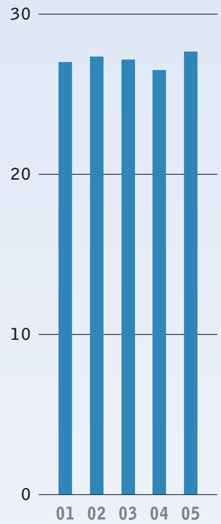
# Utah Medical Products, Inc.

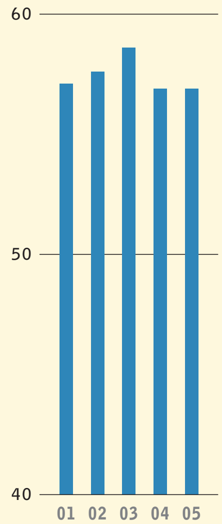
## 2005 Annual Report

# Utah Medical Products, Inc.

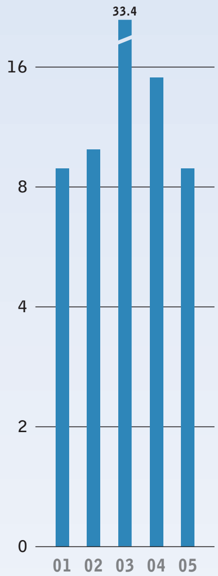
*with particular interest in healthcare for women and their babies, develops, manufactures, assembles and markets a broad range of well-established disposable and reusable specialty medical devices designed for better health outcomes for patients and their care-providers.*




**Net Sales**
(millions of dollars)




**Gross Profit Margin**
(percent of sales)

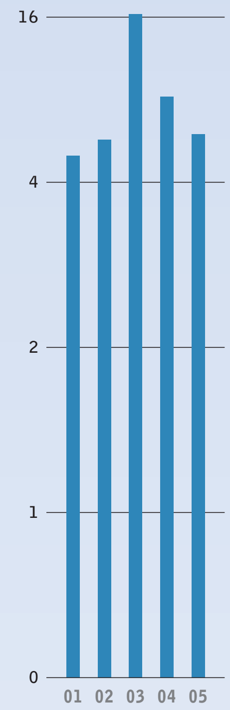



**Operating Profits**
(millions of dollars)

## Five-year Summary of Operations

*(In thousands, except per share data)*

| | 2005 | 2004 | 2003 | 2002 | 2001 |
|---|---|---|---|---|---|
| Net sales | $ 27,692 | $ 26,485 | $ 27,137 | $ 27,361 | $ 26,954 |
| Net income | 7,547 | 10,220 | 20,761 | 7,165 | 5,934 |
| Total assets | 41,642 | 41,262 | 49,694 | 23,387 | 23,572 |
| Long-term debt | 5,336 | — | — | 4,956 | 2,501 |
| Stockholders' equity | 32,857 | 36,157 | 36,532 | 15,722 | 18,207 |
| Earnings per common share (diluted) | $ 1.80 | $ 2.19 | $ 4.25 | $ 1.36 | $ 1.14 |
| Cash dividends per share | $ .63 | $ .45 | None | None | None |
| Weighted average common shares (diluted) | 4,192 | 4,675 | 4,885 | 5,263 | 5,210 |

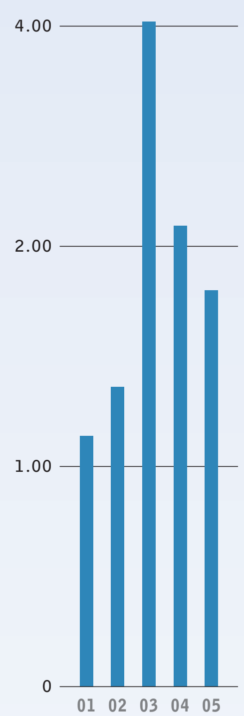



**Net Profits**
(millions of dollars)

## Quarterly Income Statement Summaries

*(In thousands, except per share data)*

| | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
|---|---|---|---|---|
| **2005** | | | | |
| Net sales | $ 6,652 | $ 7,028 | $ 7,001 | $ 7,011 |
| Gross margin | 3,734 | 4,022 | 4,014 | 3,983 |
| Net income | 1,969 | 1,887 | 1,789 | 1,903 |
| Earnings per share | $ .46 | $ .45 | $ .44 | $ .46 |
| **2004** | | | | |
| Net sales | $ 6,616 | $ 6,827 | $ 6,670 | $ 6,372 |
| Gross margin | 3,850 | 3,934 | 3,779 | 3,503 |
| Net income | 5,175 | 1,841 | 1,807 | 1,397 |
| Earnings per share | $ 1.07 | $ .38 | $ .39 | $ .32 |
| **2003** | | | | |
| Net sales | $ 6,877 | $ 6,840 | $ 6,761 | $ 6,659 |
| Gross margin | 3,977 | 4,033 | 3,979 | 3,902 |
| Net income | 1,788 | 1,837 | 1,861 | 15,274 |
| Earnings per share | $ .37 | $ .38 | $ .38 | $ 3.11 |




**Earnings per Share**
(dollars)

# To Our Shareholders

In 2005, Utah Medical Products, Inc. (UTMD) continued to effectively execute its mission of providing high quality, safe and effective products that help physicians and nurses protect the health of women and their children.

In regard to financial performance, 2005 sales and gross profits increased 5% compared to the prior year, yielding earnings per share (eps) of $1.80. Dividends of $.63 per share were paid to shareholders, while the Company also repurchased about 9% of its shares in the open market for $8.6 million, an average cost of $23.09 per share repurchased.

For the financial details, shareholders may wish to access UTMD's January 24, 2006 press release reporting audited 2005 financial results via the Company's website www.utahmed.com, the MD&A section of this report and UTMD's SEC Form 10-K.

To be sure, the Company's recent performance was an even more substantial accomplishment than may appear on paper, because it was achieved at the same time that the "compliance" arm of the largest agency of the U.S. Federal Government was applying its best efforts to shut down a small company which was in fact in compliance with the Quality System Regulation (QSR). The FDA's method of internally and publicly disparaging UTMD would be the subject of a defamation lawsuit, except for the cloak of the government's sovereign immunity. I am confident that a private citizen would be doing jail time now for the fraud and abusive acts utilized by the FDA under the guise of discretionary function privilege. Until becoming victims of this type of extreme tyranny, it wasn't believable to us that it could happen in the U.S.A.

The FDA allegations, which didn't become clear until the pretrial hearing process when they had to make their claims of QSR violations known, were fabricated from multiple years of extensive and intensive inspections of UTMD's quality system. UTMD's written responses to the inspections and entreaties for dialog, which were not responded to, have been proven to be valid and on target. It is a travesty of the FDA's own policy that after UTMD respectfully disagreed with a baseless 2001 Warning Letter, the FDA chose to cut off all dialog instead of constructively addressing the issues. Instead, they mounted inspection after inspection to build a case, wasting dear taxpayer resources at a time when other well-publicized and real public health risks went without adequate attention. The explanation of this experience as a "personality conflict" by some, who were not present and express unwarranted deference to FDA, completely misses the point. Although UTMD has a well-documented record, including audio-taped inspection meetings, correspondence and depositions under oath of government employees, that supports we were indeed cooperative, cordial and professional, the FDA's role is to assess compliance with the regulations. Despite the costs and trauma that we underwent, it has been, however, gratifying that we have received many expressions of gratitude for our challenge to the FDA corruption from knowledgeable participants in the industry.

UTMD believes it has established deserved remedies from the government, including an investigation of inspector behavior that high level FDA officials misrepresented as having been done, when it wasn't. In July 2005, UTMD filed an administrative claim for abuse of process with the Department of Health and Human Services. The agency denied that claim on February 10, 2006. Paradoxically, this agency (the FDA) is charged with protecting the public health through enforcement of the QSR. The essence of an operative quality system is the ability to openly communicate the truth, take responsibility for errors, apologize when appropriate, and take corrective/preventive actions that will help ensure the same failures do not happen again in the future. "Doing the right thing" simply does not appear, in our experience, to be part of the current FDA's leadership paradigm.

UTMD remains proud of decades of safe and effective use of its innovative devices, which have improved health outcomes and lowered the cost of healthcare, primarily through fewer complications in critical care applications. We accept the millions of dollars in taxes we pay each year to support our government, but insulted and distressed how those hard-earned funds were wasted by the FDA on an initiative in which they didn't even bother to assess risk to the public health if the company were not in compliance with the QSR, which, of course, it was.

The development and introduction of helpful new products, which has been one key for UTMD's differentiation from its competitors, has been thwarted for several years because of the need to obtain FDA premarketing concurrence for new products. Now, we have the opportunity to reinvigorate our product development pipeline which provides the highest return on shareholder capital.

The other competitive key has been UTMD's ability to consistently manufacture devices that convey predictable clinical results. By every measure of quality, UTMD's manufacturing performance has excelled and continues to excel. I am grateful for our customers who expressed confidence in the Company by continuing to purchase its products, and for our experienced employees who remained committed to executing our mission.

Nothing has changed with respect to our fundamental objectives, including our commitment to provide the best possible devices for specific clinical procedures, high ethics in our business practices and excellent shareholder returns. Thank you for being a UTMD shareholder! Also, for those who sold our stock short in late 2004 and 2005, thank you for enhancing continued excellent shareholder returns!

**Kevin L. Cornwell**
*Chairman & CEO*

# Report of Independent Registered Public Accounting Firm

**To the Board of Directors and Stockholders
of Utah Medical Products, Inc.**

We have audited the accompanying consolidated balance sheets of Utah Medical Products, Inc. as of December 31, 2005 and 2004 and the related consolidated statements of income and comprehensive income, stockholders' equity and cash flows for the years ended December 31, 2005, 2004 and 2003. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Utah Medical Products, Inc. as of December 31, 2005 and 2004 and the results of its operations and its cash flows for the years ended December 31, 2005, 2004 and 2003 in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Utah Medical Products, Inc. internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control-Integrated Framework* issued by the *Committee of Sponsoring Organizations of the Treadway Commission (COSO)* and our report dated January 17, 2006 expressed an unqualified opinion on management's assessment of internal control over financial reporting and an unqualified opinion on the effectiveness of internal control over financial reporting.

Jones Simkins, P.C.

**Jones Simkins, P.C.**
*Logan, Utah*
*January 17, 2006*

# Consolidated Balance Sheet

*(In thousands)*

| December 31, | 2005 | 2004 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash | $ 703 | $ 1,818 |
| Investments, available-for-sale (note 3) | 16,750 | 15,110 |
| Accounts and other receivables, net (note 2) | 4,418 | 3,730 |
| Inventories (note 2) | 3,305 | 2,859 |
| Prepaid expenses and other current assets | 280 | 263 |
| Deferred income taxes (note 7) | 402 | 750 |
| Total current assets | 25,858 | 24,530 |
| Property and equipment, net (note 4) | 8,160 | 9,058 |
| Goodwill | 7,191 | 7,191 |
| Other intangible assets, net (note 2) | 433 | 483 |
| Total assets | $ 41,642 | $ 41,262 |
| **Liabilities and Stockholders' Equity** | | |
| Current liabilities: | | |
| Accounts payable | $ 757 | $ 698 |
| Accrued expenses (note 2) | 2,418 | 3,638 |
| Total current liabilities | 3,175 | 4,336 |
| Note payable (note 5) | 5,336 | — |
| Deferred income taxes (note 7) | 274 | 769 |
| Total liabilities | 8,785 | 5,105 |
| Commitments and contingencies (notes 6 and 10) | — | — |
| Stockholders' equity: | | |
| Preferred stock, $.01 par value; 5,000 shares authorized, no shares issued and outstanding | — | — |
| Common stock, $.01 par value; 50,000 shares authorized, issued 3,856 shares in 2005 and 4,105 shares in 2004 | 39 | 41 |
| Accumulated other comprehensive income | (495) | 226 |
| Retained earnings | 33,314 | 35,890 |
| Total stockholders' equity | 32,857 | 36,157 |
| Total liabilities and stockholders' equity | $ 41,642 | $ 41,262 |

*See accompanying notes to financial statements.*

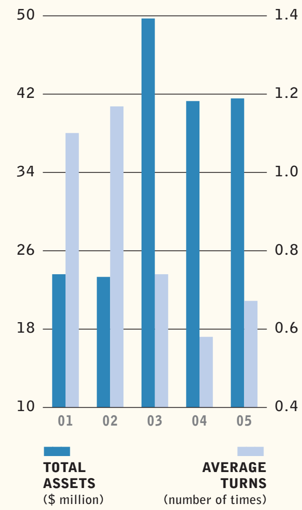
The following comments should be read in conjunction with accompanying financial statements. Dollar amounts are in thousands except per-share amounts and where noted.

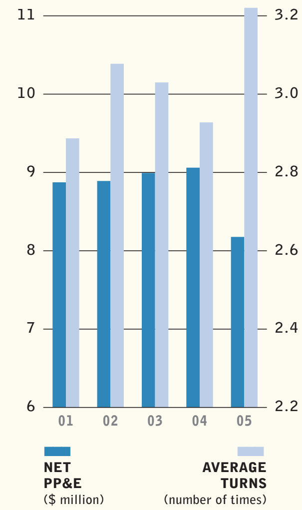
## Productivity of Assets and Working Capital

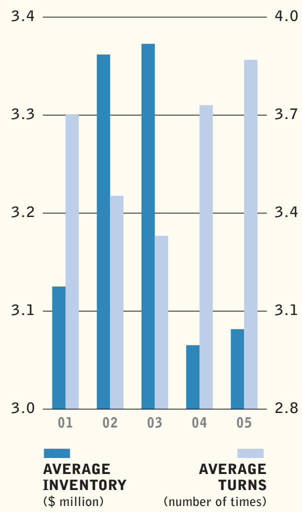
**a) Assets —** Year-end 2005 total assets were $41,642, compared to $41,262 in 2004. Cash (and investments of cash) balances were $17,453 and $16,928, 42% and 41% of total assets, at year-end 2005 and 2004, respectively. Year-end cash balances increased, even though UTMD paid $2,445 in dividends, $8,604 in share repurchases and $2,933 in litigation costs in 2005, because of continuing excellent cash generated from operations (before litigation costs) of $9,384 and a $5,336 loan taken out by UTMD's Ireland subsidiary. Excluding cash and investment balances, average total asset turns in 2005 were 1.14, consistent with years prior to 2003. Year-end assets since 2003 were substantially higher than in prior years due to Tyco patent infringement damages awarded to UTMD. In 2006, total assets excluding cash balances will continue to be less than annual sales. Improvement in total asset turns will depend on reduction of excess cash and investment balances.

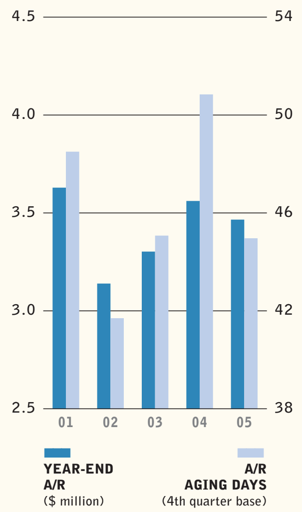
Property, plant and equipment (PP&E) assets are comprised of Utah, Oregon and Ireland manufacturing molds, production tooling and equipment, test equipment, computer/communications equipment and software, and the Utah and Ireland facilities. UTMD leases the Oregon facility as part of the 1997 CMI acquisition, and a portion of its Midvale, Utah parking lot. In 2005, net PP&E declined $898 because depreciation of $626 exceeded new purchases of $345, while Ireland assets decreased $605 in dollar-value as a result of a weaker U.S. dollar (USD). The lower consolidated PP&E balances combined with higher sales resulted in substantially higher PP&E turns. The current book value of consolidated PP&E is 35% of acquisition cost. Management believes that PP&E is in good working order and capable of supporting increased sales activity. In 2006, depreciation of fixed assets is expected to again exceed new PP&E purchases required to sustain current operations. Combining this with expected higher 2006 sales suggests that PP&E asset turns will again improve in 2006, unless offset by a strengthening of the euro relative to the USD, inflating the dollar value of Ireland PP&E.

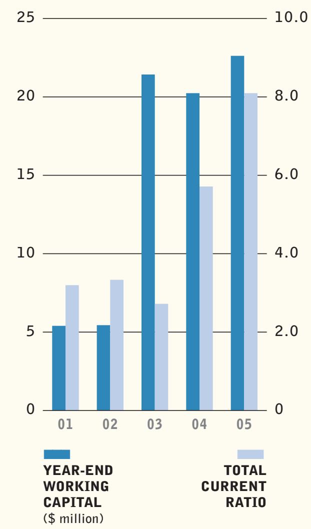
Average inventory turns in 2005 increased to 3.9 from 3.7 in 2004, despite a $446 increase in ending inventories, primarily as a result of the 5% increase in 2005 sales activity. Management has set this level of turns for its objective in 2006. Net (after allowance for doubtful accounts) year-end accounts receivable (A/R) balances decreased $90 at the same time that 2005 sales activity increased, yielding lower average days in A/R on December 31, 2005 of 45 days, based on 4Q 2005 shipment activity. This was well within management's continuing objective of 55 days. A/R over 90 days

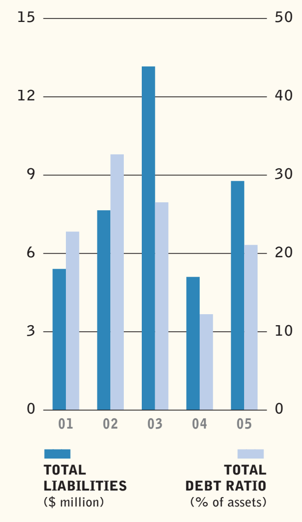


# Consolidated Statement of Income and Comprehensive Income

*(In thousands, except per share amounts)*

| Years ended December 31, | 2005 | 2004 | 2003 |
|---|---|---|---|
| Sales, net (notes 9 and 10) | $ 27,692 | $ 26,485 | $ 27,137 |
| Cost of goods sold (notes 9 and 10) | 11,939 | 11,419 | 11,245 |
| Gross margin | 15,753 | 15,066 | 15,892 |
| Operating income (expense): | | | |
| Sales and marketing expense | (2,214) | (2,253) | (2,364) |
| Research and development expense | (320) | (292) | (288) |
| General and administrative expense | (3,981) | (3,262) | (3,834) |
| Other operating income (note 11) | — | 6,060 | 23,992 |
| Operating income | 9,237 | 15,320 | 33,398 |
| Other income (expense): | | | |
| Dividend and interest income | 398 | 238 | 5 |
| Royalty income | 450 | 450 | 450 |
| Interest expense | (10) | — | (47) |
| Other, net | 139 | 110 | 46 |
| Income before provision for income taxes | 10,214 | 16,117 | 33,852 |
| Provision for income taxes (note 7) | 2,667 | 5,897 | 13,091 |
| Net income | $ 7,547 | $ 10,220 | $ 20,761 |
| Earnings per common share (basic) (notes 1 and 2): | $ 1.91 | $ 2.32 | $ 4.59 |
| Earnings per common share (diluted) (notes 1 and 2): | $ 1.80 | $ 2.19 | $ 4.25 |
| Other comprehensive income: | | | |
| Foreign currency translation net of taxes of $(153), $107 and $288 | $ (502) | $ 222 | $ 548 |
| Unrealized gain (loss) on investments net of taxes of $(42), $100 and $12 | (65) | 157 | 19 |
| Total comprehensive income | $ 6,980 | $ 10,599 | $ 21,328 |

*See accompanying notes to financial statements.*

from invoice date of about 5% of total A/R at year-end were about the same as at the end of the prior year. The Company believes the older A/R are collectible or within its reserve balances for uncollectible accounts.

Working capital at year-end 2005 was $22,683 compared to $20,194 at year-end 2004. Both of these amounts substantially exceed working capital needs for normal operations. UTMD's current ratio increased to 8.1 from 5.7, due to a substantial decrease in UTMD's litigation reserve (part of accrued expenses) reflecting the dismissal and conclusion of the FDA lawsuit filed in August 2004, as well as a substantial decrease in income tax payable resulting from the one-time tax holiday from the American Jobs Creation Act of 2004. Since the large majority of the working capital balance is excess cash (and cash investments), the current ratio going forward in 2006 will depend primarily upon the timing and extent of use of existing cash and investment balances. The other current asset and current liability components of working capital are expected to remain consistent with 2005 and within management targets, given an increase in 2006 sales.

Intangible assets, which are comprised of goodwill resulting from acquisitions and the costs of obtaining patents and other technology rights, were $7,624 at the end of 2005 compared to $7,674 at the end of 2004. The goodwill balance of $7,191, reduced 24% from time of acquisition, is the result of three acquisitions in 1997, 1998 and 2004 which were made in cash at conservative valuations. The reduction was goodwill amortization as a result of UTMD using previous GAAP through 2001 for the purchase method of acquisition accounting. Under current GAAP, goodwill will not be expensed unless and until the market value of the acquired entity becomes impaired. The three acquisitions continue to be viable parts of UTMD's overall business activities, representing 33% of total sales in 2005. UTMD does not expect the goodwill value of the acquisitions to become impaired in 2006. Other intangible assets decreased $50 in 2005 as a result of amortization. Total net intangible assets at the end of 2005 represented 18% of total assets.

**b) Liabilities —** Although UTMD's current liabilities decreased from the end of 2004 to the end of 2005 by $1,161, total liabilities increased $3,680, yielding a 2005-ending total debt ratio of 21%, up from 12% at the end of 2004. Current liabilities declined primarily because the ending litigation reserve (accrued liabilities) was $1,135 lower. However, the long-term note payable initiated in Ireland in December, which had a balance of $5,336 at the end of 2005, more than offset the reductions in other liabilities. The purpose of the note payable was to finance the repatriation of profits achieved in Ireland since 1996, under The American Jobs Creation Act of 2004. UTMD Ltd. plans to repay this note from profits generated over the next five years. Deferred income taxes declined in 2005 due mainly to reversing previously accrued deferred income taxes for undistributed earnings from UTMD's foreign subsidiary.

## Results of Operations

**a) Revenues —** Global consolidated sales increased 5% in 2005 compared to 2004. Foreign (international) sales increased 6%. U.S. (domestic) sales increased 4%. Sales increased despite customers being negatively affected by the August 10, 2004 FDA press release that announced that the FDA had filed a lawsuit against UTMD alleging lack of compliance with the Quality System Regulation (QSR). In October 2005, a Federal Court ruled that UTMD has been and is complying with the QSR, and dismissed the FDA allegations in entirety. The FDA did not appeal. International revenues also continued to be negatively affected in 2005 because of the FDA's refusal from early 2003 until late November 2005 to provide Certificates to Foreign Governments (CFGs) certifying UTMD's compliance with the QSR for the benefit of countries outside the U.S. which depend on the FDA's regulatory lead.

UTMD divides its domestic sales into two primary distribution channels: "direct sales" which are sales to end user customers by UTMD's direct sales force, independent commissioned sales reps, specialty distributors and national hospital distribution companies, and "OEM sales" which are component sales to other companies where products are packaged and resold as part of another company's finished product offerings. As a percentage of total domestic sales, direct sales were 94% of domestic sales in 2005, and 93% in both 2004 and 2003. The remaining sales were OEM sales, e.g. 6% of domestic sales in 2005 were domestic OEM sales. Domestic direct sales represented 72% of global consolidated sales in both 2005 and 2004, compared to 73% in 2003.

Domestic direct sales which appeared least affected by the FDA announcement were sales where clinicians make the purchase decision. Consequently, the least affected sales were sales to physician offices and clinics. Hospital labor and delivery (L&D) department sales where administrators determine what products are purchased appeared to be the most affected. Hospital NICU sales were less affected than L&D because clinical practitioners still have major discretion in determining what products are purchased. In order to help offset hospital administrators' concern over the August 10, 2004 FDA press release, UTMD employed a special "loyalty discount" which lasted for about three months in late 2004. The amount of the discount which affected only 2004 sales was $374.

International sales in 2005 were 23% of global consolidated sales compared to 23% and 22% in years 2004 and 2003, respectively. Of the 2005 international sales, 55% were for customers in Europe, compared to 60% in 2004 and 58% in 2003. Ireland operations (UTMD Ltd.) shipped 57% of international sales (in USD terms) in 2005, compared to 59% in 2004 and 63% in 2003. UTMD Ltd. 2005 shipments, including intercompany sales to Midvale, were up 5% in euro terms and up 4% in USD terms compared to 2004.

UTMD groups sales into four product-line categories: 1) obstetrics, comprised of labor and delivery management tools for monitoring fetal and maternal well-being, for reducing risk in performing difficult delivery procedures and for improving clinician and patient safety; 2) gynecology/ electrosurgery/urology, comprised of tools for gynecological procedures associated primarily with cervical/uterine disease including LETZ, endometrial sampling, diagnostic laparoscopy, and other MIS procedures; specialty excision and incision tools; conservative urinary incontinence therapy devices; and urology tools; 3) neonatal care, comprised of devices that provide developmentally-friendly care to the most critically ill babies including providing vascular access, administering vital fluids, maintaining a neutral thermal environment, providing protection and assisting in specialized applications; and 4) blood pressure monitoring/accessories/ other, comprised of specialized components as well as molded parts sold on an OEM basis to other companies. In these four categories, UTMD's primary revenue contributors often enjoy a dominant market share and typically have differentiated product features protected by patents.

| Global revenues by product category | 2005 | | 2004 | | 2003 | |
|---|---|---|---|---|---|---|
| Obstetrics | $ 9,774 | 36% | $ 10,918 | 41% | $ 11,435 | 42% |
| Gynecology/ Electrosurgery/ Urology | 5,397 | 19% | 5,142 | 19% | 5,324 | 20% |
| Neonatal | 6,475 | 23% | 4,134 | 16% | 4,142 | 15% |
| Blood Pressure Monitoring and Accessories* | 6,046 | 22% | 6,292 | 24% | 6,236 | 23% |
| Total | $ 27,692 | 100% | $ 26,485 | 100% | $ 27,137 | 100% |

**includes molded components sold to OEM customers.*

| International revenues by product category | 2005 | | 2004 | | 2003 | |
|---|---|---|---|---|---|---|
| Obstetrics | $ 593 | 9% | $ 774 | 13% | $ 665 | 11% |
| Gynecology/ Electrosurgery/ Urology | 1,199 | 19% | 966 | 16% | 1,064 | 18% |
| Neonatal | 400 | 6% | 278 | 5% | 200 | 4% |
| Blood Pressure Monitoring and Accessories* | 4,200 | 66% | 4,010 | 66% | 3,942 | 67% |
| Total | $ 6,392 | 100% | $ 6,028 | 100% | $ 5,871 | 100% |

**includes molded components sold to OEM customers.*

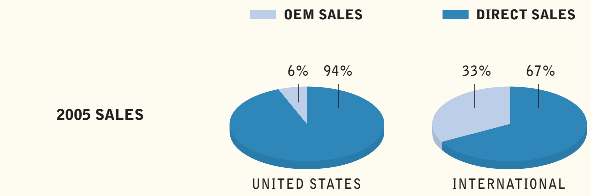
As a brief explanation of revenues in the above tables:

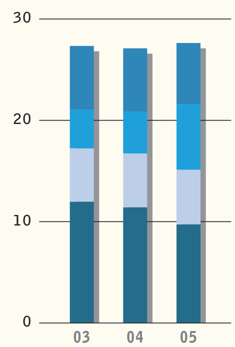
1. Of the $1,144 decline in total obstetrics sales in 2005, $76 was from lower sales of vacuum-assisted delivery systems (VADS), a 6% decline, and $902 from lower Intran Plus (IUPC) sales, an 11% decline. The lower IUPC and VADS sales resulted primarily from concerns of hospital administrators related to the FDA press release of August 10, 2004. Other contributing factors included a trend in obstetrics practice that favors abdominal operative deliveries over vaginal operative deliveries because of medical malpractice litigation risk, and increased competition including effects of product bundling agreements. Cheaper priced, less clinically-effective products represent significant competition where hospital administrators are constrained by GPO contracts or may not take the total cost of care into consideration, including increased risk of complications and utilization rates.

2. Gynecology/electrosurgery/urology product sales which had been negatively affected by the 2003 FDA refusal to provide CFGs for foreign customers, and the 2004 FDA press release which caused concern among domestic customers, rebounded in 2005.

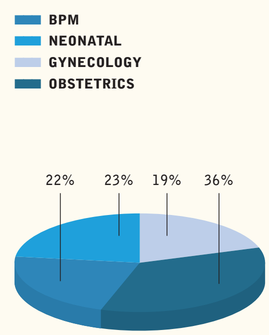
3. Consolidated global neonatal product sales increased 57% in 2005. The closing and move to Mexico of the San Antonio

**PRODUCT LINE SALES BY SALES CHANNEL**

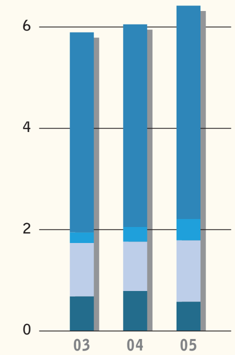


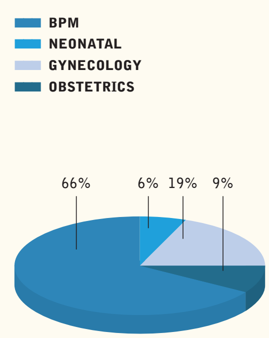

**GLOBAL SALES BY PRODUCT LINE**
(millions of dollars)




**2005 REVENUE BY PRODUCT LINE**
(percent of sales)




**INTERNATIONAL SALES BY PRODUCT LINE**
(millions of dollars)




**2005 INTERNATIONAL REVENUE BY PRODUCT LINE**
(percent of sales)

manufacturing operations of UTMD's competitor, NeoCare, a subsidiary of Arrow International, was a positive factor for UTMD's 2005 neonatal product sales.

4. International blood pressure monitoring and accessories (BPM) sales increased 5%, but domestic BPM sales decreased 19%. Domestic BPM sales were negatively affected by the August 2004 FDA press release.

Looking forward to 2006, UTMD's improvement in sales depends on UTMD's continued recapture of lost sales due to the unnecessary concern caused by the August 10, 2004 FDA press release, continued expansion in clinical acceptance of newer specialty products, release of new products after FDA concurrence with premarketing submissions and continued development of UTMD's international distribution channels. Management targets a 5% revenue increase again in 2006, relative to the prior year.

**b) Gross Profit —** UTMD's average 2005 gross profit margin (GPM), the surplus after costs of manufacturing, inspecting, packaging, sterilizing and shipping products (CGS) are subtracted from net revenues, was 56.9%, the same as in 2004. The GPM in 2003 was a Company record 58.6%. In 2005, UTMD experienced higher materials costs, particularly for plastics, along with increased labor costs, including particularly costs of medical care coverage for employees. The Company continues to maintain facilities and other manufacturing overheads far in excess of its needs. As a result, it projects that the dilution of fixed overhead costs that will occur with increased sales in 2006 will offset the continuing increase in incremental direct material and labor costs, together with some competitive pressure on prices, yielding a GPM in 2006 comparable to 2005.

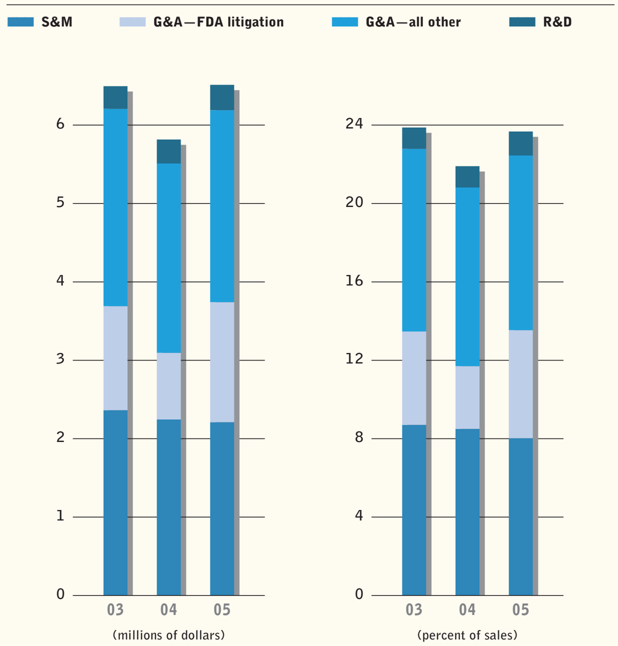
OEM sales are sales of UTMD components that are marketed by other companies as part of their product offerings. UTMD utilizes OEM sales as a means to help maximize utilization of its capabilities established to satisfy its direct sales business. As a general rule, prices for OEM sales expressed as a multiple of direct variable manufacturing expenses are lower than for direct sales because, in the OEM and international channels, UTMD's business partners incur significant expenses of sales and marketing. Because of UTMD's small size and period-to-period fluctuations in OEM business activity, allocations of fixed manufacturing overheads cannot be meaningfully allocated between direct and OEM sales. Therefore, UTMD does not report GPM by sales channels.

**c) Operating Profit —** Operating profit, or income from operations, is the surplus after operating expenses are subtracted from gross profits. In 2004 and 2003, operating profit includes other operating income resulting from UTMD's patent infringement victory over Tyco, net of associated expenses. That added income resulted in a net contribution to income from operating income (expense) in those two years, an unusual result. Operating expenses include sales and marketing (S&M) expenses, research and development (R&D) expenses and general and administrative (G&A) expenses. Combined operating expenses were $6,516 in 2005, compared to $5,807 in 2004 and $6,486 in 2003. Litigation expenses are included as part of G&A expenses. Substantial litigation expenses associated with the dispute with the FDA are included in 2003, 2004 and 2005 G&A expenses. In order to help clarify operating expenses, we provide the table below:

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| R&D expenses | $ 320 | $ 292 | $ 289 |
| S&M expenses | 2,214 | 2,253 | 2,364 |
| G&A—FDA litigation expenses | 1,527 | 850 | 1,316 |
| G&A—all other expenses | 2,454 | 2,412 | 2,517 |
| G&A expenses—total | 3,981 | 3,262 | 3,833 |
| Total operating expenses | $ 6,516 | $ 5,807 | $ 6,486 |

UTMD's operating profit margin (operating profits divided by total sales) was 33.4% in 2005, compared to 57.8% in 2004 and 123.1% in 2003, which does not correlate to sales since there were substantial expenses and/or other income in all three periods unrelated to sales. Excluding the other operating income related to patent infringement damages and FDA litigation expenses, operating profits would have been $10,764, $10,109 and $10,722, and operating profit margins would have been 38.9%, 38.2% and 39.5% in 2005, 2004 and 2003, respectively, which management believes is a better measure of operating profits relative to sales activity. Looking forward to 2006, UTMD expects to control operating expenses, excluding consideration for any remaining required FDA litigation expenses, at a level below 19% of sales, yielding a 2006 operating profit margin about 38%.

**OPERATING EXPENSE DETAIL**



# Consolidated Statement of Stockholders' Equity

*(In thousands)*

Years ended December 31, 2005, 2004 and 2003

| | Common Stock Shares | Common Stock Amount | Additional Paid-in Capital | Accumulated Other Comprehensive Income | Retained Earnings | Total Stockholders' Equity |
|---|---|---|---|---|---|---|
| **Balance at December 31, 2002** | 4,443 | $ 44 | $ — | $ (1,115) | $ 16,793 | $ 15,722 |
| Shares issued upon exercise of employee stock options for cash | 299 | 3 | 2,465 | — | — | 2,468 |
| Shares received and retired upon exercise of stock options | (101) | (1) | (2,141) | — | — | (2,142) |
| Tax benefit attributable to appreciation of stock options | — | — | 1,108 | — | — | 1,108 |
| Common stock purchased and retired | (97) | (1) | (1,432) | — | (807) | (2,240) |
| Foreign currency translation adjustment | — | — | — | 836 | — | 836 |
| Unrealized holding gain from investments, available-for-sale, net of taxes | — | — | — | 19 | — | 19 |
| Net income | — | — | — | — | 20,761 | 20,761 |
| **Balance at December 31, 2003** | 4,544 | $ 45 | $ — | $ (260) | $ 36,747 | $ 36,532 |
| Shares issued upon exercise of employee stock options for cash | 123 | 1 | 1,234 | — | — | 1,235 |
| Shares received and retired upon exercise of stock options | (5) | (0) | (124) | — | — | (124) |
| Tax benefit attributable to appreciation of stock options | — | — | 446 | — | — | 446 |
| Common stock purchased and retired | (557) | (5) | (1,556) | — | (9,130) | (10,691) |
| Foreign currency translation adjustment | — | — | — | 329 | — | 329 |
| Unrealized holding gain from investments, available-for-sale, net of taxes | — | — | — | 157 | — | 157 |
| Common stock dividends | — | — | — | — | (1,947) | (1,947) |
| Net income | — | — | — | — | 10,220 | 10,220 |
| **Balance at December 31, 2004** | 4,105 | $ 41 | $ — | $ 226 | $ 35,890 | $ 36,157 |
| Shares issued upon exercise of employee stock options for cash | 207 | 2 | 2,420 | — | — | 2,422 |
| Shares received and retired upon exercise of stock options | (84) | (1) | (2,395) | — | — | (2,396) |
| Tax benefit attributable to appreciation of stock options | — | — | 936 | — | — | 936 |
| Common stock purchased and retired | (373) | (4) | (960) | — | (7,640) | (8,604) |
| Foreign currency translation adjustment | — | — | — | (654) | — | (654) |
| Unrealized holding gain from investments, available-for-sale, net of taxes | — | — | — | (67) | — | (67) |
| Common stock dividends | — | — | — | — | (2,484) | (2,484) |
| Net income | — | — | — | — | 7,547 | 7,547 |
| **Balance at December 31, 2005** | 3,856 | $ 39 | $ — | $ (495) | $ 33,314 | $ 32,857 |

*See accompanying notes to financial statements.*

**i) S&M expenses —** S&M expenses are the costs of communicating UTMD's differences and product advantages, providing training and other customer service in support of the use of UTMD's solutions, processing orders and funding GPO fees. Because UTMD sells internationally through third party distributors, its S&M expenses are predominantly employed for U.S. business activity where it sells directly to clinical users. The largest component of S&M expenses is the cost of directly employing representatives that provide coverage across the U.S. As a percent of total sales, S&M operating expenses were 8.0% in 2005, 8.5% in 2004 and 8.7% in 2003. In 2006, UTMD intends to substantially expand its direct sales force, but intends to manage S&M expenses to less than 9% of total sales.

**ii) R&D expenses —** R&D expenses include the costs of investigating clinical needs, developing innovative concepts, testing concepts for viability, validating methods of manufacture, completing regulatory documentation and other activities required for design control, responding to customer requests for product enhancements, and assisting manufacturing engineering on an ongoing basis in developing new processes or improving existing processes. As a percent of sales, 2005 R&D expenses were 1.2% compared to 1.1% in both 2004 and 2003. In addition to new products still being developed, a number of existing products were enhanced or updated in 2005. In 2006, UTMD plans to increase R&D spending modestly as a percentage of sales in order to reinvigorate its product development pipeline.

**iii) G&A expenses —** G&A expenses include the "front office" functional costs of executive management, finance and accounting, corporate information systems, human resources, shareholder relations, risk management, protection of intellectual property and legal costs. In addition to employing the personnel required to coordinate or manage those functions, G&A expenses include outside director costs, outside legal counsel and litigation experts, independent accounting audit fees, 401(k) administration, NASDAQ exchange fees, write-offs of uncollectible receivables, business insurance costs and corporate contributions to charitable organizations. Aggregate G&A expenses as a percent of sales were 14.4% in 2005, 12.3% in 2004 and 14.1% in 2003. G&A expenses excluding the FDA litigation expenses were 8.9%, 9.1% and 9.3% of sales in 2005, 2004 and 2003, respectively, which management believes is a better indicator of G&A expenses related to sales. Excluding any remaining required FDA litigation expenses, UTMD plans to hold G&A expenses at a level about 9% of 2006 sales.

**iv) Other operating income —** Other operating income in both 2004 and 2003 resulted from UTMD's patent infringement victory over Tyco. In January 2004, the Company received a payment of $30,944 in damages and interest resulting from a 2002 District Federal Court judgment, and a post judgment settlement. The Company recognized operating income from that payment of $6,060 in first quarter 2004 and $23,992 in fourth quarter 2003. Expenses related to the judgment of $892 reduced the net other operating income recognized in 2003.

**d) Non-operating Income, Non-operating Expense and EBT —** Non-operating income, or other income, includes royalties from licensing UTMD's technology to other companies, rent from leasing underutilized property to others, income earned from investing the Company's excess cash and gains or losses from the sale of assets, offset by non-operating expenses which include interest expenses and bank fees. In prior SEC Form 10-Ks, UTMD reported the Tyco patent infringement damages as part of non-operating income, instead as part of operating expenses (i.e., negative G&A expenses). After the change in allocating Tyco patent infringement damages to operating expenses, non-operating income was $977 in 2005, $798 in 2004 and $454 in 2003. In 2005 and 2004, the increases in investment income resulted from higher average cash and investment balances during the applicable years. Royalties received were $450 in all three years. Future royalties may vary depending on the success of other companies in selling products licensed by UTMD, and the remaining life of the applicable patents. In 2005, UTMD paid $10 for interest expense after it borrowed €4.5 million ($5,336) in December to facilitate the repatriation of profits generated by its Ireland operations since 1996. In 2004 and 2003, interest expense was $0 and $47, respectively. UTMD expects interest expense of about $230 in 2006, as a result of the Ireland note payable. However, management still expects 2006 non-operating income (after subtracting the interest expense) to be about the same as in 2005 because of projected higher investment balances and higher interest rates in the U.S. The actual amount of 2006 non-operating income may be lower if UTMD utilizes its excess cash for an acquisition, continued litigation with the FDA seeking to recover damages or substantial share repurchases. Non-operating income may be higher if investment balances are higher because the FDA or a Federal Court honors UTMD's claims for damages.

Earnings before income taxes (EBT) result from adding UTMD's non-operating income to its operating profits. EBT margin is EBT divided by sales. UTMD's EBT margin was 36.9%, 60.9% and 124.7% in 2005, 2004 and 2003, respectively. Excluding the Tyco and FDA items in the table above, UTMD's EBT margin would have been 42%, 41% and 41% of sales in 2005, 2004 and 2003, respectively, which management believes is a better indicator of past EBT related to sales. Given the 2006 projections previously noted, management is targeting 2006 EBT of about $11,800, or an EBT margin of 41% of sales.

**e) Net Income, EPS and ROE —** Net income is EBT minus income taxes, often called the "bottom line." Net income was $7,547, $10,220 and $20,761 in 2005, 2004 and 2003, respectively. The effective income tax rate was 26.1%,

# Consolidated Statement of Cash Flow

*(In thousands)*

| Years ended December 31, | 2005 | 2004 | 2003 |
|---|---|---|---|
| **Cash flows from operating activities:** | | | |
| Net income | $ 7,547 | $ 10,220 | $ 20,761 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation and amortization | 676 | 809 | 984 |
| Gain on investments | (70) | (52) | (11) |
| Provision for (recovery of) losses on accounts receivable | (4) | 3 | (93) |
| (Gain) loss on disposal of assets | (5) | 5 | 4 |
| Deferred income taxes | (129) | 75 | (47) |
| Tax benefit attributable to exercise of stock options | 936 | 446 | 1,108 |
| (Increase) decrease in: | | | |
| Accounts receivable | (51) | (226) | 36 |
| Accrued interest and other receivables | (770) | (191) | 257 |
| Inventories | (573) | 437 | 174 |
| Prepaid expenses and other current assets | (13) | (43) | (32) |
| Litigation receivable | — | 24,884 | (24,884) |
| Increase (decrease) in: | | | |
| Accounts payable | 81 | 312 | (291) |
| Accrued expenses | (1,175) | (9,220) | 10,369 |
| Net cash provided by operating activities | 6,451 | 27,459 | 8,335 |
| **Cash flows from investing activities:** | | | |
| Capital expenditures for: | | | |
| Property and equipment | (345) | (411) | (272) |
| Intangible assets | — | (10) | (122) |
| Purchases of investments | (10,600) | (22,103) | (737) |
| Proceeds from the sale of: | | | |
| Investments | 9,045 | 8,202 | 98 |
| Property and equipment | 5 | — | — |
| Net cash paid in acquisition | — | (1,012) | — |
| Net cash used in investing activities | (1,895) | (15,334) | (1,033) |
| **Cash flows from financing activities:** | | | |
| Proceeds from issuance of common stock — options | 858 | 1,111 | 882 |
| Common stock purchased and retired | (8,604) | (10,692) | (2,240) |
| Common stock purchased and retired — options | (833) | (6) | (555) |
| Proceeds from note payable | 5,336 | — | — |
| Repayments of note payable | — | — | (4,956) |
| Dividends paid | (2,445) | (1,331) | — |
| Net cash used in financing activities | (5,687) | (10,918) | (6,869) |
| Effect of exchange rate changes on cash | 16 | (151) | 44 |
| Net increase (decrease) in cash and cash equivalents | (1,116) | 1,056 | 477 |
| Cash at beginning of year | 1,818 | 762 | 285 |
| Cash at end of year | $ 703 | $ 1,818 | $ 762 |

## Supplemental Disclosure of Cash Flow Information

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| Cash paid during the year for: | | | |
| Income taxes | $ 2,915 | $ 14,294 | $ 2,628 |
| Interest | 10 | — | 47 |

*See accompanying notes to financial statements.*

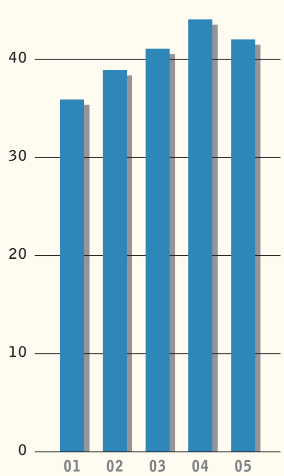
During 2004, the Company purchased all of the outstanding stock of Abcorp Medical, Inc. The Company paid cash and recorded net assets from the acquisition as follows:

| | |
|---|---|
| Cash | $ 11 |
| Accounts receivable | 127 |
| Inventory | 25 |
| Prepaid insurance | 19 |
| Equipment, net | 16 |
| Accounts payable | (96) |
| Accrued expenses | (25) |
| Goodwill | 946 |
| Total cash paid | 1,023 |
| Less cash received | (11) |
| Net cash investment | $ 1,012 |

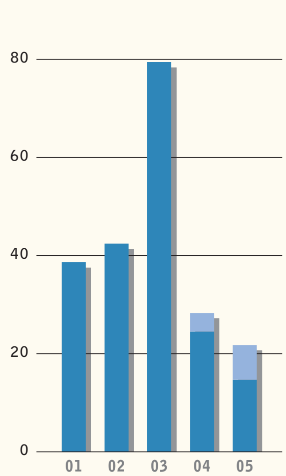
36.6% and 38.7% respectively. The significantly lower income tax provision in 2005 was a result of The American Jobs Creation Act of 2004 (the Act) enacted in October 2004 which allows a temporary tax deduction on repatriated foreign earnings, which must be accomplished in 2005. UTMD previously included a deferred tax liability in reported results, anticipating that profits generated by its Ireland facility would eventually be repatriated, triggering additional U.S. income taxes. Also, UTMD recorded a favorable deferred tax liability adjustment after the conclusion of a formal IRS audit in 3Q 2005. These were non-recurring tax benefits limited to the year 2005. Other year to year fluctuations in the tax rate have resulted from: 1) differences in distribution of state income taxes; 2) variations in profits of the Ireland subsidiary which is taxed at a 10% rate on exported manufactured products; 3) extraterritorial income exclusions; 4) higher marginal tax rates for EBT above $10 million; and 5) other factors such as R&D tax credits. Management expects that UTMD's 2006 consolidated income tax rate will be around 34%, but this is difficult to predict.

UTMD's net income expressed as a percentage of sales was 27.3%, 38.6% and 76.5% for years 2005, 2004 and 2003, respectively. Excluding the Tyco and FDA items identified in the table in operating expenses, UTMD's bottom line was $7,714, $7,166 and $7,335, or 28%, 27% and 27% of sales, in 2005, 2004 and 2003, respectively. UTMD's profitability has consistently ranked in the top performance tier of all U.S. publicly-traded companies, and has been a primary driver for UTMD's past excellent returns on shareholders' equity (ROE).

Earnings per share (EPS) is net income divided by the number of shares of stock outstanding (diluted to take into consideration stock option awards which are "in the money," i.e., have exercise prices below the current period's weighted average market value). Diluted EPS were $1.80, $2.19 and $4.25 in 2005, 2004 and 2003, respectively. Excluding the Tyco and FDA items, EPS would have been $1.82, $1.53 and $1.50 in 2005, 2004 and 2003, respectively. UTMD's EPS has grown at a compounded rate of 17% per year since 1997.



YEAR-END INSTITUTIONAL OWNERSHIP
(percent of total ownership)



RETURN ON EQUITY
(percent)

The end of 2005 weighted average number of diluted common shares (the number used to calculate diluted EPS) were 4,192 (in thousands) compared to 4,675 shares in 2004 and 4,885 shares in 2003. Dilution for "in the money" unexercised options for the year 2005 was 230 (in thousands) shares compared to 276 in 2004 and 359 in 2003. The total number of options outstanding at year-end 2005 declined 27% from year-end 2004, following no decline in the prior year. Dilution decreased in 2005 from 2004 because the average number of options outstanding decreased substantially, even though a higher average share price in the stock market increased the dilution effect of each option. Actual outstanding common shares as of December 31, 2005 were 3,856,000.

Return on shareholders' equity (ROE) is the portion of net income retained by UTMD (after payment of dividends) to internally finance its growth, divided by the average accumulated shareholders' equity during the applicable time period. ROE includes balance sheet measures as well as income statement measures. ROE in 2005 was 15% (22% before dividends). ROE was negatively affected by FDA litigation costs, but enhanced by share repurchases which were helped because of a lower share price than probably would have existed without the FDA lawsuit. ROE in 2004 and 2003, which was aided by Tyco patent infringement damages, was 24% (28% before dividends) and 79%, respectively. UTMD's ROE (before dividends) has averaged 33% per year over the last 20 years. This ratio determines how fast the Company can afford to grow without adding external financing that would dilute shareholder interests. For example, a 30% ROE will financially support 30% annual growth in revenues without issuing more stock.

The lower ROE in 2005, despite a continued excellent net profit margin, was due to payment of dividends to shareholders which reduced retained profits, much higher average cash and investment balances which reduced total asset turns, and a low debt ratio. Looking forward, unless UTMD utilizes its cash to make an acquisition or repurchase shares, 2006 ROE will be lower than 2005 even though net profits are projected to increase, because average shareholders' equity will increase faster on a percentage basis than net profits.

## Liquidity and Capital Resources

**Cash Flows —** Net cash provided by operating activities, including adjustments for depreciation and other non-cash operating expenses, along with changes in working capital and the tax benefit attributable to exercise of employee incentive stock options, totaled $6,451 in 2005 compared to $27,459 in 2004 and $8,335 in 2003. The major changes in operating assets and liabilities in both 2004 and 2003 were related to the accrual and receipt of about $31 million from Tyco International for patent infringement, and taxes on that income. Cash provided by operating activities in 2005 includes continued excellent net income performance, aided by a $936 tax benefit attributable to exercise of employee options, compared to $446 in 2004 and $1,108 in 2003.

The Company's use of cash for investing activities was primarily as a result of purchases of liquid investments, in an effort to maximize returns on excess cash balances while maintaining liquidity. UTMD expended $10,600 in 2005 on such purchases, compared to $22,103 in 2004 and $737 in 2003. In 2005, UTMD received $9,045 from selling short-term investments, compared to $8,202 in 2004 and $98 in 2003. No acquisitions were made in 2005 or 2003. UTMD invested $1,012 in second quarter 2004 to acquire Abcorp, Inc., its vendor for fetal monitoring belts. Please see the table under "Supplemental Disclosure of Cash Flow Information" for more detail of the Abcorp assets purchased.

In 2005, UTMD received $858 and issued 123,478 shares of stock upon the exercise of employee and director stock options. Employees and directors exercised a total of 207,133 option shares in 2005, with 83,655 shares immediately being retired as a result of the individuals trading the shares in payment of the exercise price of the options and related tax withholding. UTMD paid $833 in 2005 to meet tax withholding requirements on options exercised. UTMD repurchased 372,599 shares of stock in the open market at a cost of $8,604 during 2005. Option exercises in 2005 were at an average price of $11.69 per share. Share repurchases in the open market were at an average cost of $23.09 per share, including commissions and fees. In 2004, the Company received $1,111 from issuing 117,482 shares of stock on the exercise of employee and director stock options, including 5,426 shares retired upon employees trading those shares in payment of the stock option exercise price.

In December 2005, UTMD's foreign subsidiary borrowed €4.5 million ($5,336) to finance repatriation (from Ireland to the U.S.) of profits achieved since 1996 under The American Jobs Creation Act of 2004. UTMD did not borrow during 2004. In 2004, UTMD made repayments of $4,956 on its note payable, which eliminated the line of credit balance remaining at the end of 2003, while receiving $0 in proceeds from the line of credit. The previous loan was undertaken to finance repurchase of shares. Although UTMD has not borrowed under its revolving line of credit since it paid off the balance in 2004, the line of credit is used to guarantee the current Ireland loan in order to achieve the most favorable credit terms.

Management believes that future income from operations and effective management of working capital will provide the liquidity needed to finance internal growth plans. Planned 2006 capital expenditures are expected to be approximately $500 to keep facilities, equipment and tooling in good working order. In addition, UTMD may use cash in 2006 for selective infusions of technological, marketing or product manufacturing rights to broaden the Company's product offerings; for continued share repurchases if the price of the stock remains undervalued; and if available for a reasonable price, acquisitions that may strategically fit UTMD's business and are accretive to performance. The revolving line of credit will continue to be available for liquidity when the timing of acquisitions or repurchases of stock require a large amount of cash in a short period of time not otherwise available from existing cash and investment balances.

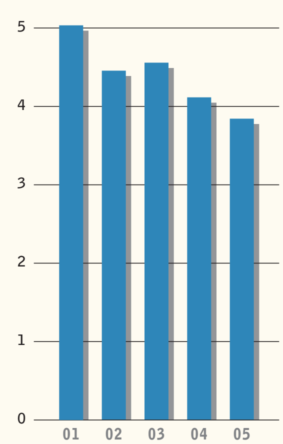
In summary, management plans to utilize cash not needed to support normal operations in one or a combination of the following: 1) to make investments in new technology; 2) to acquire a product line that will augment revenue growth and better utilize UTMD's infrastructure; and/or 3) to repurchase UTMD shares in the open marketplace.

## Contractual Obligations and Contingent Liabilities and Commitments

The following is a summary of UTMD's significant contractual obligations and commitments as of December 31, 2005:

| Contractual Obligations and Commitments | Total | 2006 | 2007-2008 | 2009-2010 | 2011 and thereafter |
|---|---|---|---|---|---|
| Long-term debt obligations | $ 6,333 | $ 633 | $ 1,266 | $ 1,266 | $ 3,168 |
| Operating lease obligations | 985 | 66 | 74 | 74 | 771 |
| Purchase obligations | 1,752 | 1,752 | — | — | — |
| Total | $ 9,070 | $ 2,451 | $ 1,340 | $ 1,340 | $ 3,939 |

Additional information regarding the Company's contractual obligations and commitments may be found in notes 5 and 6 of the Company's Notes to Consolidated Financial Statements.




**YEAR-END SHARES OUTSTANDING**
(millions of shares)

## Critical Accounting Policies and Estimates

The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as well as the reported amounts of revenues and expenses during the reporting period.

Management bases its estimates and judgments on historical experience, current economic and industry conditions and on various other factors that are believed to be reasonable under the circumstances. This forms the basis for making judgments about the carrying values of assets and liabilities that are not readily available from other sources. Management has identified the following as the Company's most critical accounting policies which require significant judgment and estimates. Although management believes its estimates are reasonable, actual results may differ from these estimates under different assumptions or conditions.

- Allowance for doubtful accounts: The majority of the Company's receivables are with hospitals and medical device distributors. Although the Company has historically not had significant write-offs of bad-debt, the possibility exists, particularly with foreign customers where collection efforts can be difficult or in the event of widespread U.S. hospital bankruptcies.
- Inventory valuation reserves: The Company strives to maintain a good balance of inventory to (1) meets its customer's needs while (2) not tying-up an unnecessary amount of the Company's resources increasing the possibility of, among other things, obsolescence. The Company believes its method of reviewing actual and projected demand for its existing inventory allows it to arrive at a fair inventory valuation reserve. While the Company has historically not had significant inventory write-offs, the possibility exists that one or more of its products may become unexpectedly obsolete for which a reserve has not previously been created. The Company's historical write-offs have not been materially different from its estimates.

## Management's Outlook

In summary, in 2006 UTMD plans to:

*1) increase efforts to regain business lost as a result of the FDA's August 10, 2004 press release;*

*2) reinvigorate internal new product development;*

*3) continue outstanding operating performance;*

*4) look for new acquisitions to augment sales growth; and*

*5) utilize current cash balances in shareholders' best long-term interest.*

Item 3 of UTMD's SEC Form 10-K describes the legal proceedings regarding UTMD's dispute with the FDA. The U.S. Court determined that UTMD has been and is in compliance with the provisions of the Quality System Regulation. The Company remains proud of its long-term record of compliance with all government regulations.

The reliability and performance of UTMD's products is high and represents significant clinical benefits while providing minimum total cost of care. Physicians do care about the well-being of their patients, but their time is limited to evaluate choices, and they have hospital administrators to deal with who often look at the initial price of a product without understanding the total cost of care which includes risk of unwanted complications and unnecessary utilization.

In the U.S., UTMD will continue to leverage its reputation as an innovator which will responsively take on challenges to work with physicians who use its products in specialty hospital areas, or outside the hospital in their office practices. Internationally, where UTMD must depend on the knowledge, focus, relationships and energy of independent distributors, management will continue to closely monitor performance and recruit needed business partners.

UTMD will continue to focus on differentiating itself, especially from commodity-oriented competitors. UTMD is small, but its employees are experienced and diligent in their work. Our passion is in providing innovative clinical solutions that will help reduce health risks for women and their babies. The Company has a defined focus and does not seek revenue growth as its primary motivation. We fundamentally seek to do an excellent job in meeting our customers' and their patients' needs and provide our shareholders with excellent returns.

Looking back five years from the end of 2005 to the end of 2000, UTMD's EPS have more than doubled, and its year-ending share price has more than quadrupled (up 326%). In comparison, the NASDAQ Composite, S&P 500 Index and DJIA indices were all down: 11%, 5% and down 1%, respectively, over that same five-year time span.

In 2005, UTMD again demonstrated a high positive cash flow, managing working capital effectively and keeping new capital expenditures below its rate of depreciation of existing assets. UTMD's balance sheet is strong enough to finance an acquisition in 2006 without issuing stock. In considering acquisitions, UTMD looks to acquire successful companies that will enhance its specialist focus. When UTMD acquires a company, it probably will be for cash and with the idea that it will be able to retain key resources that helped make the acquired entity successful.

# Notes to Consolidated Financial Statements

*December 31, 2005, 2004 and 2003. Dollar amounts are in thousands except per-share amounts and where noted.*

## NOTE 1. Summary of Significant Accounting Policies

**Organization —** Utah Medical Products, Inc. and its wholly owned subsidiaries, principally Utah Medical Products Ltd., which operates a manufacturing facility in Ireland, and Columbia Medical, Inc., (the Company) are in the business of producing specialized devices for the healthcare industry. The Company's broad range of products includes those used in critical care areas and the labor and delivery departments of hospitals, as well as outpatient clinics and physicians' offices. Products are sold in both domestic U.S. and international markets.

**Use of Estimates in the Preparation of Financial Statements —** The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although actual results could differ from those estimates, management believes it has considered and disclosed all relevant information in making its estimates that materially affect reported performance and current values.

**Principles of Consolidation —** The consolidated financial statements include those of the Company and its subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation.

**Cash and Cash Equivalents —** For purposes of the consolidated statement of cash flows, the Company considers cash on deposit and short-term investments with original maturities of three months or less to be cash and cash equivalents.

**Investments —** The Company classifies its investments as "available for sale." Securities classified as "available for sale" are carried in the financial statements at fair value. Realized gains and losses, determined using the specific identification method, are included in operations; unrealized holding gains and losses are reported as a separate component of accumulated other comprehensive income. Declines in fair value below cost that are other than temporary are included in operations.

**Concentration of Credit Risk —** The primary concentration of credit risk consists of trade receivables. In the normal course of business, the Company provides credit terms to its customers. Accordingly, the Company performs ongoing credit evaluations of its customers and maintains allowances for possible losses which, when realized, have been within the range of management's expectations as reflected by its reserves.

The Company's customer base consists of hospitals, medical product distributors, physician practices and others directly related to healthcare providers, as well as other manufacturing companies. Although the Company is affected by the well-being of the global healthcare industry, management does not believe significant trade receivable credit risk exists at December 31, 2005.

The Company maintains its cash in bank deposit accounts, which at times, may exceed federally insured limits in addition to Fidelity Investments accounts. The Company has not experienced any losses in such accounts and believes it is not exposed to a significant credit risk on cash and cash equivalent balances.

**Accounts Receivable —** Accounts receivable are amounts due on product sales and are unsecured. Accounts receivable are carried at their estimated collectible amounts. Credit is generally extended on a short-term basis; thus accounts receivable do not bear interest although a finance charge may be applied to such receivables that are past the due date. Accounts receivable are periodically evaluated for collectibility based on past credit history with clients. Provisions for losses on accounts receivable are determined on the basis of loss experience, known and inherent risk in the account balance and current economic conditions (see note 2).

**Inventories —** Finished products, work-in-process, raw materials and supplies inventories are stated at the lower of cost (computed on a first-in, first-out method) or market (see note 2).

**Property and Equipment —** Property and equipment are stated at cost. Depreciation and amortization are computed using the straight-line and units-of-production methods over estimated useful lives as follows:

| | |
|---|---|
| Building and improvements | 30-40 years |
| Furniture, equipment and tooling | 3-10 years |

**Long-Lived Assets —** The Company evaluates its long-lived assets in accordance with Statement of Financial Accounting Standards (SFAS) No. 144, "Accounting for the Impairment of Long-Lived Assets." Long-lived assets held and used by the Company are reviewed for impairment whenever events or changes in circumstances indicate that their net book value may not be recoverable. When such factors and circumstances exist, the Company compares the projected undiscounted future cash flows associated with the related asset or group of assets over their estimated useful lives against their respective carrying amounts. Impairment, if any, is based on the excess of the carrying amount over the fair value of those assets and is recorded in the period in which the determination was made.

**Intangible Assets —** Costs associated with the acquisition of patents, trademarks, license rights and non-compete agreements are capitalized and are being amortized using the straight-line method over periods ranging from 5 to 17 years. UTMD's goodwill is tested for impairment annually, in the fourth quarter of each year, using a fair value measurement test, in accordance with SFAS 142. UTMD would also perform an impairment test, between annual tests, if circumstances changed that would more than likely reduce the fair value of goodwill below its net book value. If UTMD determined that its goodwill were impaired, a second step would be completed to measure the amount of the impairment loss. UTMD does not expect its goodwill to become impaired in the foreseeable future (see note 2).

**Loans to Related Parties —** The Company has not made loans to related entities including employees, directors, shareholders, suppliers or customers, nor does it guarantee the debt of related entities.

**Revenue Recognition —** The Company believes that revenue should be recognized at the time of shipment as title generally passes to the customer at the time of shipment. Revenue recognized by UTMD is based upon documented arrangements and fixed contracts in which the selling price is fixed prior to completion of an order. Revenue from product and service sales is generally recognized at the time the product is shipped or service completed and invoiced, and collectibility is reasonably assured. There are circumstances under which revenue may be recognized when product is not shipped, which meet the criteria of SAB 104: the Company provides engineering services, for example, design and production of manufacturing tooling that may be used in subsequent UTMD manufacturing of custom components for other companies. This revenue is recognized when UTMD's service has been completed according to a fixed contractual agreement.

**Income Taxes —** The Company accounts for income taxes under SFAS No. 109, "Accounting for Income Taxes," whereby deferred taxes are computed under the asset and liability method.

**Legal Costs —** The Company has been involved in lawsuits which are an expected consequence of its operations and in the ordinary course of business. The Company maintains a reserve for legal costs which are probable and estimated based on its previous experience. The reserve for legal costs at December 31, 2005 and 2004 was $125 and $1,260, respectively (see note 2).

**Earnings per Share —** The computation of basic earnings per common share is based on the weighted average number of shares outstanding during each year.

The computation of earnings per common share assuming dilution is based on the weighted average number of shares outstanding during the year plus the weighted average common stock equivalents which would arise from the exercise of stock options outstanding using the treasury stock method and the average market price per share during the year.

The shares (in thousands) used in the computation of the Company's basic and diluted earnings per share are reconciled as follows:

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| Weighted average number of shares outstanding — basic | 3,962 | 4,399 | 4,526 |
| Dilutive effect of stock options | 230 | 276 | 359 |
| Weighted average number of shares outstanding, assuming dilution | 4,192 | 4,675 | 4,885 |

**Stock-Based Compensation —** At December 31, 2005, the Company has stock-based employee compensation plans, which are described more fully in note 8. The Company accounts for those plans under the recognition and measurement principles of APB Opinion 25, "Accounting for Stock Issued to Employees," and related Interpretations, and has adopted the disclosure-only provisions of SFAS 123, "Accounting for Stock-Based Compensation." Accordingly, no compensation cost has been recognized in the financial statements, as all options granted under those plans had an exercise price equal to or greater than the market value of the underlying common stock on the date of grant.

Starting January 1, 2006, in accordance with SFAS 123 (revised 2004), the Company will be required to begin recognizing compensation cost related to its stock option plans. Please see note 14, below.

Had compensation cost for the Company's stock option plans been determined based on the fair value at the grant date consistent with the provisions of SFAS 123, the Company's net earnings and earnings per share would have been reduced to the pro forma amounts indicated below:

| | Years ended December 31, | | |
|---|---|---|---|
| | 2005 | 2004 | 2003 |
| Net income as reported | $ 7,547 | $ 10,220 | $ 20,761 |
| Deduct: | | | |
| Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects | (869) | (388) | (178) |
| Net income pro forma | $ 6,678 | $ 9,832 | $ 20,583 |
| Earnings per share: | | | |
| Basic — as reported | $ 1.91 | $ 2.32 | $ 4.59 |
| Basic — pro forma | $ 1.69 | $ 2.24 | $ 4.55 |
| Diluted — as reported | $ 1.80 | $ 2.19 | $ 4.25 |
| Diluted — pro forma | $ 1.59 | $ 2.10 | $ 4.21 |

On May 6, 2005 the Compensation and Option Committee of the Board accelerated the vesting of certain unvested stock options awarded to employees, officers and directors under the Company's stock option plans, which had exercise prices that were underwater as of market close May 5, 2005.

Options to purchase 124,800 shares become fully exercisable on December 1, 2005 as a result of the vesting acceleration. Exercise prices of the options accelerated are $24.02 and $25.59 per share. These options previously became fully vested on October 1, 2007 and January 1, 2008.

The Company took this action to avoid an accounting charge (as compensation expense) for these options starting in the quarter ending March 31, 2006, as required by FAS 123(R). The increase in proforma compensation expense in 2005, as shown above, is a result of the vesting acceleration.

**Translation of Foreign Currencies —** Assets and liabilities of the Company's foreign subsidiary are translated into U.S. dollars at the applicable exchange rates at year-end. Net gains or losses resulting from the translation of the Company's assets and liabilities are reflected as a separate component of stockholders' equity. A negative translation impact on stockholders' equity reflects a current relative U.S. dollar value higher than at the point in time that assets were actually acquired in a foreign currency. A positive translation impact would result from a U.S. dollar weaker in value than at the point in time foreign assets were acquired.

Income and expense items are translated at the weighted average rate of exchange (based on when transactions actually occurred) during the year.

## NOTE 2. Detail of Certain Balance Sheet Accounts

| | December 31, 2005 | December 31, 2004 |
|---|---|---|
| Accounts and other receivables: | | |
| Accounts receivables | $ 3,542 | $ 3,636 |
| Income tax receivable | 783 | — |
| Accrued interest and other | 166 | 171 |
| Less allowance for doubtful accounts | (73) | (77) |
| | $ 4,418 | $ 3,730 |
| Inventories: | | |
| Finished products | $ 1,058 | $ 932 |
| Work-in-process | 657 | 640 |
| Raw materials | 1,590 | 1,287 |
| | $ 3,305 | $ 2,859 |

| | December 31, 2005 | December 31, 2004 |
|---|---|---|
| Other intangible assets: | | |
| Patents | $ 2,025 | $ 2,025 |
| License rights | 293 | 293 |
| Trademarks | 224 | 224 |
| Non-compete agreements | 175 | 175 |
| | 2,717 | 2,717 |
| Accumulated amortization | (2,284) | (2,234) |
| | $ 433 | $ 483 |
| Accrued expenses: | | |
| Income taxes payable | $ 45 | $ 384 |
| Payroll and payroll taxes | 949 | 963 |
| Reserve for litigation costs | 125 | 1,260 |
| Dividends payable | 658 | 616 |
| Other | 641 | 415 |
| | $ 2,418 | $ 3,638 |

## NOTE 3. Investments

The Company's investments, classified as available-for-sale consist of the following:

| | December 31, 2005 | December 31, 2004 |
|---|---|---|
| Investments, at cost | $ 16,571 | $ 14,822 |
| Equity securities: | | |
| Unrealized holding gains | 298 | 295 |
| Unrealized holding (losses) | (119) | (7) |
| Investments, at fair value | $ 16,750 | $ 15,110 |

Changes in the unrealized holding gain on investment securities available-for-sale and reported as a separate component of accumulated other comprehensive income are as follows:

| | December 31, 2005 | December 31, 2004 |
|---|---|---|
| Balance, beginning of year | $ 176 | $ 19 |
| Gross unrealized holding gains, net of (losses), in equity securities | (110) | 257 |
| Deferred income taxes on unrealized holding gain | 43 | (100) |
| Balance, end of year | $ 109 | $ 176 |

UTMD held available-for-sale investments in municipal debt securities with the following maturities and amounts:

| | December 31, 2005 | December 31, 2004 |
|---|---|---|
| Maturity less than 1 year | $ — | $ 9,081 |
| Maturity greater than 10 years | — | 1,475 |

During 2005, 2004 and 2003, UTMD had proceeds from sales of available-for-sale securities of $9,045, $8,202 and $98, respectively and associated realized gains of $72, $52 and $11, respectively. UTMD uses the specific identification method to calculate its realized gains.

## NOTE 4. Property and Equipment

Property and equipment consists of the following:

| | December 31, 2005 | December 31, 2004 |
|---|---|---|
| Land | $ 1,028 | $ 1,089 |
| Buildings and improvements | 8,631 | 9,283 |
| Furniture, equipment and tooling | 13,781 | 13,763 |
| Construction-in-progress | 179 | 41 |
| | 23,619 | 24,176 |
| Accumulated depreciation and amortization | (15,459) | (15,118) |
| | $ 8,160 | $ 9,058 |

Included in the Company's consolidated balance sheet are the assets of its manufacturing facilities in Utah, Oregon and Ireland. Property and equipment, by location, are as follows:

| | December 31, 2005 | | | |
|---|---|---|---|---|
| | Utah | Oregon | Ireland | Total |
| Land | $ 621 | $ — | $ 407 | $ 1,028 |
| Building and improvements | 4,236 | 32 | 4,363 | 8,631 |
| Furniture, equipment and tooling | 11,750 | 1,251 | 781 | 13,782 |
| Construction-in-progress | 179 | — | — | 179 |
| Total | 16,786 | 1,283 | 5,551 | 23,619 |
| Accumulated depreciation and amortization | (12,672) | (1,274) | (1,513) | (15,459) |
| Property and equipment, net | $ 4,114 | $ 9 | $ 4,038 | $ 8,160 |

| | December 31, 2004 | | | |
|---|---|---|---|---|
| | Utah | Oregon | Ireland | Total |
| Land | $ 621 | $ — | $ 468 | $ 1,089 |
| Building and improvements | 4,234 | 32 | 5,017 | 9,283 |
| Furniture, equipment and tooling | 11,627 | 1,245 | 891 | 13,763 |
| Construction-in-progress | 41 | — | — | 41 |
| Total | 16,523 | 1,277 | 6,376 | 24,176 |
| Accumulated depreciation and amortization | (12,224) | (1,271) | (1,623) | (15,118) |
| Property and equipment, net | $ 4,299 | $ 6 | $ 4,753 | $ 9,058 |

## NOTE 5. Note Payable

In December 2005, the Company borrowed €4.5 million ($5,336) from the Bank of Ireland to finance repatriation of profits achieved since 1996 under The American Jobs Creation Act of 2004. The loan term is 10-years at an interest rate of 0.70% plus the bank's money market rate, which is a total of the bank's cost of funds and cost of liquidity.

The Company has an unsecured bank line-of-credit agreement with U.S. Bank which allows the Company to borrow up to a fixed maximum amount of $8,000 at an interest rate equal to the bank's one-month LIBOR rate plus 1.25%. The line-of-credit-balance matures on May 31, 2006 and had an outstanding balance of $0 at both December 31, 2005 and 2004. The principal financial loan covenants are a restriction on the total amount available for borrowing to 1.25 times the last twelve months' EBITDA, and a requirement to maintain a net worth in excess of $18.5 million, which at the end of 2005 and 2004 was $32,857 and $36,157, respectively. U.S. Bank also guarantees the Bank of Ireland loan through a letter of credit arrangement at an interest rate of 1.25%.

## NOTE 6. Commitments and Contingencies

**Operating Leases —** The Company has a lease agreement for land adjoining its Utah facility for a term of forty years commencing on September 1, 1991. On September 1, 2001 and subsequent to each fifth lease year, the basic rental was and will be adjusted for published changes in a price index. The Company also leases its CMI building in Oregon under a two-year noncancelable operating lease. Rent expense charged to operations under these operating lease agreements was approximately $107, $107 and $105 for the years ended December 31, 2005, 2004 and 2003, respectively.

Future minimum lease payments under its lease obligations as of December 31, 2005 were as follows:

| Years ending December 31: | Amount |
|---|---|
| 2006 | $ 66 |
| 2007 | 37 |
| 2008 | 37 |
| 2009 | 37 |
| 2010 | 37 |
| Thereafter | 771 |
| Total future minimum lease payments | $ 985 |

**Purchase Obligations —** The Company has obligations to purchase raw materials for use in its manufacturing operations. The Company has the right to make changes in, among other things, purchase quantities, delivery schedules and order acceptance.

**Product Liability —** The Company is self-insured for product liability risk. "Product liability" is an insurance industry term for the cost of legal defense and possible damages awarded as a result of use of a company's product during a procedure that results in an injury of a patient. The Company maintains a reserve for product liability litigation and damages consistent with its previous long-term experience. Actual product liability litigation costs and damages during the last three reporting years have been immaterial which is consistent with the Company's overall history.

The Company absorbs the costs of clinical training and trouble-shooting in its on-going operating expenses.

**Warranty Reserve —** UTMD maintains a warranty reserve to provide for estimated costs which are likely to occur. The amount of this reserve is adjusted, as required, to reflect its historical experience. The following table summarizes changes to UTMD's warranty reserve during 2005:

| | |
|---|---|
| Beginning balance, January 1, 2005 | $ 60 |
| Changes in warranty reserve during 2005: | |
| Aggregate reductions for warranty repairs | (3) |
| Aggregate changes for warranties issued during reporting period | 21 |
| Aggregate changes in reserve related to preexisting warranties | (18) |
| Ending balance, December 31, 2005 | $ 60 |

**Litigation —** The Company has been involved in lawsuits which are an expected consequence of its operations and in the ordinary course of business. There are no such lawsuits currently pending. The Company applies its accounting policy to accrue legal costs that can be reasonably estimated. The significant decrease in the litigation reserve during 2005, from $1,260 to $125 reflects the conclusion of the FDA lawsuit.

**Irish Development Agency —** In order to satisfy requirements of the Irish Development Agency in assisting the start-up of its Ireland subsidiary, the Company agreed to invest certain amounts and maintain a certain capital structure in its Ireland subsidiary. The effect of these financial relationships and commitments are reflected in the consolidated financial statements and do not represent any significant credit risk that would affect future liquidity.

## NOTE 7. Income Taxes

Deferred tax assets (liabilities) consist of the following temporary differences:

| | December 31 | | | |
|---|---|---|---|---|
| | 2005 | | 2004 | |
| | Current | Long-term | Current | Long-term |
| Inventory write-downs and differences due to UNICAP | $ 84 | $ — | $ 73 | $ — |
| Allowance for doubtful accounts | 28 | — | 30 | — |
| Accrued liabilities and reserves | 290 | (63) | 641 | 23 |
| Other | — | (53) | 6 | 70 |
| Depreciation and amortization | — | (89) | — | 161 |
| Unrealized investment gains | — | (70) | — | (112) |
| Earnings from subsidiary | — | — | — | (911) |
| Deferred income taxes, net | $ 402 | $ (274) | $ 750 | $ (769) |

The components of income tax expense are as follows:

| | Years ended December 31, | | |
|---|---|---|---|
| | 2005 | 2004 | 2003 |
| Current | $ 2,519 | $ 5,822 | $ 13,138 |
| Deferred | 148 | 75 | (47) |
| Total | $ 2,667 | $ 5,897 | $ 13,091 |

Income tax expense differed from amounts computed by applying the statutory federal rate to pretax income as follows:

| | Years ended December 31, | | |
|---|---|---|---|
| | 2005 | 2004 | 2003 |
| Federal income tax expense at the statutory rate | $ 3,473 | $ 5,480 | $ 11,510 |
| State income taxes | 337 | 806 | 1,693 |
| ETI, foreign sales corporation and tax credits | (172) | (164) | (68) |
| Reversal of deferred tax for foreign subsidiary earnings, net of repatriation tax | (434) | — | — |
| Other | (537) | (225) | (44) |
| Total | $ 2,667 | $ 5,897 | $ 13,091 |

## NOTE 8. Options

The Company has stock option plans which authorize the grant of stock options to eligible employees, directors and other individuals to purchase up to an aggregate of 895,208 shares of common stock, of which 548,621 are outstanding as of December 31, 2005. All options granted under the plans are granted at current market value at date of grant, and may be exercised between six months and ten years following the date of grant. The plans are intended to advance the interest of the Company by attracting and ensuring retention of competent directors, employees and executive personnel, and to provide incentives to those individuals to devote their utmost efforts to the advancement of the Company. Changes in stock options were as follows:

| | Shares | Price Range Per Share | | |
|---|---|---|---|---|
| **2005** | | | | |
| Granted | 27,900 | $ 21.68 | — | $ 21.68 |
| Expired or canceled | 27,672 | 9.13 | — | 25.59 |
| Exercised | 207,133 | 6.50 | — | 25.59 |
| Total outstanding at December 31 | 548,621 | 6.50 | — | 25.59 |
| Total exercisable at December 31 | 491,070 | 6.50 | — | 25.59 |
| **2004** | | | | |
| Granted | 164,100 | $ 18.00 | — | $ 25.59 |
| Expired or canceled | 44,767 | 6.75 | — | 25.59 |
| Exercised | 122,908 | 6.50 | — | 17.71 |
| Total outstanding at December 31 | 755,526 | 6.50 | — | 25.59 |
| Total exercisable at December 31 | 554,727 | 6.50 | — | 24.02 |
| **2003** | | | | |
| Granted | 82,200 | $ 17.71 | — | $ 24.02 |
| Expired or canceled | 12,562 | 6.75 | — | 17.71 |
| Exercised | 298,852 | 6.50 | — | 15.01 |
| Total outstanding at December 31 | 759,101 | 6.50 | — | 24.02 |
| Total exercisable at December 31 | 625,859 | 6.50 | — | 14.60 |

For the years ended December 31, 2005, 2004 and 2003, the Company reduced current income taxes payable and increased additional paid-in capital by $936, $446 and $1,108, respectively, for the income tax benefit attributable to sale by optionees of common stock received upon the exercise of stock options.

**Stock-Based Compensation —** The Company has adopted the disclosure-only provisions of SFAS No. 123, "Accounting for Stock-Based Compensation," as described in note 1.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

| | Years ended December 31, 2005 | 2004 | 2003 |
|---|---|---|---|
| Expected dividend yield | 2.9% | 0.7% | — |
| Expected stock price volatility | 39.7% | 39.0% | 40.5% |
| Risk-free interest rate (weighted average) | 4.1% | 3.7% | 3.5% |
| Expected life of options | 5.1 years | 6.2 years | 5.9 years |

The per-share weighted average fair value of options granted during 2005, 2004 and 2003 is $6.88, $10.07 and $8.89, respectively.

The following table summarizes information about stock options outstanding at December 31, 2005:

| | Options Outstanding | | | Options Exercisable | |
|---|---|---|---|---|---|
| Range of Exercise Prices | Number Outstanding | Weighted Average Remaining Contractual Life (Years) | Weighted Average Exercise Price | Number Exercisable | Weighted Average Exercise Price |
| $ 6.50 – 7.25 | 209,686 | 2.63 | $ 6.87 | 209,686 | $ 6.87 |
| 9.125 – 15.01 | 145,799 | 2.62 | 12.00 | 140,767 | 11.89 |
| 17.71 – 25.59 | 193,136 | 8.18 | 22.93 | 140,617 | 24.19 |
| $ 6.50 – 25.59 | 548,621 | 4.58 | $ 13.89 | 491,079 | $ 13.27 |

## NOTE 9. Geographic Sales Information

The Company had sales in the following geographic areas:

| Year | United States | Europe | Other |
|---|---|---|---|
| 2005 | $ 21,301 | $ 3,501 | $ 2,890 |
| 2004 | 20,452 | 3,639 | 2,394 |
| 2003 | 21,266 | 3,376 | 2,495 |

## NOTE 10. Revenues by Product Category

The Company had revenues in the following product categories:

| Product Category | 2005 | 2004 | 2003 |
|---|---|---|---|
| Obstetrics | $ 9,774 | $ 10,918 | $ 11,435 |
| Gynecology/Electrosurgery/Urology | 5,397 | 5,142 | 5,324 |
| Neonatal | 6,475 | 4,134 | 4,142 |
| Blood Pressure Monitoring and Accessories | 6,046 | 6,292 | 6,236 |

### NOTE 11. Other Operating Income

In January 2004, the Company received a payment of $30,944 in damages and interest resulting from a 2002 District Federal Court judgment and ensuing post judgment settlement relating to Tyco/Kendall•LTP's patent infringement. The Company recognized other operating income from that payment of $6,060 in first quarter 2004 and $23,992 in fourth quarter 2003. Related expenses of $892 reduced the amount recognized in 2003 from $24,884.

### NOTE 12. Product Sale and Purchase Commitments

The Company has license agreements for the rights to develop and market certain products or technologies owned by unrelated parties. The confidential terms of such agreements are unique and varied, depending on many factors relating to the value and stage of development of the technology licensed. Royalties on future product sales are a normal component of such agreements and are included in the Company's cost of goods sold on an ongoing basis.

The Company has in the past received and continues to receive royalties as a result of license agreements with unrelated companies that allow exclusive or nonexclusive rights to the Company's technology.

### NOTE 13. Employee Benefit Plan

The Company has a contributory 401(k) savings plan for employees, who are at least 21 years of age, work 30 hours or more each week, and have a minimum of one year of service with the Company. The Company's contribution is determined annually by the board of directors. Company contributions were approximately $92, $92 and $95 for the years ended December 31, 2005, 2004 and 2003, respectively.

### NOTE 14. Fair Value Financial Instruments

None of the Company's financial instruments, which are current assets and liabilities that could be readily traded, are held for trading purposes, except investments. Detail on investments is provided in note 3. The Company estimates that the fair value of all financial instruments at December 31, 2005, does not differ materially from the aggregate carrying value of its financial instruments recorded in the accompanying consolidated balance sheet.

### NOTE 15. Recent Accounting Pronouncements

In December 2004, the FASB issued SFAS 123 (revised 2004), "Accounting for Stock-Based Compensation." This statement supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees." This revised statement establishes standards for the accounting of transactions in which an entity exchanges its equity instruments for goods and services, including the grant of stock options to employees and directors. The statement is effective for periods beginning after December 15, 2005, and will require the Company to recognize compensation cost based on the grant date fair value of the equity instruments it awards. The Company currently accounts for those instruments under the recognition and measurement principles of APB Opinion 25, including the disclosure-only provisions of the original SFAS 123. Accordingly, no compensation cost from issuing equity instruments has been recognized in the Company's financial statements. The Company estimates that the required adoption of SFAS 123 (R) in first quarter 2006 will have a negative impact on its consolidated financial statements. Please see note 1 for an estimate of the impact this statement would have had on the Company's net income for the periods covered by this report. The Company estimates that adoption of this Statement will result in about $130 additional compensation expense during the year 2006 related to options outstanding on the date of this report. The Company intends to continue granting stock options or other equity instruments, although at a lower level than in the past, which will increase the amount of stock-based compensation in 2006 and beyond. The Board of Director's action on May 6, 2005 to accelerate the vesting of underwater options reduced the financial statement impact of this accounting policy change.

## Management's Report on Internal Control Over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934. The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America ("GAAP"). The Company's internal control over financial reporting includes those policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with GAAP, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

As required by Section 404 of the Sarbanes-Oxley Act of 2002, management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2005. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control-Integrated Framework.*

Based on our assessment and those criteria, management believes that the Company maintained effective internal control over financial reporting as of December 31, 2005.

The Company's independent registered public accounting firm, Jones Simkins, P.C., has audited management's assessment of the Company's internal control over financial reporting as of December 31, 2005, and their report is shown on page 24.

**Kevin L. Cornwell**
*Chief Executive Officer*

**Greg A. LeClaire**
*Chief Financial Officer*

## Report of Independent Registered Public Accounting Firm

We have audited management's assessment, included in the accompanying report titled *Management's Report on Internal Control Over Financial Reporting,* that Utah Medical Products, Inc. maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in *Internal Control-Integrated Framework* issued by the *Committee of Sponsoring Organizations of the Treadway Commission (COSO).* Utah Medical Products, Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Utah Medical Products, Inc. maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on criteria established in *Internal Control-Integrated Framework* issued by the *Committee of Sponsoring Organizations of the Treadway Commission (COSO).* Also in our opinion, Utah Medical Products, Inc. maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005 based on criteria established in *Internal Control-Integrated Framework* issued by the *Committee of Sponsoring Organizations of the Treadway Commission (COSO).*

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the December 31, 2005 consolidated balance sheets and the related consolidated statements of income and comprehensive income, stockholders' equity and cash flows of Utah Medical Products, Inc., and our report dated January 17, 2006 expressed an unqualified opinion.

Jones Simkins, P.C.

**Jones Simkins, P.C.**
*Logan, Utah*
*January 17, 2006*

# Corporate Information

## Forward-looking Information

*This report contains certain forward-looking statements and information relating to the Company that are based on the beliefs of management as well as assumptions made by management based on information currently available. When used in this document, the words "anticipate," "believe," "project," "estimate," "expect," "intend" and similar expressions, as they relate to the Company or its management, are intended to identify forward-looking statements. Such statements reflect the current view of the Company respecting future events and are subject to certain risks, uncertainties and assumptions, including the risks and uncertainties stated throughout the document. Although the Company has attempted to identify important factors that could cause actual results to differ materially, there may be other factors that cause the forward statement not to come true as anticipated, believed, projected, expected or intended. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may differ materially from those described herein as anticipated, believed, projected, estimated, expected or intended.*

*General risk factors that may impact the Company's revenues include: the market acceptance of competitive products; administrative practices of group purchasing organizations; obsolescence caused by new technologies; the possible introduction by competitors of new products that claim to have many of the advantages of UTMD's products at lower prices; the timing and market acceptance of UTMD's own new product introductions; UTMD's ability to efficiently and responsively manufacture its products, including the possible effects of lack of performance of suppliers; success in gaining access to important global distribution channels; budgetary constraints; the timing of regulatory approvals for newly introduced products; regulatory intervention in current operations; and third party reimbursement of healthcare costs of customers.*

*Risk factors, in addition to the risks outlined in the previous paragraph and elsewhere in this report that may impact the Company's assets and liabilities, as well as cash flows, include: risks inherent to companies manufacturing products used in healthcare, including claims resulting from the improper use of devices and other product liability claims; defense of the Company's intellectual property; productive use of assets in generating revenues; management of working capital, including inventory levels required to meet delivery commitments at a minimum cost; and timely collection of accounts receivable.*

*Additional risk factors that may affect non-operating income include: the continuing viability of the Company's technology license agreements; actual cash and investment balances; asset dispositions; and acquisition activities that may require external funding.*

## Board of Directors

**Kevin L. Cornwell**
*Chairman and CEO*

**Stephen W. Bennett, M.D., Dr. P.H.**
*Retired Senior Healthcare Analyst*
*G. T. Management Ltd.*

**Ernst G. Hoyer**
*Retired, General Manager*
*Petersen Precision Engineering Co.*

**Barbara A. Payne, Ph.D.**
*Retired Consultant*

**Paul O. Richins**
*Chief Administrative Officer*

## Officers

**Kevin L. Cornwell**
*President and Secretary*

**Marcena H. Clawson**
*Vice President, Materials*

**Greg A. LeClaire**
*Chief Financial Officer, VP*

**Paul O. Richins**
*Chief Administrative Officer, VP*

**Ben D. Shirley**
*Vice President,*
*Product Development*
*and Quality Assurance*

**Jean P. Teasdale**
*Vice President, Manufacturing*

## Investor Information

### CORPORATE HEADQUARTERS

**Utah Medical Products, Inc.**
7043 South 300 West
Midvale, Utah 84047

### FOREIGN OPERATIONS

**Utah Medical Products Ltd.**
Athlone Business & Technology Park
Dublin Road
Athlone, County Westmeath
Ireland

### TRANSFER AGENT

**Registrar and Transfer Company**
10 Commerce Street
Cranford, New Jersey 07016

### AUDITORS

**Jones Simkins, P.C.**
Logan, Utah

### CORPORATE COUNSEL

**Kruse, Landa, Maycock & Ricks, L.L.C.**
Salt Lake City, Utah

**Arthur Cox, Solicitors**
Dublin, Ireland

## Corporate Stock

The Company's common stock trades on the Nasdaq Stock Market (symbol: UTMD). The following table sets forth the high and low sales price information as reported by Nasdaq for the periods indicated.

UTMD™ NASDAQ LISTED

| | 2005 | | 2004 | |
|---|---|---|---|---|
| | High | Low | High | Low |
| First Quarter | $ 22.80 | $ 20.06 | $ 26.45 | $ 23.52 |
| Second Quarter | 23.50 | 20.20 | 27.19 | 23.80 |
| Third Quarter | 24.88 | 22.80 | 27.00 | 16.02 |
| Fourth Quarter | 32.80 | 24.50 | 23.45 | 17.50 |

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