STRYKER CORP
Form 10-Q
October 28, 2016

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q
(Mark
one)

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

For the quarterly period ended September 30, 2016

OR

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

Commission file number: 000-09165
STRYKER CORPORATION
(Exact name of registrant as specified in its charter)

Michigan	38-1239739
(State of incorporation)	(I.R.S. Employer Identification No.)
2825 Airview Boulevard, Kalamazoo, Michigan	49002
(Address of principal executive offices)	(Zip Code)

(269) 385-2600
(Registrant’s telephone number, including area code)

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

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

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

Large accelerated filer [X] Accelerated filer [ ]

Non-accelerated filer [ ] Small reporting company [ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES [ ] NO [X]

Number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 374,451,718 shares of Common Stock, $0.10 par value, on September 30, 2016.

STRYKER CORPORATION 2016 Third Quarter Form 10-Q

PART I. - FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
Stryker Corporation and Subsidiaries

CONSOLIDATED STATEMENTS OF EARNINGS (Unaudited)

	Three Months		Nine Months	
	2016	2015	2016	2015
Net sales	$2,833	$2,420	$8,168	$7,231
Cost of sales	960	796	2,759	2,449
Gross profit	$1,873	$1,624	$5,409	$4,782
Research, development and engineering expenses	184	155	526	461
Selling, general and administrative expenses	1,057	887	3,044	2,640
Recall charges	57	150	104	316
Amortization of intangible assets	89	54	230	152
Total operating expenses	$1,387	$1,246	$3,904	$3,569
Operating income	$486	$378	$1,505	$1,213
Other income (expense), net	(67)	(33)	(172)	(90)
Earnings before income taxes	$419	$345	$1,333	$1,123
Income taxes	64	44	196	206
Net earnings	$355	$301	$1,137	$917
Net earnings per share of common stock:				
Basic net earnings per share of common stock	$0.95	$0.80	$3.04	$2.43
Diluted net earnings per share of common stock	$0.94	$0.79	$3.01	$2.40
Weighted-average shares outstanding:				
Basic	374.4	376.3	373.9	377.4
Effect of dilutive employee stock options	4.6	4.4	4.4	4.4
Diluted	379.0	380.7	378.3	381.8

There were no anti-dilutive shares for any of the periods presented.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)

	Three Months		Nine Months	
	2016	2015	2016	2015
Net earnings	$355	$301	$1,137	$917
Other comprehensive (loss) income, net of tax:				
Marketable securities	—	—	—	(3)
Pension plans	(1)	—	(4)	10
Unrealized losses on designated hedges	—	(15)	(35)	(4)
Financial statement translation	(4)	(83)	78	(278)
Total other comprehensive (loss) income, net of tax	$(5)	$(98)	$39	$(275)
Comprehensive income	$350	$203	$1,176	$642

See accompanying notes to Consolidated Financial Statements.

1 Dollar amounts are in millions except per share amounts or as otherwise specified.

STRYKER CORPORATION 2016 Third Quarter Form 10-Q

Stryker Corporation and Subsidiaries

CONSOLIDATED BALANCE SHEETS

	September 30 2016 (Unaudited)	December 31 2015
ASSETS		
Current assets		
Cash and cash equivalents	$ 2,953	$ 3,379
Marketable securities	69	700
Accounts receivable, less allowance of $64 ($61 in 2015)	1,803	1,662
Inventories:		
Materials and supplies	396	304
Work in process	126	103
Finished goods	1,570	1,232
Total inventories	$ 2,092	$ 1,639
Prepaid expenses and other current assets	449	563
Total current assets	$ 7,366	$ 7,943
Property, plant and equipment:		
Land, buildings and improvements	802	687
Machinery and equipment	2,321	2,043
Total property, plant and equipment	3,123	2,730
Less allowance for depreciation	1,618	1,531
Net property, plant and equipment	$ 1,505	$ 1,199
Goodwill	6,475	4,136
Other intangibles, net	3,608	1,794
Other noncurrent assets	1,233	1,151
Total assets	$ 20,187	$ 16,223
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$ 420	$ 410
Accrued compensation	640	637
Income taxes	213	141
Dividend payable	142	142
Accrued recall	603	694
Accrued expenses and other liabilities	873	710
Current maturities of debt	135	768
Total current liabilities	$ 3,026	$ 3,502
Long-term debt, excluding current maturities	6,713	3,230
Other noncurrent liabilities	1,116	980
Total liabilities	$ 10,855	$ 7,712
Shareholders' equity		
Common stock, $0.10 par value:		
Authorized: 1 billion shares, outstanding: 374 million shares (373 million shares in 2015)	37	37
Additional paid-in capital	1,404	1,321
Retained earnings	8,491	7,792
Accumulated other comprehensive income	(600)	(639)

Total shareholders' equity	$ 9,332	$ 8,511
Total liabilities & shareholders' equity	$ 20,187	$ 16,223

See accompanying notes to Consolidated Financial Statements.

Stryker Corporation and Subsidiaries

CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY (Unaudited)

	Common Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive (Loss) Income	Total
December 31, 2015	$ 37	$ 1,321	$ 7,792	$ (639)	$ 8,511
Net earnings			1,137		1,137
Other comprehensive income				39	39
Issuance of 1.6 million shares of common stock under stock option and benefit plans, including $31 excess income tax benefit		13			13
Repurchase of 0.1 million shares of common stock		(1)	(12)		(13)
Share-based compensation		71			71
Cash dividends declared of $1.14 per share of common stock			(426)		(426)
September 30, 2016	$ 37	$ 1,404	$ 8,491	$ (600)	$ 9,332

CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

	Nine Months 2016	Nine Months 2015
Operating activities		
Net earnings	$ 1,137	$ 917
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation	165	137
Amortization of intangible assets	230	152
Share-based compensation	71	65
Recall charges	104	316
Sale of inventory stepped up to fair value at acquisition	37	7
Excess income tax benefits from stock issued under employee stock plans	(31)	(20)
Changes in operating assets and liabilities:		
Accounts receivable	22	26
Inventories	(307)	(124)
Accounts payable	(11)	15
Accrued expenses and other liabilities	(72)	(35)
Recall-related payments	(181)	(1,172)
Income taxes	(58)	(241)
Other	58	185
Net cash provided by operating activities	$ 1,164	$ 228
Investing activities		
Acquisitions, net of cash acquired	(4,296)	(140)
Purchases of marketable securities	(136)	(1,184)
Sales of marketable securities	769	4,056
Purchases of property, plant and equipment	(347)	(191)
Other investing, net	(4)	—
Net cash (used in) provided by investing activities	$ (4,014)	$ 2,541
Financing activities		
Proceeds from borrowings	4,248	1,298
Payments on borrowings	(1,430)	(1,799)

Dividends paid	(426)	(391)
Repurchase of common stock	(13)	(446)
Excess income tax benefits from stock issued under employee stock plans	31	20
Other financing	(7)	16
Net cash provided by (used in) financing activities	$2,403	$(1,302)
Effect of exchange rate changes on cash and cash equivalents	21	(99)
Change in cash and cash equivalents	$(426)	$1,368
Cash and cash equivalents at beginning of period	3,379	1,795
Cash and cash equivalents at end of period	$2,953	$3,163

See accompanying notes to Consolidated Financial Statements.

3 Dollar amounts are in millions except per share amounts or as otherwise specified.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

NOTE 1 - BASIS OF PRESENTATION

General Information

These statements should be read in conjunction with our Annual Report on Form 10-K for 2015. Management believes that the accompanying unaudited Consolidated Financial Statements contain all adjustments, including normal recurring items, considered necessary for a fair presentation of the interim periods. However, the results of operations included in these Consolidated Financial Statements may not necessarily be indicative of our annual results. Certain prior year amounts on the Consolidated Balance Sheets were reclassified as a result of the adoption of Accounting Standards Update (ASU) 2015-03, Interest - Imputation of Interest: Simplifying the Presentation of Debt Issuance Costs, to conform with the current year presentation. Refer to Note 7 for further information. Certain prior year amounts have been reclassified to conform to the current year presentation of our segment information in Note 10.

New Accounting Pronouncements Not Yet Adopted

In August 2016 the Financial Accounting Standards Board (FASB) issued ASU 2016-15, Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments, which eliminates diversity in practice related to how certain cash receipts and cash payments are presented and classified in the Consolidated Statement of Cash Flows. We plan to adopt this update on January 1, 2017 and do not anticipate that the adoption of this update will have a material impact on our Consolidated Financial Statements.

In March 2016 the FASB issued ASU 2016-09, Compensation-Stock Compensation: Improvements to Employee Share-Based Payment Accounting. This update simplifies the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures and statutory tax withholding requirements, as well as simplifying classification in the Consolidated Statements of Cash Flows. We plan to adopt this update on January 1, 2017. Upon adoption of this update, excess income tax benefits associated with share-based compensation, which are currently recognized within additional paid in capital, will be recognized within the income tax provision in our Consolidated Statements of Earnings. Additionally, our Consolidated Statements of Cash Flows will present such excess income tax benefits, which are currently presented as a financing activity, as an operating activity. If we had adopted this update on January 1, 2016, the impact would have been $31 through September 30, 2016. The impact of adopting this update in 2017 on our Consolidated Financial Statements will be dependent on market factors, the timing and intrinsic value of future share-based compensation award vests and exercises.

In February 2016 the FASB issued ASU 2016-02, Leases. This update requires an entity to recognize assets and liabilities on the balance sheet for leases with lease terms greater than 12 months. We plan to adopt this update on January 1, 2019. We are still evaluating the impact that this update will have on our Consolidated Financial Statements.

In May 2014 the FASB issued ASU 2014-09, Revenue from Contracts with Customers. This update outlines a single, comprehensive model for accounting for revenue from contracts with customers. We plan to adopt this update on January 1, 2018. We are still evaluating the impact that this update will have on our Consolidated Financial Statements.

No other new accounting pronouncements were issued or became effective during the period that had, or are expected to have, a material impact on our Consolidated Financial Statements.

NOTE 2 - ACCUMULATED OTHER COMPREHENSIVE INCOME

Three Months 2016	Marketable Securities	Pension Plans	Hedges	Financial Statement Translation	Total
Beginning	$ —	$ (122)	$ (31)	$ (442)	$ (595)
OCI	1	(4)	(4)	(8)	(15)

Income taxes	—	1	2	4	7
Reclassifications to:					
Cost of sales	—	2	3	—	5
Other income	(1)	—	—	—	(1)
Income taxes	—	—	(1)	—	(1)
Net OCI	—	(1)	—	(4)	(5)
Ending	$ —	$(123)	$(31)	$(446)	$(600)

Three Months 2015	Marketable Securities	Pension Plans	Hedges	Financial Statement Translation	Total
Beginning	$ —	$(126)	$24	$(329)	$(431)
OCI	(1)	(2)	(14)	(83)	(100)
Income taxes	—	—	4	—	4
Reclassifications to:					
Cost of sales	—	2	(7)	—	(5)
Other expense	1	—	—	—	1
Income taxes	—	—	2	—	2
Net OCI	—	—	(15)	(83)	(98)
Ending	$ —	$(126)	$9	$(412)	$(529)

Nine Months 2016	Marketable Securities	Pension Plans	Hedges	Financial Statement Translation	Total
Beginning	$ —	$(119)	$4	$(524)	$(639)
OCI	3	(10)	(43)	69	19
Income taxes	(1)	2	13	9	23
Reclassifications to:					
Cost of sales	—	5	(5)	—	—
Other income	(3)	—	—	—	(3)
Income taxes	1	(1)	—	—	—
Net OCI	—	(4)	(35)	78	39
Ending	$ —	$(123)	$(31)	$(446)	$(600)

Nine Months 2015	Marketable Securities	Pension Plans	Hedges	Financial Statement Translation	Total
Beginning	$ 3	$(136)	$13	$(134)	$(254)
OCI	2	8	6	(278)	(262)
Income taxes	(1)	(2)	(2)	—	(5)
Reclassifications to:					
Cost of sales	—	6	(12)	—	(6)
Other income	(5)	—	—	—	(5)
Income taxes	1	(2)	4	—	3
Net OCI	(3)	10	(4)	(278)	(275)
Ending	$ —	$(126)	$9	$(412)	$(529)

4 Dollar amounts are in millions except per share amounts or as otherwise specified.

NOTE 3 - DERIVATIVE INSTRUMENTS

We use operational and economic hedges, foreign currency exchange forward contracts, net investment hedges and interest rate derivative instruments to manage the impact of currency exchange and interest rate fluctuations on earnings and cash flow. At inception the derivative is designated as a cash flow hedge, a fair value hedge or a free standing derivative. We do not enter into derivative instruments for speculative purposes. We did not change our hedging strategies, accounting practices, or objectives from those disclosed in our Annual Report on Form 10-K for 2015.

Designated Net Investment Hedges

We have designated certain long-term intercompany loans payable and forward exchange contracts as net investment hedges of our investments in certain international subsidiaries that use the Euro as their functional currency. For derivative instruments that are designated and qualify as a net investment hedge, the effective portion of the derivative's gain or loss is recognized in OCI and reported as a component of Accumulated Other Comprehensive Income (AOCI). On September 30, 2016 the total after-tax amount in AOCI related to our designated net investment hedges was $6.

We use the forward method to measure ineffectiveness. Under this method the change in the carrying value of the Euro-denominated amounts, due to remeasurement of the effective portion, is reported as a component of AOCI. The remaining change in the carrying value of the ineffective portion, if any, is recognized in other income (expense), net. The gain or loss related to settled net investment hedges will be subsequently reclassified into net earnings when the hedged net investment is either sold or substantially liquidated. We evaluate the effectiveness of our net investment hedges quarterly and did not recognize any ineffectiveness in the nine months 2016.

Designated and Non-Designated Hedges

September 2016	Designated	Non-Designated	Total
Gross notional amount	$ 1,100	$ 2,851	$3,951
Maximum term in days			548
Fair value:			
Other current assets	$ 7	$ 4	$11
Other noncurrent assets	1	—	1
Other current liabilities	(25)	(6)	(31)
Other noncurrent liabilities	(2)	—	(2)
Total	$ (19)	$ (2)	$(21)

December 2015	Designated	Non-Designated	Total
Gross notional amount	$ 889	$ 4,061	$4,950
Maximum term in days			546
Fair value:			
Other current assets	$ 27	$ 41	$68
Other noncurrent assets	1	—	1
Other current liabilities	(6)	(3)	(9)
Other noncurrent liabilities	(1)	—	(1)
Total	$ 21	$ 38	$59

We are exposed to credit loss in the event of nonperformance by our counterparties on our outstanding derivative instruments but do not anticipate nonperformance by any of our counterparties. Should a counterparty default, our maximum exposure to loss is the asset balance of the instrument.

Net Currency Exchange Rate Gains (Losses)

	Three Months		Nine Months	
Reported in:	2016	2015	2016	2015
Cost of sales	$(3)	$ 7	$5	$12
Other income (expense), net	(5)	(5)	(15)	(16)

Total	$(8)	$ 2	$(10)	$(4)

On September 30, 2016 and December 31, 2015 pretax (losses) gains on derivatives designated as hedges of ($25) and $17, reported in AOCI, were expected to be reclassified to earnings during the next 12 months. This reclassification is primarily due to the sale of inventory that includes previously hedged purchases. There were no ineffective portions of derivatives that resulted in gains or losses in any of the periods presented.

Interest Rate Risk on Future Debt Issuance

Forward starting interest rate derivative instruments designated as cash flow hedges are used to manage the exposure to interest rate volatility with regard to future issuance and refinancing of debt. The effective portion of the gains or losses on forward starting interest rate derivative instruments that are designated and qualify as cash flow hedges is reported as a component of AOCI. Beginning in the period in which the debt refinancing occurs and the related derivative instruments is terminated, the effective portion of the gains or losses is then reclassified into interest expense over the term of the related debt.

On September 30, 2016 we had interest rate swaps with notional amounts of $600 designated as forward starting interest rate swaps in anticipation of future debt issuances. The market value of outstanding interest rate swap agreements on September 30, 2016 was $1, which is recorded in other assets with an offsetting amount recorded in AOCI. Upon the probable issuance of the debt, these amounts will be released to interest expense over the term of the debt. The cash flow effect of this hedge is recorded in cash flow from operations.

In the nine months 2016 we terminated multiple designated interest rate cash flow hedges, recognized $7 in OCI related to hedges on our debt issuances and recognized a nominal amount of ineffectiveness in interest expense. The remaining amounts in AOCI will be reclassified to interest expense over the term of the debt. The cash flow effect of these hedges is recognized in cash flow from operations.

Fair Value Hedges

On September 30, 2016 we had interest rate swaps with gross notional amounts of $500 designated as fair value hedges of underlying fixed rate obligations representing a portion of our $600 senior unsecured notes due in 2024. In the nine months 2016 there was no hedge ineffectiveness recorded as a result of these fair value hedges.

Fair Value Interest Rate Hedge Instruments

	September 2016	December 2015
Gross notional amount	$ 500	$ 500
Fair value:		
Other noncurrent assets	$ 38	$ 15
Long-term debt	(38)	(15)
Total	$ —	$ —

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NOTE 4 - FAIR VALUE MEASUREMENTS

Financial assets and liabilities carried at fair value are classified and disclosed in one of the following three categories:

Level 1	Quoted market prices in active markets for identical assets or liabilities
Level 2	Observable market-based inputs or unobservable inputs that are corroborated by market data
Level 3	Unobservable inputs reflecting our assumptions or external inputs from active markets

When applying the fair value principles in the valuation of assets and liabilities, we are required to maximize the use of quoted market prices and minimize the use of unobservable inputs. We calculate the fair value of our Level 1 and Level 2 instruments based on the exchange traded price of identical or similar instruments, where available, or based on other observable inputs taking into account our credit risk and that of our counterparties. Foreign currency exchange contracts and interest rate hedges are included in Level 2, as we use inputs other than quoted prices that are observable for the asset or liability. The Level 2 derivative instruments are primarily valued using standard calculations and models that use readily observable market data as their basis. Our Level 3 liabilities represent milestone payments for acquisitions. For certain Level 3 liabilities, the Black-Scholes option pricing model was used to value the liabilities, while the fair value of other liabilities was estimated using a discounted cash flow technique. Significant unobservable inputs to this technique included our probability assessments related to the occurrence of certain events, appropriately discounted considering the uncertainties associated with the obligation. We remeasure the fair value of our assets and liabilities each reporting period. We record the changes in fair value within selling, general and administrative expense and the changes in the time value of money within other income (expense), net.

Assets and Liabilities Measured at Fair Value

	September 2016	December 2015
Cash and cash equivalents	$ 2,953	$ 3,379
Trading marketable securities	91	82
Level 1 - Assets	$ 3,044	$ 3,461
Available-for-sale marketable securities:		
Corporate and asset-backed debt securities	$ 26	$ 214
Foreign government debt securities	—	96
United States agency debt securities	11	120
United States treasury debt securities	14	264
Certificates of deposit	18	8
Total available-for-sale marketable securities	$ 69	$ 702
Foreign currency exchange forward contracts	12	69
Interest rate swap asset	39	15
Level 2 - Assets	$ 120	$ 786
Total assets measured at fair value	$ 3,164	$ 4,247
Deferred compensation arrangements	$ 91	$ 82
Level 1 - Liabilities	$ 91	$ 82
Foreign currency exchange forward contracts	$ 33	$ 10
Interest rate swap liability	—	4
Level 2 - Liabilities	$ 33	$ 14
Contingent consideration:		
Beginning balance	$ 56	$ 48
Additions	49	11
Losses included in earnings	(5)	—
Settlements	(3)	(3)
Balance at the end of the period	$ 97	$ 56
Level 3 - Liabilities	$ 97	$ 56

Total liabilities measured at fair value	$ 221	$ 152

There were no significant transfers into or out of any level between December 31, 2015 and September 30, 2016.

Fair Value of Available for Sale Securities by Maturity

	September 2016	December 2015
Due in one year or less	$ 42	$ 588
Due after one year through three years	$ 27	$ 114

On September 30, 2016 the aggregate difference between the cost and fair value of available-for-sale marketable securities was nominal. The total of interest and marketable securities income was $7 and $1 in the three months 2016 and 2015 and $19 and $12 in the nine months 2016 and 2015. We record interest and marketable securities income in other income (expense), net.

Less than 1% of our investments in available-for-sale marketable securities had a credit quality rating of less than A2 (Moody's), A (Standard & Poor's) and A (Fitch). We do not plan to sell the investments, and it is not more likely than not that we will be required to sell the investments before recovery of their amortized cost basis, which may be maturity. We do not consider these investments to be other-than-temporarily impaired on September 30, 2016. Substantially all our investments with unrealized losses that were not deemed to be other-than-temporarily impaired were in a continuous unrealized loss position for less than twelve months.

Securities in a Continuous Unrealized Loss Position

	Number of Investments	Fair Value
Corporate and asset-backed debt securities	6	$ 3
United States agency debt securities	1	1
United States treasury debt securities	1	2
Certificates of deposit	13	7
Total	21	$ 13

NOTE 5 - ACQUISITIONS

In April 2016 we completed the acquisition of Sage Products, LLC (Sage) for total consideration of approximately $2,875. Sage develops, manufactures and distributes disposable products used primarily in the intensive care unit. This acquisition enhanced our product offerings within our MedSurg segment. Purchase price allocations for this acquisition were based on preliminary valuations. Our estimates and assumptions are subject to change within the measurement period.

In April 2016 we completed the acquisition of Physio-Control International, Inc. (Physio) for total consideration of approximately $1,299, net of a working capital adjustment received during the three months 2016. Physio develops, manufactures and markets monitors/defibrillators, automated external defibrillators (AEDs) and CPR-assist devices along with data management and support services. This acquisition enhances our product offerings within our MedSurg segment. Purchase price allocations for this acquisition were based on preliminary valuations. Our estimates and assumptions are subject to change within the measurement period.

The Other acquisitions in 2016 include the acquisition of Synergetics' neuro portfolio (Synergetics). The Synergetics acquisition enhances our product offerings within our MedSurg segment. Purchase price allocations for the Other acquisitions were based on preliminary valuations. Our estimates and assumptions are subject to change within the measurement period.

The Other acquisitions in 2015 include the acquisition of certain assets of CHG Hospital Beds, Inc. (CHG). The CHG acquisition enhances our product offerings within our MedSurg segment. The measurement period for CHG is complete. Revisions to the original purchase price allocation were nominal.

6 Dollar amounts are in millions except per share amounts or as otherwise specified.

Goodwill acquired with the Sage, Synergetics and CHG acquisitions is deductible for tax purposes. Supplemental pro forma combined statements of earnings have not been presented for the Sage and Physio acquisitions as the impact of their results of operations were not material to our Consolidated Statements of Earnings.

Purchase Price Allocation of Acquired Net Assets

	2016			2015
	Sage	Physio	Other	Other
Purchase price paid	$2,870	$1,299	$314	$140
Contingent consideration	5	—	27	9
Loss on settlement of pre-existing contract	—	—	(19)	—
Total consideration	$2,875	$1,299	$322	$149
Tangible assets acquired:				
Cash	$91	$32	$1	$—
Accounts receivable	29	106	5	4
Inventory	63	74	19	9
Other assets	80	118	16	13
Liabilities	(76)	(387)	(29)	(7)
Goodwill	1,515	638	170	62
Intangible assets:				
Customer relationship	930	349	12	13
Trade name	70	150	13	2
Developed technology and patents	173	212	106	53
Non-compete	—	—	2	—
IPR&D	—	7	7	—
Total	$2,875	$1,299	$322	$149
Weighted-average life of intangible assets	15	14	12	10

Estimated Amortization Expense

Remainder of 2016	2017	2018	2019	2020
$86	$345	$338	$329	$310

NOTE 6 - CONTINGENCIES AND COMMITMENTS

We are involved in various ongoing proceedings, legal actions and claims arising in the normal course of business, including proceedings related to product, labor, intellectual property and other matters that are more fully described below. The outcomes of these matters will generally not be known for prolonged periods of time. In certain of the legal proceedings, the claimants seek damages as well as other compensatory and equitable relief that could result in the payment of significant claims and settlements and/or the imposition of injunctions or other equitable relief. For legal matters for which management has sufficient information to reasonably estimate our future obligations, a liability representing management's best estimate of the probable loss, or the minimum of the range of probable losses when a best estimate within the range is not known, is recorded. The estimates are based on consultation with legal counsel, previous settlement experience and settlement strategies. If actual outcomes are less favorable than those estimated by management, additional expense may be incurred, which could unfavorably affect future operating results. We are self-insured for product liability claims and expenses. The ultimate cost to us with respect to product liability claims could be materially different than the amount of the current estimates and accruals and could have a material adverse effect on our financial position, results of operations and cash flows.

In June 2012 we voluntarily recalled our Rejuvenate and ABG II Modular-Neck hip stems and terminated global distribution of these hip products. Product liability lawsuits relating to this voluntary recall have been filed against us. On November 3, 2014 we announced that we had entered into a settlement agreement to compensate eligible United States patients who had revision surgery to replace their Rejuvenate and/or ABG II Modular-Neck hip stem prior to that date. We continue to offer support for recall-related care and reimburse patients who are not eligible to enroll in the settlement program for testing and treatment services, including any necessary revision surgeries. In addition, some lawsuits remain and we continue to defend against them. Based on the information that has been received, the actuarially determined range of probable loss to resolve this matter globally is currently estimated to be approximately $1,915 to $ 2,174 ($2,147 to $2,406 before $232 of third-party insurance recoveries.) In the three months 2016 we recognized additional charges to earnings of $45, representing the excess of the minimum of the range over the previously recorded reserves. We have made a total of $1,483 of recall-related payments, including $1,382 of settlement payments. The final outcome of this matter is dependent on many factors that are difficult to predict, including the number of enrollees in the settlement program and the total awards to them, the number and costs of patients not eligible for the settlement program who seek testing and treatment services and require revision surgery and the number and actual costs to resolve the remaining lawsuits. Accordingly, the ultimate cost to resolve this entire matter globally may be materially different than the amount of the current estimate and accruals and could have a material adverse effect on our financial position, results of operations and cash flows.

In 2010 we filed a lawsuit in federal court against Zimmer Biomet Holdings, Inc. (Zimmer) alleging that a Zimmer product infringed on three of our patents. In 2013 following a jury trial favorable to us, the trial judge entered a judgment that, among other things, awarded us damages of $76 and ordered Zimmer to pay us enhanced damages. Zimmer appealed this ruling. In December 2014 the Federal Circuit affirmed the damages awarded to us, reversed the order for enhanced damages and remanded the issue of attorney fees to the trial court. In May 2015 the trial court entered a stipulated judgment that, among other things, required Zimmer to pay us the base amount of damages and interest, while the issues of enhanced damages and attorney fees continue to be pursued. In June 2015 we recorded a $54 gain, net of legal costs, which was recorded within selling, general and administrative expenses. On June 13, 2016 the United States Supreme Court vacated the decision of the Federal Circuit that reversed our judgment for enhanced damages and remanded the case to the Federal Circuit to reconsider the issue. On September 12, 2016 the Federal Circuit issued an opinion that,among other things, remanded the issue of enhanced damages to the trial court.

In April 2011 Hill-Rom Company, Inc. and affiliated entities (Hill-Rom) brought a lawsuit against us alleging infringement under United States patent laws with respect to nine patents related to electrical network communications for hospital beds. On March 31, 2015 the court granted the parties' joint motion to dismiss with prejudice the claims and counterclaims associated with three of these patents. The case has been stayed with respect to the remaining six patents until reexamination proceedings at the United States Patent Office have concluded. The ultimate resolution of this matter cannot be predicted and it is not possible at this time for us to estimate any probable loss or range of probable losses; however, the ultimate result could have a material adverse effect on our financial position, results of operations and cash flows.

7 Dollar amounts are in millions except per share amounts or as otherwise specified.

NOTE 7 - DEBT AND CREDIT FACILITIES

In March 2016 we sold $3,500 of senior unsecured notes. In September 2016 we repaid all $750 of our senior unsecured notes that were due on September 30, 2016.

In September 2016 we increased the amount of commercial paper issuable under the commercial paper program by $250 to a maximum of $1,500 outstanding with maturities up to 397 days from the date of issuance. On September 30, 2016 outstanding commercial paper totaled $100, the weighted-average original maturity of the commercial paper outstanding was approximately 50 days, and the weighted average annualized interest rate of short-term debt was approximately 0.7%.

We have lines of credit issued by various financial institutions that are available to fund our day-to-day operating needs. In August 2016 we entered into a new senior unsecured revolving credit facility that replaces our previous agreement dated August 29, 2014. The primary changes were to increase the aggregate principal amount of the commitments by $250 to $1,500 and to extend the maturity date to August 19, 2021.

Certain of our credit facilities require us to comply with financial and other covenants. We were in compliance with all covenants on September 30, 2016.

The following table is a summary of our total debt and other debt information.

		September 2016	December 2015
Senior unsecured notes:			
Rate	Due		
2.000%	09/30/2016	$ —	$ 749
1.300%	04/01/2018	598	597
2.000%	03/08/2019	746	—
4.375%	01/15/2020	497	496
2.625%	03/15/2021	745	—
3.375%	05/15/2024	631	606
3.375%	11/01/2025	744	744
3.500%	03/15/2026	986	—
4.100%	04/01/2043	391	390
4.375%	05/15/2044	394	394
4.625%	03/15/2046	979	—
Commercial paper		100	—
Other		37	22
Total debt		$ 6,848	$ 3,998
Less current maturities		135	768
Total long-term debt		$ 6,713	$ 3,230
Unamortized debt issuance costs		$ 46	$ 24
Available borrowing capacity under all existing facilities		$ 1,560	$ 1,236
Fair value of debt		$ 7,118	$ 4,009

The fair value of debt (excluding the interest rate hedge) was based on the quoted interest rates for similar types and amounts of borrowings. Substantially all of our debt was classified within Level 1 of the fair value hierarchy. The fair value of the debt was estimated using rates with identical terms and maturities based on quoted active market prices and yields, which took into account the underlying terms of the debt instruments.

On January 1, 2016 we retrospectively adopted ASU 2015-03, Interest - Imputation of Interest: Simplifying the Presentation of Debt Issuance Costs. The adoption of this update resulted in the reclassification of $24 of unamortized debt issuance costs, principally from other noncurrent assets, to a reduction of long-term debt on our Consolidated Balance Sheets on December 31, 2015.

NOTE 8 - CAPITAL STOCK

In February 2016 we declared a quarterly dividend of $0.38 per share payable on April 30, 2016 to shareholders of record at the close of business on March 31, 2016. In April 2016 we declared a quarterly dividend of $0.38 per share payable on July 29, 2016 to shareholders at the close of business on June 30, 2016. In July 2016 we declared a quarterly dividend of $0.38 per share payable on October 31, 2016 to shareholders at the close of business on September 30, 2016.

In the nine months 2016, 135 thousand shares, repurchased at the end of 2015, were settled at a cost of $13 under our authorized repurchase programs. The manner, timing and amount of repurchases is determined by management based on an evaluation of market conditions, stock price and other factors and is subject to regulatory considerations. Purchases are made from time-to-time in the open market, in privately negotiated transactions or otherwise. On September 30, 2016 the total dollar value of shares that could be acquired under our authorized repurchase programs was $1,870. We have suspended our share repurchase program through the remainder of 2016.

NOTE 9 - INCOME TAXES

Our effective tax rates were 15.2% and 12.8% in the three months 2016 and 2015 and 14.7% and 18.3% in the nine months 2016 and 2015. The increase in the effective income tax rate in the three months 2016 was primarily due to the impact of the jurisdictional allocation of tax expense related to recall matters in the three months 2015. The effective income tax rate in the nine months 2016 decreased primarily due to certain discrete tax items in 2015 related to the establishment of our European regional headquarters.

NOTE 10 - SEGMENT INFORMATION

The following table is a summary of our results of operations by reportable segment.

	Three Months		Nine Months	
	2016	2015	2016	2015
Orthopaedics	$1,077	$1,019	$3,216	$3,077
MedSurg	1,253	943	3,469	2,809
Neurotechnology and Spine	503	458	1,483	1,345
Net sales	$2,833	$2,420	$8,168	$7,231
Orthopaedics	$385	$370	$1,105	$1,041
MedSurg	255	198	706	574
Neurotechnology and Spine	156	113	455	342
Segment operating income	$796	$681	$2,266	$1,957
Items not allocated to segments:				
Corporate and other	(90)	(76)	(252)	(220)
Acquisition and integration-related charges	(49)	(1)	(120)	(31)
Amortization of intangible assets	(89)	(54)	(230)	(152)
Restructuring-related charges	(25)	(22)	(67)	(78)
Rejuvenate and ABG II and other recalls	(57)	(150)	(104)	(316)
Legal matters	—	—	12	53
Total operating income	$486	$378	$1,505	$1,213

Total assets of our MedSurg segment increased to $8,724 as a result of our recent acquisitions as discussed in Note 5. There were no other significant changes to total assets by segment from information provided in our Annual Report on Form 10-K for 2015.

8 Dollar amounts are in millions except per share amounts or as otherwise specified.

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

ABOUT STRYKER

Stryker Corporation is a global leader in medical technology with revenues of $9,946 and net earnings of $1,439 in 2015. Stryker offers a diverse array of innovative medical technologies including orthopaedic, medical and surgical, and neurotechnology and spine products to help people lead more active and satisfying lives.

We segregate our operations into three reportable business segments: Orthopaedics, MedSurg, and Neurotechnology and Spine. Orthopaedics products consist primarily of implants used in hip and knee joint replacements and trauma and extremities surgeries. MedSurg products include surgical equipment and surgical navigation systems (Instruments), endoscopic and communications systems (Endoscopy), patient handling and emergency medical equipment, disposable products for the intensive care unit and monitors/defibrillators (Medical), and reprocessed and remanufactured medical devices (Sustainability) as well as other medical device products used in a variety of medical specialties. Neurotechnology and Spine products include both neurosurgical and neurovascular devices.

Overview of the Three and Nine Months

In the three months we achieved sales growth of 17.1% and 16.7% in constant currency, including 10.5% from acquisitions. We reported net earnings per diluted share of $0.94 in the three months and achieved a 19.0% growth in net earnings per diluted share. Excluding the impact of non-GAAP adjustments noted on page 12,

we achieved adjusted net earnings of $526 and growth of 11.2% in adjusted net earnings per diluted share.

In the nine months we achieved sales growth of 13.0% and 13.3% in constant currency, including 7.0% from acquisitions. We reported net earnings per diluted share of $3.01 in the nine months and achieved a 25.4% growth in net earnings per diluted share. Excluding the impact of non-GAAP adjustments noted on page 12, we achieved adjusted net earnings of $1,519 and growth of 12.9% in adjusted net earnings per diluted share.

Recent Developments

In April 2016 we completed the acquisitions of Sage Products, LLC (Sage) for total consideration of approximately $2,875, Physio-Control International, Inc. (Physio) for total consideration of approximately $1,299, net of a working capital adjustment received during the three months 2016, and Synergetics' neuro portfolio (Synergetics). Sage develops, manufactures and distributes disposable products primarily used in the intensive care unit. Physio develops, manufactures and markets monitors/defibrillators, automated external defibrillators (AEDs) and CPR-assist devices along with data management and support services. The acquired portfolio of Synergetics includes the Malis generator, Spetzler Malis disposable forceps and our existing Sonopet tips and RF generator. Refer to Note 5 to our Consolidated Financial Statements for further information.

In March 2016 we sold $3,500 of senior unsecured notes. Refer to Note 7 to our Consolidated Financial Statements for further information.

RESULTS OF OPERATIONS

	Three Months					Nine Months				
	2016	% Sales	2015	% Sales	% Change	2016	% Sales	2015	% Sales	% Change
Net sales	$2,833	100.0 %	$2,420	100.0 %	17.1 %	$8,168	100.0 %	$7,231	100.0 %	13.0 %
Gross profit	1,873	66.1	1,624	67.1	15.3	5,409	66.2	4,782	66.1	13.1
Research, development and engineering expenses	184	6.5	155	6.4	18.7	526	6.4	461	6.4	14.1
Selling, general and administrative expenses	1,057	37.3	887	36.7	19.2	3,044	37.3	2,640	36.5	15.3
Recall charges	57	2.0	150	6.2	(62.0)	104	1.3	316	4.4	(67.1)
Amortization of intangible assets	89	3.1	54	2.2	64.8	230	2.8	152	2.1	51.3

Other income (expense), net	(67)	(2.4)	(33)	(1.4)	103.0	(172)	(2.1)	(90)	(1.2)	91.1
Income taxes	64		44		45.5	196		206		(4.9)
Net earnings	$355	12.5 %	$301	12.4 %	17.9 %	$1,137	13.9 %	$917	12.7 %	24.0 %
Net earnings per diluted share	$0.94		$0.79		19.0 %	$3.01		$2.40		25.4 %
Adjusted net earnings per diluted share	$1.39		$1.25		11.2 %	$4.02		$3.56		12.9 %

See "Non-GAAP Financial Measures" on page 12 for a discussion of non-GAAP financial measures used in this report.

Geographic and Segment Net Sales

	Three Months				Nine Months			
			Percentage Change				Percentage Change	
	2016	2015	As Reported	Constant Currency	2016	2015	As Reported	Constant Currency
Geographic:								