Therefore, the gross profit percentage has decreased 310 bps for the first nine months of fiscal 2012 compared to the adjusted gross profit percentage for the first nine months of fiscal 2011 driven by the SYSTEM 1 transition (approximately 140 bps), including the impact of the decline in SYSTEM 1 consumable volumes, a shift in mix toward capital equipment revenues, higher material costs (approximately 40 bps), the unfavorable impact of foreign currency fluctuations (approximately 20 bps), a decline in pricing (approximately 10 bps), and an inventory write-off of \$1.1 million relating to our European consolidation efforts.

Operating Expenses. The following table compares our operating expenses for the three and nine month periods ended December 31, 2011 to the three and nine month periods ended December 31, 2010:

(dollars in thousands)	Three Months Ended		Change	Percent Change	
	December 31, 2011	2010			
Operating Expenses:					
Selling, General, and Administrative	\$73,922	\$93,467	\$(19,545)	(20.9)	)%
Research and Development	9,196	7,739	1,457	18.8	%
Restructuring expenses	1,164	(23)	1,187	NM	
Total Operating Expenses	\$84,282	\$101,183	\$(16,901)	(16.7)	)%
NM - Not meaningful.					
(dollars in thousands)	Nine Months Ended		Change	Percent Change	
	December 31, 2011	2010			
Operating Expenses:					
Selling, General, and Administrative	\$227,583	\$237,583	\$(10,000)	(4.2)	)%
Research and Development	26,867	24,391	2,476	10.2	%

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Restructuring expenses	1,522	423	1,099	259.8	%
Total Operating Expenses	\$255,972	\$262,397	\$(6,425)	(2.4)	)%

Significant components of total selling, general, and administrative expenses (“SG&A”) are compensation and benefit costs, fees for professional services, travel and entertainment, facilities costs, and other general and administrative expenses. SG&A for the third quarter of fiscal 2011 includes \$19.8 million related to the SYSTEM 1 class action settlement. Expenses of

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\$4.9 million were incurred in the fiscal 2012 third quarter related to product reliability issues, in particular for the recently shipped SYSTEM 1E units, as well as strategic investments within our Healthcare business segment, including transition costs related to our previously announced facility consolidations. Offsetting these expenses is a decline in compensation related costs due to the reversal in the third quarter of fiscal 2012 of the accrual for our annual incentive compensation plan. Given our performance through the first nine months of this year, we are now assuming that bonuses will not be paid as part of our annual incentive compensation plan for this fiscal year. SG&A expenses decreased 4.2% for the first nine months of fiscal 2012, compared to the first nine months of fiscal 2011. Again, the fiscal 2011 period includes \$19.8 million related to the SYSTEM 1 class action settlement. Excluding the impact of this class action settlement from the prior year period, SG&A increased for the first nine months of fiscal 2012 due to costs associated with product reliability issues, in particular for the recently shipped SYSTEM 1E units and V-Pro units, as well as strategic investments within our Healthcare business segment, including transition costs related to our previously announced facility consolidations. Offsetting these expenses is a decline in compensation related costs due to the previously mentioned reversal of the accrual for our annual incentive compensation plan.

For the three month period ended December 31, 2011, research and development expenses increased 18.8% compared to the three month period ended December 31, 2010. For the first nine months of fiscal 2012, research and development expenses were \$26.9 million, representing an increase of 10.2% compared to the same fiscal 2011 period. Research and development expenses are influenced by the number and timing of in-process projects and labor hours and other costs associated with these projects. Our research and development initiatives continue to emphasize new product development, product improvements, and the development of new technological platform innovations. Our investments in research and development continue to be focused on, but not limited to, enhancing capabilities of sterile processing combination technologies, surgical products and accessories, and the areas of emerging infectious agents such as Prions and Nanobacteria.

Restructuring expenses incurred during the three and nine month periods of fiscal 2012 and fiscal 2011 relate to previously announced restructuring plans. Production has ceased in our Switzerland manufacturing facility. We recognized an impairment loss with regard to this facility based on the value of an offer to purchase that was received during the fiscal 2012 third quarter. The following tables summarize our total pre-tax restructuring expenses for the three and nine month periods ended December 31, 2011 and December 31, 2010:

(dollars in thousands)

Three Months Ended December 31, 2011	Fiscal 2010 Restructuring Plan (1)
Severance, payroll, and other related costs	\$7
Asset impairment and accelerated depreciation	1,157
Lease termination obligation and other	3
Total restructuring charges	\$1,167

(1)Includes \$3 in charges recorded in cost of revenues on Consolidated Statements of Income.

(dollars in thousands)

Three Months Ended December 31, 2010	Fiscal 2010 Restructuring Plan (1)	Fiscal 2008 Restructuring Plan	Total
Severance, payroll, and other related costs	\$489	\$—	\$489
Asset impairment and accelerated depreciation	—	(289	)(289
Other	7	—	7
Total restructuring charges	\$496	\$(289	)\$207



(1) Includes \$230 in charges recorded in cost of revenues on Consolidated Statements of Income.

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(dollars in thousands)

Nine Months Ended December 31, 2011	Fiscal 2010	Fiscal 2008	Total
	Restructuring Plan (1)	Restructuring Plan	
Severance, payroll, and other related costs	\$ (73	) \$ —	\$ (73 )
Product rationalization	335	—	335
Asset impairment and accelerated depreciation	1,341	—	1,341
Lease termination obligation and other	3	(152	) (149 )
Total restructuring charges	\$ 1,606	\$ (152	) \$ 1,454

(1) Includes \$(68) in charges recorded in cost of revenues on Consolidated Statements of Income.

(dollars in thousands)

Nine Months Ended December 31, 2010	Fiscal 2010	Fiscal 2008	Total
	Restructuring Plan	Restructuring Plan	
Severance, payroll, and other related costs	\$ 498	\$ —	\$ 498
Asset impairment and accelerated depreciation	356	(289	) 67
Other	88	—	88
Total restructuring charges	\$ 942	\$ (289	) \$ 653

(1) Includes \$230 in charges recorded in cost of revenues on Consolidated Statements of Income.

Liabilities related to restructuring activities are recorded as current liabilities on the accompanying Consolidated Balance Sheets within “Accrued payroll and other related liabilities” and “Accrued expenses and other.” The following table summarizes our liabilities related to these restructuring activities:

(dollars in thousands)	Fiscal 2010 Restructuring Plan			
	March 31, 2011	Fiscal 2012 Provision	Payments/ Impairments (1)	December 31, 2011
Severance and termination benefits	\$ 1,993	\$ (73	) \$ (863	) \$ 1,057
Product rationalization	—	335	(335	) —
Asset impairments	—	1,341	(1,341	) —
Lease termination obligations	1,790	—	152	1,942
Other	193	3	(107	) 89
Total	\$ 3,976	\$ 1,606	\$ (2,494	) \$ 3,088

(1) Certain amounts reported include the impact of foreign currency movements relative to the U.S. dollar.

Non-Operating Expenses, Net. Non-operating expense, net consists of interest expense on debt, offset by interest earned on cash, cash equivalents, short-term investment balances, and other miscellaneous expense. The following table compares our non-operating expense, net for the three and nine month periods ended December 31, 2011 and 2010:

(dollars in thousands)	Three Months Ended		
	December 31, 2011	December 31, 2010	Change
Non-Operating Expenses, Net:			

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Interest expense	\$3,005	\$3,049	\$(44	)
Interest income and miscellaneous expense	(373	) (321	) (52	)
Non-Operating Expenses, Net	\$2,632	\$2,728	\$(96	)

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(dollars in thousands)	Nine Months Ended		
	December 31, 2011	2010	Change
Non-Operating Expenses, Net:			
Interest expense	\$9,083	\$9,052	\$31
Interest income and miscellaneous expense	(948 )	(671 )	(277 )
Non-Operating Expenses, Net	\$8,135	\$8,381	\$(246 )

Interest expense during the three and nine month periods was approximately the same.

Income Tax Expense. The following table compares our income tax expense and effective income tax rates for the three and nine month periods ended December 31, 2011 to the three and nine month periods ended December 31, 2010:

(dollars in thousands)	Three Months Ended		Change	Percent Change	
	December 31, 2011	2010			
Income Tax Expense	\$17,443	\$11,338	\$6,105	53.8	%
Effective Income Tax Rate	34.1	% 34.3	%		

(dollars in thousands)	Nine Months Ended		Change	Percent Change
	December 31, 2011	2010		
Income Tax Expense	\$48,189	\$7,091	\$41,098	NM
Effective Income Tax Rate	34.4	% 36.6	%	

NM - Not meaningful.

Income tax expense includes United States federal, state and local, and foreign income taxes, and is based on reported pre-tax income. The effective income tax rates for the three and nine month periods ended December 31, 2011 were 34.1% and 34.4% compared with 34.3% and 36.6% for the same prior year periods. The prior year periods reflect the impact of the recognition of the SYSTEM 1 Rebate Program liability and the class action settlement. The adjusted effective tax rate for the nine month period ended December 31, 2010, excluding the impact of these two items, was 36.4% (see subsection of MD&A titled "Non-GAAP Financial Measures" for additional information and related reconciliation of non-GAAP financial measures to the most comparable GAAP measures). We benefited from favorable discrete item adjustments relating to the effective settlement of certain items in connection with the United States audit examination for fiscal 2008 and 2009 during the nine month period ended December 31, 2011.

We record income tax expense during interim periods based on our estimate of the annual effective income tax rate, adjusted each quarter for discrete items. We analyze various factors to determine the estimated annual effective income tax rate, including projections of our annual earnings and taxing jurisdictions in which the earnings will be generated, the impact of state and local income taxes, our ability to use tax credits and net operating loss carryforwards, and available tax planning alternatives.

Business Segment Results of Operations. We operate in three reportable business segments: Healthcare, Life Sciences, and Isomedix. "Corporate and other," which is presented separately, contains the Defense and Industrial business unit plus costs that are associated with being a publicly traded company and certain other corporate costs. These costs include executive office costs, Board of Directors compensation, shareholder services and investor relations, external audit fees, and legacy pension and post-retirement benefit costs. Our Annual Report on Form 10-K for the year ended March 31, 2011, filed with the SEC on May 27, 2011, provides additional information regarding each business segment. The following tables compare business segment revenues for the three and nine months ended December 31,

2011 and 2010:

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(dollars in thousands)	Three Months Ended		Change	Percent Change	
	December 31, 2011	2010			
Revenues:					
Healthcare	\$259,055	\$237,843	\$21,212	8.9	%
Life Sciences	55,892	51,247	4,645	9.1	%
Isomedix	39,615	38,081	1,534	4.0	%
Total reportable segments	354,562	327,171	27,391	8.4	%
Corporate and other	653	1,112	(459)	(41.3)	)%
Total Revenues	\$355,215	\$328,283	\$26,932	8.2	%

(dollars in thousands)	Nine Months Ended		Change	Percent Change	
	December 31, 2011	2010			
Revenues:					
Healthcare	\$725,455	\$561,723	\$163,732	29.1	%
Life Sciences	167,675	151,374	16,301	10.8	%
Isomedix	121,617	113,721	7,896	6.9	%
Total reportable segments	1,014,747	826,818	187,929	22.7	%
Corporate and other	1,814	2,870	(1,056)	(36.8)	)%
Total Revenues	\$1,016,561	\$829,688	\$186,873	22.5	%

Healthcare revenues increased \$21.2 million, or 8.9%, to \$259.1 million for the quarter ended December 31, 2011, as compared to \$237.8 million for the same prior year quarter. The increase is primarily attributable to growth in revenues within infection prevention technologies, including revenues for SYSTEM 1E related products and services, which were somewhat offset by the year over year decline in SYSTEM 1 related products and services. The increase in capital equipment revenues was partially offset by decline of 6.6% and 1.3% in consumable and service revenues, respectively. The decline in consumable revenues was driven by lower demand in the United States for SYSTEM 1 consumables. Healthcare revenues increased \$163.7 million or 29.1%, to \$725.5 million for the first nine months of fiscal 2012. The prior year period was negatively impacted by the SYSTEM 1 Rebate Program. Adjusted revenues for the prior year first nine months were \$664.0 million (see subsection of MD&A titled "Non-GAAP Financial Measures" for additional information and related reconciliation of non-GAAP financial measures to the most comparable GAAP measures). Compared to the adjusted revenues for the prior year first nine months, Healthcare revenues grew 9.2%. At December 31, 2011, the Healthcare segment's backlog amounted to \$135.8 million, decreasing \$33.2 million, or 19.7%, compared to the backlog of \$169.0 million at December 31, 2010. Backlog at December 31, 2011 decreased \$2.9 million, or 2.1%, compared to the backlog of \$138.6 million at March 31, 2011.

Life Sciences revenues increased \$4.6 million, or 9.1%, to \$55.9 million for the quarter ended December 31, 2011, as compared to \$51.2 million for the same prior year quarter. The increase in Life Sciences revenues was driven by increases of 24.6% in capital equipment revenues and 4.3% in consumable revenues. Services revenues declined 0.9%. The increase in capital equipment revenues was primarily the result of increased revenues in the United States and Asia Pacific. The increase is attributable, in part, to replacement product purchases from pharmaceutical Customers. For the first nine months of fiscal 2012, Life Sciences revenues increased \$16.3 million, or 10.8%, to \$167.7 million compared to \$151.4 million in the first nine months of fiscal 2011. The increase in Life Sciences revenues was driven by increases of 22.8%, 9.1% and 1.2% in capital equipment, consumables, and service revenues, respectively. While this is a positive development, the prior year first nine month periods provided a relatively low base for comparison. At December 31, 2011, the Life Sciences segment's backlog amounted to \$45.0 million, increasing \$2.5 million, or 5.9% compared to the backlog of \$42.5 million at December 31, 2010. Backlog at

December 31, 2011 increased \$4.3 million, or 10.7%, compared to the backlog of \$40.7 million at March 31, 2011.

Isomedix segment revenues increased \$1.5 million, or 4.0%, to \$39.6 million for the quarter ended December 31, 2011, as compared to \$38.1 million for the same prior year quarter. For the first nine months of fiscal 2012, revenues increased \$7.9 million, or 6.9%, to \$121.6 million as compared to \$113.7 million for the first nine months of fiscal 2011. Revenues were favorably impacted by increased demand from our medical device Customers, as well as the benefits realized from capacity expansions in select locations.

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The following table compares our business segment operating results for the three and nine months ended December 31, 2011 to the three and nine months ended December 31, 2010:

(dollars in thousands)	Three Months Ended		Change	Percent Change	
	December 31, 2011	2010			
Operating Income (Loss):					
Healthcare	\$33,951	\$20,389	\$13,562	66.5	%
Life Sciences	10,297	7,345	2,952	40.2	%
Isomedix	11,750	10,250	1,500	14.6	%
Total reportable segments	55,998	37,984	18,014	47.4	%
Corporate and other	(2,274 )	(2,153 )	(121 )	5.6	%
Total Operating Income (Loss)	\$53,724	\$35,831	\$17,893	49.9	%
(dollars in thousands)	Nine Months Ended		Change	Percent Change	
	December 31, 2011	2010			
Operating Income (Loss):					
Healthcare	\$88,213	\$(19,460 )	\$107,673	NM	
Life Sciences	30,820	23,075	7,745	33.6	%
Isomedix	35,924	30,858	5,066	16.4	%
Total reportable segments	154,957	34,473	120,484	NM	
Corporate and other	(6,689 )	(6,735 )	46	(0.7 )	%
Total Operating Income (Loss)	\$148,268	\$27,738	\$120,530	NM	

NM - Not meaningful.

Segment operating income (loss) is calculated as the segment's gross profit less direct expenses and indirect cost allocations, which results in the full allocation of all distribution and research and development expenses, and the partial allocation of corporate costs. Corporate cost allocations are based on each segment's percentage of revenues, headcount, or other variables in relation to those of the total Company. In addition, the Healthcare segment is responsible for the management of all but one manufacturing facility and uses standard cost to sell products to the Life Sciences segment. "Corporate and other" includes the revenues, gross profit and direct expenses of the Defense and Industrial business unit, as well as certain unallocated corporate costs related to being a publicly traded company and legacy pension and post-retirement benefits, as previously discussed.

The Healthcare segment's operating income increased \$13.6 million, to \$34.0 million for the third quarter as compared to \$20.4 million in the same prior year period. Operating income for the three months ended December 31, 2010 was negatively impacted by \$19.8 million associated with the SYSTEM 1 class action settlement. Negative drivers of fiscal 2012 operating income include lower SYSTEM 1 consumable volumes, the shift toward lower gross margin capital equipment revenues, declines in pricing, the inventory write-offs relating to our European consolidation efforts, transition costs and investments made to improve product reliability. For the first nine months of fiscal 2012 the segment's operating income was \$88.2 million compared to a loss of \$19.5 million for the first nine months of fiscal 2011. Operating income for the nine months ended December 31, 2010 was negatively impacted by the SYSTEM 1 Rebate Program and class action settlement. Adjusted operating income, excluding the impact of the SYSTEM 1 Rebate Program and class action settlement, for the prior year period was \$110.3 million (see subsection of MD&A titled "Non-GAAP Financial Measures" for additional information and related reconciliation of non-GAAP financial measures to the most comparable GAAP measures). The fiscal 2012 decrease from adjusted operating income in fiscal 2011 is attributable to lower SYSTEM 1 consumable volumes, the shift toward lower gross margin



capital equipment revenues, a decline in pricing, higher sales related costs, transition costs and investments made to improve product reliability.

The Life Sciences segment's operating income increased \$3.0 million for the third quarter of fiscal 2012 as compared to the same prior year period. The segment's operating margin was 18.4% for the third quarter of fiscal 2012, representing an increase of 410 basis points over the comparable prior year period. The segment's operating income for the first nine months of fiscal

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2012 was \$30.8 million or 18.4% of revenues compared to \$23.1 million or 15.2% of revenues in the same prior period. The increases were the result of volume increases in both periods. Operating income in the first nine months of fiscal 2012 also benefited from lower operating expenses during the first half of fiscal 2012.

The Isomedix segment's operating income increased \$1.5 million for the third quarter of fiscal 2012 as compared to the same prior year period. The segment's operating margin was 29.7% for the third quarter of fiscal 2012, representing an increase of 280 basis points over the comparable prior year period. The segment's operating income for the first nine months of fiscal 2012 was \$35.9 million or 29.5% of revenues compared to \$30.9 million or 27.1% of revenues in the same prior period. The increase in operating income reflects the benefit of increased revenues.

## Liquidity and Capital Resources

The following table summarizes significant components of our cash flows for the nine months ended December 31, 2011 and 2010:

(dollars in thousands)	Nine Months Ended	
	December 31, 2011	2010
Operating activities:		
Net income	\$91,944	\$12,266
Non-cash items	73,626	430
Change in Accrued SYSTEM 1 Rebate Program and class action settlement	(27,449 )	128,770
Changes in operating assets and liabilities	(25,282 )	(58,069 )
Net cash provided by operating activities	\$112,839	\$83,397
Investing activities:		
Purchases of property, plant, equipment, and intangibles, net	\$(54,238 )	\$(56,390 )
Proceeds from the sale of property, plant, equipment, and intangibles	—	1,298
Equity investment in joint venture	—	(16,900 )
Investments in businesses, net of cash acquired	(22,269 )	(4,000 )
Net cash used in investing activities	\$(76,507 )	\$(75,992 )
Financing activities:		
Repurchases of common shares	\$(56,751 )	\$(19,900 )
Cash dividends paid to common shareholders	(28,751 )	(24,344 )
Stock option transactions, net	3,749	10,813
Tax benefit from stock options exercised	816	2,197
Net cash used in financing activities	\$(80,937 )	\$(31,234 )
Debt-to-total capital ratio	21.2	% 21.9 %
Free cash flow	\$58,601	\$28,305

**Net Cash Provided by Operating Activities.** The net cash provided by our operating activities was \$112.8 million for the first nine months of fiscal 2012 as compared with \$83.4 million for the first nine months of fiscal 2011. The increase in net cash provided by operating activities is driven by a lower use of cash to fund operating assets including higher cash collections on accounts receivable and a decline in cash used for inventory purchases which were partially offset by the current year use of cash of \$27.4 million for the SYSTEM 1 Rebate Program.

**Net Cash Used In Investing Activities –** The net cash used in investing activities totaled \$76.5 million for the first nine months of fiscal 2012 compared with \$76.0 million for the first nine months of fiscal 2011. The following discussion summarizes the significant changes in our investing cash flows for the first nine months of fiscal 2012 and fiscal 2011:

Purchases of property, plant, equipment, and intangibles, net – Capital expenditures were \$54.2 million for the first nine months of fiscal 2012 as compared to \$56.4 million during the same prior year period.

Proceeds from the sale of property, plant, equipment, and intangibles, net - There were no sales of property, plant, equipment, and intangibles during fiscal 2012. We received proceeds of \$1.3 million during the first nine months of fiscal 2011.

Equity investments in joint ventures - During fiscal 2012, we made no additional equity investments in joint ventures. During fiscal 2011, we increased our investment in our joint venture with VTS Medical Systems, Inc. by \$16.9

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million.

Investment in business, net of cash acquired – During fiscal 2012, we used \$22.3 million in cash to acquire the stock of a privately held company with operations located near Sao Paulo, Brazil. Total consideration is approximately \$30 million, including contingent consideration obligations. The acquired company designs and manufactures small, medium, and large sterilizers used by public hospitals, clinics, dental offices and industrial companies (e.g., research laboratories and pharmaceutical research and production companies). During fiscal 2011, we acquired a company designed to improve a hospital's perioperative process for \$4.0 million.

Net Cash Used In Financing Activities – The net cash used in financing activities amounted to \$80.9 million for the first nine months of fiscal 2012 compared with net cash used in financing activities of \$31.2 million for the first nine months of fiscal 2011. The following discussion summarizes the significant changes in our financing cash flows for the first nine months of fiscal 2012 and fiscal 2011:

Repurchases of common shares – The Company's Board of Directors has provided authorization to repurchase the Company's common shares. During the first nine months of fiscal 2012, we paid for the repurchase of 1,851,510 of our common shares under this authorization at an average purchase price of \$30.21 per common share. We also obtained 22,927 of our common shares during the first nine months of fiscal 2012 in connection with share-based compensation award programs.

Cash dividends paid to common shareholders – During the first nine months of fiscal 2012, we paid total cash dividends of \$28.8 million, or \$0.49 per outstanding common share. During the first nine months of fiscal 2011, we paid total cash dividends of \$24.3 million, or \$0.41 per outstanding common share.

Stock option transactions, net – We receive cash in some cases for issuing common shares under our various employee stock compensation programs. During the first nine months of fiscal 2012 and fiscal 2011, we received cash proceeds totaling \$3.7 million and \$10.8 million, respectively, under these programs.

Tax benefit from stock options exercised - During the first nine months of fiscal 2012 and fiscal 2011, our income taxes were reduced by \$0.8 million and \$2.2 million, respectively, as a result of deductions allowed for stock options exercised.

Cash Flow Measures. Free cash flow was \$58.6 million in the first nine months of fiscal 2012 compared to \$28.3 million in the prior year first nine months reflecting higher cash from operations resulting primarily from increased cash collections on accounts receivable and a decline in cash used for inventory purchases, partially offset by the funding of the SYSTEM 1 Rebate Program (see subsection of MD&A titled "Non-GAAP Financial Measures" for additional information and related reconciliation of non-GAAP financial measures to the most comparable GAAP measures). Our debt-to-total capital ratio was 21.2% at December 31, 2011 and 21.1% at March 31, 2011.

Sources of Credit and Contractual and Commercial Commitments. Information related to our sources of credit and contractual and commercial commitments is included in our Annual Report on Form 10-K for the year ended March 31, 2011, filed with the SEC on May 27, 2011. Our commercial commitments were approximately \$35.5 million at December 31, 2011 reflecting a net increase of \$1.1 million in surety bonds and other commercial commitments from March 31, 2011. The maximum aggregate borrowing limits under our revolving credit facility ("Facility") have not changed since March 31, 2011. At December 31, 2011, there was \$400.0 million available under the Facility for borrowing. The maximum aggregate borrowing limit of \$400.0 million under the Facility is reduced by outstanding borrowings and letters of credit issued under a sub-limit within the Facility. The Company entered into an agreement providing for up to \$35 million of letters of credit to obtain increased flexibility regarding the terms of its letters of credit. There were \$21.3 million in letters of credit outstanding under this agreement at December 31, 2011.

Cash Requirements. Currently, we intend to use our existing cash and cash equivalent balances, cash generated from operations, and our existing credit facilities for short-term and long-term capital expenditures and our other liquidity needs. We believe that these amounts will be sufficient to meet working capital needs, capital requirements, and

commitments for at least the next twelve months. However, our capital requirements will depend on many uncertain factors, including our rate of sales growth, our Customers' acceptance of our products and services, the costs of obtaining adequate manufacturing capacities, the timing and extent of our research and development projects, and changes in our operating expenses. An increase in bad debt expense or significant change in the timeliness of collection of our accounts receivable may impact our future cash generated from operations. To the extent that our existing sources of cash are not sufficient to fund our future activities, we may need to raise additional funds through additional borrowings or selling equity securities. We cannot assure you that we will be able to obtain additional funds on terms favorable to us, or at all.

Critical Accounting Policies, Estimates, and Assumptions

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Information related to our critical accounting policies, estimates, and assumptions is included in our Annual Report on Form 10-K for the year ended March 31, 2011, filed with the SEC on May 27, 2011. Our critical accounting policies, estimates, and assumptions have not changed materially from March 31, 2011.

### SYSTEM 1 Rebate Program

The Accrued SYSTEM 1 Rebate Program (the “Rebate Program”), initially recognized during the first quarter of fiscal 2011, is based upon the quantity of SYSTEM 1 processors eligible for rebates and the estimated value of rebates to be provided upon their return. Rebates of \$102,313 were recognized as contra-revenue consistent with other returns and allowances offered to Customers. The estimated cost of \$7,691 to facilitate the disposal of the returned SYSTEM 1 processors has been recognized as cost of revenues. Both components were recorded as current liabilities. The key assumptions involved in the estimates associated with the Rebate Program included: the number and age of SYSTEM 1 processors eligible for rebates under the Rebate Program, the number of Customers that would elect to participate in the Rebate Program, the proportion of Customers that would choose each rebate option, and the estimated per unit costs of disposal.

The number and age of SYSTEM 1 processors was estimated based on our historical sales and service records and we assumed that 100% of eligible Customers would elect to participate in the Rebate Program. In order to estimate the portion of Customers that would choose each available rebate option, we first assessed trends in sales of the proprietary consumable products utilized in the SYSTEM 1 processor. We noted a decline of approximately 19% in shipments of SYSTEM 1 consumables during the period between the notice by FDA to healthcare facility administrators and infection control practitioners and the announcement of the Rebate Program, which indicated that a portion of our Customers transitioned away from the SYSTEM 1 technology during that period. The remaining 81% provided the best available indication of the portion of Customers projected to elect the rebate for the SYSTEM 1E processor. Order and quote data for fiscal 2011 provided indications of the proportion of Customers that are expected to choose each of the other rebate options. The per unit costs associated with disposal were estimated based on the service hours involved and quotes from our vendors using existing freight and disposal contracts.

### Contingencies

We are involved in various patent, product liability, consumer, commercial, environmental, tax proceedings and claims, governmental investigations, and other legal and regulatory proceedings that arise from time to time in the course of our business. We record a liability for such contingencies to the extent that we conclude that their occurrence is both probable and estimable. We consider many factors in making these assessments, including the professional judgment of experienced members of management and our legal counsel. We have made estimates as to the likelihood of unfavorable outcomes and the amounts of such potential losses. In our opinion, the ultimate outcome of these proceedings and of claims that are probable and estimable is not anticipated to have a material adverse affect on our consolidated financial position, results of operations, or cash flows. However, the ultimate outcome of claims, litigation, and other proceedings is unpredictable and actual results could be materially different from our estimates. We record anticipated recoveries under applicable insurance contracts when assured of recovery. Refer to Part II, Item 1, “Legal Proceedings” for additional information.

We are subject to taxation from United States federal, state, and local, and foreign jurisdictions. Tax positions are settled primarily through the completion of audits within each individual tax jurisdiction or the closing of a statute of limitation. Changes in applicable tax law or other events may also require us to revise past estimates. The IRS routinely conducts audits of our federal income tax returns. In the first quarter of fiscal 2012, we reached an agreement with the IRS on all material tax matters for fiscal 2008 and fiscal 2009. The IRS also began its audit of fiscal 2010 in the first quarter of fiscal 2012. We remain subject to tax authority audits in various other jurisdictions in which we operate. If we prevail in matters for which accruals have been recorded, or are required to pay amounts in excess of recorded accruals, our effective income tax rate in a given financial statement period could be materially impacted.

Additional information regarding our commitments and contingencies is included in note 10 to our consolidated financial statements titled, "Contingencies."

#### International Operations

Since we conduct operations outside of the United States using various foreign currencies, our operating results are impacted by foreign currency movements relative to the U.S. dollar. During the third quarter of fiscal 2012, our revenues were unfavorably impacted by \$0.1 million, or 0.1%, and income before taxes was favorably impacted by \$1.9 million, or 3.9%, as a result of foreign currency movements relative to the U.S. dollar. During the first nine months of fiscal 2012, our revenues were favorably impacted by \$7.7 million, or 0.8%, and income before taxes was unfavorably impacted by \$2.6 million, or 1.8%, as a result of foreign currency movements relative to the U.S. dollar.

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Forward-Looking Statements

This Quarterly Report on Form 10-Q may contain statements concerning certain trends, expectations, forecasts, estimates, or other forward-looking information affecting or relating to the Company or its industry, products or activities that are intended to qualify for the protections afforded “forward-looking statements” under the Private Securities Litigation Reform Act of 1995 and other laws and regulations. Forward-looking statements speak only as to the date of this report, and may be identified by the use of forward-looking terms such as “may,” “will,” “expects,” “believes,” “anticipates,” “plans,” “estimates,” “projects,” “targets,” “forecasts,” “outlook,” “impact,” “potential,” “confidence,” “improve,” “comfortable,” “trend”, and “seeks,” or the negative of such terms or other variations on such terms or comparable terminology. Many important factors could cause actual results to differ materially from those in the forward-looking statements including, without limitation, disruption of production or supplies, changes in market conditions, political events, pending or future claims or litigation, competitive factors, technology advances, actions of regulatory agencies, and changes in laws, government regulations, labeling or product approvals or the application or interpretation thereof. Other risk factors are described herein and in the Company's Form 10-K and other securities filings. Many of these important factors are outside STERIS's control. No assurances can be provided as to any result or the timing of any outcome regarding matters described herein or otherwise with respect to any regulatory action, administrative proceedings, government investigations, litigation, warning letters, consent decree, rebate program, transition, cost reductions, business strategies, earnings and revenue trends, expense reduction or other future financial results. References to products, the consent decree, the transition or rebate program, or the settlement agreement are summaries only and do not alter or modify the specific terms of the decree, agreement, program or product clearance or literature. Unless legally required, the Company does not undertake to update or revise any forward-looking statements even if events make clear that any projected results, express or implied, will not be realized. Other potential risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements include, without limitation, (a) the potential for increased pressure on pricing or costs that leads to erosion of profit margins, (b) the possibility that market demand will not develop for new technologies, products or applications or the Company's rebate program, transition plan or other business initiatives will take longer, cost more or produce lower benefits than anticipated, (c) the possibility that application of or compliance with laws, court rulings, certifications, regulations, regulatory actions, including without limitation those relating to FDA warning letters, government investigations, the December 3, 2009 or February 22, 2010 FDA notices, the April 20, 2010 consent decree and related transition plan and rebate program, the SYSTEM 1E device, the outcome of any pending FDA requests, submissions and clearances or other requirements or standards may delay, limit or prevent new product introductions, affect the production and marketing of existing products or services or otherwise affect Company performance, results, prospects or value, (d) the potential of international unrest or effects of fluctuations in currencies, tax assessments or anticipated rates, raw material costs, benefit or retirement plan costs, or other regulatory compliance costs, (e) the possibility of reduced demand, or reductions in the rate of growth in demand, for the Company's products and services, (f) the possibility that anticipated growth, cost savings, rebate assumptions, new product acceptance, performance, or approvals, including without limitation SYSTEM 1E and accessories thereto, or other results may not be achieved, or that transition, labor, competition, timing, execution, regulatory, governmental, or other issues or risks associated with our business, industry or initiatives including, without limitation, the consent decree, the transition from the SYSTEM 1 processing system, or those matters described in our Form 10-K for the year ended March 31, 2011 and this Form 10-Q and other securities filings may adversely impact Company performance, results, prospects or value, (g) the effect of the contraction in credit availability, as well as the ability of our Customers and suppliers to adequately access the credit markets when needed, and (h) those risks described in our Annual Report on Form 10-K for the year ended March 31, 2011 and this Form 10-Q for the quarter ended December 31, 2011.

Availability of Securities and Exchange Commission Filings



We make available free of charge on or through our website our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to these reports as soon as reasonably practicable after we file such material with, or furnish such material to, the Securities Exchange Commission ("SEC.") You may access these documents on the Investor Relations page of our website at <http://www.steris-ir.com>. The information on our website is not incorporated by reference into this report. You may also obtain copies of these documents by visiting the SEC's Public Reference Room at 100 F Street, NE, Washington, D.C. 20549, or by accessing the SEC's website at <http://www.sec.gov>. You may obtain information on the Public Reference Room by calling the SEC at 1-800-SEC-0330.

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

In the ordinary course of business, we are subject to interest rate, foreign currency, and commodity risks. Information related to these risks and our management of these exposures is included in Part II, Item 7A, "Quantitative and Qualitative

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Disclosures about Market Risk,” in our Annual Report on Form 10-K for the year ended March 31, 2011, filed with the SEC on May 27, 2011. Our exposures to market risks have not changed materially since March 31, 2011.

ITEM 4. CONTROLS AND PROCEDURES

Under the supervision of and with the participation of our management, including the Principal Executive Officer (“PEO”) and Principal Financial Officer (“PFO”), we evaluated the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as of the end of the period covered by this Quarterly Report. Based on that evaluation, including the assessment and input of our management, the PEO and PFO concluded that, as of the end of the period covered by this Quarterly Report, our disclosure controls and procedures were effective.

There were no changes in our internal control over financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) promulgated under the Securities Exchange Act of 1934, that occurred during the quarter ended December 31, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II—OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are, and will likely continue to be, involved in a number of legal proceedings, government investigations, and claims, which we believe generally arise in the course of our business, given our size, history, complexity, and the nature of our business, products, Customers, regulatory environment, and industries in which we participate. These legal proceedings, investigations and claims generally involve a variety of legal theories and allegations, including, without limitation, personal injury (e.g., slip and falls, burns, vehicle accidents), product liability or regulation (e.g., based on product operation or claimed malfunction, failure to warn, failure to meet specification, or failure to comply with regulatory requirements), product exposure (e.g., claimed exposure to chemicals, asbestos, contaminants, radiation), property damage (e.g., claimed damage due to leaking equipment, fire, vehicles, chemicals), commercial claims (e.g., breach of contract, economic loss, warranty, misrepresentation), financial (e.g., taxes, reporting), employment (e.g., wrongful termination, discrimination, benefits matters), and other claims for damage and relief.

We believe we have adequately reserved for our current litigation and claims that are probable and estimable, and further believe that the ultimate outcome of these pending lawsuits and claims will not have a material adverse affect on our consolidated financial position or results of operations taken as a whole. Due to their inherent uncertainty, however, there can be no assurance of the ultimate outcome or effect of current or future litigation, investigations, claims or other proceedings (including without limitation the FDA-related matters discussed below). For certain types of claims, we presently maintain insurance coverage for personal injury and property damage and other liability coverages in amounts and with deductibles that we believe are prudent, but there can be no assurance that these coverages will be applicable or adequate to cover adverse outcomes of claims or legal proceedings against us.

As previously disclosed, we received a warning letter (the “warning letter”) from the FDA on May 16, 2008 regarding our SYSTEM 1 sterile processor and the STERIS™ 20 sterilant used with the processor (sometimes referred to collectively in the FDA letter and in this Item 1 as the “device”). Among other matters, the warning letter included the FDA's assertion that significant changes or modifications had been made in the design, components, method of manufacture, or intended use of the device beyond the FDA's 1988 clearance, such that the FDA believed a new premarket notification submission (known within FDA regulations as a 510(k) submission) should have been made, and the assertion that our failure to make such a submission resulted in violations of applicable law. On July 30, 2008 (with an Addendum on October 9, 2008), we provided a detailed response contending that the assertions in the warning letter were not correct. On November 4, 2008, we received a letter from the FDA (dated November 3, 2008) in which the FDA stated without elaboration that, after reviewing our response, it disagreed with our position and that a new premarket notification submission was required. After discussions with the FDA regarding the November 3rd letter, we received an additional letter on November 6, 2008 from the FDA. The November 6th letter stated that the intent of the November 3rd letter was to inform us of the FDA's preliminary disagreement with our response to the warning letter and, before finalizing a position, the FDA reiterated that it wanted to meet with us to discuss the Company's response, issues related to the warning letter and next steps to resolve any differences between the Company and the FDA. We thereafter met with the FDA and, on January 20, 2009, we announced that we had submitted to the FDA a new liquid chemical sterilant processing system for 510(k) clearance, and we communicated to Customers that we would continue supporting the existing SYSTEM 1 installed base in the U.S. for at least a two year period from that date.

On December 3, 2009, the FDA provided a notice (“notice”) to healthcare facility administrators and infection control practitioners describing FDA's “concerns about the SYSTEM 1 Processor, components and accessories, and FDA recommendations.” In the notice, among other things, FDA stated its belief that the SYSTEM 1 device had been significantly modified, that FDA had not cleared or approved the modified device, and that FDA had not determined whether the SYSTEM 1 was safe or effective for its labeled claims. The notice further stated that use of a device that

does not properly sterilize or disinfect a medical or surgical device poses risks to patients and users, including the transmission of pathogens, exposure to hazardous chemicals and affect the quality and functionality of reprocessed instruments. The notice stated that FDA was aware of reports of malfunctions of the SYSTEM 1 that had the potential to cause or contribute to serious injuries to patients, such as infections, or injuries to healthcare staff, such as burns. Included in FDA's December 3, 2009 notice was a recommendation from FDA that if users had acceptable alternatives to meet sterilization and disinfection needs, they should transition to that alternative as soon as possible. After its December 3, 2009 notice, we engaged in extensive discussions with the FDA regarding a comprehensive resolution of this matter. On February 2, 2010, the FDA notified healthcare facility administrators and infection control practitioners that FDA's total recommended time period for transitioning from SYSTEM 1 in the U.S. was 18 months from that date.

On April 5, 2010, we received FDA clearance of the new liquid chemical sterilant processing system (SYSTEM 1E). Also in April 2010 we reached agreement with the FDA on the terms of a consent decree ("Consent Decree"). On April 19, 2010, a

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Complaint and Consent Decree were filed in the U.S. District Court for the Northern District of Ohio, and on April 20, 2010, the Court approved the Consent Decree. In general, the Consent Decree addresses regulatory matters regarding SYSTEM 1, restricts further sales of SYSTEM 1 processors in the U.S., defines certain documentation and other requirements for continued service and support of SYSTEM 1 in the U.S., prohibits the sale of liquid chemical sterilization or disinfection products that do not have FDA clearance, describes various process and compliance matters, and defines penalties in the event of violation of the Consent Decree.

The Consent Decree also provides that we may continue to support our Customers' use of SYSTEM 1 in the U.S., including the sale of consumables, parts and accessories and service for a transition period, not to extend beyond August 2, 2011, subject to compliance with requirements for documentation of the Customer's need for continued support and other conditions and limitations (the "Transition Plan"). This transition period has since been extended by the FDA until August 2, 2012. Our Transition Plan includes the "SYSTEM 1 Rebate Program" (the "Rebate Program"). In April 2010, we began to offer rebates to qualifying Customers. Generally, U.S. Customers that purchased SYSTEM 1 processors directly from us or who were users of SYSTEM 1 at the time the Rebate Program was introduced and who return their units have the option of either a pro-rated cash value or rebate toward the future purchase of new STERIS capital equipment (including SYSTEM 1E) or consumable products. In addition, we provide credits for the return of SYSTEM 1 consumables in unbroken packaging and within shelf life and for the unused portion of SYSTEM 1 service contracts. As a result, we recorded a pre-tax liability of \$110.0 million related to the SYSTEM 1 Rebate Program in the first quarter of fiscal 2011. Of the \$110.0 million, \$102.3 million is attributable to the Customer Rebate portion of the Program and was recorded as a reduction of revenues, and \$7.7 million is attributable to the disposal liability of the SYSTEM 1 units to be returned and was recorded as an increase in cost of revenues. This also resulted in a \$110.0 million reduction in operating income.

The Consent Decree has defined the resolution of a number of issues regarding SYSTEM 1, and we believe our actions since January 2009 with respect to SYSTEM 1, including the Transition Plan, were and are not recalls, corrections or removals under FDA regulations. However, there is no assurance that these or other claims will not be brought or that judicial, regulatory, administrative or other legal or enforcement actions, notices or remedies will not be pursued, or that action will not be taken in respect of the Consent Decree, the Transition Plan, SYSTEM 1, or otherwise with respect to regulatory or compliance matters, as described in this Item 1 or in various portions of Item 1A. of Part I contained in our Annual Report on Form 10-K for the year ended March 31, 2011 filed with the SEC on May 27, 2011.

In December of 2010, we began shipping SYSTEM 1E units after having received FDA clearance for the SYSTEM 1E chemical indicator, which is used in conjunction with the SYSTEM 1E. We also submitted a 510(k) to FDA for an optional spore-based indicator strip for use with SYSTEM 1E. Thereafter, as a result of discussions with FDA, we filed a de novo submission requesting classification of this strip in accordance with Section 513(f)(2) of the Federal Food Drug & Cosmetic Act. The de novo process is part of the initial classification for new devices. This spore-based monitoring strip is an optional accessory and is not required for the proper use of SYSTEM 1E. These actions do not affect the prior clearance of the SYSTEM 1E processor or the SYSTEM 1E chemical indicator. There is no assurance regarding the outcome or timing of the de novo submission.

On February 5, 2010, a complaint was filed by a Customer that claimed to have purchased two SYSTEM 1 devices from STERIS, Physicians of Winter Haven LLC d/b/a Day Surgery Center v. STERIS Corp., Case No. 1:1-cv-00264-CAB (N.D. Ohio). The complaint alleged statutory violations, breaches of various warranties, negligence, failure to warn, and unjust enrichment and Plaintiff sought class certification, damages, and other legal and equitable relief including, without limitation, attorneys' fees and an order requiring STERIS to replace, recall or adequately repair the product and/or to take appropriate regulatory action. On February 7, 2011 we entered into a settlement agreement in which we agreed, among other things, to provide various categories of economic relief for members of the settlement class and not object to plaintiff's counsel's application to the court for attorneys' fees and

expenses up to a specified amount. Certification of a settlement class was approved and final approval of the settlement was given by the court in the first quarter of fiscal 2012. During the third quarter of fiscal 2011, we recorded in operating expenses a pre-tax charge of approximately \$19.8 million related to the settlement of these proceedings.

Other civil, criminal, regulatory or other proceedings involving our products or services also could possibly result in judgments, settlements or administrative or judicial decrees requiring us, among other actions, to pay damages or fines or effect recalls, or be subject to other governmental, Customer or other third party claims or remedies, which could materially affect our business, performance, prospects, value, financial condition, and results of operations.

For additional information regarding these matters, see the following portions of our Annual Report on Form 10-K for the fiscal year ended March 31, 2011: “Business - Information with respect to our Business in General - Government Regulation”, and the “Risk Factor” titled: “We may be adversely affected by product liability claims or other legal actions or regulatory or

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compliance matters, including the Warning Letter and Consent Decree.”, the “Risk Factor” titled: “Our business may be adversely affected as a result of the U.S. Food and Drug Administration notices to healthcare administrators and device manufacturers, and related matters,” and the “Risk Factor” titled “Compliance with the Consent Decree may be more costly and burdensome than anticipated.”

From time to time, STERIS is also involved in legal proceedings as a plaintiff involving contract, patent protection, and other claims asserted by us. Gains, if any, from these proceedings are recognized when they are realized.

Except as noted above, we believe there have been no material recent developments concerning these legal proceedings since September 30, 2011 and no new material pending legal proceedings that are required to be reported.

**ITEM 1A. RISK FACTORS**

The risk factor entitled “The economic climate may adversely affect us,” contained in Item 1A of Part I of our Annual Report on Form 10-K for the fiscal year ended March 31, 2011, filed with the SEC on May 27, 2011, is supplemented by adding the following paragraph at the end:

The current financial crisis in Europe and the general economic downturn in that region have impacted and may continue to impact the timeliness of receivables collections from some of our European Customers, especially those trade receivables due from Spanish and Italian hospitals dependent upon government healthcare systems and/or government funding. We cannot predict at this time how this situation will develop and whether any European trade receivables may need to be reserved in future periods.

Except as set forth above, we believe there have been no material changes to the risk factors included in our Annual Report on Form 10-K for the fiscal year ended March 31, 2011, filed with the SEC on May 27, 2011, that would materially affect our business, results of operations or financial condition.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

During the third quarter of fiscal 2012, we repurchased 347,113 of our common shares. These repurchases were pursuant to a single repurchase program which was approved by the Company’s Board of Directors and announced on March 14, 2008, authorizing the repurchase of up to \$300.0 million of our common shares. As of December 31, 2011, \$118,460 in common shares remained authorized for repurchase under this authorization. This common share repurchase authorization does not have a stated maturity date. The following table summarizes the common share repurchase activity during the third quarter of fiscal 2012 under our common share repurchase program:

	(a) Total Number of Shares Purchased	(b) Average Price Paid Per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans	(d) Maximum Dollar Value of Shares that May Yet Be Purchased Under the Plans at Period End
October 1-31	—	\$ —	—	\$ 128,460
November 1-30	318,900	28.71	318,900	119,303
December 1-31	28,213	29.89	28,213	118,460
Total	347,113	(1) \$ 28.81	(1) 347,113	\$ 118,460

(1) Does not include 14 shares purchased during the quarter at an average price of \$29.07 per share by the STERIS Corporation 401(k) Plan on behalf of certain executive officers of the Company who may be deemed to be

affiliated purchasers.



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ITEM 6. EXHIBITS

Exhibits required by Item 601 of Regulation S-K

Exhibit Number	Exhibit Description
3.1	1992 Amended Articles of Incorporation of STERIS Corporation, as amended on May 14, 1996, November 6, 1996, and August 6, 1998 (filed as Exhibit 3.1 to Form 10-K filed for the fiscal year ended March 31, 2000 (Commission File No. 1-14643), and incorporated herein by reference).
3.2	Amended and Restated Regulations of STERIS Corporation, as amended on July 26, 2007 (filed as Exhibit 3.2 to Form 10-Q for the fiscal quarter ended June 30, 2007 (Commission File No. 1-14643), and incorporated herein by reference).
4.1	Specimen Form of Common Stock Certificate (filed as Exhibit 4.1 to Form 10-K filed for the fiscal year ended March 31, 2002 (Commission File No. 1-14643), and incorporated herein by reference).
10.1	Amendment No. 1 to STERIS Corporation Deferred Compensation Plan Document (as Amended and Restated Effective January 1, 2009) dated November 4, 2011.
10.2	Agreement dated November 4, 2011 between STERIS Corporation and Bank of America, N.A. providing Transfer and Advised Line for Letters of Credit.
15.1	Letter Re: Unaudited Interim Financial Information.
31.1	Certification of the Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of the Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of the Principal Executive Officer and Principal Financial Officer Pursuant to 18 U.S.C. Section 1350 as Adopted Pursuant Section 906 of the Sarbanes-Oxley Act of 2002.
EX-101	Instance Document.
EX-101	Schema Document.
EX-101	Calculation Linkbase Document.
EX-101	Definition Linkbase Document.
EX-101	Labels Linkbase Document.
EX-101	Presentation Linkbase Document.

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SIGNATURE

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.

STERIS Corporation

/S/ MICHAEL J. TOKICH

Michael J. Tokich

Senior Vice President and Chief Financial Officer

February 8, 2012

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