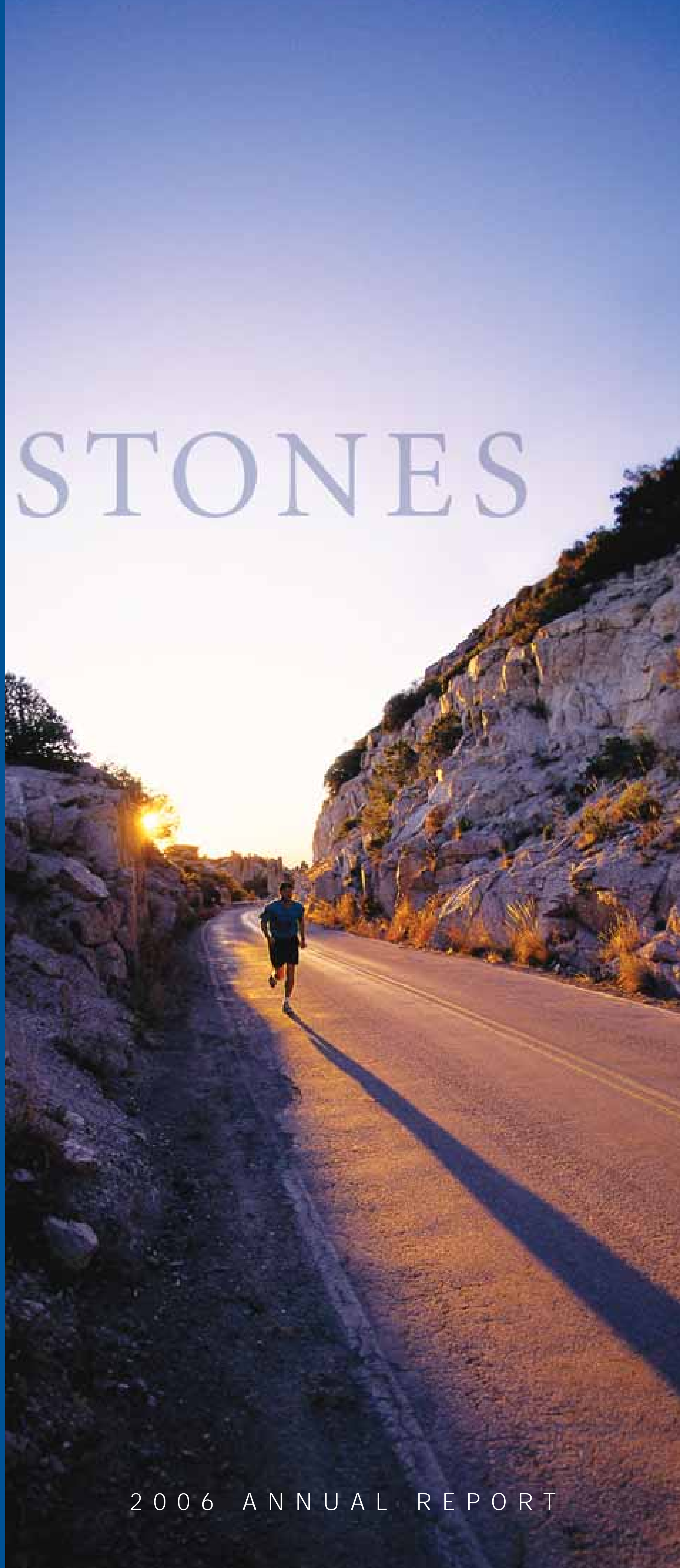
RESPIRONICS®

MILESTONES



2006 ANNUAL REPORT

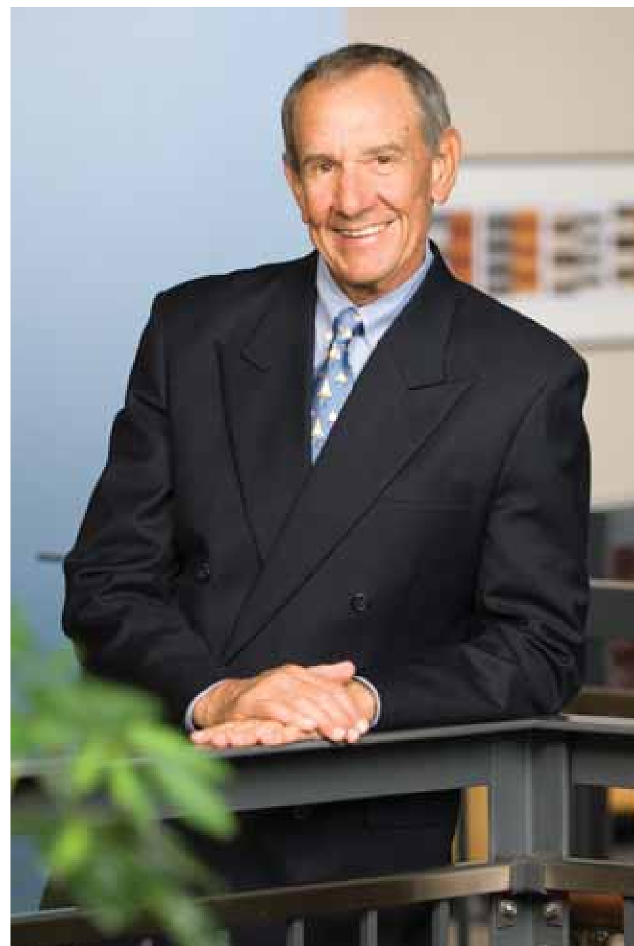
OUR VISION

To be the worldwide leader at anticipating needs and providing valued solutions
to the sleep and respiratory markets.

CORPORATE STATEMENT

Respironics is the leading developer, manufacturer, and distributor of innovative products and programs that serve the global sleep and respiratory markets. Focusing on emerging market needs, the Company is committed to providing valued solutions to help improve outcomes for patients, clinicians and healthcare providers. Respironics markets its products in 131 countries and employs more than 4,700 associates worldwide.

From the Chairman and Founder



This year, Respironics is observing its 30th Anniversary. It is fitting that in this significant year Respironics also realized another significant milestone by exceeding $1 billion in annual revenue. Both achievements reflect the strength of our Company's vision and the dedication of its people.

At Respironics, we believe that we exist as a public corporation to satisfy our shareholders in the long run. We accomplish this by assuring that our employees are motivated, rewarded, and fulfilled by anticipating and satisfying our customers' needs, and that our Company behaves as a good neighbor in the communities in which we operate. The proof that our rationale works is apparent in the results. Those of you who invested in our IPO in 1988 have seen a 50:1 increase in your stock value, better than 25 percent compounded annual return.

Accomplishing that kind of performance over the last three decades, Respironics has faced many challenges, but the people of this Company remained optimistic and never lost their focus. Their sense of conviction and the importance they place on making a difference in other people's lives is what makes Respironics act very young—like an energetic startup company, even as the first generation of its people have long lost their physical youth.

Thirty years ago, there were just a few of us at Respironics. Today, 4,700 Respironics associates speak many different languages and are scattered in countries around the globe. We are reaching out to more people than ever before, and are making a difference in the lives of sleep and respiratory patients with our advanced technologies and strong customer relationships.

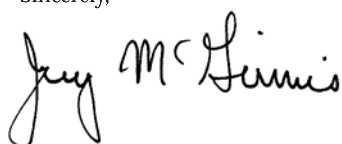
Early on, there were days when meeting the next payroll was the main milestone that we considered. Now, we have seen more fulfilling ones reached, like: profitability, going public, $50 million in sales, then $250 million in sales, and now $1,000,000,000. With every achievement we attain, we see greater opportunities to help our customers and their patients. Our desire to solve medical care problems has resulted in numerous solutions for healthcare providers to use, and we can readily observe the number of lives saved, and the improvement in the quality of life for millions of patients all over the world.

Very satisfying, indeed, for shareholders and employees alike.

I congratulate and thank all our associates on the milestones that they achieved in this last fiscal year. I'm happy that you can go home after your work day enjoying the satisfaction that you really matter in this crazy world of ours, that you have done a good job, and that you are the key to achieving these milestones. That kind of feeling is what keeps us doing our thing—satisfying our customers and our shareholders.

To our shareholders, the Board of Directors believes that, thanks to our dedicated management and employees, we can continue our consistent growth in the coming years. I appreciate and thank you for your continued support of Respironics.

Sincerely,



Gerald E. McGinnis
Advanced Technology Officer and Chairman of the Board

From the President and CEO

Thirty years of providing solutions that have helped thousands of people. One billion dollars in revenues that reflects three decades of growth and innovation. These two significant milestones mark Fiscal Year 2006 for Respironics.

For 27 consecutive quarters, the Company has met or exceeded its financial expectations, with net sales up 15 percent for the fiscal year. Consistency in financial performance, continued focus on anticipating market needs, and most importantly, strong adherence to our strategic plan have helped to achieve these record results.

The sound principles of Respironics' strategic plan continue to guide the Company. We continue to invest in our organization through acquisitions, joint ventures and aggressive R&D efforts. We remain committed to bringing our investors consistent and dependable growth. And, we are poised to address customer needs with the increased agility inherent in our decentralized business structure.

Leadership in our core business of obstructive sleep apnea, the evolution of our home respiratory business through acquisition and growth, advancements in Respironics' Total Ventilation Solutions℠ technologies, and progress in international expansion fueled Respironics' financial success in Fiscal Year 2006. In addition, the aggressive development of potential markets beyond these core drivers continues to broaden the scope of our business into exciting new areas of opportunity.

Three areas of future growth remain Children's Medical Ventures, Respiratory Drug Delivery and the emerging Sleep Well Ventures business. 'White space' potential—the identification and development of uncultivated business opportunities—in these areas is promising, and we are making steady strides in anticipating solutions outside of our traditional obstructive sleep apnea and chronic obstructive respiratory disease markets. We will continue to invest in these areas and view these endeavors as drivers for on-going success, helping to broaden the scope of our business.

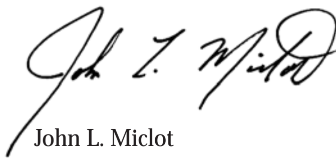
Respironics' innovative solutions and continued R&D investments set the pace for the industry. In the homecare setting, the acceptance of the new REMstar® M Series with C-Flex™ has helped to advance revenues in the sleep-disordered breathing market. Answering customer requests for more patient-friendly products, Respironics' M Series is small, easy-to-use and more life-style oriented. Combined with the latest addition to the Comfort Series™ of masks, ComfortLite™ 2, Respironics continues to meet customers' needs.

In the hospital setting, our Total Ventilation Solutions program provides clinicians more efficient and cost-effective strategies for managing their patients. The newly developed Cadence™ Self-Breathing Technology differs from competitive products by delivering oxygen-enriched, heated and humidified gas to prolonged mechanical ventilator patients for greater patient mobility. BiPAP® Focus™ with Auto-Trak™ Sensitivity is the latest noninvasive ventilator in the suite of Total Ventilation Solutions that offers bi-level therapy to patients with respiratory insufficiency or failure, and also to patients with OSA. For in-home respiratory care, the acquisition of OxyTec Medical Corporation and its portable oxygen product for more ambulatory patients significantly strengthens Respironics' home oxygen portfolio.

While we proudly celebrate the milestones achieved in Fiscal Year 2006, we are keenly aware of the new opportunities, challenges and responsibilities that accompany this success. Going forward, we will continue to draw upon our Company's spirit of innovation and our global strength to advance Respironics' solutions to broader audiences. We will continue to execute our clear, long-term strategy in order to increase shareholder value, and to leverage our core capabilities to achieve consistent growth and results.

I would like to thank all of our shareholders for their sustained loyalty and confidence in Respironics. I would also like to extend my appreciation to our associates who have helped to build a culture of accomplishment, commitment and pride that continues to flourish throughout our organization. The milestones that we have achieved, and those to come in our future, are due to the hard work and dedication of Respironics' global team of associates.

Sincerely,



John L. Miclot
President and Chief Executive Officer

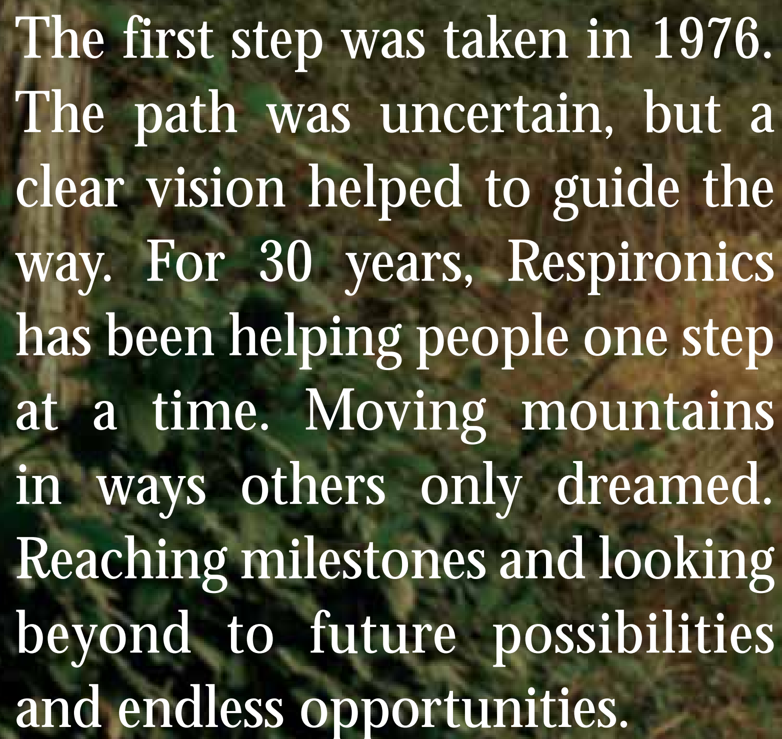
LEFT TO RIGHT:

Craig B. Reynolds
Executive Vice President and
Chief Operating Officer

Gerald E. McGinnis
Advanced Technology Officer
and Chairman of the Board

John L. Miclot
President and
Chief Executive Officer

Daniel J. Bevevino
Vice President and
Chief Financial Officer



The first step was taken in 1976. The path was uncertain, but a clear vision helped to guide the way. For 30 years, Respironics has been helping people one step at a time. Moving mountains in ways others only dreamed. Reaching milestones and looking beyond to future possibilities and endless opportunities.

Sleep and Home Respiratory Group

Sleep-Disordered Breathing • Home Respiratory Care • Sleep Well Ventures

Respironics' Sleep and Home Respiratory Group focuses on developing innovative solutions to help diagnose, treat and monitor patients in the home who suffer from sleep disorders or respiratory illnesses. Working with homecare providers, clinicians and sleep labs, the Company offers products that can assist patients throughout the continuum of care—from the onset of symptoms through compliant treatment, and ultimately, to an improved quality of life.

Since bringing the first Continuous Positive Airway Pressure (CPAP) machine to market, the Company has introduced numerous innovations to help diagnose and treat the millions of people who suffer from sleep disorders. The Alice® 5 Sleep Diagnostic System continues to gain worldwide recognition for its inclusive capabilities. Alice 5 helps to facilitate a more efficient process for sleep lab technicians and generates more comprehensive data for analysis.

This year's launch of the Respironics M Series changed the competitive landscape in sleep therapy by presenting patients with a smaller, sleeker CPAP option rich in features and convenient for travel. The product is designed to enhance a patient's acceptance of therapy, increase comfort, and improve treatment results. Respironics' M Series devices along with the Company's revolutionary C-Flex™ technology, offer healthcare professionals and homecare providers a variety of sophisticated solutions for patients with Obstructive Sleep Apnea (OSA). By combining these advanced technology flow generators with improved patient interface devices such as the ComfortLite™ 2 and other Comfort Series™ masks, Respironics is making therapy more comfortable, more convenient and more customer focused.

Sleep and Home Respiratory Group Milestones

REMstar® M Series with C-Flex revolutionizes the CPAP therapy market with more patient-friendly features and a smaller design for easy travel.

1985

Respironics commercializes the world's first Continuous Positive Airway Pressure (CPAP) therapy system for sleep apnea.

1989

Respironics releases the world's first Bi-Level Continuous Positive Airway Pressure (BiPAP®) device.

2002

The Company introduces C-Flex™ — a revolutionary technology clinically proven for comfortable CPAP therapy.

2004

The Company forms Sleep Well Ventures to broaden its presence in the sleep market beyond OSA to help millions of problem sleepers.

2005

Alice® 5 Sleep Diagnostics System is introduced worldwide.

2006

The Company acquires OxyTec Medical Corporation and its portable oxygen concentrator technology.

Respironics introduces the new M Series line of sleep therapy devices.

Global Sleep Therapy Revenue

Sleep and Home Respiratory Group

The Company's position in the respiratory market continues to expand with ongoing investments in the Home Respiratory Care business. The Company's strategic direction focuses the business on improving existing respiratory products while developing emerging technologies through acquisition and a rich R&D pipeline. Acquisitions and organic growth have strengthened the Company's oxygen portfolio, helping to broaden the scope of respiratory solutions to include products that offer increased mobility and flexible therapeutic care. Respironics will continue to invest resources in the respiratory homecare area in order to provide comprehensive, cost-effective solutions to manage home respiratory patients.

While Respironics continues to leverage its leadership position in treating OSA and solutions for chronic respiratory problems, the Company is moving beyond its two traditional core markets to help people who experience other sleep disorders. There are more than 80 known sleep disorders. Through Sleep Well Ventures, the Company is aggressive in its efforts to identify solutions for "problem sleepers" who suffer from nonrespiratory sleep problems such as insomnia, circadian rhythm disorders, and sleep-related movement disorders such as restless legs syndrome. Products like the Actiwatch® family of devices position Respironics to help the millions of problem sleepers who suffer from conditions beyond OSA. The Actiwatch device uniquely enables clinicians and researchers to objectively assess the nature of a patient's sleep disorder and the efficacy of therapies.

A long history of innovation, a deep understanding of the sleep and respiratory markets, and an appreciation of its customers' needs, positions Respironics for continued leadership in the sleep and respiratory markets.

Respironics M Series is a complete line of sleep devices that provides a range of therapy options – from conventional CPAP to auto bi-level – all in a small, sleek, easy-to-use design that fits patients' lifestyles.

Hospital Group

Critical Care • Children's Medical Ventures • Respiratory Drug Delivery

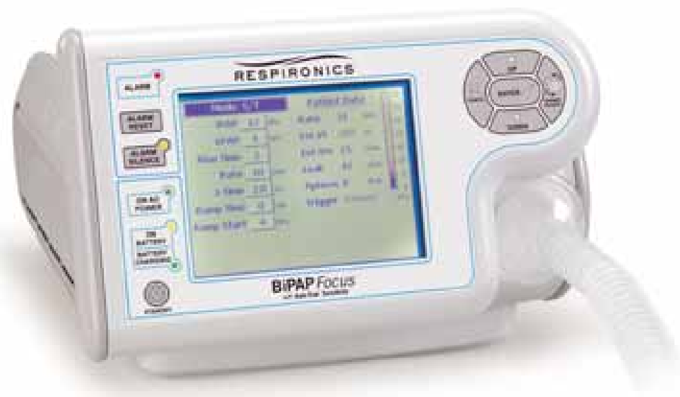
Respironics' Hospital Group provides a range of respiratory, monitoring and developmental care solutions for treating patients in a variety of medical environments. From pre-hospital admission and Neonatal Intensive Care Units (NICUs), to long-term treatment in multi-level hospital facilities and the home, the Company's products are designed for a continuum of care.

Through its three businesses—Critical Care, Respiratory Drug Delivery and Children's Medical Ventures—the Hospital Group interacts with a variety of medical professionals and touches upon the needs of patients of all ages and in various stages of treatment. The Group offers comprehensive, and cost-effective solutions to help facilitate positive, long-term outcomes, and understands the main concerns facing practitioners in the critical care environment.

Respironics' Total Ventilation Solutions℠ is a unique platform designed to help clinicians assess, treat, monitor and manage respiratory patients. Through the Total Ventilation Solutions program, healthcare providers have a diverse portfolio of invasive and noninvasive ventilator options, patient interface products, accessories and patient monitoring technologies to help manage respiratory-impaired patients.

Hospital Group Milestones

Critical Care increases global hospital ventilation sales by 15% to $130 million.



BiPAP® Focus™ Noninvasive Bi-Level Ventilatory System is the latest addition to Respironics' continuum of noninvasive ventilation products for use in the hospital.

1989

Respironics offers the first noninvasive ventilatory support system as an alternative to traditional invasive ventilation.

1991

Children's Medical Ventures is founded to provide developmental care solutions in Neonatal Intensive Care Units (NICUs).

1999

The Food and Drug Administration (FDA) clears BiliChek® Noninvasive Bilirubin System for jaundice detection in infants.

2002

Respironics acquires Novametrix Medical Systems —a leading cardiorespiratory monitoring company.

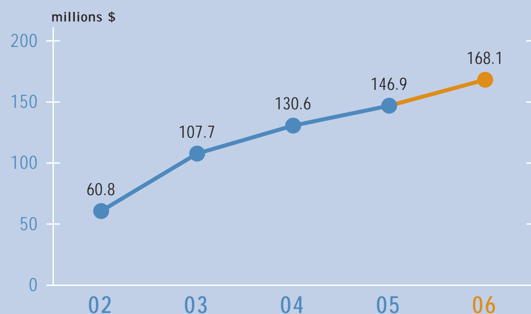
2004

The Company acquires Profile Therapeutics, plc—offering innovative technologies for respiratory drug delivery.

2005

The Company receives 510(k) clearance from the FDA for I-neb® in the United States to deliver Ventavis® for patients with pulmonary hypertension.*

* Ventavis® is a trademark of Schering AG.



Hospital Group

In the NICU environment, Children's Medical Ventures remains the leading provider of developmentally supportive products for premature babies and ill infants. With a focus on innovative technology and education, Children's Medical Ventures sets itself apart as a resource for practitioners and patients. Apnea monitors and recorders, diagnostic and treatment solutions for neonatal jaundice, and hands-on educational programs for neonatal nurses and parents are all designed to help assure the well-being of infants requiring special care.

The Respiratory Drug Delivery (RDD) business allows the Company to expand its presence in the respiratory market by exploring opportunities beyond the standard treatment for respiratory airway disorders. By building upon its proprietary Adaptive Aerosol Delivery® (AAD) technology and forging relationships that will further integrate this unique tool into other areas of therapy delivery, RDD is poised to be among the leaders in this promising market space. AAD helps to track a patient's breathing pattern to deliver optimal dosing with every breath, and helps to deliver medication directly to the respiratory airway—reducing waste of expensive drug therapies. The Company is leveraging this technology for the treatment of Cystic Fibrosis and Pulmonary Hypertension, and is exploring the application of AAD to treat other serious illnesses.

I-neb™ integrates Respironics' Adaptive Aerosol Delivery technology to help assure that patients receive the medication they need efficiently and effectively.

International Group

Respironics' International Group distributes the Company's sleep and respiratory solutions in 131 countries. With an appreciation for the diversity of the international markets it serves and an unwavering determination to develop and strengthen business relationships in each region, Respironics is committed to understanding each country's distinct business environment. This strategy has proven to be very successful, enabling Respironics to make solid advances in key international markets.

International expansion continues to be a fundamental element in Respironics' strategic plan. The Company remains dedicated to investing resources in its international infrastructure and sales channels to broaden the scope of its global reach. Measured investments in the form of acquisitions, affiliations and expansion of the Company's infrastructure have contributed to the Company's success in the international marketplace in recent years. International revenues now account for 31 percent of Respironics' total sales and global opportunities in both the sleep and respiratory markets remain promising.

In the future, the Company will continue its focus on expanding opportunities in the Western European and Asia Pacific regions as well as South America. Other less penetrated areas and less developed regions are also areas of focus for the Company. Numerous opportunities to increase awareness of sleep and respiratory disorders in these countries exist, and the potential for greater market penetration remains promising.

International Group Milestones

International revenues surpass $300 million accounting for more than 30% of Respironics' consolidated revenues.

1981

Respironics opens a manufacturing facility in Hong Kong to produce anesthesia masks due to demand.

1997

Respironics opens new European headquarters in France.

1999

The Company formally establishes International Group as part of the decentralized organizational structure.

2001

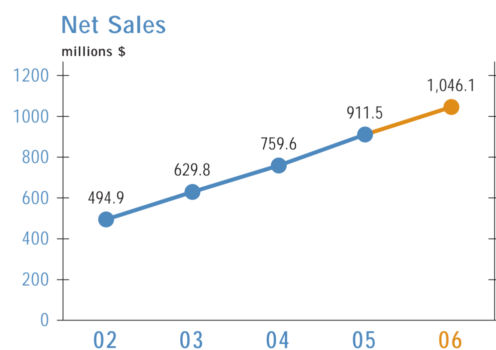
Respironics sponsors the creation of Sleep and Respiratory Academy of Japan to help train sleep laboratory technicians in an effort to improve the rate of OSA diagnosis in Japan.

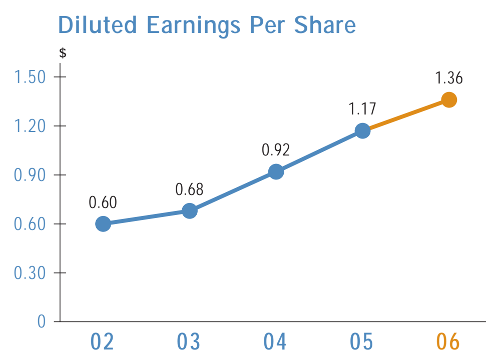
2002

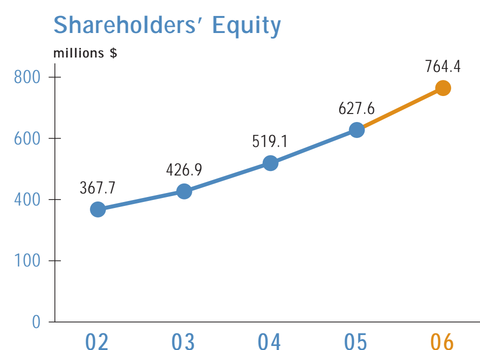
The Company acquires majority interest in Fuji RC Co. Ltd—the leading provider of homecare and hospital products and services for respiratory patients in Japan.

2006

The International Group distributes Respironics' products in 131 countries.







Financial Highlights

Year Ended June 30	2006	2005	2004	2003	2002
Net Sales	$ 1,046,141	$ 911,497	$ 759,550	$ 629,817	$ 494,919
Net Income	99,893 [1,2]	84,356 [3]	65,020 [4]	46,581 [5]	38,417 [6,7]
Diluted Earnings Per Share	1.36 [1,2]	1.17 [3]	0.92 [4]	0.68 [5]	0.60 [6,7]
Diluted Shares Outstanding	73,570	72,255	70,619	68,688	64,016
Working Capital	431,050	338,102	301,032	212,787	198,966
Long-term Obligations	26,756	29,241	26,897	16,513	59,502
Total Assets	1,017,378	878,446	711,139	582,196	550,911
Shareholders' Equity	764,448	627,646	519,053	426,869	367,720

[1] *Includes stock compensation expense pursuant to the adoption of FASB No. 123(R), "Share-Based Payment" on July 1, 2005. This expense reduced pre-tax income by $11,955, and net income by $8,524 ($0.12 per share) in fiscal year 2006.*

[2] *Includes a pre-tax gain of $4,398 as a result of the sale of the Company's investment in AirLogix. Also includes $3,953 of restructuring and acquisition-related expenses, primarily related to the closure of the Company's Galway, Ireland manufacturing facility, the integration of acquired companies (Profile and Mini-Mitter) and other costs. Collectively, these events increased net income by $445 (less than $0.01 per share) in fiscal year 2006.*

[3] *Includes the impact of restructuring and acquisition-related expenses related primarily to the restructuring of operations at the Wallingford, Connecticut manufacturing facility and the integration of Profile. These costs reduced pre-tax income by $6,415 and net income by $3,987 ($0.05 per share) in fiscal year 2005.*

[4] *Includes the impact of restructuring and acquisition-related expenses related primarily to the restructuring of operations at the Wallingford, Connecticut manufacturing facility. These costs reduced pre-tax income by $10,942, and $6,777 ($0.10 per share) in fiscal year 2004.*

[5] *Includes the impact of restructuring and acquisition-related expenses related to the integration of Novametrix Medical Systems Inc. "Novametrix" and restructuring of operations at the Kennesaw, Georgia and Wallingford, Connecticut manufacturing facilities, and other acquisition-related costs. These costs reduced pre-tax income by $18,144, and net income by $11,286 ($0.16 per share) in fiscal year 2003.*

[6] *Includes the impact of a non-recurring purchase accounting adjustment related to reversing acquisition date inventory fair market value adjustments as inventory was sold subsequent to the acquisition of Novametrix, restructuring and acquisition-related expenses related to the integration of Novametrix, and an asset impairment charge. These costs reduced pre-tax income by $5,947, and $3,853 ($0.06 per share) in fiscal year 2002.*

[7] *Includes goodwill amortization expense. These costs reduced pre-tax income by $3,507, and net income by $3,302 ($0.10 per share) in fiscal 2002. As of July 1, 2002 the Company ceased amortizing goodwill due to the adoption of FASB No. 142, "Goodwill and Other Intangible Assets."*

Executive Summary

The Company reported record financial results in fiscal year 2006, exceeding $1 billion in revenues. The year was marked by the Company's continued growth in the global OSA marketplace, the successful release of the new M Series family of CPAP products, the further acceptance and adoption of the Company's ventilation therapies in various geographic markets, and successful international expansion. The Company's strategy is to continue to grow these core drivers, while also broadening the scope of its products in the sleep and respiratory markets. In connection with this strategy, during 2006, the Company continued to invest and gain critical mass in Respiratory Drug Delivery, Children's Medical Ventures, and Sleep Well Ventures. Listed below are some of the individual measures of the Company's performance in 2006 and other significant highlights:

- The Company achieved 15% revenue growth in fiscal year 2006 compared to fiscal year 2005, led by global OSA growth of $89,880,000, or 18% (domestic – 17%; international – 19%). The Company's growth in OSA therapy products was achieved through the success of recent product introductions, including the M Series family of CPAP devices and new masks, and the Company's overall product breadth in OSA therapy, continued acceptance and recognition of C-Flex technology among patients and providers, strong sales channels with sleep labs, thought leaders, and homecare providers, strength of the sales force and the success of customer programs, and growth of the domestic sleep apnea therapy market (estimated to be approximately 15% – 20%). Overall global hospital ventilation growth was $16,915,000, or 15% compared to fiscal year 2005, as the Company's Esprit and Vision critical care ventilators continued to gain market acceptance. The Company's global Respiratory Drug Delivery revenue exceeded the $53,000,000 level during the 2006 fiscal year, representing 34% growth compared to the prior year. The primary geographic locations experiencing organic revenue increases were the U.S., Europe and the Far East/Asia Pacific, where the Company has made significant investments in sales force and marketing programs.
- The Company completed several business acquisitions during fiscal year 2006, enabling the Company to expand its presence in the oxygen market and Children's Medical Ventures by enhancing the breadth of products and services in these areas. Overall, $5,580,000 of incremental sales were contributed by acquired companies in fiscal year 2006, primarily from acquisitions made in the prior year. This represents less than 1% of the Company's sales growth.
- The Company achieved earnings of $1.36 per diluted share in fiscal year 2006, compared to $1.17 per diluted share in fiscal year 2005. The improved earnings were primarily driven by the 15% revenue growth described above. Fiscal year 2006 earnings also included stock compensation expense totaling $8,524,000 or $0.12 per diluted share after tax, pursuant to the Company's adoption of FASB No. 123(R).
- The Company spent approximately $58,966,000 on research and development activities in fiscal year 2006, which represents 6% of net sales. The Company introduced a number of new products across all major product groups, including the REMstar M Series sleep therapy device system; two new patient interface products, the ComfortFull 2 and ComfortLite 2; software enhancements for the Alice sleep diagnostic device; the international launch of the Synchrony II noninvasive ventilator and the Virtuox overnight oximetry testing software. New hospital products include the Cadence Breathing System; the LoFlo C5 Engine; software and functional enhancements were made to the Espirit ventilation system; international release of the Esprit – NICO interface; and the I-neb Adaptive Aerosol Delivery (AAD) System.
- During the 2006 fiscal year the Company contributed $1,500,000 to the Respironics Sleep and Respiratory Research Foundation (Foundation), which was formed for scientific, educational, and charitable purposes and is used to promote awareness of and research into the medical consequences of sleep and respiratory problems.
- On July 21, 2005, Centene Corporation (Centene) acquired AirLogix, Inc. (AirLogix) for approximately $35,000,000 in cash plus additional consideration of up to $5,000,000 based on the achievement of certain performance milestones. At the time of the sale, the Company held approximately 17% ownership in AirLogix. As a result of the sale, the Company received $5,488,000 of proceeds and recorded a pre-tax gain of $4,398,000.
- During the 2006 fiscal year, the Company incurred $3,953,000 of restructuring and acquisition-related expenses. This included costs associated with the integration of recently acquired companies. Additionally, in the fourth quarter of 2006, the Company announced the closure of its Galway, Ireland manufacturing facility. As a result of this closure the Company incurred $1,640,000 of restructuring and acquisition-related expenses. Products previously manufactured in Galway (including the NeoPAP and WhisperFlow) will be transferred to the Wallingford, Connecticut; Carlsbad, California; and Murrysville, Pennsylvania manufacturing facilities. The Company expects the transition to be complete by December 31, 2006.
- The Company adopted FASB No. 123(R) on July 1, 2005, which resulted in the recognition of stock compensation expenses in the consolidated statement of operations during the fiscal year ended June 30, 2006. The Company adopted FASB No. 123(R) using the modified prospective method; as such, prior period financial statements have not been restated. Stock-based compensation expenses for the year ended June 30, 2006 totaled $11,955,000 on a pre-tax basis ($8,524,000 after tax, or $0.12 per basic and diluted share).

- The Company generated $92,965,000 in cash from operations during the 2006 fiscal year. After spending $29,227,000 on the acquisitions of businesses, intangible assets, and strategic investments during the 2006 fiscal year, the Company added $30,719,000 to its cash, cash equivalents and short-term investments balance during the year. As of June 30, 2006, the Company has $265,351,000 of cash, cash equivalents, and short-term investments and $148,735,000 in borrowing capacity under its Revolving Credit Agreement available for future expansion.

Results of Operations

Fiscal Year Ended June 30, 2006, Compared to Fiscal Year Ended June 30, 2005:

Year Ended June 30	2006	2005	Percent Increase (Decrease)
Net sales	$ 1,046,140,962	$ 911,496,811	15%
Cost of goods sold	473,263,286	413,214,533	15%
	572,877,676	498,282,278	15%
General and administrative expenses			
(excluding acquisition earn-out expenses)	149,484,784	123,040,210	21%
Acquisition earn-out expenses	2,934,571	3,492,699	(16%)
Sales, marketing and commission expenses	206,433,281	182,796,568	13%
Research and development expenses	58,966,164	45,625,059	29%
Contribution to foundation	1,500,000	3,000,000	(50%)
Restructuring and acquisition-related expenses	3,953,312	6,415,363	(38%)
Other income	(9,616,528)	(1,806,475)	
	413,655,584	362,563,424	14%
Income Before Income Taxes	**159,222,092**	135,718,854	17%
Income taxes	59,328,706	51,362,800	16%
Net Income	**$ 99,893,386**	$ 84,356,054	18%
Diluted earnings per share	**$ 1.36**	$ 1.17	16%
Diluted shares outstanding	73,570,239	72,254,509	

Net Sales

Net sales for the year ended June 30, 2006 were $1,046,141,000, representing a 15% increase over sales of $911,497,000 recorded for the year ended June 30, 2005. The Company's sales growth occurred across all product groups, summarized as follows:

Year Ended June 30	2006		2005		Dollar Increase	Percent Increase
Domestic Sleep and Home Respiratory Products	$ 535,654,000	51%	$ 463,073,000	51%	72,581,000	16%
Domestic Hospital Products	189,128,000	18%	162,138,000	18%	26,990,000	17%
International Products	321,359,000	31%	286,286,000	31%	35,073,000	12%
Total	**$ 1,046,141,000**	**100%**	$ 911,497,000	100%	134,644,000	15%

The Company's core growth drivers—devices for the diagnosis and treatment of OSA, total ventilation solutions aimed at the range of ventilator-assisted patients and international expansion—as well as other emerging product lines, including Respiratory Drug Delivery and Children's Medical Ventures—led the Company's year-over-year growth during the year ended June 30, 2006. Changes in foreign currency exchange rates reduced revenues by $7,941,000 (1%) during the year ended June 30, 2006 compared to the prior year. Revenues from acquired businesses contributed $5,580,000 (less than 1%) of revenues during the fiscal year ended June 30, 2006. On July 1, 2005, the Company changed the reporting classification of certain product revenues within the Sleep and Home Respiratory, Hospital, and International product categories. These changes are reflected in the table above and the following discussion for all periods presented.

The Company's domestic Sleep and Home Respiratory revenue gains during the year ended June 30, 2006 were led by year-over-year increases of $66,520,000 (17%) in OSA (consisting of sleep therapy and sleep diagnostics products). The Company's growth in OSA was achieved through the Company's overall product breadth in OSA therapy, strong sales channels with thought leaders and homecare providers, and growth of the domestic OSA therapy market (estimated to be approximately 15% – 20%). The increase in sleep therapy revenues was achieved as the Company continued its transition to the new M Series platform of CPAP devices. The new CPAP series incorporates the Company's C-Flex technology, as well as auto-titrating capability in certain devices. The Company's Alice 5 Sleep Diagnostics System also continued to gain acceptance in sleep labs, posting a domestic year-over-year increase of $7,381,000 (63%) in the year ended June 30, 2006.

Sales of domestic Hospital products during the year ended June 30, 2006 increased by $26,990,000 (17%). Sales of domestic Critical Care products (consisting of ventilation therapy and cardiorespiratory monitoring products) increased by $14,241,000 (17%) during the year ended June 30, 2006. These gains were led by increased Vision and Esprit ventilator sales. Revenues from domestic Respiratory Drug Delivery products (consisting of traditional asthma and nebulizer products as well as advanced respiratory drug delivery systems) increased by $10,097,000 (40%) during the fiscal year ended June 30, 2006. These increases were largely driven by the success of the Company's I-neb Adaptive Aerosol Delivery System. Domestic Children's Medical Ventures product revenues (consisting of infant monitors, bilirubin devices, and developmental care products) increased by $2,652,000 (5%) during the year ended June 30, 2006.

The Company's international growth during the year ended June 30, 2006 included increased sales of both Sleep and Home Respiratory and Hospital products. The most significant increases were driven by OSA, which increased by $23,359,000 (19%) during the fiscal year ended June 30, 2006. International Hospital product sales increased by $10,948,000 (14%) for the year ended June 30, 2006. The increase was driven primarily by higher ventilation therapy and respiratory drug delivery product sales. The Company's international revenue growth occurred across many key markets, with Europe, Canada, the Far East/Asia Pacific, and South and Latin Americas all experiencing revenue increases.

Gross Profit

The Company's gross profit was 55% of net sales for the years ended June 30, 2006 and 2005. Gross profit percentage remained flat as the Company transitioned to the new M Series platform of CPAP devices in the last two quarters of fiscal year 2006. During this transition the Company continued to aggressively sell its legacy CPAP platform, sometimes at discounted prices, and has not yet reached peak manufacturing efficiency on the new M Series.

The margin pressure from the CPAP platform transition was partially offset by higher revenue, product sales mix and material cost reductions achieved through the Company's successful negotiations with suppliers and product design changes, resulting in the Company maintaining its gross profit at 55% of net sales.

General and Administrative Expenses (Excluding Acquisition Earn-out Expenses)

General and administrative expenses were $149,485,000 (14% of net sales) for the year ended June 30, 2006, compared to $123,040,000 (13% of net sales) for the year ended June 30, 2005. The dollar increases for the year ended June 30, 2006 were due primarily to stock-based compensation expenses as a result of the adoption of FASB No. 123(R); higher employee compensation consistent with the growth of the Company's business and the financial performance achieved during the fiscal year; and other expenses incurred consistent with the Company's growth, including warranty and business development expenses.

Acquisition Earn-out Expenses

During the years ended June 30, 2006 and 2005, the Company incurred acquisition earn-out expenses related to the Company's May 2002 acquisition of Fuji equal to $2,935,000 and $3,493,000 (less than 1% of net sales in both periods), respectively. See Note R to the Consolidated Financial Statements for additional information regarding the Fuji acquisition.

Sales, Marketing and Commission Expenses

Sales, marketing and commission expenses were $206,433,000 (20% of net sales) for the year ended June 30, 2006, compared to $182,797,000 (20% of net sales) for the year ended June 30, 2005. The dollar increases were driven by stock-based compensation expenses as a result of the adoption of FASB No. 123(R); higher variable sales force compensation, consistent with the increase in sales levels from the prior year; and the Company's continued investments in sales and marketing programs and sales force, especially in the international markets as well as related to the market release of M Series.

Research and Development Expenses

Research and development expenses were $58,966,000 (6% of net sales) compared to $45,625,000 (5% of net sales) for the prior year. The increase was due to the Company's continuing commitment to research, development and new product introductions. Significant product development efforts are ongoing and new product launches in certain of the Company's major product lines were made during the year and are scheduled over the next 18 months. Additional development work and clinical trials are being conducted in certain product areas within the sleep and respiratory markets outside the Company's current core products and patient groups.

Contribution to Foundation

During the years ended June 30, 2006 and 2005, respectively, the Company made contributions totaling $1,500,000 (less than 1% of net sales) and $3,000,000 (less than 1% of net sales) to the Foundation. The Foundation was formed for scientific, educational and charitable purposes and is used to promote awareness of and research into the medical consequences of sleep and respiratory problems.

Restructuring and Acquisition-Related Expenses

During the year ended June 30, 2006, the Company incurred restructuring and acquisition-related expenses of $3,953,000, related primarily to closure of its Galway, Ireland manufacturing facility ($1,640,000), the integration of acquired companies (Profile and Mini-Mitter $2,211,000), and other costs ($102,000). Current year expense related to the closure of the Galway, Ireland manufacturing facility is primarily comprised of employee termination benefits, lease termination costs, and grant money which must be refunded to local governmental agencies. It is anticipated that the closure of the Galway, Ireland manufacturing facility will result in future cost reductions and operational efficiencies. Products previously manufactured in Galway (including the NeoPAP and WhisperFlow) will be transitioned to the Wallingford, Connecticut; Carlsbad, California; and Murrysville, Pennsylvania manufacturing facilities. The Company expects the transition to be complete by December 31, 2006.

During the year ended June 30, 2005, the Company incurred restructuring and acquisition-related expenses of $6,415,000, related primarily to the restructuring of operations at the Wallingford, Connecticut manufacturing facility ($4,701,000) and the integration of recently acquired companies ($2,611,000), offset by a reduction to the reserve for idle facility lease obligation at the Kennesaw, Georgia manufacturing facility based on increased utilization ($897,000 credit).

See Note Q to the Consolidated Financial Statements for additional information regarding restructuring and acquisition-related expenses.

Other Income

Other income was ($9,617,000) for the year ended June 30, 2006 as compared to ($1,806,000) for the year ended June 30, 2005. Other income in the year ended June 30, 2006 includes a one-time gain of ($4,398,000) from the sale of a minority equity investment in AirLogix that is more fully described in Note S to the Consolidated Financial Statements. Other income in all periods presented is also comprised of net interest income and realized and unrealized foreign currency exchange (gains) losses, partially offset by recognized losses (gains) on designated cash flow hedges that are more fully described in Note J to the Consolidated Financial Statements.

Income Taxes

The Company's effective income tax rate was approximately 37% for the year ended June 30, 2006 compared to 38% for the year ended June 30, 2005, despite the current year adoption of FASB No. 123(R) that added 1% to the tax rate. The decrease in the Company's effective tax rate from the prior year was driven by income tax benefits associated with various on-going tax planning activities, primarily in the state and international tax areas. Additionally, in the prior year, the Company incurred additional income tax expense from the repatriation of foreign earnings that is more fully described in Note M to the Consolidated Financial Statements.

Except as disclosed in Note M to the Consolidated Financial Statements, the Company has not provided a valuation allowance for deferred income tax assets because it has determined that it is more likely than not that these assets can be realized, at a minimum, through carrybacks to prior years in which taxable income was generated.

Net Income

As a result of the factors described above, the Company's net income was $99,893,000 (10% of net sales) or $1.36 per diluted share for the year ended June 30, 2006 as compared to net income of $84,356,000 (9% of net sales) or $1.17 per diluted share for the year ended June 30, 2005. Stock-based compensation expenses from the Company's implementation of FASB No. 123(R) were $11,955,000 on a pre-tax basis, or $0.12 per basic and diluted share after tax for the year ended June 30, 2006. Additionally, restructuring and acquisition-related expenses totaled $3,953,000 on a pre-tax basis in fiscal year 2006, or approximately $0.03 per diluted share after tax, compared to $6,415,000 on a pre-tax basis, or approximately $0.05 per diluted share after tax in fiscal year 2005.

Fiscal Year Ended June 30, 2005, Compared to Fiscal Year Ended June 30, 2004:

Year Ended June 30	2005	2004	Percent Increase (Decrease)
Net sales	$ 911,496,811	$ 759,549,845	20%
Cost of goods sold	413,214,533	356,625,125	16%
	498,282,278	402,924,720	24%
General and administrative expenses			
(excluding acquisition earn-out expenses)	123,040,210	100,231,728	23%
Acquisition earn-out expenses	3,492,699	8,533,000	(59)%
Sales, marketing and commission expenses	182,796,568	147,739,729	24%
Research and development expenses	45,625,059	29,477,699	55%
Contribution to foundation	3,000,000	2,844,475	5%
Restructuring and acquisition-related expenses	6,415,363	10,942,352	(41)%
Other income	(1,806,475)	(2,078,417)	
	362,563,424	297,690,566	22%
Income Before Income Taxes	**135,718,854**	105,234,154	29%
Income taxes	51,362,800	40,214,309	28%
Net Income	**$ 84,356,054**	$ 65,019,845	30%
Diluted earnings per share	**$ 1.17**	$ 0.92	27%
Diluted shares outstanding	72,254,509	70,618,700	

Net Sales

Net sales for the year ended June 30, 2005 were $911,497,000 representing a 20% increase over sales of $759,550,000 recorded for the year ended June 30, 2004. The Company's sales growth occurred across all product groups, summarized as follows:

Year Ended June 30	2005		2004		Dollar Increase	Percent Increase
Domestic Sleep and Home Respiratory Products	$ 463,073,000	51%	$ 402,595,000	56%	60,478,000	15%
Domestic Hospital Products	162,138,000	18%	144,630,000	19%	17,508,000	12%
International Products	286,286,000	31%	212,325,000	25%	73,961,000	35%
Total	**$ 911,497,000**	**100%**	$ 759,550,000	100%	151,947,000	20%

Domestic Sleep and Home Respiratory product sales for the year ended June 30, 2005 were driven primarily by year-over-year increase totaling $64,620,000 (20%) in OSA. The Company's growth in OSA therapy products was achieved through the success of recent product introductions and the Company's overall product breadth in OSA therapy, continued acceptance and recognition of C-Flex technology among patients and providers, strong sales channels with sleep labs, thought leaders, and homecare providers, strength of the sales force and the success of customer programs, and growth of the domestic OSA therapy market (estimated to be approximately 15% – 20%).

Within domestic Hospital product sales, ventilation growth was 5% during the year ended June 30, 2005. During fiscal year 2005 the Company initiated a change related to the distribution of its BiPAP Vision Noninvasive Ventilation System, whereby the Company transitioned from distributor-based sales to a direct-sales model for this product line. Effective July 1, 2005 the Company began selling the Vision ventilator directly to its domestic hospital customers. During the transition, this change resulted in lower overall hospital ventilation growth in fiscal year 2005. The Company's Esprit critical care ventilator continued to gain market acceptance in 2005, evidencing the growing acceptance of the Company's approach to the management of ventilated patients in the hospital setting. Sales of Children's Medical Ventures developmental infant care products constituted the majority of the remainder of the sales increase over the prior year.

The Company's international growth during the year ended June 30, 2005 included increased sales of both Sleep and Home Respiratory and Hospital products; the most significant increases coming from OSA ($28,187,000 increase over the prior year, representing 29% growth), home ventilation systems and accessories ($19,131,000 over the prior year, representing 32% growth), and international hospital ventilation products ($10,454,000 increase over the prior year, representing 27% growth). The Company's 2005 acquisitions, including Profile and Caradyne, contributed $27,238,000 of international sales during the year ended June 30, 2005. The primary geographic locations experiencing organic revenue increases were Europe and the Far East/Asia Pacific, where the Company has made significant investments in sales force and marketing programs. Changes in foreign currency exchange rates contributed $4,500,000 of revenues during the year ended June 30, 2005 (less than 1% of net sales) compared to the prior year.

Gross Profit

The Company's gross profit was 55% of net sales for the year ended June 30, 2005, compared to 53% of net sales for the year ended June 30, 2004. The increase in gross profit percentage was primarily due to higher revenue, product sales mix (between sales of electromechanical devices and masks and accessories and between domestic and international sales) and material cost reductions achieved through the Company's successful negotiations with suppliers and product design changes.

General and Administrative Expenses (Excluding Acquisition Earn-out Expenses)

General and administrative expenses were $123,040,000 (13% of net sales) for the year ended June 30, 2005 as compared to $100,232,000 (13% of net sales) for the year ended June 30, 2004. The increase for the year ended June 30, 2005 was due primarily to higher employee compensation, consistent with the growth of the Company's business and the financial performance achieved during the year, increases in information technology, legal and product warranty costs, and general and administrative expenses at recently acquired companies (which constituted $9,133,000 of the increase).

Acquisition Earn-out Expenses

During the years ended June 30, 2005 and 2004, the Company incurred acquisition earn-out expenses related to the Company's May 2002 Fuji acquisition of $3,493,000 (less than 1% of net sales) and $8,533,000 (1% of net sales), respectively. Included in the fiscal year 2004 amount was the impact of a revision to the estimated earn-out obligation due to Fuji's positive financial performance since the acquisition date. See Note R to the Consolidated Financial Statements for additional information regarding the Fuji acquisition.

Sales, Marketing and Commission Expenses

Sales, marketing and commission expenses were $182,797,000 (20% of net sales) for the year ended June 30, 2005 as compared to $147,740,000 (19% of net sales) for the year ended June 30, 2004. The increase was driven by higher variable sales force compensation, consistent with the increase in sales levels from the prior year, sales, marketing and commission expenses incurred at acquired companies (which contributed $8,850,000 of the increase), costs associated with the Company's change in distribution of the BiPAP Vision Noninvasive Ventilation System, as well as the Company's continued investments in sales and marketing programs and sales force, especially in international markets.

Research and Development Expenses

Research and development expenses were $45,625,000 (5% of net sales) for the year ended June 30, 2005 as compared to $29,478,000 (4% of net sales) for the year ended June 30, 2004. The increases were due to the Company's continuing commitment to research, development and new product introductions, as well as research and development expenses incurred at acquired companies (which contributed $5,048,000 of the increase). Significant product development efforts were in process and new product launches in many of the Company's major product lines are scheduled over the next 18 months. Additional development work and clinical trials are being conducted in certain product areas within the sleep and respiratory markets outside the Company's current core products and patient groups.

Contribution to Foundation

During the years ended June 30, 2005 and 2004, respectively, the Company made contributions totaling $3,000,000 (less than 1% of net sales) and $2,844,000 (less than 1% of net sales) to the Foundation. The Foundation was formed for scientific, educational and charitable purposes and is used to promote awareness of and research into the medical consequences of sleep and respiratory problems.

Restructuring and Acquisition-Related Expenses

During the year ended June 30, 2005, the Company incurred restructuring and acquisition-related expenses of $6,415,000, related primarily to the restructuring of operations at the Wallingford, Connecticut manufacturing facility ($4,701,000) and the integration of recently acquired companies ($2,611,000), offset by a reduction to the reserve for idle facility lease obligation at the Kennesaw, Georgia manufacturing facility based on increased utilization ($897,000 credit). During the year ended June 30, 2004, the Company incurred restructuring and acquisition-related expenses of $10,942,000, related primarily to the restructuring of operations at the Wallingford, Connecticut manufacturing facility. See Note Q to the Consolidated Financial Statements for additional information regarding restructuring and acquisition-related expenses.

Other Income

Other income was ($1,806,000) for the year ended June 30, 2005 as compared to ($2,078,000) for the year ended June 30, 2004. Other income in all periods presented is comprised of interest income on cash and cash equivalents (net of interest expense on long-term debt), realized and unrealized foreign currency exchange (gains) losses, partially offset by recognized (gains) losses on designated cash flow hedges that are more fully described in Note J to the Consolidated Financial Statements.

Income Taxes

The Company's effective income tax rate was approximately 38% for the years ended June 30, 2005 and 2004. The income tax benefits associated with various on-going tax planning, primarily in the state and international tax areas, were offset by additional income tax expense from the repatriation of foreign earnings during the year ended June 30, 2005 (partially offset by foreign tax credits and other items) that is more fully described in Note M to the Consolidated Financial Statements, and higher nondeductible acquisition earn-out expenses during the year ended June 30, 2004.

Except as disclosed in Note M to the Consolidated Financial Statements, the Company has not provided a valuation allowance for deferred income tax assets because it has determined that it is more likely than not that these assets can be realized, at a minimum, through carrybacks to prior years in which taxable income was generated.

Net Income

As a result of the factors described above, the Company's net income was $84,356,000 (9% of net sales) or $1.17 per diluted share for the year ended June 30, 2005 as compared to net income of $65,020,000 (9% of net sales) or $0.92 per diluted share for the year ended June 30, 2004. The restructuring and acquisition-related expenses described above constituted a reduction of $0.05 and $0.10 per diluted share on an after-tax basis, respectively, for the years ended June 30, 2005 and 2004.

FINANCIAL CONDITION, LIQUIDITY, AND CAPITAL RESOURCES

The Company had working capital of $431,050,000 at June 30, 2006 and $338,102,000 at June 30, 2005. Net cash provided by operating activities for the year ended June 30, 2006 was $92,965,000, compared to $135,078,000 for the year ended June 30, 2005 and $140,937,000 for the year ended June 30, 2004. Cash provided by operating activities for all years included increasing amounts of net income before the impact of depreciation, amortization and stock compensation (fiscal year 2006 only) expense. During the year ended June 30, 2006, this increase was offset by excess tax benefits from share-based payment arrangements that are required to be presented as a reduction to operating cash flows with a corresponding increase to financing cash flows, in accordance with FASB No. 123(R). The Company also made significant investment in working capital in 2006, including accounts receivable, as a result of the Company's 15% sales growth, and inventories as a result of the Company's growth and new product introductions including the CPAP transition to M Series.

Net cash used by investing activities was $94,135,000, $128,215,000, and $62,386,000 for fiscal years 2006, 2005, and 2004, respectively. During the year ended June 30, 2006, the Company paid $29,227,000 to acquire businesses, intangible assets, and strategic investments. Business acquisitions included: $8,400,000 to acquire an oxygen generation technology company, on October 6, 2005; $10,400,000 to acquire OxyTec on April 21, 2006; $2,510,000 to acquire Omni Therm on May 15, 2006; and $7,917,000 to acquire other businesses, intangible assets and strategic investments. Additional purchase price payments and transaction costs for previously acquired businesses totaled $6,063,000, $3,218,000, and $1,442,000, respectively, for the years ended June 30, 2006, 2005, and 2004. During the years ended June 30, 2006, 2005, and 2004 cash used by investing activities included capital expenditures of $58,484,000, $61,900,000, and $51,391,000 respectively, including the purchase of leasehold improvements, production equipment, computer hardware and software, telecommunications and office equipment, and the production of equipment leased to customers. Prior year capital expenditures also included the purchase of a 138,000 square foot facility near the Company's current Murrysville, Pennsylvania campus for a purchase price of $5,500,000 (net of rent that was prepaid by the seller for a transitional rental period that is recorded in accrued expenses and other current liabilities in the consolidated balance sheet). During the 2006 fiscal year, cash flows used in investing activities also include $5,847,000 invested in short-term marketable securities and $5,488,000 of proceeds from the sale of AirLogix. During the year ended June 30, 2005, the Company paid $63,097,000 to acquire businesses, including: $43,524,000 to acquire Profile, net of cash acquired in the transaction of $4,675,000 on July 1, 2004; $10,085,000 to acquire Mini-Mitter on April 1, 2005; and $9,488,000 to acquire other businesses and intangible assets.

Net cash provided by financing activities was $26,050,000, $35,323,000, and $17,995,000 during the years ended June 30, 2006, 2005, and 2004, respectively. These amounts include proceeds from the issuance of common stock under the Company's stock option plans of $18,625,000, $24,971,000, and $18,070,000, respectively, during the years ended June 30, 2006, 2005, and 2004. The Company also received proceeds from equipment financing at its Fuji subsidiary in Japan, in the amount of $13,084,000, $16,415,000, and $10,419,000, during the years ended June 30, 2006, 2005, and 2004, respectively. These proceeds were partially offset by payments on these equipment financing arrangements and other long-term borrowings in each year of $12,182,000, $6,063,000, and $10,494,000, respectively. Cash provided by financing activities in fiscal year 2006 also includes $6,524,000 of excess tax benefits from share-based payment arrangements.

The Company believes that its sources of funding—consisting of projected positive cash flow from operating activities, the availability of additional funds under its revolving credit facility (totaling approximately $148,735,000 at June 30, 2006), and its accumulated cash and cash equivalents and short-term investments—will be sufficient to meet its current and presently anticipated short-term and long-term needs for operating activities, investing activities and financing activities (primarily consisting of scheduled payments on long-term debt).

CONTRACTUAL OBLIGATIONS AND OFF-BALANCE SHEET ARRANGEMENTS

The Company has contractual financial obligations and commercial financial commitments consisting primarily of long-term debt, capital lease obligations, and noncancelable operating leases. See Notes H and K to the Consolidated Financial Statements for additional information about these obligations and commitments. The composition and nature of these obligations and commitments have not changed materially since June 30, 2005.

On August 19, 2002 and as subsequently amended, the Company entered into a Revolving Credit Agreement with a group of banks under which a total of $150,000,000 is available through August 31, 2009. The revolving credit agreement is unsecured and contains certain financial covenants with which the Company must comply. The Company is currently in compliance with these covenants. The interest rate on the revolving credit facility is based on a spread over the London Interbank Offered Rate (LIBOR). As of June 30, 2006, no borrowings are outstanding under the revolving credit agreement.

The following table summarizes significant contractual obligations and commercial commitments of the Company as of June 30, 2006:

Contractual Obligations and Commercial Commitments

		Payments Due by Period			
Contractual Obligations	Total	Up to 1 Year	1-3 Years	3-5 Years	Over 5 Years
Short-term and long-term debt	$ 1,244,000	$ 964,000	$ 280,000	$ —	$ —
Capital lease obligations	43,712,000	17,237,000	21,734,000	4,741,000	—
Operating leases	41,155,000	9,667,000	13,727,000	9,236,000	8,525,000
Amounts payable to selling parties of previously acquired businesses	7,364,000	6,864,000	500,000	—	—
Total Contractual Obligations	**$93,475,000**	$ 34,732,000	$ 36,241,000	$ 13,977,000	$ 8,525,000

		Amount of Commitment Expiration Per Period			
Other Commercial Commitments	Total Amounts Committed	Up to 1 Year	1-3 Years	3-5 Years	Over 5 Years
Letters of Credit	**$ 1,265,000**	$ 1,265,000	$ —	$ —	$ —

In addition to the amounts payable to the selling parties of previously acquired businesses that are set forth in the Contractual Obligations and Commercial Commitments table above, the Company may be obligated to make additional future payments under earn-out provisions pertaining to the acquisitions of Mini-Mitter, the acquired oxygen generation technology company, and OxyTec, for which the total amount of the obligations will not be known until the occurrence of future events. Obligations pertaining to the Fuji acquisitions are scheduled to be paid by December 31, 2006 and are reflected in the table above. The amounts reflected in the Contractual Obligations and Commercial Commitments table include the future payments that are accrued as of June 30, 2006 in accordance with the earn-out provisions and the Company's other fixed obligations under the acquisition agreements. See Note R to the Consolidated Financial Statements for additional information about these obligations.

The Contractual Obligations and Commercial Commitments table above does not reflect obligations under purchase orders that arise in the ordinary course of business and that are typically fulfilled within 90 days. In addition to ordinary course purchase orders, the Company enters into supply agreements and distribution agreements in the ordinary course of business, some of which make the purchase of minimum quantities of products a condition to exclusivity or to obtaining or retaining more favorable pricing. Since failure to purchase the minimum amounts under these agreements generally does not result in a breach of contract, but only to an option on the part of the vendor to terminate the Company's exclusivity or increase the product prices the Company pays to the vendor, they are not included in the Contractual Obligations and Commercial Commitments table above.

In connection with customer leasing programs, the Company uses independent leasing companies for the purpose of providing financing to certain customers for the purchase of the Company's products. In some cases, the Company is contingently liable, in the event of a customer default, to the leasing companies within certain limits for unpaid installment receivables initiated by or transferred to the leasing companies. The transfer of certain of these installment receivables meets the criteria of FASB No. 140 and therefore are not recorded on the Company's financial statements.

As of June 30, 2006, the total exposure for unpaid installment receivables approximates $15,718,000, compared to $16,835,000 as of June 30, 2005. Included in these amounts are unpaid installment receivables totaling $14,970,000 and $16,087,000 that meet the FASB No. 140 criteria and are not recorded on the Company's financial statements at June 30, 2006 and June 30, 2005, respectively. The estimated fair value of the Company's contingent recourse guarantee is $3,406,000 and $1,765,000 as of June 30, 2006 and June 30, 2005, respectively. Approximately 9% of the Company's net sales were made under these financing arrangements during the year ended June 30, 2006 and 8% during the years ended June 30, 2005 and 2004. A portion of these sales was made with recourse. The Company is not dependent on these off-balance sheet arrangements.

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to market risk from changes in foreign exchange rates.

Interest Rates

Interest rates have not had a significant effect on the Company's business during the periods discussed. All of the Company's long-term obligations are subject to fixed interest rates, and the Company has no interest rate hedging agreements.

Foreign Exchange Rates

The Company's reporting currency is the U.S. Dollar and a substantial majority of the Company's sales, expenses and cash flows are transacted in U.S. Dollars. The Company also conducts business in various foreign currencies, primarily the Japanese Yen, the Euro, the British Pound, the Canadian Dollar, the Hong Kong Dollar, the Swiss Franc, and the Chinese Yuan. As part of the Company's risk management strategy, the Company put in place a hedging program under which the Company enters into foreign currency option and forward contracts to hedge a portion of cash flows denominated in certain foreign currencies. These contracts are entered into to reduce the risk that the Company's earnings and cash flows, resulting from certain forecasted and recognized currency transactions, will be affected by changes in foreign currency exchange rates. See Note J to the Consolidated Financial Statements for additional information about the Company's foreign currency hedging activities.

For the year ended June 30, 2006, sales denominated in currencies other than the U.S. Dollar totaled $178,814,000, or approximately 17% of net sales (compared to 19% in the prior year). An adverse change of 10% in exchange rates would have resulted in a decrease in sales of $16,256,000 for the year ended June 30, 2006. Foreign currency losses included in the determination of the Company's net income, net of gains related to designated cash flow hedges, were $956,000 for the year ended June 30, 2006.

Inflation

Inflation has not had a significant effect on the Company's business during the periods discussed.

NEW ACCOUNTING PRONOUNCEMENTS

In June 2005, the FASB issued Statement No. 154, "Accounting Changes and Error Corrections," a replacement of APB Opinion No. 20, "Accounting Changes," and FASB No. 3, "Reporting Accounting Changes in Interim Financial Statements." FASB No. 154 changes the requirements for the accounting and reporting of a change in accounting principles. Previously, most voluntary changes in accounting principles required recognition via a cumulative effect adjustment within net income of the period of the change. FASB No. 154 requires retrospective application to prior periods' financial statements, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. FASB No. 154 is effective for accounting changes made in fiscal years beginning after December 15, 2005, however, the Statement does not change the transition provisions of any existing accounting pronouncements. The Company will adopt FASB No. 154 as of July 1, 2006.

In February 2006, the FASB issued Statement No. 155, "Accounting for Certain Hybrid Financial Instruments – an amendment of FASB Statements No. 133 and 140" (FASB No. 155). FASB No. 155 permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, clarifies which interest-only strips and principal-only strips are not subject to the requirements of FASB Statement No. 133, and establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation. In addition, FASB No. 155 clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives and amends FASB No. 140 to eliminate the prohibition on a qualifying special purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. FASB No. 155 is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The Company will adopt FASB No. 155 as of July 1, 2007, and does not expect that this statement will have a material impact on its Consolidated Financial Statements.

In March 2006, the FASB issued Statement No. 156, "Accounting for Servicing of Financial Assets—an amendment of FASB Statement No. 140" (FASB No. 156). FASB No. 156 requires that an entity separately recognize a servicing asset or a servicing liability when it undertakes an obligation to service a financial asset under a servicing contract in certain situations. Such servicing assets or servicing liabilities are required to be initially measured at fair value, if practicable. FASB No. 156 also allows an entity to choose either the amortization method or the fair value measurement method to account for servicing assets and servicing liabilities within the scope of this Statement. FASB No. 156 is effective after the beginning of an entity's first fiscal year that begins after September 15, 2006. The Company will adopt FASB No. 156 as of July 1, 2007, and does not believe it will have a material impact to its Consolidated Financial Statements.

In April 2006, the FASB issued FASB Staff Position (FSP) FIN 46R-6, "Determining the Variability to Be Considered in Applying FASB Interpretation No. 46(R)" (FIN 46R-6). FIN 46R-6 addresses certain implementation issues related to FASB Interpretation No. 46 (revised December 2003), "Consolidation of Variable Interest Entities" (FIN 46R). Specifically, FSP FIN 46R-6 addresses how a reporting enterprise should determine the variability to be considered in applying FIN 46R. The variability that is considered in applying FIN 46R affects the determination of (a) whether an entity is a variable interest entity (VIE), (b) which interests are "variable interests" in the entity, and (c) which party, if any, is the primary beneficiary of the VIE. That variability affects any calculation of expected losses and expected residual returns, if such a calculation is necessary. The Company is required to apply the guidance in FIN 46R-6 prospectively to all entities (including newly created entities) and to all entities previously required to be analyzed under FIN 46R when a "reconsideration event" has occurred, beginning July 1, 2006. The Company will evaluate the impact of this FSP at the time any such "reconsideration event" occurs and for any new entities created.

In July 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes" (FIN 48). FIN 48 creates a single model to address uncertainty in income tax positions. FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. It also provides guidance on de-recognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 scopes income taxes out of FASB Statement No. 5, "Accounting for Contingencies." FIN 48 is effective for an entity's fiscal year beginning after December 15, 2006. The Company will adopt FIN 48 as of July 1, 2007, as required, and is currently evaluating the impact of such adoption on its financial statements.

CRITICAL ACCOUNTING POLICIES

The Company's Consolidated Financial Statements are prepared in accordance with accounting principles generally accepted in the United States, which require the Company to make estimates and assumptions that may affect the reported financial condition and results of operations should actual results differ. The Company bases its estimates and assumptions on the best available information and believes them to be reasonable under the circumstances. The Company believes that of its significant accounting policies, the following may involve a higher degree of judgment and complexity.

Stock Based Compensation

In conjunction with the adoption of FASB No. 123(R), the Company is required to record the fair value of stock-based compensation awards as expenses in the Consolidated Statement of Operations. In order to determine the fair value of stock options on the date of grant, the Company applies the Black-Scholes option-pricing model. Inherent in this model are assumptions related to expected stock-price volatility, option life, risk-free interest rate and dividend yield. While the risk-free interest rate and dividend yield are less subjective assumptions, typically based on factual data derived from public sources, the expected stock-price volatility and option life assumptions require a greater level of judgment which makes them critical accounting estimates.

The Company's expected stock-price volatility assumption is based on both current and historical implied volatilities of the underlying stock which is obtained from public data sources. For stock option grants issued during the year ended June 30, 2006, the Company used a weighted-average expected stock-price volatility of 24.6% based upon the calculated volatility at the time of issuance.

The Company determined the weighted-average option life assumption based on the exercise behavior that different employee groups exhibited historically, adjusted for specific factors that may influence future exercise patterns. For stock option grants made during the year ended June 30, 2006, the Company used a weighted-average expected option life assumption of 3.5 years. As of June 30, 2006, the total unrecognized stock-based compensation expenses related to nonvested stock awards was $21,335,000, which will be recognized over a weighted-average period of 1.75 years.

The Company believes the above critical estimates are based on outcomes that are reasonably likely to occur. However, if the expected option life of grants made during the year ended June 30, 2006 were to increase by one year and simultaneously the expected volatility was to increase by 100 basis points, recognized compensation expenses would have increased by approximately $412,000 for the year ended June 30, 2006, and unrecognized compensation expense would have increased by $2,236,000 as of June 30, 2006.

Revenue Recognition

The Company's revenues are recognized when title to product passes to the customer, which generally occurs upon shipment to a customer location and, in the case of rental revenue and long-term service contracts, is recognized ratably over the period the product is rented or service is performed. For those sales shipped FOB destination, revenue is recognized upon receipt by the customer. The Company's standard conditions of sale do not include customer acceptance, installation, price protection agreements, or other post-shipment obligations. At times, the Company performs installation and/or training after certain products are shipped as a service to customers (at their request). As of June 30, 2006 and 2005 the amounts of deferred service revenue for post-shipment obligations were immaterial in relation to the Company's financial condition and results of operations. The Company's revenue transactions are sometimes made pursuant to standard terms and conditions included in distributor agreements and customer contracts. These contracts generally include price lists that apply to specified products shipped to customers during the terms of their agreement. These contracts also generally include rights of return provisions that only permit customers to return sold product in the case of a defective product or order entry, shipping, or similar error made by the Company. Product returns, which are recorded as a reduction of net sales and cost of sales, are generally insignificant in relation to net sales. The Company accrues for estimated sales returns and allowances based on historical trends, adjusted for specific product programs and individual transactions where appropriate.

The Company does not offer variable sales prices for subsequent events; all prices are fixed when customers' orders are received. Certain customers' and group purchasing organizations' contracts provide customers with price rebates based on their level of purchases from the Company. Rebates are accrued by the Company as a reduction in net sales as they are earned by customers. Price discounts that may be awarded to customers for payment of invoices within specified periods are recorded as reductions to net sales at the time of payment and are generally insignificant in relation to net sales. As part of the Company's sales process, pricing discounts may be provided for large orders to support sales initiatives, including new product introductions. In the Company's domestic sales activities, a number of independent manufacturers' representatives are used to sell the Company's products. These independent representatives are paid a direct commission on sales made to customers in their respective territories and are an integral component of the Company's domestic sales force. The Company does not ship or sell its products to these representatives, and therefore does not recognize any revenue from transactions with these independent representatives. The SEC's SAB Nos. 101 and 104, "Revenue Recognition," provides guidance on the application of generally accepted accounting principles to selected revenue recognition issues. The Company has concluded that its revenue recognition policy is appropriate and in accordance with generally accepted accounting principles and SAB Nos. 101 and 104.

Allowance for Uncollectible Accounts Receivable

Accounts receivable are reduced by an allowance for amounts that may become uncollectible in the future. Provisions to increase the allowance for uncollectible accounts receivable are recorded as a component of general and administrative expenses in the Company's Consolidated Statements of Operations during the fiscal years ended June 30, 2006, 2005, and 2004. Substantially all of the Company's receivables are due from homecare providers, distributors, hospitals, and independent leasing companies. The Company's customers are located throughout the U.S. and around the world. A significant portion of products sold to homecare providers, distributors and hospitals, both foreign and domestic, is ultimately funded through government reimbursement or private insurance programs. As a consequence, changes in these programs can have an adverse impact on a homecare provider, distributor and hospital liquidity and profitability. In addition, because a concentration of market share exists in the sleep and home respiratory product industry in the U.S. among national and large regional homecare providers, the Company experiences a comparable concentration of credit risk with these customers. The Company records an estimated allowance for uncollectible amounts based primarily on the Company's evaluation of the payment pattern, financial condition, cash flows, and credit history of its customers as well as current industry and economic conditions. Adverse changes in these factors may impair the ability of the Company's customers to make payments; as a consequence, additional allowances for uncollectible accounts receivable may be required. The Company is also contingently liable, within certain limits, in the event of a customer default on unpaid installment receivables initiated by or transferred to several independent leasing companies in connection with customer leasing programs. The Company monitors the collection status of these installment receivables and provides amounts necessary for estimated losses in the allowance for doubtful accounts.

Inventories and Related Allowance for Obsolete and Excess Inventory

Inventories are valued at the lower of cost or market value and have been reduced by an allowance for excess and obsolete inventories. Provisions to increase the allowance for obsolete and excess inventory are recorded as a component of cost of goods sold in the Company's Consolidated Statements of Operations during the fiscal years ended June 30, 2006, 2005, and 2004. The estimated allowance is based on the Company's review of inventories on hand compared to historical and estimated future usage and sales. If it is determined that inventory on hand is in excess of estimated future usage and sales because of changes in competitive conditions, new product introductions, product obsolescence, changes in customer demand, or other reasons, additional allowances for obsolete and excess inventory may need to be provided. The establishment of these additional allowances may have an adverse impact on earnings, depending on the extent and amount of inventory affected.

Intangible Assets

Intangible assets are comprised primarily of intellectual property rights, patent registration costs, product technology, customer contracts and relationships, and employee agreements. Intangible assets are amortized to expense over their useful lives, which are based on the Company's estimates of the period that the assets will generate positive cash flows. Intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. If such carrying amounts are determined to be unrecoverable because of changes in technology, extended delays in obtaining regulatory approval, competition, significant changes in the Company's strategic business objectives, utilization of the asset, or other reasons, the carrying amounts would be written down to their fair market values. These adjustments may have an adverse impact on earnings, depending on the significance of the carrying amounts and the extent of the required adjustments.

Contingencies

As a normal part of its business operations, the Company incurs liabilities that may be difficult to quantify precisely, such as future warranty obligations, potential liabilities relating to legal or regulatory matters, and tax exposures. The Company follows the requirements of FASB No. 5, "Accounting for Contingencies," which dictate when a charge to income should be taken to accrue for a loss contingency. These requirements necessitate the application of judgment regarding the likelihood and amount of the liability. The Company will adopt FIN 48 effective on July 1, 2007 to address uncertainty in income tax positions.

CAUTIONARY STATEMENT FOR PURPOSES OF THE "SAFE HARBOR" PROVISIONS OF THE PRIVATE SECURITIES REFORM ACT OF 1995

The statements contained in this Annual Report, including those contained in "Management's Discussion and Analysis of Results of Operations and Financial Condition," along with statements in reports filed with the SEC, external documents and oral presentations which are not historical are "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21B of the Securities Exchange Act of 1934, as amended. These forward-looking statements represent the Company's present expectations or beliefs concerning future events. The Company cautions that such statements are qualified by important factors that could cause actual results to differ materially from the expected results included in the forward-looking statements. Those factors include, but are not limited to, the following: developments in the healthcare industry; the success of the Company's marketing, sales, and promotion programs; future sales, acceptance, and quality of the Company's products and programs; the timing and success of new product introductions; new product development; anticipated cost savings; FDA and other regulatory requirements, enforcement actions, product recalls or related field actions; future results from acquisitions and strategic investments; growth rates in foreign markets; regulations and other factors affecting operations and sales outside the United States; foreign currency fluctuations; the effects of a major earthquake, cyber-attack or other catastrophic event that results in the destruction or disruption of any critical business or information technology systems; customer consolidation and concentration; increasing price competition and other competitive factors in the manufacture, distribution, and sale of products; interest rate fluctuations; expiration of intellectual property rights; intellectual property and related litigation; other litigation; future levels of earnings and revenues; the number of equity awards granted to employees and changes in the Company's stock price; and third party reimbursement; all of which are subject to change.

Consolidated Balance Sheets

Respironics, Inc. and Its Subsidiaries

At June 30	2006	2005
Assets		
Current Assets		
Cash and cash equivalents	$ 259,513,275	$ 234,632,280
Short-term investments	5,838,020	—
Trade accounts receivable	187,501,600	153,479,117
Inventories	124,149,106	96,314,972
Prepaid expenses and other current assets	19,196,541	11,930,547
Deferred income tax benefits	45,893,406	39,767,465
Total Current Assets	**642,091,948**	536,124,381
Property, Plant and Equipment		
Land	4,371,831	4,387,557
Buildings	27,420,536	23,088,982
Production and office equipment	313,884,506	279,156,393
Leasehold improvements	10,982,910	9,386,856
	356,659,783	316,019,788
Less allowances for depreciation and amortization	218,717,264	188,643,863
	137,942,519	127,375,925
Other Assets	55,981,290	48,318,790
Goodwill	181,361,861	166,627,295
Total Assets	**$ 1,017,377,618**	$ 878,446,391
Liabilities and Shareholders' Equity		
Current Liabilities		
Accounts payable	$ 70,667,025	$ 57,474,169
Accrued expenses and other current liabilities	122,173,359	123,136,829
Current portion of long-term obligations	18,201,496	17,411,475
Total Current Liabilities	**211,041,880**	198,022,473
Long-Term Obligations	26,755,813	29,240,901
Other Non-Current Liabilities	15,131,953	23,537,406
Shareholders' Equity		
Common Stock, $.01 par value; authorized 100,000,000 shares; issued 79,730,591 shares at June 30, 2006 and 78,689,442 shares at June 30, 2005; outstanding 72,740,276 shares at June 30, 2006 and 71,698,913 at June 30, 2005	797,306	786,894
Additional capital	315,857,213	278,764,548
Accumulated other comprehensive income (loss)	(5,068,361)	(4,873,567)
Retained earnings	494,301,163	394,407,777
Treasury stock	(41,439,349)	(41,440,041)
Total Shareholders' Equity	**764,447,972**	627,645,611
Total Liabilities and Shareholders' Equity	**$ 1,017,377,618**	$ 878,446,391

See notes to Consolidated Financial Statements.

Year Ended June 30	**2006**	2005	2004
Net sales	$ 1,046,140,962	$ 911,496,811	$ 759,549,845
Cost of goods sold	473,263,286	413,214,533	356,625,125
	572,877,676	498,282,278	402,924,720
General and administrative expenses			
(excluding acquisition earn-out expenses)	149,484,784	123,040,210	100,231,728
Acquisition earn-out expenses	2,934,571	3,492,699	8,533,000
Sales, marketing and commission expenses	206,433,281	182,796,568	147,739,729
Research and development expenses	58,966,164	45,625,059	29,477,699
Contribution to foundation	1,500,000	3,000,000	2,844,475
Restructuring and acquisition-related expenses	3,953,312	6,415,363	10,942,352
Other income	(9,616,528)	(1,806,475)	(2,078,417)
	413,655,584	362,563,424	297,690,566
Income Before Income Taxes	**159,222,092**	135,718,854	105,234,154
Income taxes	59,328,706	51,362,800	40,214,309
Net Income	**$ 99,893,386**	$ 84,356,054	$ 65,019,845
Basic earnings per share	**$ 1.38**	$ 1.19	$ 0.95
Basic shares outstanding	72,310,655	70,895,884	68,753,542
Diluted earnings per share	**$ 1.36**	$ 1.17	$ 0.92
Diluted shares outstanding	73,570,239	72,254,509	70,618,700

All share and per share information has been adjusted to reflect the two-for-one stock split effected in the form of a 100% stock dividend that was declared on April 20, 2005 and distributed on June 1, 2005.

See notes to Consolidated Financial Statements.

Consolidated Statements of Shareholders' Equity

Respironics, Inc. and Its Subsidiaries

	Common Stock		
	Shares	Amount	Additional Capital
Balance at June 30, 2003	**75,011,400**	**$ 750,114**	**$ 226,509,624**
Shares sold pursuant to stock option and purchase plans	1,945,622	19,456	17,622,644
Income tax benefit from exercise of stock options	—	—	5,077,492
Comprehensive income (loss):			
Net income for the year ended June 30, 2004	—	—	—
Foreign currency translation adjustments	—	—	—
Unrealized losses on derivatives qualifying as hedges	—	—	—
Total comprehensive income (loss)	—	—	—
Balance at June 30, 2004	**76,957,022**	**$ 769,570**	**$ 249,209,760**
Shares sold pursuant to stock option and purchase plans	1,732,420	17,324	24,956,854
Income tax benefit from exercise of stock options	—	—	4,597,934
Comprehensive income (loss):			
Reclassification to other income of realized losses on derivatives qualifying as hedges	—	—	—
Net income for the year ended June 30, 2005	—	—	—
Foreign currency translation adjustments	—	—	—
Total comprehensive income (loss)	—	—	—
Balance at June 30, 2005	**78,689,442**	**$ 786,894**	**$ 278,764,548**
Shares sold pursuant to stock option and purchase plans	1,041,149	10,412	18,614,036
Income tax benefit from exercise of stock options	—	—	6,523,573
Stock Compensation	—	—	11,955,056
Comprehensive income (loss):			
Net income for the year ended June 30, 2006	—	—	—
Foreign currency translation adjustments	—	—	—
Unrealized gain (loss) on marketable securities			
Total comprehensive income (loss)	—	—	—
Balance at June 30, 2006	**79,730,591**	**$ 797,306**	**$ 315,857,213**

All share information has been adjusted to reflect the two-for-one stock split effected in the form of a 100% stock dividend that was declared on April 20, 2005 and distributed on June 1, 2005.

See notes to Consolidated Financial Statements.

Accumulated Comprehensive Income (Loss)	Retained Earnings	Treasury Stock Shares	Treasury Stock Amount	Total
$ (3,557,902)	$ 245,031,878	7,096,958	$ (41,864,395)	$ 426,869,319
—	—	(106,474)	427,752	18,069,852
—	—	—	—	5,077,492
—	65,019,845	—	—	65,019,845
4,232,150	—	—	—	4,232,150
(215,627)	—	—	—	(215,627)
4,016,523	65,019,845	—	—	69,036,368
$ 458,621	$ 310,051,723	6,990,484	$ (41,436,643)	$ 519,053,031
—	—	45	(3,398)	24,970,780
—	—	—	—	4,597,934
215,627	—	—	—	215,627
—	84,356,054	—	—	84,356,054
(5,547,815)	—	—	—	(5,547,815)
(5,332,188)	84,356,054	—	—	79,023,866
$ (4,873,567)	$ 394,407,777	6,990,529	$ (41,440,041)	$ 627,645,611
—	—	(214)	692	18,625,140
—	—	—	—	6,523,573
—	—	—	—	11,955,056
—	99,893,386	—	—	99,893,386
(195,810)	—	—	—	(195,810)
1,016				1,016
(194,794)	99,893,386	—	—	99,698,592
$ (5,068,361)	$ 494,301,163	6,990,315	$ (41,439,349)	$ 764,447,972

Consolidated Statements of Cash Flows

Respironics, Inc. and Its Subsidiaries

Year Ended June 30	2006	2005	2004
Operating Activities			
Net income	$ 99,893,386	$ 84,356,054	$ 65,019,845
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	46,042,545	38,732,235	38,456,432
Amortization	11,752,755	7,550,570	6,099,888
Stock Based Compensation	11,955,066	—	—
Excess tax benefits from share-based payment arrangements	(6,523,573)	4,597,934	5,077,492
Gain on sale of investment	(4,398,274)	—	—
Provision for bad debts	4,046,151	3,980,985	5,163,819
Acquisition earn-out payments, net of provisions	(1,349,272)	(1,600,904)	6,308,236
Provision (credit) for deferred income taxes	(3,467,302)	(11,472,178)	(757,030)
Changes in operating assets and liabilities:			
Accounts receivable	(37,877,134)	(11,835,655)	(16,993,791)
Inventories and other current assets	(34,984,400)	(10,346,030)	(2,154,529)
Accounts payable and other current liabilities	7,537,739	29,446,920	30,984,491
Other assets and liabilities	337,547	1,668,430	3,731,677
Net Cash Provided by Operating Activities	**92,965,234**	135,078,361	140,936,530
Investing Activities			
Proceeds from sale of investment	5,488,097	—	—
Purchase of property, plant and equipment	(58,484,375)	(61,900,002)	(51,391,196)
Purchases of short-term marketable securities	(5,847,487)	—	—
Acquisition of businesses, intangible assets and strategic investments, net of cash acquired	(29,227,443)	(63,096,966)	(9,552,589)
Additional purchase price for previously acquired businesses	(6,063,366)	(3,217,875)	(1,441,962)
Net Cash Used by Investing Activities	**(94,134,574)**	(128,214,843)	(62,385,747)
Financing Activities			
Excess tax benefits from share-based payment arrangements	6,523,573	—	—
Proceeds from long-term obligations	13,083,767	16,414,828	10,418,891
Payment on long-term obligations	(12,182,145)	(6,062,712)	(10,493,774)
Issuance of common stock	18,625,140	24,970,780	18,069,852
Net Cash Provided by Financing Activities	**26,050,335**	35,322,896	17,994,969
Increase in Cash and Cash Equivalents	24,880,995	42,186,414	96,545,752
Cash and cash equivalents at beginning of period	234,632,280	192,445,866	95,900,114
Cash and Cash Equivalents at End of Period	**$ 259,513,275**	$ 234,632,280	$ 192,445,866

See notes to Consolidated Financial Statements.

NOTE A SIGNIFICANT ACCOUNTING POLICIES

Basis of Consolidation

The Consolidated Financial Statements include the accounts of Respironics, Inc. (the Company) and its wholly and majority owned subsidiaries. All significant inter-company accounts and transactions have been eliminated in consolidation.

Certain amounts in the June 30, 2005 financial statements were reclassified to conform with the presentation in the current period.

Cash and Cash Equivalents

The Company considers all highly liquid investments with maturities of 90 days or less when purchased to be cash and cash equivalents. Cash and cash equivalents are stated at cost, which approximates market.

Short-Term Investments

Short-term investments consist primarily of U.S. Treasury bills, other government securities, commercial paper, and certificates of deposit, with maturities greater than 90 days. These investments are designated as available for sale and are stated at fair value.

Inventories

Inventories are valued at the lower of cost (determined on a first-in, first-out moving average basis) or market and have been reduced by an allowance for excess and obsolete inventories. The estimated allowance is based on the Company's review of inventories on hand compared to historical and estimated future demand.

Property, Plant and Equipment

Property, plant and equipment is recorded on the basis of cost. Costs incurred to purchase or develop software for internal use, including upgrades and enhancements, are capitalized during the software application development stage in accordance with Statement of Position No. 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." Depreciation is computed using the straight-line method based upon the estimated useful lives of the respective assets, which are 30 years for buildings and range from two to five years for production and office equipment. Leasehold improvements are depreciated over their lease terms, or useful lives if shorter. Amortization of assets under capital leases is included in depreciation expense. Maintenance and repairs are charged to expense as incurred.

Capitalized Software Production Costs

Software development costs have been capitalized when technological feasibility was established and are being amortized to the cost of goods sold over the estimated economic lives (generally three to seven years) of the products that include such software. Total net capitalized software production costs were $11,642,000, $11,799,000 and $11,025,000 at June 30, 2006, 2005, and 2004, respectively. During the fiscal years ended June 30, 2006, 2005, and 2004, the Company recorded $3,621,000, $2,609,000, and $1,786,000, respectively, of amortization expense related to capitalized software production costs.

Goodwill and Intangible Assets

Goodwill is the cost in excess of the fair value of net (tangible and intangible) assets of businesses acquired. In June 2001, the FASB issued Statement No. 141, "Business Combinations," and Statement No. 142, "Goodwill and Other Intangible Assets," effective for fiscal years beginning after December 15, 2001. Under these rules, goodwill and intangible assets deemed to have indefinite lives are no longer amortized but are subject to annual impairment tests in accordance with the Statements. Other intangible assets continue to be amortized over their useful lives. The Company applied the provisions of FASB No. 141 to account for business combinations consummated after July 1, 2001.

Effective July 1, 2002, the Company adopted Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets," under which goodwill and intangible assets deemed to have indefinite lives are no longer amortized but are subject to annual impairment tests. The Company performed its annual impairment tests as of December 31, 2005 and 2004 and determined that no impairment exists. No impairment indicators were identified subsequent to the annual impairment test. The Company will update this annual test as of December 31 in future years, and on an interim basis as determined necessary in accordance with FASB No. 142.

The Company evaluates the carrying value of long-lived assets, including intangible assets, to be held and used when events and circumstances indicate that the carrying amount of an asset may not be recovered. Such evaluation considers projected future operating results, trends and other circumstances. If factors indicated long-lived assets could be impaired, the Company would use an estimate of the related undiscounted future cash flows over the remaining life of the long-lived asset in measuring whether the asset is recoverable. If such an analysis indicated that impairment had occurred, the Company would adjust the book value of the long-lived asset to fair value. Assets to be disposed of are reported at the lower of the carrying amount or fair value, less costs to sell.

Product Warranties

Estimated future warranty costs related to certain products are charged to operations in the period in which the related revenue is recognized. See Note G to these Consolidated Financial Statements for additional information about the Company's product warranties.

Comprehensive Income

Comprehensive income consists of net income, foreign currency translation adjustments, unrealized gains (losses) on derivatives qualifying as hedges, and unrealized gains (losses) on marketable securities, and is presented in the Consolidated Statements of Shareholders' Equity. The Company does not provide for U.S. income taxes on foreign currency translation adjustments since it does not provide for such taxes on the undistributed earnings of foreign subsidiaries. The other components of comprehensive income are recorded net of income taxes.

Foreign Currency Translation

Foreign currency assets and liabilities are translated into U.S. Dollars at the rate of exchange existing at the statement date or historical rates depending upon the nature of the account. Income and expense amounts are translated at the average of the monthly exchange rates. Adjustments resulting from these translations are credited or charged directly to accumulated comprehensive income (loss). Gains and losses resulting from foreign currency transactions, denominated in other than the functional currency of the entity, are credited or charged directly to income.

Stock Options

Stock options are granted to certain employees and certain members of the Company's Board of Directors at the fair market value of the Company's stock on the date of the grant. Proceeds from the exercise of common stock options are credited to shareholders' equity at the date the options are exercised. Prior to July 1, 2005, the Company applied APB Opinion No. 25, "Accounting for Stock Issued to Employees," as amended, in accounting for its stock option plans and accordingly, no compensation cost was recognized for its stock options in the financial statements.

Effective July 1, 2005, the Company adopted FASB No. 123(R). This statement replaces FASB No. 123, "Accounting for Stock-Based Compensation" (FASB No. 123) and supersedes APB No. 25. FASB No. 123(R) requires that all stock-based compensation be measured at the fair value of the award and be recognized as an expense in the financial statements. The Company adopted this statement using the modified prospective method, which requires the Company to recognize compensation expense on a prospective basis. Therefore, prior years' financial statements have not been restated. Under this method, in addition to reflecting compensation expense for new share-based awards, expense is also recognized to reflect the remaining service period of awards that had been included in pro-forma disclosures in prior years. FASB No. 123(R) also requires that excess tax benefits related to stock option exercises be reflected as financing cash inflows instead of operating cash inflows.

See Note N to these Consolidated Financial Statements for additional information about the Company's stock options.

Earnings Per Share

Basic earnings per share are based on the weighted-average number of shares actually outstanding. Diluted earnings per share are based on the weighted-average number of shares actually outstanding and dilutive potential shares, such as dilutive stock options which are determined using the treasury stock method.

Revenue Recognition

Revenue is recognized from sales when title to product passes to the customer, which generally occurs upon shipment to a customer location. Rental and service revenues are recognized ratably over the period the product is rented or service is performed.

Shipping and Handling Costs

Shipping and handling fees billed to customers are included in net sales. Shipping and handling costs incurred by the Company are expensed as incurred and are included in cost of goods sold.

Advertising Costs

Advertising costs are expensed during the period in which they are incurred. Total advertising expenses for the fiscal years ended June 30, 2006, 2005 and 2004 were $3,198,000, $3,589,000, and $2,345,000, respectively.

Income Taxes

Provisions for income taxes include deferred taxes resulting from temporary differences in income for financial and tax purposes using the liability method. Such temporary differences result primarily from differences in the carrying value of assets and liabilities.

The Company does not provide for federal income taxes on the undistributed earnings of its foreign subsidiaries (other than dividends which are taxed currently) because such earnings are reinvested and, in the opinion of management, will continue to be reinvested indefinitely. During the year ended June 30, 2005, the Company declared and paid one-time dividends from certain foreign subsidiaries to take advantage of a temporary incentive under the American Jobs Creation Act of 2004 (the Act) and to generate foreign tax credits. See Note M to these Consolidated Financial Statements for additional information.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the U.S. requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

NOTE B CASH EQUIVALENTS

Cash equivalents consist primarily of money market accounts and certificates of deposit issued by large commercial banks located in the U.S., Hong Kong, Japan, Germany, France, Italy, the UK, Switzerland, and Ireland.

NOTE C SHORT-TERM INVESTMENTS

During the fourth quarter of the current fiscal year the Company invested a portion of its cash into money management funds at high credit quality financial institutions. Short-term investments consist of U.S. Treasury bills, other government securities, commercial paper, and certificates of deposit, with maturities greater than 90 days.

NOTE D ACCOUNTS RECEIVABLE

Trade accounts receivable in the Consolidated Balance Sheets is net of allowances for doubtful accounts of $15,188,000 as of June 30, 2006, and $14,856,000 as of June 30, 2005.

NOTE E INVENTORIES

Inventories consisted of the following, net of allowances for obsolete and excess inventories of $20,767,000, and $16,596,000 at June 30, 2006 and 2005, respectively:

June 30	2006	2005
Raw materials	$ 41,059,000	$ 31,611,000
Work-in-process	9,606,000	10,584,000
Finished goods	73,484,000	54,120,000
Total inventory	**$ 124,149,000**	$ 96,315,000

NOTE F GOODWILL AND INTANGIBLE ASSETS

Changes in the carrying amount of goodwill for the year ended June 30, 2006 were as follows:

Balance at June 30, 2005	$ 166,627,000
Goodwill on businesses acquired	11,193,000
Additional purchase price for prior acquisitions	3,440,000
Foreign currency changes	102,000
Balance at June 30, 2006	**$ 181,362,000**

The Company's intangible assets are comprised of product-related intellectual property acquired from third parties, the appraised fair market values of acquired product-related intellectual property, acquired customer contracts and relationships, and employee contracts obtained through business acquisitions (including the acquisitions disclosed in Note R), and patent registration costs. Intangible assets at June 30 are summarized below, net of accumulated amortization of $21,364,000 and $14,373,000 as of June 30, 2006 and 2005, respectively:

June 30	2006	2005
Product-related intellectual property	$ 31,428,000	$ 26,886,000
Patent registration costs	4,295,000	3,483,000
Customer contracts and relationships	6,255,000	7,394,000
Employee contracts	2,266,000	1,087,000
Total intangible assets	**$ 44,244,000**	$ 38,850,000

Intangible asset amortization is computed using the straight-line method based upon the estimated useful lives of the respective assets, which range from one to 16 years.

Intangible asset amortization expense was $6,991,000, $5,963,000, and $4,037,000 during the years ended June 30, 2006, 2005, and 2004, respectively. The estimated aggregate intangible asset amortization expenses for the next five years are as follows:

2007	$ 6,229,000
2008	5,482,000
2009	4,849,000
2010	4,082,000
2011	3,475,000

NOTE G ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

Accrued expenses and other current liabilities at June 30 consist of the following:

June 30	2006	2005
Promotional programs, royalties and similar obligations	$ 7,367,000	$ 11,869,000
Product warranties	18,600,000	12,753,000
Restructuring and acquisition obligations	2,916,000	3,647,000
Recourse obligations	748,000	748,000
Deferred service revenues	8,238,000	6,657,000
Deferred rental revenue	614,000	1,259,000
Compensation	32,884,000	32,247,000
Taxes	19,756,000	29,925,000
Charitable foundation and other contributions	929,000	3,262,000
Fuji earn-out obligation and note payable	6,809,000	—*
Other, including professional fees and other accrued expenses	23,312,000	20,770,000
Total	**$ 122,173,000**	$ 123,137,000

**$8,822,000 related to Fuji earn-out and note payable was classified with noncurrent liabilities as of June 30, 2005.*

Generally, the Company's standard product warranties are for a one- or two-year period (based on the specific product sold and country in which the Company does business) that covers both parts and labor. The Company provides for the estimated cost of product warranties at the time revenue is recognized. The Company's product warranty liability reflects management's best estimate of probable liability under its product warranties. Management estimates the liability based on the Company's stated warranty policies, which project the estimated warranty obligation on a product-by-product basis based on the historical frequency of claims, the cost to replace or repair its products under warranty, and the number of products under warranty based on the warranty terms and historical units shipped. The warranty liability also includes estimated warranty costs that may arise from specific product issues, including product recalls or related field actions. The Company periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary. The Company also engages in the sale of extended warranties and long-term service contracts for which revenue is deferred and recognized over the warranty terms, which are generally between two and eight years. Changes in the liability for product warranty and deferred service revenues associated with these service programs for the year ended June 30, 2006 are as follows:

Product Warranties	
Balance as of June 30, 2005	$ 12,753,000
Warranty accruals during the year	14,813,000
Service costs incurred during the year	(8,966,000)
Balance at June 30, 2006	**$ 18,600,000**

Deferred Service Revenues	
Balance as of June 30, 2005	$ 6,657,000
Revenues deferred during the year	3,731,000
Amounts recorded as revenue during the year	(2,150,000)
Balance at June 30, 2006	**$ 8,238,000**

NOTE H LONG-TERM OBLIGATIONS

Long-term obligations consist of the following:

June 30	2006	2005
Bank Debt with varying maturities (final maturity in May 2007) including interest rates ranging from 0.8% to 1.7%	$ 1,173,000	$ 2,713,000
Capital Lease Obligations, payable in monthly installments with varying completion dates through July 2011 including interest rates ranging from 1.0% to 4.5%	43,713,000	43,419,000
Other	71,000	520,000
	44,957,000	46,652,000
Less current portion	18,201,000	17,411,000
	$ 26,756,000	$ 29,241,000

On August 19, 2002, the Company entered into a Revolving Credit Agreement with a group of banks under which a total of $150,000,000 is available through August 2009 (as amended and as more fully described below), replacing a $125,000,000 Commercial Bank Credit Agreement that had similar terms. The new Revolving Credit Agreement is unsecured and contains certain financial covenants with which the Company must comply, including those relating to current ratio, ratio of total liabilities to tangible net worth, minimum tangible net worth, leverage, and interest coverage (as these terms are defined in the Revolving Credit Agreement). The Company is currently in compliance with these covenants. The interest rate on the revolving credit facility is based on a spread over the London Interbank Offered Rate (LIBOR). The Commercial Bank Revolving Credit Agreement includes a commitment fee, currently equal to 0.16%, on the unused portion of the facility. No amounts are outstanding under the Revolving Credit Facility as of June 30, 2006 or 2005.

In August, 2004, the Company amended the Revolving Credit Agreement to extend the maturity date through August 31, 2009. The Revolving Credit Facility maintained substantially the same terms after the amendment (but generally more favorable and flexible to the Company, including potentially lower interest rate spreads over LIBOR and greater flexibility to make investments).

The Bank Debt and Capital Lease Obligations reflected in the above table are primarily for equipment rented to outside customers by the Company's Fuji subsidiary in Japan.

Scheduled maturities of long-term obligations for the next five years are as follows:

	Maturities of Long-Term Debt
2007	18,201,000
2008	14,089,000
2009	7,925,000
2010	3,706,000
2011	1,036,000
Thereafter	—
Total	**$ 44,957,000**

Interest paid was $1,357,000, $1,366,000, $1,745,000 for the years ended June 30, 2006, 2005, and 2004, respectively.

NOTE I FAIR VALUE OF FINANCIAL INSTRUMENTS

The following methods and assumptions were used to estimate the fair value of financial instruments:

Cash and Cash Equivalents

The carrying amount approximates fair value because of the short maturity of those investments.

Short-Term Investments

Short-term investments are recorded in the Consolidated Balance Sheet at fair value. Fair values are based on quoted market prices, estimates from brokers, and other appropriate valuation techniques. The fair value estimates do not necessarily reflect the values that could be realized in the current market on any one day.

Long-Term Obligations

The fair values of long-term debt obligations are established from the market values of similar issues. The carrying amounts of the Company's obligations approximate their fair values at June 30, 2006 and 2005.

Foreign Currency Exchange Derivative Contracts

Foreign currency exchange derivative contracts are recorded in the Consolidated Balance Sheets at fair value. As of June 30, 2006 and 2005, foreign currency option and forward contracts with a fair value of $58,000 and $553,000, respectively, are recorded with prepaid expenses and other current assets.

NOTE J DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The Company's reporting currency is the U.S. Dollar, and a substantial majority of the Company's sales, expenses, and cash flows are transacted in U.S. Dollars. The Company also does business in various foreign currencies, primarily the Japanese Yen, the Euro, the British Pound, the Hong Kong Dollar, the Canadian Dollar, the Swiss Franc, and the Chinese Yuan. As part of the Company's risk management strategy, management has put in place a hedging program under which the Company enters into foreign currency option and forward contracts to hedge a portion of cash flows denominated in certain foreign currencies.

As of June 30, 2006 the Company acquired foreign currency option and forward contracts to hedge a portion of forecasted cash flows and recognized foreign currency transactions denominated in Japanese Yen. The foreign currency option and forward contracts have notional amounts of approximately $8,597,000 as of June 30, 2006 and mature at various dates through October 15, 2006. As of June 30, 2006, foreign currency option and forward contracts with a fair value of $58,000 are recorded with prepaid expenses and other current assets. As of June 30, 2005, foreign currency options contracts with a fair value of $553,000 are recorded with prepaid expenses and other current assets.

The Company enters into foreign currency contracts to reduce the risk that the Company's earnings and cash flows, resulting from certain forecasted and recognized currency transactions, will be affected by changes in foreign currency exchange rates. However, the Company may be impacted by changes in foreign exchange rates related to the portion of the forecasted transactions that is not hedged. The success of the hedging program depends, in part, on forecasts of the Company's transactions in foreign currencies. Hedges are placed for periods consistent with identified exposures, but not longer than the end of the year for which the Company has substantially completed its annual business plan.

The Company may experience unanticipated foreign currency exchange gains or losses to the extent that there are timing differences between forecasted and actual activity during periods of currency volatility. However, since the critical terms of contracts designated as cash flow hedges are the same as the underlying forecasted and recognized currency transactions, changes in fair value of the contracts should be highly effective in offsetting the present value of changes in the expected cash flows from the forecasted and recognized currency transactions. The ineffective portion of changes in the fair value of contracts designated as hedges, if any, is recognized immediately in earnings. The Company did not recognize material gains or losses resulting from either hedge ineffectiveness or changes in forecasted transactions during the years ended June 30, 2006 and 2005.

The effective portion of any changes in the fair value of the derivative instruments, designated as cash flow hedges, is recorded in Other Comprehensive Income (loss) (OCI) until the hedged forecasted transaction occurs or the recognized currency transaction affects earnings. Once the forecasted transaction occurs or the recognized currency transaction affects earnings, the effective portion of any related gains or losses on the cash flow hedge is reclassified from OCI to earnings. In the event the hedged forecasted transaction does not occur, or it becomes probable that it will not occur, the ineffective portion of any gain or loss on the related cash flow hedge would be reclassified from OCI to earnings at that time.

For the years ended June 30, 2006 and 2005, the Company recognized net gains (losses) related to designated cash flow hedges in the amount of ($201,000) and $600,000, respectively. These amounts are classified with other income in the Consolidated Statements of Operations. During the years ended June 30, 2006 and 2005, the derivative (gains) losses were more than offset by realized and unrealized currency (gains) losses on the cash flows being hedged, which are also classified with other income in the Consolidated Statements of Operations. As of June 30, 2006 and 2005, no amounts are included in OCI.

NOTE K OPERATING LEASES

The Company leases its service centers, its central distribution center, and certain of its offices, warehouses and manufacturing facilities in the U.S. and also leases its offices, warehouses and manufacturing facilities in the Far East and in Europe. Certain of these leases contain renewal options and rent escalation clauses.

The minimum rentals due under noncancelable leases with recurring terms of one year or more as of June 30, 2006 are as follows:

Year Ended June 30	Amount
2007	$ 9,667,000
2008	7,729,000
2009	5,998,000
2010	5,364,000
2011	3,872,000
Thereafter	8,525,000
Total	**$ 41,155,000**

Total rent expense for the years ended June 30, 2006, 2005, and 2004, was $10,951,000, $9,521,000, and $8,338,000, respectively.

NOTE L CONTINGENCIES

Invacare Litigation

On March 5, 2004, the Company filed a lawsuit against Invacare in the U.S. District Court for the Western District of Pennsylvania alleging that Invacare's manufacture, sale and marketing of a new CPAP device infringes one or more of 11 U.S. patents of the Company. In its complaint, the Company has sought preliminary and permanent injunctive relief, damages and an award of three times actual damages. In its answer to the complaint, Invacare has denied the infringement allegations of the complaint and has asserted that the Company's patents are invalid. Discovery has concluded, and the Court delivered an opinion on issues regarding the interpretation of patent claims on August 30, 2006. The Court postponed the May 2006 trial but has not yet set a new trial date.

On August 6, 2004, Invacare filed a lawsuit against the Company in the U.S. District Court in the Northern District of Ohio alleging that the Company has engaged in monopolization, restraint of trade and unfair competition in the sale and distribution of sleep apnea products. The lawsuit's claims include allegations that the Company's actions and alleged market power have foreclosed competitors from alleged markets and have created markets where there has not been competitive pricing or availability of competitive product offerings. In the lawsuit, Invacare seeks damages in an unspecified amount and to treble such damages pursuant to the antitrust laws, as well as attorney's fees and punitive damages. Invacare also seeks injunctive relief as to certain marketing practices. The Company is vigorously defending itself in this suit.

Other

The Company is, as a normal part of its business operations, a party to other legal proceedings in addition to those described above. Legal counsel has been retained for each proceeding, and none of these proceedings is expected to have a material adverse impact on the Company's results of operations or financial condition.

Contingent Obligations Under Recourse Provisions

In connection with customer leasing programs, the Company uses independent leasing companies for the purpose of providing financing to certain customers for the purchase of the Company's products. In some cases, the Company is contingently liable, in the event of a customer default, to the leasing companies within certain limits for unpaid installment receivables initiated by or transferred to the leasing companies. The transfer of certain of these installment receivables meets the criteria of FASB No. 140 and therefore are not recorded on the Company's financial statements.

As of June 30, 2006, the total exposure for unpaid installment receivables approximates $15,718,000, compared to $16,835,000 as of June 30, 2005. Included in these amounts are unpaid installment receivables totaling $14,970,000 and $16,087,000 that meet the FASB No. 140 criteria and are not recorded on the Company's financial statements at June 30, 2006 and June 30, 2005, respectively. The estimated fair value of the Company's contingent recourse guarantee is $3,406,000 and $1,765,000 as of June 30, 2006 and 2005, respectively. Approximately 9% of the Company's net sales were made under these financing arrangements during the year ended June 30, 2006 and 8% during the years ended June 30, 2005 and 2004. A portion of these sales was made with recourse. The Company is not dependent on these off-balance sheet arrangements.

NOTE M INCOME TAXES

Income before income taxes consisted of the following:

Year Ended June 30	2006	2005	2004
United States	$ 124,839,000	$ 106,841,000	$ 86,647,000
Foreign	34,383,000	28,878,000	18,587,000
Total	**$ 159,222,000**	$ 135,719,000	$ 105,234,000

Income taxes (benefit) consisted of:

Year Ended June 30	2006	2005	2004
Current:			
Federal	$ 38,870,000	$ 44,823,000	$ 29,451,000
Foreign	14,536,000	12,868,000	7,713,000
State	2,867,000	5,144,000	3,807,000
	56,273,000	62,835,000	40,971,000
Deferred:			
Federal	(2,879,000)	(9,059,000)	(1,550,000)
Foreign	(124,000)	(861,000)	1,208,000
State	(465,000)	(1,552,000)	(415,000)
	(3,468,000)	(11,472,000)	(757,000)
Tax benefits resulting from allocating employee stock option tax benefits to additional paid-in-capital	6,524,000	—	—
Total Income Taxes	**$ 59,329,000**	$ 51,363,000	$ 40,214,000

The difference between the statutory U.S. federal income tax rate and the Company's effective income tax rate is explained below:

Year Ended June 30	2006	2005	2004
Statutory federal income tax rate	**35%**	35%	35%
Increases (decreases):			
State taxes, net of federal benefit	1	2	2
Foreign taxes	1	1	2
Tax credits	—	(7)	—
Non-deductible expenses	(1)	7	(1)
Other items, net	1	—	—
Effective Income Tax Rate	**37%**	38%	38%

Deferred income tax assets consist of the following:

June 30	2006	2005
Allowance for bad debts	$ 5,343,000	$ 5,258,000
Property, plant, equipment and intangible assets	(113,000)	(1,494,000)
Inventory reserves	6,440,000	5,508,000
Inter-company profit in inventories	10,286,000	11,502,000
Product warranty reserves	7,358,000	5,367,000
Restructuring and acquisition obligations	1,219,000	2,537,000
Net operating loss carry-forward, limited by Section 382	1,465,000	381,000
Business credits carry-forward, limited by Section 383	475,000	480,000
Foreign tax credit	1,429,000	1,900,000
FASB No. 123(R)	3,306,000	—
Other	9,195,000	8,533,000
	46,403,000	39,972,000
Less current portion	45,893,000	39,767,000
	$ 510,000	$ 205,000

Income taxes paid were $66,307,000, $39,996,000, and $36,621,000 for the years ended June 30, 2006, 2005, and 2004, respectively.

On April 12, 2002, the Company acquired Novametrix, which had a federal and state net operating loss as of April 12, 2002 of approximately $5,800,000. Such net operating loss on a carry-forward basis expires in 2022. Additionally, Novametrix had unused research tax credits of approximately $475,000 which expire in varying amounts through 2013, and alternative minimum tax credits of $237,000 which do not have expiration dates. As a result of the ownership change, the utilization of the net operating loss and the credit carryforwards is limited each year by Internal Revenue Code Sections 382 and 383, respectively. As of June 30, 2005, the Company has fully utilized the net operating loss and the alternative minimum tax credits and expects to utilize the research tax credits carry forward.

On July 1, 2004, the Company acquired Profile, which had a net operating loss carry-forward in the UK as of June 30, 2004 of approximately $14,338,000, all of which carry-forward without expirations. The potential tax benefits associated with these foreign net operating losses are approximately $4,300,000. The Company has established a full valuation allowance against this deferred tax asset. To the extent these net operating losses are utilized in the future and deferred tax assets are recoverable, the Company's recorded goodwill balance associated with the Profile acquisition will be reduced.

On April 1, 2005, the Company acquired Mini-Mitter, which had a federal and state net operating loss carry-forward as of April 1, 2005 of approximately $1,200,000. Such net operating loss on a carry-forward basis expires in 2025. As a result of the ownership change, the utilization of the net operating loss carry-forwards is limited each year by Internal Revenue Code section 382. The Company expects to fully utilize the net operating loss carry-forwards.

On October 22, 2004, the "American Jobs Creation Act of 2004" (the Act) was signed into law. The Act creates a temporary incentive for U.S. multinational companies to repatriate a portion of accumulated income earned outside the U.S. at an effective tax rate of 5.25%. In December 2004, the FASB issued Staff Position No. 109-2, "Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004." FSP 109-2 allows companies additional time to assess the effect of repatriating foreign earnings under the law, including whether unrepatriated foreign earnings continue to qualify for FASB No. 109s exception to recognizing deferred tax liabilities, and requires explanatory disclosures from those who need the additional time. In June 2005 the Company repatriated $37,500,000 from certain foreign subsidiaries, of which $22,500,000 was repatriated in order to take advantage of temporary incentives under the Act. The repatriated dividends were declared and paid in June 2005. As a result of the Company's decision to repatriate these earnings, the Company incurred a net federal and state tax liability in the amount of $1,900,000. This liability was offset partially by foreign tax credits and other items resulting in a 38% effective tax rate for the year ended June 30, 2005. Undistributed earnings of the foreign subsidiaries on which no U.S. income tax has been provided amounted to $45,306,000 and $22,891,000 as of June 30, 2006 and 2005, respectively. The Company intends to reinvest these undistributed earnings of foreign subsidiaries.

The Company maintains reserves for contingent tax liabilities, for differences between the benefit of tax deductions as filed on various income tax returns and recorded income tax provisions. These liabilities are estimated based on analysis of probable return-to-provision adjustments using currently available information.

NOTE N STOCK OPTION AND PURCHASE PLANS

At June 30, 2006, the Company has two active employee stock option plans, the 2000 Stock Incentive Plan and the 2006 Stock Incentive Plan, and one employee stock purchase plan. The 2000 Stock Incentive Plan provides for the issuance of up to 6,552,000 shares for grant to eligible employees, consultants, and nonemployee directors for a period of up to 10 years at option prices not less than the fair market value at the time of grant. As of June 30, 2006, 651,000 shares were reserved and available to be granted pursuant to the 2000 Stock Incentive Plan (2000 Plan). The 2006 Stock Incentive Plan (2006 Plan) was approved by shareholders on November 15, 2005, and provides for the issuance of up to 5,019,000 shares to be granted to eligible employees, consultants, and nonemployee directors for a period of up to 10 years at option prices not less than the fair market value at the time of grant. As of June 30, 2006, no shares have been granted from the 2006 Plan. The Company may satisfy the awards upon exercise under both plans with either newly-issued or treasury shares.

Under the 2000 Plan and the 2006 Plan (collectively, the Plans), options become exercisable at such times or upon the occurrence of such events as determined by the Committee administering the Plans. The Company's past practice has been to award options that vest ratably over four years (25% per year) from the grant date. Under the 2000 Plan, options may include cash payment rights, and restricted shares of the Company's common stock may also be awarded. The 2006 Plan also authorizes awards of restricted share units, performance awards, and other stock-based awards including awards tied to the achievement of specific performance goals.

Options are also granted under the Plans to members of the Company's Board of Directors who are not employees of the Company. Each nonemployee director receives an option to purchase shares on the third business day following the Company's annual meeting of shareholders. The number of options is stated as 13,000 in the 2000 Plan. Pursuant to an amendment made in August 2006, the Committee administering the Plans has discretion, under the 2006 Plan, to reduce the number of options granted in order to align with market competitive levels. Additionally, each nonemployee director is granted an option to purchase 13,000 shares, or less depending on market competitiveness on the first business day following the date they become a member of the Board of Directors. Such options are granted at fair market value on the date of grant. For options granted to nonemployee directors, 25% of the shares are exercisable one year after the date of the grant, 25% are exercisable two years after the date of grant, and the remaining 50% are exercisable three years after the date of grant. All options granted under the Plans expire 10 years after the date of grant.

Each of the Company's equity compensation plans was approved by security holders.

In December 2004, the FASB issued FASB No. 123(R), which is a revision of FASB Statement No. 123, "Accounting for Stock-Based Compensation" (FASB No. 123). FASB No. 123(R) replaces FASB No. 123, and supersedes Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APB 25). FASB No. 123(R) requires that all stock-based compensation be recognized as expenses in the financial statements and that such expenses are measured at the fair value of the award.

The Company adopted FASB No. 123(R) on July 1, 2005 using the modified prospective method, which resulted in the recognition of stock compensation expenses in the Consolidated Statement of Operations during the year ended June 30, 2006. Under the modified prospective method, prior period financial statements have not been restated, and the stock-based compensation expense recorded in the Consolidated Statement of Operations after adoption of FASB No. 123(R) includes both share-based awards granted subsequent to the adoption of FASB No. 123(R) and the remaining service period of awards that had been included in pro forma disclosures prior to the adoption of FASB No. 123(R). Stock-based compensation expenses for the year ended June 30, 2006 was $11,955,000 ($8,524,000 after tax, or $0.12 for both basic and diluted net earnings per share). For the year ended June 30, 2006 stock-based compensation expense is comprised of $11,124,000 attributable to stock option plans and $831,000 attributable to the employee stock purchase plan. As of June 30, 2006, the total unrecognized stock-based compensation expenses related to nonvested stock awards was $21,335,000, which will be recognized over a weighted-average period of 1.75 years.

FASB No. 123(R) also requires that excess tax benefits related to stock option exercises be reflected as a component of financing cash flows instead of operating cash flows. For the year ended June 30, 2006, the adoption of FASB No. 123(R) resulted in cash flows provided by financing activities of $6,523,000, which reduced cash flows provided by operating activities by the same amount.

The following table summarizes the Company's stock option information as of, and for the years ended June 30, 2006, 2005, and 2004:

	Option Shares	Weighted-Average Exercise Price	Aggregate Intrinsic Value[1]	Weighted-Average Contractual Life Remaining in Years
Outstanding at June 30, 2003	5,400,000	$ 12.01		
Granted at fair value	1,594,000	21.14		
Exercised	(1,816,000)	9.34		
Cancelled	(76,000)	14.92		
Outstanding at June 30, 2004	5,102,000	$ 15.81	$ 13.57	7.54
Granted at fair value	1,720,000	27.13		
Exercised	(1,601,000)	13.19		
Cancelled	(35,000)	18.29		
Outstanding at June 30, 2005	5,186,000	$ 20.31	$ 15.80	7.64
Granted at fair value	1,759,000	38.75		
Exercised	(910,000)	17.15		
Cancelled	(278,000)	25.82		
Outstanding at June 30, 2006	**5,757,000**	**$ 26.17**	**$ 9.39**	**7.54**
Exercisable at June 30, 2006	**1,841,000**	**$ 17.51**	**$ 16.71**	**5.89**

[1] *The intrinsic value of a stock option is the amount by which the current market value of the underlying stock exceeds the exercise price of the option.*

The exercise period for all stock options may not exceed 10 years from the date of grant. Stock options granted to employees become exercisable ratably over four years (25% per year) from the date of grant. Stock options granted to nonemployee directors become exercisable over three years from the date of grant (25% after one year from the date of grant, an additional 25% after two years, and the remaining 50% after three years). The Company attributes stock-based compensation expenses to the consolidated statement of operations using the straight-line method over the applicable vesting periods.

The weighted-average grant date fair value of stock options granted during the years ended June 30, 2006, 2005, and 2004 was $9.39, $9.15, and $7.19 per share, respectively. The total intrinsic value of stock options exercised during the year ended June 30, 2006, 2005, and 2004 was $18,796,000 and $23,679,000, and $28,869,000 respectively.

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

Year Ended June 30	2006	2005	2004
Weighted-average expected stock-price volatility	24.6%	32.4%	32.1%
Weighted-average expected option life	3.5 years	4.8 years	4.8 years
Average risk-free interest rate	4.0%	3.4%	3.7%
Average dividend yield	0.0%	0.0%	0.0%

The average risk-free interest rate is based on the U.S. treasury security rate with a term to maturity that approximates the option's expected life as of the grant date. Expected volatility is determined using both current and historical implied volatilities of the underlying stock which is obtained from public data sources. The expected life of the stock options is determined using historical data adjusted for the estimated exercise dates of unexercised options. Additionally, separate groups of employees that have similar historical exercise behavior are considered separately for valuation purposes.

Prior to the Company's adoption of FASB No. 123(R), FASB No. 123 required that the Company provide pro-forma information regarding net income and earnings per share as if stock-based compensation expense for the Company's stock-based awards had been determined in accordance with the fair value method prescribed therein. The Company accounted for these plans under the recognition and measurement principles of APB 25 and related interpretations. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of FASB No. 123 to stock-based employee compensation:

Year Ended June 30	2005	2004
Net income, as reported	$ 84,356,000	$ 65,020,000
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	—	—
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(8,162,000)	(6,702,000)
Pro forma net income	$ 76,194,000	$ 58,318,000
Earnings per share:		
Basic–as reported	$ 1.19	$ 0.95
Basic–pro forma	$ 1.07	$ 0.85
Diluted–as reported	$ 1.17	$ 0.92
Diluted–pro forma	$ 1.06	$ 0.83

In August 2001, the Company adopted the 2002 Employee Stock Purchase Plan (the 2002 Plan) under which employees can purchase common stock of the Company through payroll deductions during each Plan year beginning on January 1, 2002 through December 31, 2006. The purchase price under each Plan is the lesser of 85% of the market value of the Company's common stock on either the first or last day of the Plan year. The maximum amount employees can purchase currently under the 2002 Plan is equal to 20% of their annual compensation (subject to statutory limitations). There were no charges or credits to income in fiscal years 2005 and 2004 in connection with the Plans under APB Opinion No. 25. Shares are purchased at the end of each Plan year with the funds set aside through payroll deductions.

The Company maintains a shareholders' rights plan (Rights Agreement) under which existing and future shareholders receive a right for each share outstanding entitling such shareholders to purchase shares of the Company's common stock at a specified exercise price. The right to purchase such shares is not currently exercisable, but would become exercisable in the future if certain events occurred relating to a person or group (the acquirer) acquiring or attempting to acquire 20% or more of the Company's outstanding shares of common stock. In the event the rights become exercisable, each right would entitle the holder (other than the acquirer) to purchase shares of the Company's common stock having a value equal to two times the specified exercise price.

In June 2006, the Company amended the Rights Agreement (Amendment No. 3) to extend the final expiration date of the Rights Agreement to June 28, 2016. In addition, Amendment No. 3 changed the purchase price (as defined in the Rights Agreement) for each Unit from $55 to $185, subject to adjustment as provided in the Rights Agreement. Amendment No. 3 also revised the period during which the Company's Board of Directors can redeem the Rights Agreement so that it ends on the earlier of such time as any person becomes an acquiring person (as defined in the Rights Agreement) or the final expiration date of June 28, 2016. Amendment No. 3 also revised the period during which the Company's Board of Directors can amend the Rights Agreement without shareholder approval so that it refers to the period prior to the time when any person becomes an acquiring person.

NOTE O INDUSTRY SEGMENT, FINANCIAL INFORMATION BY GEOGRAPHIC AREAS AND MAJOR CUSTOMERS

The Company aggregates its products into one reportable industry segment: the design, development, manufacture and sale of medical devices used primarily for the treatment of patients suffering from sleep and respiratory disorders. Sales by product within this segment are as follows:

Year Ended June 30	2006	2005	2004
NET SALES			
Domestic Sleep and Home Respiratory products	$ 535,654,000	$ 463,073,000	$ 402,595,000
Domestic Hospital products	189,128,000	162,138,000	144,630,000
International products	321,359,000	286,286,000	212,325,000
Net Sales	**$ 1,046,141,000**	$ 911,497,000	$ 759,550,000

The Company is a Delaware corporation, with its corporate offices located in Murrysville, Pennsylvania. Its principal manufacturing operations are currently located in Pennsylvania, California, Georgia, Connecticut, Oregon, China, the Philippines, the UK, and Ireland. Other major distribution and sales sites are located throughout the U.S., Germany, France, Italy, Switzerland, the UK, Hong Kong and Japan.

Financial information about the Company by geographic area is presented below.

Year Ended June 30	2006	2005	2004
NET SALES			
Domestic	$ 724,781,000	$ 625,211,000	$ 547,224,000
International:			
Europe, Africa and Middle East	163,292,000	143,375,000	95,001,000
Americas	44,544,000	37,425,000	31,309,000
Far East/Asia Pacific	113,524,000	105,486,000	86,016,000
Net Sales	**$ 1,046,141,000**	$ 911,497,000	$ 759,550,000

June 30	2006	2005
LONG-LIVED ASSETS		
United States	$ 134,269,000	$ 119,727,000
International:		
Europe	17,145,000	17,082,000
Far East/Asia Pacific	42,510,000	38,886,000
Total Long-Lived Assets	**$ 193,924,000**	$ 175,695,000

The Company develops, manufactures and markets medical devices primarily for the treatment of patients suffering from sleep and respiratory disorders. Its products are used primarily in the home and in hospitals, as well as emergency medical settings and alternative care facilities. The Company sells and rents primarily to providers and distributors in the healthcare industry and closely monitors the extension of credit to both domestic and foreign customers, including obtaining and analyzing credit applications for all new accounts and maintaining an active program to contact customers promptly when invoices become past due. The Company generally does not require collateral for the extension of credit. During the fiscal years ended June 30, 2006, 2005, and 2004, respectively, no customer accounted for more than 10% of net sales.

NOTE P RETIREMENT PLANS

The Company has a Retirement Savings Plan (the Plan) that is available to all U.S. employees. Employees may contribute up to 75% (subject to statutory limitations) of their compensation to the Plan (amended from 30% as of January 1, 2005). The Company matches employee contributions (up to 3% of each employee's compensation) at a 100% rate, and may make discretionary contributions to the Plan. Total Company contributions to the Plan were $3,869,000, $3,249,000, and $2,368,000 for the years ended June 30, 2006, 2005, and 2004, respectively.

NOTE Q RESTRUCTURING AND ACQUISITION-RELATED EXPENSES

The Company incurred the following restructuring and acquisition-related expenses during the years ended June 30:

Year Ended June 30	2006	2005	2004
Galway, Ireland facility changes	$ 1,640,000	$ —	$ —
Wallingford, Connecticut facility changes	102,000	4,701,000	10,380,000
Kennesaw, Georgia facility changes	—	(897,000)	180,000
Acquisition-related integration expenses	2,211,000	2,611,000	382,000
Total	**$ 3,953,000**	$ 6,415,000	$ 10,942,000

Galway, Ireland Manufacturing Facility Changes

On May 11, 2006, the Company announced that it would be closing its Galway, Ireland manufacturing facility. The facility is expected to close by October 31, 2006, and substantially all of the accrued obligations are expected to be paid by December 31, 2006.

The manufacturing activities previously conducted at the Galway facility will be transferred to three existing manufacturing sites in the U.S. It is anticipated that the closure will result in future cost reductions and operational efficiencies. Approximately 40 employees, primarily from manufacturing and manufacturing support, purchasing and certain administrative support functions, were involuntarily terminated as a result of the closure. The costs reflected in the table above for Galway, Ireland facility changes relate primarily to employee retention and transition benefits, lease termination costs, and grant money which must be refunded to local governmental agencies.

Wallingford, Connecticut Facility Changes

On April 11, 2003, the Company announced that it would be consolidating product manufacturing activities and other support functions from the Company's Wallingford, Connecticut plant to its Carlsbad, California location. The relocation allowed the Company to standardize its manufacturing support and engineering functions at the Carlsbad plant, enabled the Wallingford facility to concentrate on new product research and development, and improved the overall efficiency of the Company. Approximately 60 employees were involuntarily terminated as a result of the restructuring actions, primarily from manufacturing and manufacturing support, purchasing and certain administrative support functions. The costs reflected in the table above for Wallingford, Connecticut facility changes relate primarily to employee retention and transition benefits and other costs associated with the relocation and transition process.

Following is a summary of the restructuring and acquisition-related liabilities related to the Wallingford, Connecticut facility changes, including the payments made against the obligations during the years ended June 30, 2006, 2005, and 2004 and the remaining obligations as of June 30, 2006, 2005, and 2004.

Year Ended June 30, 2004	Accrued Employee Costs	Accrued Facility Costs
Balance at July 1, 2003	$ 1,834,000	$ 1,075,000
Restructuring and acquisition-related expenses	3,366,000	—
Liability adjustment – costs of acquired businesses	(270,000)	—
Cash Payments	(2,873,000)	(32,000)
Balance at June 30, 2004	$ 2,057,000	$ 1,043,000
Year Ended June 30, 2005		
Balance at July 1, 2004	$ 2,057,000	$ 1,043,000
Restructuring and acquisition-related expenses	677,000	—
Cash payments	(805,000)	(253,000)
Balance at June 30, 2005	$ 1,929,000	$ 790,000
Year Ended June 30, 2006		
Balance at July 1, 2005	$ 1,929,000	$ 790,000
Restructuring and acquisition-related expenses	—	—
Cash payments	(1,829,000)	(253,000)
Balance at June 30, 2006	**$ 100,000**	**$ 537,000**

Substantially all of the accrued obligations are expected to be paid by September 30, 2006, except for the idle facility costs that will be paid over the remaining term of the lease.

Kennesaw, Georgia Facility Changes

On October 23, 2002, the Company announced the relocation of several of its smaller product lines and related support functions from the Company's Kennesaw, Georgia manufacturing facility to its Murrysville, Pennsylvania location. This relocation allowed the Company to standardize its manufacturing support, engineering and marketing functions as well as improve the overall efficiency of its manufacturing operations in Kennesaw. Approximately 134 employees were involuntarily terminated and six were relocated as a result of the restructuring actions, primarily from manufacturing and manufacturing support, engineering, purchasing and marketing. The costs reflected in the table on page 49 for Kennesaw, Georgia facility changes relate primarily to involuntary termination benefits accruing to employees affected by the restructuring plan, employee transition and relocation benefits, idle facility rent obligations and certain asset write-offs related to products that were discontinued as a result of the restructuring plan. The transition of products and manufacturing processes from Kennesaw to Murrysville was completed during the quarter ended September 30, 2003.

During the year ended June 30, 2005, the Company recorded an $897,000 reduction to the idle facility rent obligation, based on increased utilization at the facility, as a credit to restructuring and acquisition-related expenses. As of June 30, 2006 and 2005, substantially all of the restructuring obligations were paid except for $565,000 and $713,000, respectively of remaining idle facility costs that were paid over the remaining term of the lease.

Acquisition-Related Integration Expenses

As more fully described in Note R to these Consolidated Financial Statements, the Company has recently completed several business acquisitions. The Company's acquisition strategy includes the centralization and harmonization of business processes which often results in the elimination of redundancies, centralization of corporate services functions, and the implementation of standardized processes across several business functions, including information systems, manufacturing, quality systems, and marketing. Additionally, the Company periodically makes one-time compensation related payments in order to retain personnel to assist with the acquisition and related integration activities. These costs, collectively referred to as acquisition-related integration expenses, are incremental, nonrecurring costs directly related to business acquisitions that are expensed as incurred in the Consolidated Statement of Operations.

NOTE R ACQUISITIONS

Fuji

In May 2002, the Company acquired a 60% controlling interest in Fuji RC Kabushiki Kaisha (now known as "Fuji Respironics Kabushiki Kaisha" and referred to herein as "Fuji"), a leading provider of sleep and home respiratory and hospital products and services for respiratory-impaired patients in Japan, and entered into an agreement to purchase all of the remaining outstanding shares of Fuji in four annual installments of $1,433,000, the last of which is due on December 31, 2006 (before the amendments described below). The remaining net present value of the Company's remaining obligation under the fixed-price forward contract, $1,415,000 is accounted for as a financing of the Company's purchase of the minority interest and is classified with accrued expenses and other current liabilities in the Company's June 30, 2006 consolidated balance sheet. As of June 30, 2005, the net present value of $2,079,000 is classified with other noncurrent liabilities. Including the fixed-price forward contract and costs directly associated with the acquisition, the base cash purchase price for all of the outstanding shares is approximately $12,662,000 with provisions for additional payments to one of the shareholders of Fuji to be made based on the operating performance of Fuji over four years, payable on December 31, 2006. These additional payments were accrued as compensation over the four-year period as they were earned by the shareholder during his post-acquisition employment period, through June 30, 2006. As of June 30, 2006, $5,394,000 is accrued in the Consolidated Balance Sheet and classified with accrued expenses and other current liabilities pertaining to this obligation. At June 30, 2005, $6,743,000 is included in the Consolidated Balance Sheet, and classified with other noncurrent liabilities. These liability balances are net of amounts paid in conjunction with the amendments to the stock purchase agreement described below. No amounts of the purchase price were assigned to goodwill or other intangible assets since the initial purchase price equaled the fair market value of the net tangible assets acquired.

At various times since May 2002, the Company and the 40% shareholder of Fuji entered into amendments to the stock purchase agreement noted above, whereby the Company acquired 20% of the outstanding shares of Fuji for $5,090,000 on October 29, 2003, an additional 5% of the outstanding shares of Fuji for $3,560,000 on December 29, 2004, and an additional 5% on December 31, 2005 for $5,000,000. The Company will acquire the remaining 10% of the outstanding shares of Fuji on December 31, 2006 for an amount that is determined based on the operating performance of Fuji. A portion of the October 29, 2003, December 29, 2004, and December 31, 2005 payments will result in a direct reduction to the additional payment due on December 31, 2006 (in comparison to the amounts that would have become due on December 31, 2006 under the original acquisition agreement). The Company does not expect the total of the payments due under the amended purchase agreement to be materially different than the total of those payments under the original purchase agreement described previously, including the total of the fixed-price forward contract and the additional payments based on the operating performance of Fuji.

Caradyne

On February 27, 2004, the Company acquired 100% of the outstanding capital stock of Caradyne, an Ireland-based company, for a base purchase price of $5,970,000 (including transaction costs), of which $4,470,000 was paid at closing and $1,500,000 was paid on March 2, 2006 upon the conclusion of a two-year retention period. The Company was also required to make up to $2,500,000 of additional future payments based on the achievement of various performance milestones following the acquisition through March 31, 2006 (as amended). The Company paid $2,000,000 as of December 31, 2005, and $500,000 on May 1, 2006, as a result of the successful achievement of performance milestones. These additional payments were recorded as costs of the acquisition at the time they became payable. The total purchase price, including the additional payments was $8,470,000. No additional future amounts will be paid as of June 30, 2006.

Caradyne is involved in the development, manufacturing, and marketing of unique technologies that are complementary with the Company's ventilation product portfolio, primarily used in hospital settings and prehospital applications. In connection with the acquisition, the Company recorded $3,751,000 of intangible assets, representing the fair market value of acquired product-related intellectual property and employee contracts. The weighted-average amortization period for these intangible assets is approximately 15 years.

Profile

On July 1, 2004, the Company's previously announced offer to acquire 100% of the outstanding stock of Profile was declared unconditional, and the Company paid 50.9 British Pence for each share of Profile. The total purchase price was 26,309,000 British Pounds (or approximately $43,524,000 net of $4,675,000 of cash acquired in the transaction), including transaction costs directly related to the acquisition (consisting primarily of investment banking and other professional fees). Profile is a UK-based company that distributes, develops and commercializes specialty products to improve the treatment of sleep and respiratory patients. The acquisition of Profile expands the Company's presence in the global sleep and respiratory markets, and enhances the breadth of its products and services with Profile's innovative technologies for respiratory drug delivery. The results of operations of Profile are included in the Company's Consolidated Statement of Operations beginning on the acquisition date, July 1, 2004. The acquisition added in excess of approximately $28,800,000 to the Company's net sales during the year ended June 30, 2005, but did not materially impact the Company's net income during the year.

The following table summarizes the fair value of the assets acquired and liabilities assumed from Profile at the date of acquisition:

	At July 1, 2004
Cash	$ 4,675,000
Accounts receivable	3,690,000
Inventories	2,104,000
Prepaid expenses and other current assets	3,057,000
Property, plant and equipment	1,554,000
Other noncurrent assets, including intangible assets	8,549,000
Goodwill	36,344,000
Total Assets Acquired	**$ 59,973,000**
Current liabilities, primarily consisting of accounts payable and accrued expense	9,141,000
Other noncurrent liabilities	2,633,000
Net Assets Acquired	**$ 48,199,000**

In connection with the Profile acquisition, the Company recorded $8,290,000 of intangible assets, representing the fair market value of acquired product-related intellectual property and customer relationships. The weighted-average amortization period for these intangible assets is approximately nine years. The amounts assigned to these major classes of intangible assets are shown below:

Product-related intellectual property, primarily patents	$ 2,520,000
Customer contracts and relationships	5,770,000
Total Intangible Assets	**$ 8,290,000**

Mini-Mitter

On April 1, 2005, the Company acquired 100% of the outstanding shares of Mini-Mitter. The base cash purchase price (including $500,000 scheduled to be paid after a three-year retention period) approximated $10,500,000, with provisions for up to $7,500,000 of additional payments to be made based on Mini-Mitter's operating performance though March 31, 2007. These additional future payments will be recorded as costs of the acquisition at the time they become payable. As of June 30, 2006, no amounts became payable. Mini-Mitter, located in Bend, Oregon, develops and sells sleep and physiological monitoring products to commercial sleep laboratories and other medical, pharmaceutical and health research institutions involved in clinical trials. The acquisition did not materially impact the Company's net sales or net income during the years ended June 30, 2006 and 2005.

OxyTec

On April 21, 2006, the Company purchased 100% of the outstanding stock of OxyTec for a cash purchase price of $10,400,000 (including transaction costs), with provisions for up to $30,000,000 of additional payments to be made based on the acquired company's operating performance in future years. OxyTec, located in Anaheim Hills, California, developed an innovative portable oxygen concentrator that has the potential to provide ambulatory oxygen patients greater freedom to be mobile while reducing homecare providers' costs associated with the delivery of oxygen to these patients. The results of operations of OxyTec are included in the Company's Consolidated Statement of Operations beginning on the acquisition date, April 21, 2006. The acquisition did not materially impact the Company's net sales or net income during the year ended June 30, 2006.

Omni Therm

On May 15, 2006, the Company purchased certain assets and liabilities of Omni Therm for a cash purchase price of $2,510,000 (including transaction costs). Omni Therm, located in St. Louis, Missouri, is an original equipment manufacturer, supplier, and wholesaler of infant heel warmers, infant warming mattresses, and hospital thermometer products. Prior to the acquisition, Omni Therm was the Company's supplier of these products through Children's Medical Ventures. The results of operations of Omni Therm are included in the Company's Consolidated Statement of Operations beginning on the acquisition date, May 15, 2006. The acquisition did not materially impact the Company's net sales or net income during the year ended June 30, 2006.

Other

On October 6, 2005, Respironics acquired an oxygen generation technology company. The acquired technology has the potential to be used as a basis for a cost effective oxygen generation device. The cash purchase price totaled $8,400,000, with provisions for uncapped additional payments to be made based on the acquired company's operating performance in future years through 2010. The acquired entity's results of operations are included in the Company's Consolidated Statement of Operations beginning on the acquisition date, October 6, 2005. The acquisition did not materially impact the Company's net sales or net income during the year ended June 30, 2006.

NOTE S SALE OF INVESTMENT

On July 21, 2005, Centene acquired AirLogix for approximately $35,000,000 in cash plus additional consideration of up to $5,000,000 based on the achievement of certain performance milestones. At the time of the sale, the Company held approximately 17% ownership in AirLogix. In connection with the sale of AirLogix, the Company has received $5,488,000 as of June 30, 2006, and total proceeds may exceed $7,000,000. The Company recorded a pre-tax gain of $4,398,000 during the year ended June 30, 2006 as a result of the sale.

NOTE T EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share:

Year Ended June 30	**2006**	2005	2004
Numerator:			
Net income	$ 99,893,000	$ 84,356,000	$ 65,020,000
Denominator:			
Denominator for basic earnings per share—weighted-average shares	72,311,000	70,896,000	68,754,000
Effect of dilutive securities - stock options and warrants	1,259,000	1,359,000	1,864,000
Denominator for diluted earnings per share—adjusted weighted-average shares and assumed conversions	**73,570,000**	72,255,000	70,618,000
Basic Earnings Per Share	**$ 1.38**	$ 1.19	$ 0.95
Diluted Earnings Per Share	**$ 1.36**	$ 1.17	$ 0.92

NOTE U QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

Following are the unaudited quarterly results of operations for the fiscal years ended June 30, 2006 and 2005:

Three Months Ended	September 30	December 31	March 31	June 30
2006				
Net Sales	$ 240,222,000	$ 257,901,000	$ 267,312,000	$ 280,706,000
Gross Profit	132,679,000	142,732,000	146,713,000	150,753,000
Restructuring and Acquisition-Related Expenses	1,089,000	224,000	407,000	2,233,000
Contribution to Foundation	1,500,000	—	—	—
Net Income	18,576,000	24,053,000	27,862,000	29,402,000
Basic Earnings Per Share	0.26	0.33	0.38	0.40
Diluted Earnings Per Share	0.25	0.33	0.38	0.40

Three Months Ended	September 30	December 31	March 31	June 30
2005				
Net Sales	$ 199,437,000	$ 225,929,000	$ 236,488,000	$ 249,643,000
Gross Profit	107,375,000	122,778,000	130,236,000	137,894,000
Restructuring and Acquisition-Related Expenses	2,135,000	2,290,000	203,000	1,786,000
Contribution to Foundation	—	1,500,000	—	1,500,000
Net Income	15,191,000	20,070,000	24,410,000	24,686,000
Basic Earnings Per Share	0.22	0.28	0.34	0.34
Diluted Earnings Per Share	0.21	0.28	0.34	0.34

Board of Directors and Shareholders of Respironics, Inc. and Subsidiaries

We have audited the accompanying consolidated balance sheets of Respironics, Inc. and subsidiaries as of June 30, 2006 and 2005, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended June 30, 2006. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 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 financial statements referred to above present fairly, in all material respects, the consolidated financial position of Respironics, Inc. and subsidiaries at June 30, 2006 and 2005, and the consolidated results of their operations and their cash flows for each of the three years in the period ended June 30, 2006, in conformity with U.S. generally accepted accounting principles.

As discussed in Note A to the Consolidated Financial Statements, the Company adopted Statement of Financial Accounting Standards No. 123(R), "Share-Based Payment," effective July 1, 2005.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of June 30, 2006, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated September 8, 2006 expressed an unqualified opinion thereon.

Pittsburgh, Pennsylvania
September 8, 2006

Board of Directors and Shareholders of Respironics, Inc.

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that Respironics, Inc. maintained effective internal control over financial reporting as of June 30, 2006 based on criteria established in Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). The Company'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 the Company maintained effective internal control over financial reporting as of June 30, 2006 is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of June 30, 2006, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the accompanying consolidated balance sheets of Respironics, Inc. and subsidiaries as of June 30, 2006 and 2005, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended June 30, 2006 of the Company and our report dated September 8, 2006 expressed an unqualified opinion thereon.

Pittsburgh, Pennsylvania
September 8, 2006

Management's Evaluation of Disclosure Controls and Procedures

The Company's President and Chief Executive Officer, and Vice President and Chief Financial and Principal Accounting Officer have evaluated the Company's disclosure controls and procedures as of June 30, 2006. Based on that evaluation, they have concluded that the Company's disclosure controls and procedures are effective in ensuring that material information required to be in this Annual Report is made known to them on a timely basis.

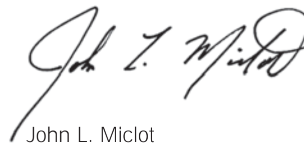
Management's Report on Internal Control Over Financial Reporting

Management has responsibility for establishing and maintaining adequate internal control over financial reporting. 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 reporting purposes in accordance with accounting principles generally accepted in the United States. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. As of June 30, 2006, management has assessed the effectiveness of the Company's internal control over financial reporting. In making its assessment, management has utilized the criteria set forth by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission in Internal Control—Integrated Framework. Based on this assessment, management concluded that, as of June 30, 2006, the Company's internal control over financial reporting is effective.

Management's assessment of the effectiveness of internal control over financial reporting as of June 30, 2006 was audited by the Company's independent registered public accounting firm. This audit report appears below.

Changes in Internal Control over Financial Reporting

There have been no changes in the Company's internal control over financial reporting that occurred during the fiscal year ended June 30, 2006 that materially affected, or are reasonably likely to materially affect the Company's internal control over financial reporting.



John L. Miclot
President and Chief Executive Officer

Daniel J. Bevevino
Vice President and Chief Financial and Principal Accounting Officer

(amounts in thousands except per share data)

Year Ended June 30	2006 [1,2]	2005 [3]	2004 [4]	2003 [5]	2002 [6,7]
Per Share Data					
Net Income	$ 1.36	$ 1.17	$ 0.92	$ 0.68	$ 0.60
Book Value at year end	10.51	8.75	7.42	6.29	5.52
Results of Operations					
Net sales	$ 1,046,141	$ 911,497	$ 759,550	$ 629,817	$ 494,919
Cost of goods sold	473,263	413,215	356,625	310,385	260,795
Income before income taxes	159,222	135,719	105,234	74,890	64,036
Net income	99,893	84,356	65,020	46,581	38,417
Financial Position at Year End					
Working Capital	431,050	338,102	301,032	212,787	198,966
Property, plant, and equipment (net)	137,943	127,376	111,057	98,680	99,935
Total assets	1,017,378	878,446	711,139	582,196	550,911
Long-term obligations	26,756	29,241	26,897	16,513	59,502
Shareholders' equity	764,448	627,646	519,053	426,869	367,720
Other Data					
Capital expenditures	58,484	61,900	51,391	42,075	39,830
Depreciation and amortization	57,795	46,283	44,556	46,952	34,232
Number of employees at year end	4,700	3,851	3,032	2,698	2,589
Diluted shares outstanding	73,570	72,255	70,619	68,688	64,016
Selected Financial Ratios					
Gross profit as a percent of net sales	55%	55%	53%	51%	47%
Income before income taxes as a % of net sales	15%	15%	14%	12%	13%
Effective income tax rate	37%	38%	38%	38%	40%
Net income as a percent of net sales	10%	9%	9%	7%	8%
Return on average equity	14%	15%	14%	12%	13%
Debt to equity ratio	4%	5%	5%	4%	16%
Current ratio	3.04x	2.67x	2.99x	2.67x	2.79x

[1] Includes stock compensation expense pursuant to the adoption of FASB No. 123(R), "Share-Based Payment" on July 1, 2005. This expense reduced pre-tax income by $11,955, and net income by $8,524 ($0.12 per share) in fiscal year 2006.

[2] Includes a pre-tax gain of $4,398 as a result of the sale of the Company's investment in AirLogix. Also includes $3,953 of restructuring and acquisition-related expenses, primarily related to the closure of the Company's Galway, Ireland manufacturing facility, the integration of acquired companies (Profile and Mini-Mitter) and other costs. Collectively, these events increased net income by $445 (less than $0.01 per share) in fiscal year 2006.

[3] Includes the impact of restructuring and acquisition-related expenses related primarily to the restructuring of operations at the Wallingford, Connecticut manufacturing facility and the integration of Profile. These costs reduced pre-tax income by $6,415 and net income by $3,987 ($0.05 per share) in fiscal year 2005.

[4] Includes the impact of restructuring and acquisition-related expenses related primarily to the restructuring of operations at the Wallingford, Connecticut manufacturing facility. These costs reduced pre-tax income by $10,942, and net income by $6,777 ($0.10 per share) in fiscal year 2004.

[5] Includes the impact of restructuring and acquisition-related expenses related to the integration of Novametrix Medical Systems Inc. (Novametrix) and restructuring of operations at the Kennesaw, Georgia and Wallingford, Connecticut manufacturing facilities, and other acquisition-related costs. These costs reduced pre-tax income by $18,144, and net income by $11,286 ($0.16 per share) in fiscal year 2003.

[6] Includes the impact of a non-recurring purchase accounting adjustment related to reversing acquisition date inventory fair market value adjustments as inventory was sold subsequent to the acquisition of Novametrix, restructuring and acquisition-related expenses related to the integration of Novametrix, and an asset impairment charge. These costs reduced pre-tax income by $5,947, and net income by $3,853 ($0.06 per share) in fiscal year 2002.

[7] Includes goodwill amortization expense. These costs reduced pre-tax income by $3,507, and net income by $3,302 ($0.10 per share) in fiscal year 2002. As of July 1, 2002 the Company ceased amortizing goodwill due to the adoption of FASB No. 142, "Goodwill and Other Intangible Assets."

Corporate Headquarters

1010 Murry Ridge Lane
Murrysville, Pennsylvania 15668-8525
724.387.5200

Annual Meeting of Shareholders

The annual meeting of shareholders will be held at the Hyatt Pittsburgh International Airport, 1111 Airport Boulevard, Pittsburgh, Pennsylvania on Tuesday, November 14, 2006 at 5:15 PM.

Market for the Company's Common Stock and Related Shareholder Matters

The common stock is traded on the NASDAQ Stock Market under the symbol "RESP." The Company began trading on the national over-the-counter market on May 12, 1988. As of September 1, 2006, there were approximately 2,600 holders of record of the Company's common stock.

On April 20, 2005, the Company declared a two-for-one stock split effected in the form of a 100% stock dividend that was distributed on June 1, 2005. Accordingly, all share price information has been adjusted to reflect the stock split.

The Company has never paid a cash dividend with respect to its common stock. While the Company periodically reviews its policies with respect to dividends, it does not intend to pay cash dividends in the immediate future.

High and low sales price information for the Company's common stock for the applicable quarters is shown below.

Form 10-K

Copies of the Respironics, Inc. Annual Report on Form 10-K can be found on the Company's website as filed with the Securities and Exchange Commission; otherwise, copies will be mailed without charge upon request. Address requests to Dorita Pishko, Corporate Secretary, Respironics, Inc., 1010 Murry Ridge Lane, Murrysville, Pennsylvania 15668-8525.

Shareholder Inquiries/Financial Data

Shareholders, analysts, or others seeking information about the Company are encouraged to contact Daniel Bevevino, Vice President and Chief Financial Officer, or Damian Rippole, Corporate Controller, Respironics, Inc., 1010 Murry Ridge Lane, Murrysville, Pennsylvania 15668-8525 or by calling 724-387-5200.

Year Ended June 30	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2006				
High	$ 42.18	$ 42.62	$ 38.91	$ 37.96
Low	$ 36.06	$ 35.73	$ 34.14	$ 33.39
2005				
High	$ 29.48	$ 28.45	$ 30.76	$ 37.40
Low	$ 25.08	$ 21.88	$ 26.08	$ 29.13

Market Makers

Archipelago Stock Exchange
Automated Trading Desk
B-Trade Services LLC
Banc of America Securities
Bear, Stearns and Co. Inc.
BMO Capital Markets Corp.
Boston Stock Exchange
Calyon Securities (USA) Inc.
Cantor, Fitzgerald & Co.
Citadel Derivatives Group LLC
Citigroup Global Markets, Inc.
Cowen and Company, LLC
Credit Suisse Securities USA
Deutsche Banc Alex Brown
E*Trade Capital Markets LLC
First Albany Capital, Inc.
Goldman, Sachs & Co.
Hudson Securities, Inc.
J.P. Morgan Securities Inc.
Janney Montgomery LLC
Jefferies & Company, Inc.
Kaufman Brothers L.P.
Knight Equity Markets, L.P.
Leerink Swann & Co.
Lehman Brothers Inc.
Maxim Group LLC
Merrill Lynch, Pierce, Fenner
Morgan Stanley & Co., Inc.
Natexis Bleichroeder Inc.
National Stock Exchange
Pershing LLC
Piper Jaffray & Co.
Prudential Equity Group, LLC
SunTrust Capital Markets Inc.
Susquehanna Capital Group
Thomas Weisel Partners
Timber Hill Inc.
Tradition Asiel Securities Inc.
UBS Securities LLC
Wachovia Capital Markets
Weeden and Co. Inc.
William Blair & Co.

Board of Directors

STANDING – LEFT TO RIGHT:

John C. Miles II
Private Investor

Mylle H. Mangum
Chief Executive Officer, IBT
(a company that creates retail locations for financial institutions)

Craig B. Reynolds
Executive Vice President and Chief Operating Officer

J. Terry Dewberry
Private Investor

Joseph C. Lawyer
Vice Chairman,
Reunion Industries, Inc.
(a designer and manufacturer of fabricated and machined parts and products)

John L. Miclot
President and
Chief Executive Officer

Candace L. Littell
President, Littell Group, Inc.
(a consulting firm specializing in health policy, payment and outcomes management)

James W. Liken
Vice Chairman

SEATED – LEFT TO RIGHT:

Douglas A. Cotter
Private Investor

Donald H. Jones
Chairman,
Triangle Capital Corporation
(an investment firm)

Gerald E. McGinnis
Advanced Technology Officer and Chairman of the Board

Sean C. McDonald
President and Chief Executive Officer,
Precision Therapeutics
(a biomedical company providing comprehensive, personalized cancer management information)

RESPIRONICS, INC.

1010 Murry Ridge Lane
Murrysville, Pennsylvania 15668-8525
724.387.5200
www.respironics.com

RESEARCH COVERAGE

Banc of America Securities
First Albany Corporation
Great Lakes Review
Harris Nesbitt Corp
Janney Montgomery Scott LLC
Kaufman Bros., L.P.
Natexis Bleichroeder Inc.
Wachovia Securities

TRANSFER AGENT AND REGISTRAR

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480 Washington Boulevard
Jersey City, New Jersey 07310
www.melloninvestor.com

GENERAL COUNSEL

Steven P. Fulton

AUDITORS

Ernst & Young LLP
Pittsburgh, Pennsylvania 15222