

## FINANCIAL REVIEW

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**RECONCILIATION OF GAAP  
TO NON-GAAP FIGURES**

The following tables reconcile GAAP figures to the figures stated in the Letter to Shareholders and charts in this Annual Report that are not prepared in conformity with GAAP. These non-GAAP figures are adjusted for the impact of divestitures, purchased in-process research and development expenses, severance charges, reorganizations, and/or other items. Management has determined that inclusion of these non-GAAP figures provides a more meaningful comparison of the Company's operating results for the periods presented and better reflects the Company's ongoing operations. For more information, see "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Notes to Consolidated Financial Statements."

**ADJUSTED NET INCOME 2000-2003**

<i>Twelve months ended December 31, (in millions, except per share data)</i>	<b>2003</b>	<b>2002</b>	<b>2001</b>	<b>2000</b>
Net income, as reported (GAAP)	\$ 79.0	\$ 55.7	\$ (11.4)	\$ (271.7)
Reconciling items, net of tax				
Purchased in-process research and development expenses (see Note 6)	12.4	-	-	-
Severance charge (see Note 6)	9.6	-	-	-
Baxter arbitration settlement (see Note 6)	4.2	-	-	-
Business divestitures, net (see Note 6)	2.8	-	56.3	258.0
Pension curtailment (see Note 6)	1.8	-	-	-
Tax benefits of Brazilian reorganization (see Note 16)	(13.2)	-	-	-
Tax benefit of perfusion services divestiture (see Note 16)	-	(20.1)	-	-
WorldHeart impairment charge (see Note 5)	-	54.1	-	-
Legal settlement, net (see Note 14)	-	(9.1)	-	-
Spin-off charges (see Note 6)	-	2.3	-	11.0
Other charges	-	-	8.9	-
Asset dispositions and write downs, net	-	-	3.9	-
Breaking of interest rate swap agreement	-	-	3.7	-
Adoption of SFAS No. 133	-	-	1.5	-
Other charges, personnel costs and charges for exit activities	-	-	-	62.7
Costs associated with being an independent public company and interest expense associated with the Company's future debt facilities	-	-	-	(9.2)
Adjusted net income (non-GAAP)	<u>\$ 96.6</u>	<u>\$ 82.9</u>	<u>\$ 62.9</u>	<u>\$ 50.8</u>
Underlying net income growth rate	16.5%	31.8%	23.8%	-
Weighted average number of diluted common shares outstanding	61.1	61.3	58.9	59.6
Adjusted earnings per diluted share	<u>\$ 1.58</u>	<u>\$ 1.35</u>	<u>\$ 1.03</u>	<u>\$ 0.85</u>

**ADJUSTED FREE CASH FLOW 2003**

<i>Twelve months ended December 31, (in millions)</i>	<b>2003</b>
Net cash provided by operating activities, as reported (GAAP)	\$122.3
Capital expenditures, as reported (GAAP)	(37.9)
Reconciling items	
Acquired assets	10.6
Severance charge	7.6
Adjusted free cash flow (non-GAAP)	<u>\$102.6</u>

## SELECTED OPERATING INFORMATION

Twelve months ended December 31, <i>(in millions)</i>	2003	2002	2001
Net sales	\$ 860.5	\$ 704.0	\$ 692.1
Cost of goods sold	359.4	299.1	323.7
Gross profit	501.1	404.9	368.4
Selling, general and administrative expenses	289.4	227.9	203.2
Research and development expenses	72.8	65.2	55.0
<b>OPERATING STATISTICS</b>			
As a percentage of net sales:			
Gross profit	58.2%	57.5%	53.2%
Selling, general and administrative expenses	33.6%	32.4%	29.4%
Research and development expenses	8.5%	9.3%	7.9%

**SELECTED  
FINANCIAL DATA**

The following table sets forth selected financial information with respect to Edwards Lifesciences. The information set forth below should be read in conjunction with Edwards Lifesciences' "Management's Discussion and Analysis of Financial Condition and Results of Operations" and "Consolidated Financial Statements" found elsewhere in this document. No per share data for the years 2000 and prior have been presented because Edwards Lifesciences' earnings were part of Baxter's earnings through the close of business on March 31, 2000. See Notes 4 and 6 to the "Consolidated Financial Statements" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" for discussions of the effect of certain asset divestitures on Edwards Lifesciences' operations.

<i>(in millions except per share data)</i>	As of or for the years ended December 31,				
	<b>2003</b>	<b>2002</b>	<b>2001</b>	<b>2000</b>	<b>1999</b>
<b>OPERATING RESULTS<sup>(a)</sup></b>					
Net sales	\$ 860.5	\$ 704.0	\$ 692.1	\$ 803.8	\$ 905.0
Gross profit	501.1	404.9	368.4	380.5	439.0
Income (loss) from continuing operations <sup>(b)</sup>	79.0	55.7	(11.4)	(271.7)	82.0
<b>BALANCE SHEET DATA</b>					
Total assets <sup>(c)</sup>	\$ 1,101.4	\$ 1,004.4	\$ 982.9	\$ 1,106.7	\$ 1,437.0
Long-term debt and lease obligations	255.8	245.5	309.8	367.2	-
<b>COMMON STOCK INFORMATION</b>					
Income (loss) from continuing operations per common share:					
Basic	\$ 1.34	\$ 0.94	\$ (0.19)	\$ -	\$ -
Diluted	1.29	0.91	(0.19)	-	-
Cash dividends declared per common share	-	-	-	-	-

(a) The results prior to April 1, 2000 present Edwards Lifesciences on a divisional basis as it had historically been operated as part of Baxter. From April 1, 2000 (the date following the distribution of the Company's common stock to stockholders of Baxter) to September 30, 2002, Edwards Lifesciences' Japan business is presented on an equity basis as opposed to the consolidation method reflected in the historical results. Commencing October 1, 2002, the Company began reporting the results of its Japan business on a fully consolidated basis. See "Joint Venture in Japan" in Management's Discussion and Analysis of Financial Condition and Results of Operations for more information.

(b) See Notes 4 and 5 to the "Consolidated Financial Statements" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" for additional information regarding charges of \$67.4 million and \$83.0 million during 2002 and 2001, respectively. Additionally, during 2000, the Company recorded charges of \$312.2 million, net, related primarily to the sale of its perfusion products in the United States and Western Europe to Jostra AG.

(c) See Note 4 to the "Consolidated Financial Statements" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" for additional information regarding the write-down of goodwill of \$80.7 million (\$83.0 million pre-tax) during 2001. Additionally, during 2000, the Company wrote down goodwill by \$282.0 million in connection with the sale of its perfusion products in the United States and Western Europe to Jostra AG.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis presents the factors that had a material effect on the results of operations of Edwards Lifesciences during the three years ended December 31, 2003. Also discussed is Edwards Lifesciences' financial position as of December 31, 2003. You should read this discussion in conjunction with the historical consolidated condensed financial statements and related notes included elsewhere in this document.

### OVERVIEW

Edwards Lifesciences is a global provider of products and technologies that are designed to treat advanced cardiovascular disease. Edwards Lifesciences focuses on providing products and technologies to address four main cardiovascular disease states: heart valve disease, coronary artery disease, peripheral vascular disease, and congestive heart failure. The products and services provided by Edwards Lifesciences to treat cardiovascular disease are categorized into five main areas: Cardiac Surgery, Critical Care, Vascular, Perfusion and Other Distributed Products.

Edwards Lifesciences' cardiac surgery portfolio is comprised primarily of products relating to heart valve therapy, cannula products used during open-heart surgery and transmyocardial revascularization ("TMR"). Edwards Lifesciences is the world's leader in, and has been a pioneer in, the development and commercialization of tissue valves and repair products used to replace or repair a patient's diseased or defective heart valve. In the critical care area, Edwards Lifesciences is a world leader in hemodynamic monitoring systems used to measure a patient's heart function, and also provides central venous access products for fluid and drug delivery. Edwards Lifesciences' vascular portfolio includes a line of balloon catheter-based products, surgical clips and inserts, angiography equipment, stents and artificial implantable grafts. In the perfusion category, Edwards Lifesciences develops, manufactures and markets, in regions outside the United States and Western Europe, a diverse line of disposable products used during cardiopulmonary bypass procedures, including oxygenators, blood containers, filters and related devices. Lastly, other distributed products include sales of intra-aortic balloon pumps, pacemakers, angioplasty systems and other products sold through the Company's distribution network in Japan, and miscellaneous pharmaceutical products sold in the United States.

In order to provide greater visibility to a key part of its business, beginning in January 2004, the Company will recategorize its products into Heart Valve Therapy, Cardiac Surgery Systems, Critical Care, Vascular and Other Distributed Products. Heart Valve Therapy will include all heart valve repair and replacement products, and Cardiac Surgery Systems will include cannula products used during open-heart surgery, TMR products, and all products currently in the perfusion category. The other categories will remain the same.

The health care marketplace continues to be competitive. There has been consolidation in Edwards Lifesciences' customer base and among its competitors, which has resulted in pricing and market share pressures. Edwards Lifesciences has experienced increases in its labor and material costs, which are primarily influenced by general inflationary trends. Management expects these trends to continue.

**JOINT VENTURE IN JAPAN** Subsequent to the distribution of the Company's common stock to stockholders of Baxter International Inc. ("Baxter") on March 31, 2000 the cardiovascular business in Japan was being operated pursuant to a joint venture under which a Japanese subsidiary of Baxter retained ownership of the Japanese business assets, but a subsidiary of Edwards Lifesciences held a 90% profit interest. From April 1, 2000 to September 30, 2002, Edwards Lifesciences (a) recognized its shipments into the joint venture as sales at distributor price at the time the joint venture sold to the end customer, and (b) utilized the equity method of accounting to record its 90% profit interest in the operations of the joint venture in Other Operating Income.

On October 1, 2002, the Company acquired from Baxter for \$19.0 million, net, the cardiovascular business in Japan. The purchase price excluded approximately \$30.0 million of securitized accounts receivable. In the three months ended September 30, 2002, the Company recorded a \$3.3 million charge for legal, administrative and regulatory expenses related to the acquisition. Commencing October 1, 2002, the Company began reporting the results of the Japan business on a fully consolidated basis. The acquisition did not materially impact the Company's net income as the terms of the joint venture agreement enabled Edwards Lifesciences to record substantially all of the net profit generated by the Japan business.

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

**RESULTS OF OPERATIONS**

**NET SALES TRENDS** The following is a summary of United States and international net sales:

<i>(dollars in millions)</i>	Years Ended December 31,			Percent Change	
	<b>2003</b>	<b>2002</b>	<b>2001</b>	<b>2003</b>	<b>2002</b>
United States	\$ 384.3	\$ 383.3	\$ 420.8	0.3%	(8.9%)
International	476.2	320.7	271.3	48.5%	18.2%
Total net sales	<u>\$ 860.5</u>	<u>\$ 704.0</u>	<u>\$ 692.1</u>	22.2%	1.7%

The decrease in the United States' net sales in 2002 was due primarily to the sale of the Company's U.S. perfusion services business in June 2001, which decreased United States net sales by 14.5 percentage points. This decrease was partially offset by an increase in sales of cardiac surgery products.

The increase in international net sales in 2003 was due primarily to the following:

- the change in accounting for sales in Japan (see "Joint Venture in Japan") increased international net sales by 29.0 percentage points;
- the impact of changes in foreign currency exchange rates increased international net sales by 12.4 percentage points (primarily the strengthening of the Euro and Japanese yen against the United States dollar); and
- increased sales of cardiac surgery and vascular products (see below).

The increase in international net sales for 2002 was due primarily to the following:

- the change in accounting for sales in Japan increased international net sales by 10.4 percentage points; and
- increased sales of cardiac surgery products (see below).

The impact of foreign currency exchange rate fluctuations on net sales would not necessarily be indicative of the impact on net income due to the corresponding effect of foreign currency exchange rate fluctuations on international manufacturing and operating costs, and Edwards Lifesciences' hedging activities. For more information see "Quantitative and Qualitative Disclosure About Market Risk."

**NET SALES BY PRODUCT LINE** The following is a summary of net sales by product line:

<i>(dollars in millions)</i>	Years Ended December 31,			Percent Change	
	<b>2003</b>	<b>2002</b>	<b>2001</b>	<b>2003</b>	<b>2002</b>
Cardiac Surgery	\$ 426.6	\$ 365.9	\$ 329.0	16.6%	11.2%
Critical Care	278.8	230.3	209.9	21.1%	9.7%
Vascular	55.9	51.3	49.3	9.0%	4.1%
Perfusion	54.8	43.2	102.1	26.9%	(57.7%)
Other Distributed Products	44.4	13.3	1.8	233.8%	638.9%
Total net sales	<u>\$ 860.5</u>	<u>\$ 704.0</u>	<u>\$ 692.1</u>	22.2%	1.7%

**Cardiac Surgery** The net sales growth of cardiac surgery products in 2003 resulted primarily from the following:

- currency exchange rate fluctuations increased net sales by 5.5 percentage points (primarily the strengthening of the Euro and Japanese yen against the United States dollar);
- the change in accounting for sales in Japan increased net sales by 2.8 percentage points;
- pericardial tissue valves increased net sales by 4.8 percentage points; and
- heart valve repair products increased net sales by 1.7 percentage points.

The net sales growth of cardiac surgery products in 2002 resulted primarily from the following:

- pericardial tissue valves increased net sales by 7.9 percentage points;
- heart valve repair products increased net sales by 1.9 percentage points; and
- the change in accounting for sales in Japan increased net sales by 1.1 percentage points.

Management expects that its heart valve therapy products will continue to serve as a key driver of Edwards Lifesciences' sales growth. Beginning in January 2004, the heart valve therapy products will be in a separate product category called Heart Valve Therapy and the remaining cardiac surgery products will be included in Cardiac Surgery Systems.

**MANAGEMENT'S DISCUSSION AND ANALYSIS  
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**Critical Care** The net sales growth of critical care products in 2003 resulted primarily from the following:

- the change in accounting for sales in Japan increased net sales by 10.0 percentage points;
- currency exchange rate fluctuations increased net sales by 6.9 percentage points (primarily the strengthening of the Euro and Japanese yen against the United States dollar); and
- strong sales in global pressure monitoring products and overall strong performance in emerging global markets.

The net sales growth of critical care products in 2002 resulted primarily from the following:

- the change in accounting for sales in Japan increased net sales by 4.2 percentage points;
- increased sales of access, hemofiltration and advanced catheter products; and
- the net sales growth was partially offset by the decline in base hemodynamic catheters sales, which decreased net sales by 1.4 percentage points.

Critical care products have been, and are expected to be, significant contributors to the Company's total sales.

**Vascular** The net sales growth of vascular products for 2003 resulted primarily from the following:

- currency exchange rate fluctuations increased net sales by 7.0 percentage points (primarily the strengthening of the Euro and the Japanese yen against the United States dollar);
- the change in accounting for sales in Japan increased net sales by 4.0 percentage points;
- Lifepath AAA sales increased net sales by 2.4 percentage points, primarily in Europe; and
- net sales growth was partially offset by continued declines in base vascular products.

The net sales growth of vascular products for 2002 resulted primarily from the following:

- initial sales of Lifepath AAA increased net sales by 5.1 percentage points;
- the change in accounting for sales in Japan increased net sales by 1.6 percentage points; and
- net sales growth was partially offset by continued declines in base vascular products.

In December 2003, the Company announced its intent to explore strategic alternatives for the Lifepath AAA program. Lifepath AAA sales in 2003 were \$4.7 million.

**Perfusion** The net sales growth of perfusion for 2003 resulted primarily from the following:

- the change in accounting for sales in Japan increased net sales by 33.4 percentage points;
- currency exchange rate fluctuations increased net sales by 5.3 percentage points (primarily the strengthening of the Euro and Japanese yen against the United States dollar);
- the net sales growth was partially offset by the sale of the Company's German perfusion services subsidiary in July 2003, which decreased net sales by 4.7 percentage points; and
- the reduction of low-margin distributed product sales in North America, which decreased net sales by 6.5 percentage points.

The net sales decrease of perfusion for 2002 resulted primarily from the following:

- the sale of the Company's U.S. perfusion services business in June 2001 decreased net sales by 59.8 percentage points;
- currency exchange rate fluctuations decreased net sales by 2.6 percentage points (primarily the weakening of the Brazilian real against the United States dollar, offset by the strengthening of the Euro against the United States dollar);
- the ongoing reduction of sales in Western Europe and the United States; and
- the net sales decrease was partially offset by the change in accounting for sales in Japan, which increased global net sales by 5.3 percentage points.

Beginning in January 2004, the Perfusion category will no longer be separately reported and all perfusion products and services will be included in Cardiac Surgery Systems.

**Other Distributed Products** Other distributed products include sales of intra-aortic balloon pumps, pacemakers, angioplasty systems and other products sold through the Company's distribution network in Japan, and miscellaneous pharmaceutical products sold in the United States. The net sales for 2003 and 2002 increased primarily due to the impact of the change in accounting for sales in Japan.

**GROSS PROFIT**

	Years Ended December 31,			Percentage Point Increase	
	2003	2002	2001	2003	2002
Gross profit as a percentage of net sales	58.2%	57.5%	53.2%	0.7 pts.	4.3 pts.

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The increase in gross profit as a percentage of net sales for 2003 resulted primarily from improved manufacturing performance (1.9 percentage points) and the benefit of the consolidation of the Japan business effective October 1, 2002 (0.7 percentage points), partially offset by increased hedging expenses (2.1 percentage points).

The increase in gross profit as a percentage of net sales for 2002 resulted primarily from the sale of the U.S. perfusion services business in June 2001 (3.6 percentage points), the consolidation of the Japan business effective October 1, 2002 (0.7 percentage points), and the benefit of product mix, partially offset by the unfavorable impact of foreign currency exchange rates (0.8 percentage points).

**SELLING, GENERAL AND ADMINISTRATIVE ("SG&A") EXPENSES**

	Years Ended December 31,			Change	
	2003	2002	2001	2003	2002
SG&A expenses	\$ 289.9	\$ 227.9	\$ 203.2	\$ 62.0	\$ 24.7
SG&A expenses as a percentage of net sales	33.7%	32.4%	29.4%	1.3 pts.	3.0 pts.

The increase in selling, general and administrative expenses in 2003 resulted primarily from the consolidation of the Japan business effective October 1, 2002 (\$34.0 million), the impact of foreign currency rate fluctuations, primarily the strengthening of the Euro and Japanese yen against the United States dollar (\$12.8 million), and activities in support of increased sales.

The increase in selling, general and administrative expenses in 2002 resulted primarily from the consolidation of the Japan business effective October 1, 2002 (\$14.0 million), increased spending on heart valve growth opportunities (\$8.6 million) and the impact of foreign currency rate fluctuations, primarily the strengthening of the Euro against the United States dollar, partially offset by the weakening of the Japanese yen against the United States dollar (\$1.6 million).

The increase in selling, general and administrative expenses as a percentage of net sales for 2003 resulted primarily from the consolidation of the Japan business effective October 1, 2002 (1.1 percentage point increase) and foreign currency rate fluctuations (0.2 percentage point increase, primarily the strengthening of the Euro and Japanese yen against the United States dollar).

The increase in selling, general and administrative expenses as a percentage of net sales for 2002 resulted primarily from the sale of the U.S. perfusion services business in June 2001 (1.8 percentage points), the consolidation of the Japan business effective October 1, 2002 (0.7 percentage point increase), foreign currency rate fluctuations (0.3 percentage point increase, primarily the strengthening of the Euro against the United States dollar, partially offset by the weakening of the Japanese yen against the United States dollar), and increased spending on heart valve growth opportunities.

**RESEARCH AND DEVELOPMENT EXPENSES**

	Years Ended December 31,			Change	
	2003	2002	2001	2003	2002
Research and development expenses	\$ 72.8	\$ 65.2	\$ 55.0	\$ 7.6	\$ 10.2
Research and development expenses as a percentage of net sales	8.5%	9.3%	7.9%	(0.8) pts.	1.4 pts.

The increases in research and development expenses for 2003 and 2002 resulted primarily from investments in a broad range of interventional technologies, including market expanding endovascular heart valve repair and replacement therapies, investments in the Company's peripheral vascular disease platform and other growth initiatives.

The decrease in research and development expenses as a percentage of net sales for 2003 resulted primarily from the consolidation of the Japan business effective October 1, 2002. The increase in research and development expenses as a percentage of net sales for 2002 resulted primarily from investments in the Company's peripheral vascular disease platform and other growth initiatives, partially offset by the consolidation of the Japan business effective October 1, 2002.

**LOSS ON SALE OF STOCK** Effective June 30, 2001, the Company sold the stock of Edwards Lifesciences Cardiovascular Resources, Inc. ("ELCR") to Fresenius Medical Care AG for cash proceeds of \$45.0 million (the "ELCR Sale"), resulting in a pre-tax loss of \$68.2 million (including the write-off of \$83.0 million of goodwill). ELCR provided and managed perfusionists, monitoring systems, capital equipment and disposable material on a contract service basis to hospitals in the United States and Puerto Rico.

The following unaudited pro forma consolidated condensed statement of operations gives effect to the ELCR Sale as if it had occurred on January 1, 2001, and excludes the \$68.2 million loss on the sale. The unaudited pro forma consolidated condensed

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statement of operations does not purport to be indicative of either the results of future operations or the results of operations that would have occurred had the ELCR Sale been consummated on January 1, 2001. The following amounts are in millions, except per share amounts:

Year Ended December 31,	<b>2001</b>
Net sales	\$ 631.1
Net income	45.9
Net loss per share:	
Basic	0.78
Diluted	0.75

**ASSET IMPAIRMENTS**

**2002**

In September 2002, the Company recorded a \$67.4 million charge related to the impairment of its investment in preferred stock of World Heart Corporation ("WorldHeart"). The investment was written down to \$6.2 million, which represented the value of the Company's preferred stock investment had it been converted into common stock at October 15, 2002 (the closing date of September's books). The decision to record the charge was based primarily on WorldHeart's September 2002 decision to refocus its product development efforts by adopting a new design concept for a next generation product that resulted in a significant delay (approximately two years) in its product development timeline (with a revised commercial launch date of 2007) and impaired WorldHeart's competitive position. Accordingly, the Company concluded that sufficient risk existed that WorldHeart may be unable to fully liquidate the Company's investment in WorldHeart's preferred stock. The Company believed that the best objective indicator of the then fair value of its investment in WorldHeart's preferred stock was the market price of WorldHeart's common stock based upon the Company's expectation that the value of its preferred stock investment would be realized through the common stock, as opposed to redemption of the preferred stock.

**2001**

Based upon the non-strategic nature and declining profitability of certain products in the Company's portfolio (including certain distributed products), the Company decided during the quarter ended June 30, 2001 to discontinue its sales effort of these products. The long-lived assets and the investments related to these products were evaluated to determine whether any impairment in their recoverability existed at the determination date. As a result, Edwards Lifesciences assessed whether the estimated cash flows of the products or investments over the estimated lives of the related assets were sufficient to recover their costs. Where such cash flows were insufficient, the Company utilized a discounted cash flow model to estimate the fair value of assets or investments and recorded an impairment charge to adjust the carrying values to estimated fair values. As a result of this evaluation, Edwards Lifesciences recorded a \$14.8 million charge primarily related to the impairment of intangibles (\$8.3 million), the impairment of an investment (\$5.5 million) and the write-down of non-productive assets (\$1.0 million).

**GOODWILL AMORTIZATION**

The elimination of goodwill amortization commencing in the year 2002 resulted from the adoption of Statement of Financial Accounting Standards ("SFAS") No. 142, "Goodwill and Other Intangible Assets" (see "Effects of Recent Accounting Pronouncements"). Effective January 1, 2002, the accounting for goodwill changed from an amortization method to an impairment-only approach.

**SPECIAL CHARGES**

**2003**

**Purchased in-process Research and Development Expenses (\$13.6 million)**

On February 18, 2003, the Company acquired the endovascular mitral valve repair program of Jomed N.V., a European-based provider of products for minimally invasive vascular intervention, for \$20.0 million in cash. The acquisition included all technology and intellectual property associated with the program. At the acquisition date, the program, which was less than 50% complete, was involved in testing proprietary prototypes prior to initiating required animal studies and human clinicals. Additional design improvements, bench testing, animal studies and human clinical studies must be successfully completed prior to selling the product in Europe (expected in 2005) and in the United States (expected in 2006). The risks and uncertainties associated with completing development within a reasonable period of time include those related to the design, development and manufacturability of the product, the success of animal and clinical studies and the timing of European and United States regulatory approvals. The fair market value of the assets acquired consisted primarily of patents that are being amortized over their estimated economic life of 17 years. Approximately \$11.8 million of the purchase price has been charged to in-process research and development. The value of the in-process research and development was calculated using cash flow projections discounted for the risk inherent

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in such projects. The discount rate used was 30%. The valuation assumed approximately \$20.0 million of additional research and development expenditures would be incurred prior to the date of product introduction. In the valuation, material net cash inflows were forecasted to commence in 2008. As of December 31, 2003, the program remains reasonably on track with the Company's original expectations.

On December 5, 2003, the Company acquired the stock of Whitland Research Limited ("Whitland") for \$3.2 million in cash, although achievement of future milestones through 2006 could increase the total price to \$5.6 million. Whitland was focused on the development of critical care monitoring technologies. The \$3.2 million purchase price was allocated to acquired in-process research and development (\$1.8 million) and patents (\$1.4 million) based upon their estimated fair values. The patents will be amortized over their estimated useful life of 10 years.

### **Severance Charge (\$13.0 million)**

In July 2003, the Company recorded a charge of \$13.0 million associated with a decision to streamline operations. The charge was primarily related to the severance costs associated with reducing the Company's worldwide workforce by 136 employees, primarily in the United States and Europe. As of December 31, 2003, \$4.1 million of the charge remained unpaid.

### **Baxter Arbitration Settlement (\$5.3 million)**

In January 2004, the Company concluded a dispute resolution proceeding with Baxter. Each company sought reimbursement from the other for a variety of claims arising from the Company's spin-off from Baxter in April 2000. The resolution resulted in a \$5.3 million charge primarily related to the valuation of receivables at the date of spin-off, and a \$5.4 million increase to Additional Contributed Capital related to the true-up of the beginning balance of equity.

### **Loss on Sale of Business (\$3.3 million)**

Effective July 4, 2003, the Company sold its German perfusion services subsidiary to WKK GmbH, a German-based provider of hospital services, for a nominal amount. Sales generated by the German perfusion services subsidiary were approximately \$3.5 million, during the six months ended June 30, 2003 and \$6.6 million for the year 2002. In accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," and Staff Accounting Bulletin No. 100, "Restructuring and Impairment Charges," the Company recorded an impairment charge of \$3.3 million in 2003 to reduce the carrying value of the subsidiary's assets to fair value based upon the proceeds from the sale.

### **Pension Curtailment (\$1.9 million)**

On November 4, 2003, the Company suspended its defined benefit pension plan in Puerto Rico ("the Plan"). Effective December 31, 2003, employees do not earn additional defined benefits for future services. To mitigate the Puerto Rico employees' reduced benefits from the Plan's suspension, effective January 1, 2004, the Company increased its contributions to the Puerto Rico 1165(e) defined contribution plan. In accordance with SFAS No. 88, "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits," the Company recorded a curtailment loss of \$1.9 million during the fourth quarter 2003. As of December 31, 2003, the Plan's accumulated benefit obligation exceeded the fair value of its assets by \$2.4 million.

## **2002**

The Company recorded a \$3.3 million charge for legal, administrative and regulatory expenses related to the October 2002 acquisition of the cardiovascular business in Japan (see "Joint Venture in Japan").

### ***Equity Earnings in Japan Operations***

Equity earnings in Japan operations was \$11.0 million and \$16.4 million in 2002 and 2001, respectively. Equity earnings in Japan operations represent the Company's 90% profit interest in the cardiovascular business in Japan effective from April 1, 2000 through September 30, 2002. The decrease in 2002 results primarily from the consolidation of the Japan business effective October 1, 2002. For more information, see "Joint Venture in Japan."

### ***Interest Expense, net***

Interest expense, net was \$13.2 million, \$11.5 million and \$22.9 million in 2003, 2002, and 2001, respectively. The increase in interest expense, net for 2003 resulted primarily from the higher interest rate associated with the Company's fixed rate debt. The decrease in interest expense, net for 2002 resulted primarily from (a) the Company's reduction of debt, (b) lower interest rates on its floating rate debt, and (c) a \$6.2 million charge in 2001 related to a payment to unwind an interest rate swap agreement that had locked in a fixed interest rate on \$75.0 million of floating rate debt. The decision to unwind the interest rate swap agreement resulted from the Company's pay-down of underlying floating rate debt not anticipated to be necessary in funding future requirements of working capital, capital expenditures and other financial commitments.

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***Other (Income) Expense, net***

The following is a summary of other (income) expense, net:

Years Ended December 31, <i>(in millions)</i>	2003	2002	2001
Foreign exchange (gain) loss	\$ (10.6)	\$ (4.1)	\$ 5.0
Legal settlement, net	–	(14.7)	–
Asset dispositions and write-downs	3.6	2.3	6.5
Investment write-offs	–	1.4	–
Accounts receivable securitization costs	0.8	1.5	1.4
Other	1.5	(1.8)	(2.3)
	<u>\$ (4.7)</u>	<u>\$ (15.4)</u>	<u>\$ 10.6</u>

Foreign exchange gains and losses relate to global trade and intercompany receivable and payable balances.

Effective April 24, 2002, Edwards Lifesciences and Medtronic, Inc. entered into an agreement related to certain patent infringement claims pursuant to which the Company received a one-time cash payment of \$20.0 million (recorded as a gain of \$14.7 million, net of legal expenses).

***Provision for Income Taxes***

The effective income tax rates for 2003, 2002 and 2001 were impacted by several items as follows:

Years Ended December 31, <i>(in millions)</i>	2003	2002	2001
Income tax expense (benefit) at U.S. federal statutory rate	\$ 32.5	\$ 19.6	\$ (2.9)
Foreign income tax at different rates	(11.9)	(10.6)	(6.8)
Deemed dividend from Japan, net of foreign tax credit	6.2	–	–
Tax credits, federal and state	(2.1)	(1.9)	(1.6)
(Benefit) from Brazil reorganization	(13.7)	–	–
State and local taxes, net of federal tax benefit and transactions listed separately	1.0	(0.1)	(3.0)
(Benefit) loss on sale of perfusion services business	–	(20.1)	11.0
Valuation allowance for loss on investment	–	13.8	–
Nondeductible goodwill	–	–	6.0
Other	1.8	(0.4)	(1.2)
Income tax expense	<u>\$ 13.8</u>	<u>\$ 0.3</u>	<u>\$ 1.5</u>

Excluding the impact of special charges, the effective income tax rate was 26.0% for both 2003 and 2002, and 28.0% for 2001. The decrease in the effective income tax rate in 2002 was due primarily to the elimination of non-deductible goodwill amortization upon the adoption of SFAS No. 142 effective January 1, 2002. For more information see "Effects of Recent Accounting Pronouncements." The Company expects its effective income tax rate for recurring operations will increase to 27% for 2004 due in part to the expiration of the research credit.

During 2003, the Company commenced a legal reorganization of its Brazil subsidiary to improve its balance sheet and to enhance its ability to conduct business in Brazil. Since being acquired a number of years ago, this subsidiary has incurred net operating losses primarily due to the devaluation of the local currency and interest expense incurred on inter-company debt. In addition, the reorganization allowed the Company to recognize the accumulated losses and inter-company debt write-off under United States tax law, resulting in federal and state tax benefits of \$13.7 million.

During 2003, the Company recapitalized its Japan subsidiary. As a result, a deemed dividend occurred for U.S. tax purposes resulting in an incremental tax provision of \$6.2 million, net of foreign tax credits. The recapitalization was a one-time event and all of the future earnings of the Company's Japan subsidiary are intended to be permanently reinvested.

In exchange for the sale of the Novacor mechanical cardiac assist product line to WorldHeart in June 2000, the Company received WorldHeart preferred stock. In 2002, the investment in the WorldHeart preferred stock was deemed to be impaired and written down to its fair market value. Due to the uncertainty of using any potential tax benefit for the loss, a valuation allowance of \$13.8 million has been established.

As a result of tax law developments in 2002, the Company recorded a \$20.1 million tax benefit during 2002 related to the loss on sale of its United States perfusion services business in June 2001.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### LIQUIDITY AND CAPITAL RESOURCES

The Company's sources of cash liquidity include cash on hand and cash equivalents, amounts available under credit facilities, proceeds from a convertible debt offering, accounts receivable securitization facilities and cash from operations. The Company believes that these sources are sufficient to fund the current requirements of working capital, capital expenditures and other financial commitments. The Company further believes that it has the financial flexibility to attract long-term capital to fund short-term and long-term growth objectives. However, no assurances can be given that such long-term capital will be available to Edwards Lifesciences on favorable terms, or at all.

As of December 31, 2003, the Company had two unsecured revolving credit agreements providing for up to an aggregate of \$530.0 million in one- to six- month borrowings in multiple currencies. Borrowings currently bear interest at the London interbank offering rate (LIBOR) plus 0.75%, which includes a facility fee. One of the credit agreements provides for long-term borrowings up to an aggregate of \$430.0 million and expires on March 30, 2005 (the "Five Year Credit Facility"). The other credit agreement provides for borrowings up to an aggregate of \$100.0 million through March 25, 2004 (the "364 Day Facility"). As the 364 Day Facility has not been used recently, the Company does not plan to renew this credit agreement when it expires.

As of December 31, 2003, borrowings of \$105.8 million were outstanding under the Five Year Credit Facility and no borrowings were outstanding under the 364 Day Facility. Edwards Lifesciences pays a facility fee, regardless of available or outstanding borrowings, currently at an annual rate of 0.15% for the Five Year Credit Facility and 0.125% for the 364 Day Facility. As of December 31, 2003, all amounts outstanding under the Five Year Credit Facility have been classified as long-term obligations, as these borrowings will continue to be refinanced pursuant to that credit agreement. In March 2004, the Company will reclassify any balance outstanding on the Five Year Credit Facility to short-term as the agreement will expire within one year. The credit agreements contain various financial and other covenants, all of which the Company was in compliance with at December 31, 2003.

In May 2003, the Company issued \$150.0 million of convertible senior debentures, issued at par, bearing an interest rate of 3.875% per annum due May 15, 2033 (the "Notes"). Interest is payable semi-annually in May and November. Issuance costs of approximately \$3.6 million are being amortized to interest expense over 5 years. The Notes are convertible into 18.29 shares of the Company's common stock for each \$1,000 principal amount of Notes (conversion price of \$54.66 per share), subject to adjustment. The Notes may be converted, at the option of the holders, on or prior to the final maturity date under any of the following circumstances:

- during any fiscal quarter, if the closing sale price per share of the Company's common stock exceeds 120% of the conversion price;
- if the Notes have been called for redemption; or
- upon the occurrence of specified corporate events.

Holders of the Notes have the right to require the Company to purchase all or a portion of their Notes at a price equal to 100% of the principal amount of the Notes plus any accrued and unpaid interest on May 15, 2008, 2013, and 2018. The Company will pay cash for all Notes so purchased on May 15, 2008. For any Notes purchased by the Company on May 15, 2013 or 2018, the Company may, at its option, choose to pay the purchase price in cash, in shares of the Company's common stock, or any combination thereof. The Company must pay all accrued and unpaid interest in cash.

The Company may redeem for cash all or part of the Notes at any time on or after May 15, 2008, at a redemption price equal to 100% of the principal amount of the Notes to be redeemed, plus any accrued and unpaid interest.

Beginning with the six-month interest period commencing May 15, 2008, holders of the Notes will receive contingent interest at a rate of 0.25% if the trading price of the Notes equals or exceeds 120% of the principal amounts of the Notes. This contingent interest payment feature represents an embedded derivative. Based on the immaterial value associated with this feature, no value has been assigned to the derivative at issuance or at December 31, 2003.

As further discussed in Note 7 to the consolidated financial statements, the Company has two securitization programs whereby certain subsidiaries in the United States and Japan sell, without recourse, on a continuous basis, an undivided interest in certain eligible pools of accounts receivable. The significant benefits of the securitizations are lower cost of funds and differentiated sources of liquidity. The Company has been able to effectively lower its overall cost of funds as a result of the interest rate spreads it pays on these advances as opposed to borrowings under the current LIBOR based credit facility. Additionally, the Company believes that in diversifying its funding sources, the Company's funding availability in the capital markets is strengthened. As of December 31, 2003, the Company had sold a total of \$91.2 million of trade accounts receivable and received funding of \$76.9 million. These proceeds are generally used to reduce revolving lines of credit. The securitization program in the United States is renewable for one-year periods at the Company's option and will expire on December 21, 2004. The securitization program in Japan will expire on December 3, 2005.

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In November 2001, the Company's Board of Directors approved a stock repurchase program authorizing the Company to purchase on the open market and in privately negotiated transactions up to 2.0 million shares of the Company's outstanding common stock. This program was completed in 2003. In addition, on May 6, 2003, the Company's Board of Directors approved a second stock repurchase program authorizing the Company to purchase an additional 2.0 million shares of the Company's outstanding common stock through December 31, 2005. Stock repurchased under these programs will primarily be used to offset obligations under the Company's employee stock option programs. During 2003, the Company repurchased 1,766,300 shares at an aggregate cost of \$49.4 million under the second stock repurchase program.

Cash provided by operating activities in 2003 increased \$1.7 million from 2002 due primarily to:

- higher earnings in 2003 before non-cash charges and credits;
- decreased net cash outflows from accounts and other receivables;
- decreased net cash outflows from accounts payable and accrued expenses;
- partially offset by reduced cash inflows from increases in inventories.

Cash provided by operating activities in 2002 increased \$19.4 million from 2001 due primarily to:

- higher earnings in 2002 before non-cash charges and credits;
- increased net cash inflows from reductions in inventory;
- partially offset by increased net cash outflows from accounts and other receivables (primarily the 2002 securitization of Japan receivables); and
- increased net cash outflows from accounts payables and accrued expenses.

Cash used in investing activities in 2003 decreased \$5.0 million from 2002 due primarily to the following:

- acquisition of joint venture in Japan of \$19.0 million in 2002;
- decreased spending in 2003 on capital expenditures and investments in unconsolidated subsidiaries;
- receipt of payment on a note receivable in 2003;
- partially offset by the 2003 purchase of Jomed's intellectual property (see "Purchased in-process Research and Development Expenses") and the 2003 purchase of the technology and intellectual property associated with Embol-X Inc.'s surgically placed, intra-aortic embolic management system.

The total consideration for Embol-X Inc. was \$13.6 million, comprised of \$8.0 million cash, a deferred payment of \$2.0 million cash payable upon the completion of the technology transfer (which was completed during August 2003), stock in an unconsolidated affiliated company valued at \$3.0 million and \$0.6 million of capitalized transaction costs. In accordance with the guidance provided in Emerging Issues Task Force 98-3, "Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business," the transaction was accounted for as a purchased business combination. The purchase price was allocated to the acquired assets at their estimated fair value as follows (in millions):

Developed technology	\$	6.5
Goodwill		4.4
Patents		1.7
Trademarks and trade names		0.5
Machinery and equipment		0.2
Inventory		0.3
		\$ 13.6

If prior to April 16, 2008, the Company's sales of medical devices from the transferred technology are at least \$20.0 million in any consecutive 12-month period, the Company will pay an additional \$5.0 million to Embol-X Inc. This contingent obligation has not been recorded in the Company's balance sheet as of December 31, 2003. Forecasted sales of medical devices from the transferred technology are expected to be less than \$2.0 million for 2004.

Cash used in investing activities in 2002 increased \$64.4 million from 2001 due primarily to the cash provided by the sale of the U.S. perfusion services business in 2001, partially offset by the cash used in the acquisition of the Company's joint venture in Japan in 2002.

Cash used in financing activities in 2003 consisted primarily of purchases of treasury stock of \$49.4 million and net payments on debt of \$4.0 million, partially offset by proceeds from stock plans of \$36.6 million and proceeds from securitization programs of \$6.2 million. Cash used in financing activities in 2002 consisted primarily of net payments on debt of \$82.1 million and purchases of treasury stock of \$30.8 million, partially offset by proceeds from securitization programs of \$29.9 million and proceeds from stock plans of \$13.7 million.

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A summary of all of the Company's contractual obligations and commercial commitments as of December 31, 2003 were as follows:

<b>Contractual Obligations</b> (in millions)	<b>Payments Due By Period</b>				
	<b>Total</b>	<b>Less Than 1 Year</b>	<b>1-3 Years</b>	<b>4-5 Years</b>	<b>After 5 Years</b>
Long-term debt	\$ 255.8	\$ –	\$ 105.8	\$ –	\$ 150.0
Operating leases	36.6	11.1	14.6	8.8	2.1
Unconditional purchase obligations <sup>(b)</sup>	22.4	7.3	15.0	0.1	–
Contractual development obligations <sup>(a)</sup>	31.5	1.7	5.8	–	24.0
<b>Total contractual cash obligations</b>	<b>\$ 346.3</b>	<b>\$ 20.1</b>	<b>\$ 141.2</b>	<b>\$ 8.9</b>	<b>\$ 176.1</b>

(a) Contractual development obligations consist primarily of cash that Edwards Lifesciences is obligated to pay to unconsolidated affiliates upon their achievement of product development milestones.

(b) Unconditional purchase obligations consist primarily of minimum purchase commitments of inventory.

On January 27, 2004, the Company acquired Percutaneous Valve Technologies, Inc. ("PVT") for \$125.0 million in cash, plus up to an additional \$30.0 million upon the achievement of key milestones through 2007. The acquisition was financed through the Company's Five Year Credit Facility and operations. The Company expects to take an initial in-process research and development charge related to this transaction in the first quarter of 2004, estimated between \$60.0 million and \$90.0 million. The remainder of the purchase price will be allocated to patents involving PVT's proprietary technology. PVT, located in Fort Lee, NJ, with a subsidiary in Israel, is a leader in the development of an innovative, catheter-based (percutaneous) approach for replacing aortic heart valves. PVT's technology is a combination balloon-expandable stent technology integrated with a percutaneously delivered tissue heart valve. Unlike conventional open-heart valve replacement surgery, this less-invasive procedure is designed to be performed in a cardiac catheterization laboratory under local anesthesia.

**CRITICAL ACCOUNTING POLICIES AND ESTIMATES**

The Company's results of operations and financial position are determined based upon the application of the Company's accounting policies, as discussed in the notes to the consolidated financial statements. Certain of the Company's accounting policies represent a selection among acceptable alternatives under Generally Accepted Accounting Principles in the United States ("GAAP"). In evaluating the Company's transactions, management assesses all relevant GAAP and chooses the accounting policy that most accurately reflects the nature of the transactions. Management has not determined how reported amounts would differ based on the application of different accounting policies. Management has also not determined the likelihood that materially different amounts could be reported under different conditions or using different assumptions.

The application of accounting policies requires the use of judgment and estimates. As it relates to the Company, estimates and forecasts are required to determine sales returns and reserves, rebate reserves, allowances for doubtful accounts, reserves for excess and obsolete inventory, investments in unconsolidated affiliates, workers' compensation liabilities, employee benefit related liabilities, deferred tax asset valuation allowances, any impairments of assets, anticipated transactions to be hedged, litigation reserves and contingencies.

These matters that are subject to judgments and estimation are inherently uncertain, and different amounts could be reported using different assumptions and estimates. Management uses its best estimates and judgments in determining the appropriate amount to reflect in the financial statements, using historical experience and all available information. The Company also uses outside experts where appropriate. The Company applies estimation methodologies consistently from year to year.

The Company believes the following are the critical accounting policies which could have the most significant effect on the Company's reported results and require subjective or complex judgments by management.

**Revenue Recognition** The Company recognizes revenue for sales when all of the following have occurred: an agreement of sale exists, product delivery and acceptance has occurred or services have been rendered, and collection is reasonably assured. In the case of certain products where the Company maintains consigned inventory at customer locations, revenue is recognized at the time the Company is notified that the customer has used the inventory. The Company enters into certain arrangements in which it commits to provide multiple elements to its customers. Revenue related to an individual element is deferred unless delivery of the element represents a separate earnings process. Total revenue for these arrangements is allocated among the elements based on the fair value of the individual elements, with the relative fair values determined based on objective evidence (generally based on sales of the individual element to other third parties). Management is required to make judgments about whether or not collectibility is reasonably assured.

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The Company adopted Emerging Issues Task Force 01-9 as of January 1, 2002 and presents the cost of certain vendor considerations as reductions of revenue. Adoption of this standard did not have a material impact on the Company's consolidated financial statements. When the Company recognizes revenue from the sale of its products, an estimate of various sales returns and allowances is recorded which reduces product sales and accounts receivable. These adjustments include estimates for charge backs, rebates, returns, and other sales allowances. These provisions are estimated based upon historical payment experience, historical relationship to revenues, estimated customer inventory levels and current contract sales terms with wholesale and indirect customers. If the historical data and inventory estimates used to calculate these provisions does not properly reflect future activity, the Company's financial position, results of operations and cash flows could be impacted. The Company's estimates are subject to inherent limitations of estimates that rely on third-party data, as certain third-party information was itself in the form of estimates, and reflect other limitations.

**Allowance for Doubtful Accounts** The Company records allowances for doubtful accounts based on customer-specific analysis and general matters such as current assessments of past due balances and economic conditions. Additional allowances for doubtful accounts may be required if there is deterioration in past due balances, if economic conditions are less favorable than the Company has anticipated or for customer-specific circumstances, such as financial difficulty. The allowance for doubtful accounts was \$5.1 million and \$5.5 million at December 31, 2003 and 2002, respectively.

**Excess and Obsolete Inventory** The Company records allowances for excess and obsolete inventory based on historical and estimated future demand and market conditions. Additional inventory allowances may be required if future demand or market conditions are less favorable than the Company has estimated. Inventory reserves result from inventory, which is obsolete, is nearing its expiration date (generally triggered at six months prior to expiration), or is damaged or slow moving (defined as quantities in excess of a two year supply). The allowance for excess and obsolete inventory was \$8.5 million and \$9.6 million at December 31, 2003 and 2002, respectively.

**Patent Costs** The Company expenses legal costs incurred for patent preparation and applications. The Company capitalizes legal costs related to the defense and enforcement of issued patents for which success is deemed probable. The related costs are amortized over the remaining useful lives of the patents using the straight-line method. Such deferred costs are periodically reviewed for impairment and recoverability. To the extent the Company is successful in its defense and enforcement of its patents and receives compensation for past infringement, costs capitalized in connection with the specific defense or enforcement are expensed as an offset against any gain received.

**Impairment of Long-Lived Assets** On January 1, 2002, the Company adopted SFAS No. 142, "Goodwill and Other Intangible Assets," whereby goodwill is no longer amortized, but instead is subject to a periodic impairment review. As the Company's operations are comprised of one reporting unit, the Company reviews the recoverability of its goodwill by comparing the Company's fair value to the net book value of its assets. If the book value of the Company's assets exceeds the Company's fair value, the goodwill is written down to its implied fair value.

Additionally, management reviews the carrying amounts of goodwill and other intangibles whenever events and circumstances indicate that the carrying amounts of an asset may not be recoverable. Impairment indicators include, among other conditions, cash flow deficits, historic or anticipated declines in revenue or operating profit and adverse legal or regulatory developments. If it is determined that such indicators are present and the review indicates that the assets will not be fully recoverable, based on undiscounted estimated cash flows over the remaining amortization periods, their carrying values are reduced to estimated fair market value. Estimated fair market value is determined primarily using the anticipated cash flows discounted at a rate commensurate with the risk involved. For the purposes of identifying and measuring impairment, long-lived assets are grouped with other assets and liabilities at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities.

**Investments in Unconsolidated Affiliates** Investments in unconsolidated affiliates are designated as available-for-sale in accordance with the provisions of SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities." These investments are carried at fair market value, with unrealized gains and losses reported in stockholders' equity as Accumulated Other Comprehensive Income. Gains or losses on investments sold are based on the specific identification method. The fair values of certain investments are based on quoted market prices. For other investments, various methods are used to estimate fair value, including external valuations and discounted cash flows. When the fair value of a certain investment declines below cost, management uses the following criteria to determine if such a decline should be considered other than temporary and result in a realized loss:

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- the duration and extent to which the market value has been less than cost;
- the financial condition and near term prospects of the investee;
- the reasons for the decline in market value;
- the investee's performance against product development milestones; and
- the Company's ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value.

**Income Taxes** The Company records a liability for potential tax assessments based on its estimate of the potential exposure. New laws and new interpretations of laws and rulings by tax authorities may affect the liability for potential tax assessments. Due to the subjectivity and complex nature of the underlying issues, actual payments or assessments may differ from estimates. To the extent the Company's estimates differ from actual payments or assessments, income tax expense is adjusted. Additional information regarding income taxes is included in Note 16 of the consolidated financial statements.

The Company accounts for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes." Under this method, deferred tax assets and liabilities are recognized for the expected future tax consequences of events that have been recognized in the Company's financial statements or tax returns. At December 31, 2003, the Company had deferred tax assets of \$107.9 million, partially offset by deferred tax liabilities of \$17.2 million. The valuation allowance of \$19.5 million as of December 31, 2003 reduces certain deferred tax assets to amounts that are more likely than not to be realized. This allowance primarily relates to the deferred tax assets established for certain investments and the net operating loss carryforwards of certain non-United States subsidiaries. The Company evaluates annually the realizability of its deferred tax assets by assessing its valuation allowance and by adjusting the amount of such allowance, if necessary. The factors used to assess the likelihood of realization are the Company's forecast of future taxable income and available tax planning strategies that could be implemented to realize the net deferred tax assets. Failure to achieve forecasted taxable income in the applicable taxing jurisdictions could affect the ultimate realization of deferred tax assets and could result in an increase in the Company's effective tax rate on future earnings.

**Employee Stock Option and Stock Purchase Plans** The Company applies the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," in accounting for its fixed stock option and employee stock purchase plans. In accordance with this intrinsic value method, no compensation expense is recognized for these plans. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123, "Accounting for Stock Based Compensation":

Years Ended December 31, (in millions, except per share amounts)	2003	2002	2001
Net income (loss), as reported	\$ 79.0	\$ 55.7	\$ (11.4)
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of tax	(16.0)	(15.3)	(10.8)
Pro forma net income (loss)	<u>\$ 63.0</u>	<u>\$ 40.4</u>	<u>\$ (22.2)</u>
Earnings per basic share:			
Reported net income (loss)	\$ 1.34	\$ 0.94	\$ (0.19)
Pro forma net income (loss)	1.07	0.68	(0.38)
Earnings per diluted share:			
Reported net income (loss)	1.29	0.91	(0.19)
Pro forma net income (loss)	1.03	0.66	(0.38)

The per share weighted-average fair value for options granted during 2003, 2002 and 2001 was \$10.93, \$11.64, and \$7.00, respectively. The fair value of each option was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

	2003	2002	2001
Average risk-free interest rate	2.5%	4.4%	5.8%
Expected dividend yield	None	None	None
Expected volatility	42%	44%	45%
Expected life (years)	4	5	5

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The pro forma expense for employee stock purchase subscriptions was calculated with the following weighted-average assumptions for grants during the following periods:

	2003	2002	2001
Average risk-free interest rate	1.3%	2.1%	4.1%
Expected dividend yield	None	None	None
Expected volatility	42%	45%	44%
Expected life (years)	1	1	1

The expected volatility assumptions for the stock option and stock purchase plans used in the Black-Scholes option pricing model is estimated on the date of each grant.

**EFFECTS OF RECENT ACCOUNTING PRONOUNCEMENTS**

Effective January 1, 2001, Edwards Lifesciences adopted the provisions of SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." This statement replaces SFAS No. 125 and revises the standards for accounting for securitizations and other transfers of financial assets and collateral. SFAS No. 140 is effective for transfers and servicing of financial assets and extinguishments of liabilities occurring after March 31, 2001. This statement was effective for recognition and reclassification of collateral and for disclosures relating to securitization transactions and collateral for fiscal years ending after December 15, 2000. Adoption of this standard did not have a material impact on the Company's consolidated financial statements.

In June 2001, the FASB issued SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 142, which changes the accounting for goodwill from an amortization method to an impairment-only approach, is effective for fiscal years beginning after December 15, 2001. No transition adjustment was recorded upon adoption of this standard on January 1, 2002. However, adoption of this standard resulted in the elimination of goodwill amortization commencing January 1, 2002. See Note 8 of the consolidated financial statements for more information.

In June 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143, which changes the accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated retirement costs, is effective for fiscal years beginning after June 15, 2002. Adoption of this standard did not have a material impact on the Company's consolidated financial statements.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long Lived Assets." SFAS No. 144, which changes the accounting and reporting for the impairment of long-lived assets, is effective for fiscal years beginning after December 15, 2001. Adoption of this standard did not have a material impact on the Company's consolidated financial statements.

In July 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." SFAS No. 146 changes the accounting and reporting for costs associated with exit or disposal activities, termination benefits and other costs to exit an activity, including certain costs incurred in a restructuring. The provisions of this statement are effective for exit or disposal activities that are initiated after December 31, 2002. Adoption of this standard did not have a material impact on the Company's consolidated financial statements.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure." This standard amends SFAS No. 123, "Accounting for Stock-Based Compensation", to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this standard amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. This standard is effective for financial statements for fiscal years ending after December 15, 2002. The Company has adopted this standard and has made the necessary changes to its financial statement disclosures.

In January 2003, the FASB issued and in December 2003, revised, FASB Interpretation No. 46 "Consolidation of Variable Interest Entities-an interpretation of ARB No. 51." This interpretation addresses consolidation by business enterprises of variable interest entities, which have certain characteristics. The effective date of this interpretation varies based on certain criteria. The Company is required to apply all of this interpretation no later than the end of the first reporting period that ends after March 15, 2004. The Company is evaluating one entity to determine if it qualifies as a variable interest entity and if the entity will need to be consolidated. This entity had \$10.1 million of assets as of September 30, 2003 and had \$0.4 million of net income for the nine months ended September 30, 2003.

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In April 2003, the FASB issued, SFAS No. 149, "*Amendment of Statement 133 on Derivative Instruments and Hedging Activities.*" SFAS No. 149 amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under SFAS No. 133, "*Accounting for Derivative Instruments and Hedging Activities.*" This standard is effective for contracts entered into or modified after June 30, 2003, with exception for specified transactions. Adoption of this standard did not have a material impact on the Company's consolidated financial statements.

In May 2003, the FASB issued SFAS No. 150, "*Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity.*" SFAS No. 150 establishes how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. Adoption of this standard did not impact the Company's consolidated financial statements.

### QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

The Company's business and financial results are affected by fluctuations in world financial markets, including currency exchange rates and interest rates. The Company's hedging policy attempts to manage these risks to an acceptable level based on management's judgment of the appropriate trade-off between risk, opportunity and costs.

Edwards Lifesciences maintains an overall risk management strategy that utilizes a variety of interest rate and currency derivative financial instruments to mitigate its exposure to fluctuations in interest rates and currency exchange rates. The derivative instruments used include interest rate swaps, option-based products and forward currency contracts. The Company does not use any of these instruments for trading or speculative purposes. The total notional amounts of the Company's derivative financial instruments at December 31, 2003 and 2002 were \$569.6 million and \$588.2 million, respectively. The notional amounts of interest rate swap agreements, option-based products, and forward currency contracts do not represent amounts exchanged by the parties and, are not a measure of the Company's exposure through its use of derivatives.

### INTEREST RATE RISK

The Company utilizes interest rate swap agreements in managing its exposure to interest rate fluctuations. Interest rate swap agreements are executed as an integral part of specific debt transactions or on a portfolio basis. The Company's interest rate swap agreements involve agreements to pay a fixed rate and receive a floating rate, at specified intervals, calculated on an agreed-upon notional amount.

As part of its overall risk-management program the Company performs sensitivity analyses to assess potential gains and losses in earnings and changes in fair values to hypothetical movements in interest rates. A 46 basis-point increase in interest rates (approximately 10 percent of the Company's weighted average interest rate) affecting the Company's financial instruments, including debt obligations and related derivatives and investments, would not change the Company's annual interest expense, net because the Company has no floating rate debt, after giving effect to interest rate swaps. In January 2004, the Company borrowed \$105.0 million on its floating rate Five Year Credit Facility to fund its general operating activities and the acquisition of PVT.

### CURRENCY RISK

The Company is primarily exposed to currency exchange-rate risk with respect to its transactions and net assets denominated in Japanese yen and the Euro. Business activities in various currencies expose the Company to the risk that the eventual net United States dollar cash inflows resulting from transactions with foreign customers and suppliers denominated in foreign currencies may be adversely affected by changes in currency exchange rates. The Company manages these risks utilizing various types of foreign exchange contracts. The Company also enters into foreign exchange contracts to hedge anticipated, but not yet committed, sales expected to be denominated in foreign currencies. In addition, the Company hedges certain of its net investments in international affiliates. Such contracts hedge the United States dollar value of foreign currency denominated net assets from the effects of volatility in currency exchange rates by creating debt denominated in the respective currencies of the underlying net assets. Any changes in the carrying value of these net investments that are a result of fluctuations in currency exchange rates are offset by changes in the carrying value of the foreign currency denominated debt that are a result of the same fluctuations in currency exchange rates.

As part of the strategy to manage risk while minimizing hedging costs, the Company utilizes both foreign currency forward exchange contracts and option-based products in managing its exposure to currency rate fluctuations. Option-based products consist primarily of purchased put options in conjunction with written (sold) call options to create collars. Option-based products are agreements that either grant the Company the right to receive, or require the Company to make payments at, specified currency rate levels.

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

As part of its risk-management process, the Company uses a value-at-risk ("VAR") methodology in connection with other management tools to assess and manage its foreign currency financial instruments and measure any potential loss in earnings as a result of adverse movements in currency exchange rates. The Company utilizes a Monte Carlo simulation, with a 95 percent confidence level, using spot and three-month implied volatilities as stochastic variables and correlations (as of the measurement date) to estimate this potential loss. The Company's calculated VAR at December 31, 2003 and 2002, with a maturity of up to one year, is \$3.0 million and \$4.3 million, respectively. This amount excludes the potential effects of any changes in the value of the underlying transactions or balances. The Company's calculated VAR exposure represents an estimate of reasonably possible net losses that would be recognized on its portfolio of financial instruments assuming hypothetical movements in future market rates and is not necessarily indicative of actual results which may occur. It does not represent the maximum possible loss or any expected loss that may occur. Actual future gains or losses may differ from (and could be significantly greater than) these estimates based upon actual fluctuations in market rates, operating exposures and the timing thereof, and changes in the Company's portfolio of derivatives during the measured periods. In addition, the assumption within the VAR model is that changes in currency exchange rates are adverse, which may not be the case. Any loss incurred on the financial instruments is expected to be offset by the effects of currency movements on the hedging of all exposures; there may be currency exchange-rate gains or losses in the future.

### CREDIT RISK

Derivative financial instruments used by the Company involve, to varying degrees, elements of credit risk in the event a counterparty should default and market risk as the instruments are subject to rate and price fluctuations. Credit risk is managed through the use of credit standard guidelines, counter-party diversification, monitoring of counter-party financial condition and master-netting agreements in place with all derivative counter-parties. Credit exposure of derivative financial instruments is represented by the fair value effects of contracts with a positive fair value at December 31, 2003 reduced by the effects of master netting agreements. Additionally, at December 31, 2003, all derivative financial instruments, based on notional amounts, were with commercial banks and investment banking firms assigned investment grade ratings of "AA" or better by national rating agencies. The Company does not anticipate non-performance by its counter-parties and has no reserves related to non-performance as of December 31, 2003; the Company has not experienced any counterparty default during the three years ended December 31, 2003.

### CONCENTRATIONS OF CREDIT RISK

In the normal course of business, Edwards Lifesciences provides credit to customers in the health care industry, performs credit evaluations of these customers and maintains reserves for potential credit losses which, when realized, have been within the range of management's allowance for doubtful accounts during all periods presented.

Sales to Baxter, acting in the capacity of the Company's distributor subsequent to the Distribution, represented approximately 8% and 11% of the Company's total net sales for 2002 and 2001, respectively. Substantially all of these agreements had been terminated as of December 31, 2002. In 2003, the Company had no customers that represent greater than 10% of its total net sales or accounts receivable, net.

### INVESTMENT RISK

Edwards Lifesciences is exposed to investment risks related to changes in the fair values of its investments. The Company invests in equity instruments of public and private companies. These investments are classified in "Investments in unconsolidated affiliates" on the consolidated balance sheets.

In 2002, the Company recorded a \$67.4 million pretax charge related to the impairment of its investment in preferred stock of WorldHeart. The investment was written down to \$6.2 million, which represented the value of the Company's preferred stock investment had it been converted into common stock at October 15, 2002. The decision to record the charge was based primarily on delays in WorldHeart's product development timelines, arising from its revised strategy. Should WorldHeart fail to meet certain future development and financing milestones, further impairment charges may be necessary.

In addition to the investment in WorldHeart (\$11.6 million at December 31, 2003), Edwards Lifesciences had approximately \$23.8 million of investments in equity instruments of other companies. At December 31, 2003, the Company had recorded unrealized gains of \$4.3 million and unrealized losses of \$4.8 million on these investments in "Accumulated Other Comprehensive Income," net of tax. Management considers these declines temporary in nature based upon the individual companies' operating results, financial condition and achievement of product development milestones. Should these companies experience a decline in financial condition or fail to meet certain development milestones, the decline in the investments' values may be considered other than temporary and impairment charges may be necessary.

**REPORT  
OF MANAGEMENT**

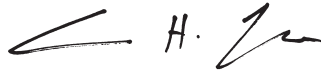
The management of Edwards Lifesciences is responsible for the integrity of the financial information presented in this document. The consolidated financial statements have been prepared in accordance with generally accepted accounting principles. Where necessary, they reflect estimates based on management's judgment.

Management relies upon established accounting procedures and related systems of internal control for meeting its responsibilities to maintain reliable financial records. These systems are designed to provide reasonable assurance that assets are safeguarded and that transactions are properly recorded and executed in accordance with management's intentions. Internal auditors periodically review the accounting and control systems, and these systems are revised if and when weaknesses or deficiencies are found.

The Audit and Public Policy Committee of the Board of Directors, composed of directors from outside the Company, meets regularly with management, the Company's internal auditors and its independent auditors to discuss audit scope and results, internal control evaluations, and other accounting, reporting and financial matters. The independent auditors and internal auditors have access to the Audit and Public Policy Committee without management's presence.



**Michael A. Mussallem**  
Chairman of the Board and  
Chief Executive Officer



**Corinne H. Lyle**  
Corporate Vice President,  
Chief Financial Officer and Treasurer

REPORT OF  
INDEPENDENT AUDITORS

**TO THE BOARD OF DIRECTORS AND SHAREHOLDERS  
OF EDWARDS LIFESCIENCES CORPORATION:**

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of Edwards Lifesciences Corporation and its subsidiaries at December 31, 2003 and 2002, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 8 to the consolidated financial statements, the Company adopted Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets, on January 1, 2002 and as a result changed its method of accounting for goodwill.



PricewaterhouseCoopers LLP

Orange County, California  
February 3, 2004

**CONSOLIDATED  
BALANCE SHEETS**

December 31, (in millions, except share data)

	<b>2003</b>	<b>2002</b>
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 61.1	\$ 34.2
Accounts receivable, net of allowances of \$5.1 and \$5.5	97.5	88.3
Other receivables	21.0	20.1
Inventories, net	120.5	111.8
Deferred income taxes	11.9	27.6
Prepaid expenses	41.8	34.8
Other current assets	6.4	3.4
Total current assets	<u>360.2</u>	<u>320.2</u>
Property, plant and equipment, net	209.9	209.4
Goodwill	338.2	333.8
Other intangible assets, net	81.0	65.0
Investments in unconsolidated affiliates	35.4	23.5
Deferred income taxes	59.3	38.8
Other assets	17.4	13.7
Total assets	<u>\$ 1,101.4</u>	<u>\$ 1,004.4</u>
Liabilities and stockholders' equity		
Current liabilities		
Accounts payable and accrued liabilities	\$ 167.2	\$ 177.3
Long-term debt	255.8	245.5
Other long-term liabilities	43.3	42.2
Commitments and contingent liabilities (Note 10 and 17)		
Stockholders' equity		
Preferred stock, \$.01 par value, authorized 50,000,000 shares, no shares outstanding	-	-
Common stock, \$1.00 par value, 350,000,000 shares authorized, 62,572,250 and 60,177,275 shares issued, 59,480,850 and 58,852,175 shares outstanding at December 31, 2003 and 2002, respectively	62.6	60.2
Additional contributed capital	463.2	412.0
Retained earnings	222.4	143.4
Accumulated other comprehensive income	(32.2)	(44.7)
Common stock in treasury, at cost, 3,091,400 and 1,325,100 shares at December 31, 2003 and 2002, respectively	(80.9)	(31.5)
Total stockholders' equity	<u>635.1</u>	<u>539.4</u>
Total liabilities and stockholders' equity	<u>\$ 1,101.4</u>	<u>\$ 1,004.4</u>

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

**CONSOLIDATED STATEMENTS  
OF OPERATIONS**

Years Ended December 31, <i>(in millions, except per share information)</i>	<b>2003</b>	<b>2002</b>	<b>2001</b>
Net sales	\$ 860.5	\$ 704.0	\$ 692.1
Cost of goods sold	359.4	299.1	323.7
Gross profit	501.1	404.9	368.4
Selling, general and administrative expenses	289.9	227.9	203.2
Research and development expenses	72.8	65.2	55.0
Loss on sale of stock (Note 4)	–	–	68.2
Asset impairments (Note 5)	–	67.4	14.8
Goodwill amortization	–	–	18.5
Special charges (Note 6)	37.1	3.3	–
Equity earnings in Japan operations (Note 1)	–	(11.0)	(16.4)
Interest expense, net	13.2	11.5	22.9
Other (income) expense, net (Note 15)	(4.7)	(15.4)	10.6
Income (loss) before provision for income taxes	92.8	56.0	(8.4)
Provision for income taxes	13.8	0.3	1.5
Income (loss) before cumulative effect of change in accounting principle	79.0	55.7	(9.9)
Cumulative effect of change in accounting principle, net of tax (Note 2)	–	–	1.5
Net income (loss)	<u>\$ 79.0</u>	<u>\$ 55.7</u>	<u>\$ (11.4)</u>
Share information (Note 2):			
Earnings (loss) per basic share			
Income (loss) before cumulative effect of change in accounting principle	\$ 1.34	\$ 0.94	\$ (0.17)
Cumulative effect of change in accounting principle (Note 2)	–	–	(0.02)
Net income (loss)	\$ 1.34	\$ 0.94	\$ (0.19)
Earnings (loss) per diluted share			
Income (loss) before cumulative effect of change in accounting principle	\$ 1.29	\$ 0.91	\$ (0.17)
Cumulative effect of change in accounting principle (Note 2)	–	–	(0.02)
Net income (loss)	\$ 1.29	\$ 0.91	\$ (0.19)
Weighted average number of common shares outstanding:			
Basic	59.1	59.0	58.9
Diluted	61.1	61.3	58.9

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

**CONSOLIDATED STATEMENTS  
OF CASH FLOWS**

Years Ended December 31, (in millions)	2003	2002	2001
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>			
Net income (loss)	\$ 79.0	\$ 55.7	\$ (11.4)
Income charges (credits) not affecting cash:			
Depreciation and amortization	45.6	40.4	57.4
Deferred income taxes	5.3	(13.8)	(29.7)
Special charges, losses and impairments	7.1	68.9	89.4
Other	5.2	8.7	(1.7)
Changes in operating assets and liabilities, net of effect from ownership change of Japan business and business acquisitions (Notes 1 and 3):			
Accounts and other receivables	(11.0)	(32.0)	(4.7)
Inventories	4.2	13.3	(7.7)
Accounts payable and accrued liabilities	(8.4)	(17.6)	7.0
Prepaid expenses	3.1	(2.0)	–
Other	(7.8)	(1.0)	2.6
Net cash provided by operating activities	<u>122.3</u>	<u>120.6</u>	<u>101.2</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>			
Capital expenditures	(37.9)	(40.7)	(37.5)
Investments in intangible assets	(26.2)	(7.0)	(8.0)
Investments in unconsolidated affiliates	(4.4)	(5.7)	(10.6)
Proceeds from asset dispositions	6.0	4.1	9.7
Proceeds from note receivable	1.7	–	–
Acquisition of joint venture in Japan	–	(19.0)	–
Proceeds from sale of business	–	–	45.0
Other	(2.5)	–	(2.5)
Net cash used in investing activities	<u>(63.3)</u>	<u>(68.3)</u>	<u>(3.9)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>			
Proceeds from issuance of short-term debt	–	0.4	26.1
Payments on short-term debt	–	(1.5)	(86.3)
Proceeds from issuance of long-term debt	333.4	150.9	180.0
Payments on long-term debt	(337.4)	(231.9)	(211.2)
Proceeds from accounts receivable securitization, net	6.2	29.9	5.2
Purchases of treasury stock	(49.4)	(30.8)	(0.7)
Proceeds from stock plans	36.6	13.7	8.9
Other	(4.4)	(0.2)	(0.6)
Net cash used in financing activities	<u>(15.0)</u>	<u>(69.5)</u>	<u>(78.6)</u>
Effect of currency exchange rate changes on cash and cash equivalents	<u>(17.1)</u>	<u>3.7</u>	<u>0.9</u>
Net increase (decrease) in cash and cash equivalents	<u>26.9</u>	<u>(13.5)</u>	<u>19.6</u>
Cash and cash equivalents at beginning of year	<u>34.2</u>	<u>47.7</u>	<u>28.1</u>
Cash and cash equivalents at end of year	<u>\$ 61.1</u>	<u>\$ 34.2</u>	<u>\$ 47.7</u>
<b>SUPPLEMENTAL DISCLOSURES:</b>			
Cash paid during the year for:			
Interest	\$ 7.9	\$ 9.8	\$ 19.2
Income taxes	14.1	10.4	10.6
Non-cash transactions:			
Purchase of intangible assets in exchange for stock	<u>\$ 3.0</u>	<u>\$ –</u>	<u>\$ –</u>

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

**CONSOLIDATED STATEMENTS OF STOCKHOLDERS'  
EQUITY AND COMPREHENSIVE INCOME (LOSS)**

Years Ended December 31, (in millions)

	<b>2003</b>	<b>2002</b>	<b>2001</b>
<b>COMMON STOCK</b>			
Beginning of year	\$ 60.2	\$ 59.3	\$ 58.7
Common stock issued under employee benefit plans	2.4	0.9	0.6
End of year	<u>\$ 62.6</u>	<u>\$ 60.2</u>	<u>\$ 59.3</u>
<b>ADDITIONAL CONTRIBUTED CAPITAL</b>			
Beginning of year	\$ 412.0	\$ 287.2	\$ 277.4
Common stock issued under employee benefit plans	35.1	12.8	8.2
Tax benefit from exercise of non-qualified stock options	10.6	–	–
Resolution of Baxter arbitration (Note 6)	5.4	–	–
Stock options issued to non-employees	0.1	1.2	1.6
Acquisition of joint venture in Japan (Notes 1 and 3)	–	110.8	–
End of year	<u>\$ 463.2</u>	<u>\$ 412.0</u>	<u>\$ 287.2</u>
<b>RETAINED EARNINGS</b>			
Beginning of year	\$ 143.4	\$ 87.7	\$ 102.9
Net income (loss)	79.0	55.7	(11.4)
Elimination of reporting lag for certain international operations (Note 2)	–	–	(3.8)
End of year	<u>\$ 222.4</u>	<u>\$ 143.4</u>	<u>\$ 87.7</u>
<b>ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)</b>			
Beginning of year	\$ (44.7)	\$ 25.2	\$ 0.6
Other comprehensive income (loss)	12.5	(69.9)	24.6
End of year	<u>\$ (32.2)</u>	<u>\$ (44.7)</u>	<u>\$ 25.2</u>
<b>TREASURY STOCK</b>			
Beginning of year	\$ (31.5)	\$ (0.7)	\$ –
Purchases of stock	(49.4)	(30.8)	(0.7)
End of year	<u>\$ (80.9)</u>	<u>\$ (31.5)</u>	<u>\$ (0.7)</u>
<b>Total stockholders' equity</b>	<u>\$ 635.1</u>	<u>\$ 539.4</u>	<u>\$ 458.7</u>
<b>COMPREHENSIVE INCOME (LOSS)</b>			
Net income (loss)	\$ 79.0	\$ 55.7	\$ (11.4)
Other comprehensive income (loss):			
Currency translation adjustments, net of tax	6.5	(8.0)	29.9
Currency translation adjustment in connection with the acquisition of joint venture in Japan (Notes 1 and 3)	–	(47.8)	–
Pension adjustments, net of tax	1.2	(1.7)	–
Unrealized net gain (loss) on investments in unconsolidated affiliates, net of tax	6.3	(1.7)	(5.8)
Net unrealized (loss) gain on cash flow hedges, net of tax	(1.5)	(10.7)	0.5
Other comprehensive income (loss)	<u>12.5</u>	<u>(69.9)</u>	<u>24.6</u>
<b>Total comprehensive income (loss)</b>	<u>\$ 91.5</u>	<u>\$ (14.2)</u>	<u>\$ 13.2</u>

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

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### Note 1.

#### DESCRIPTION OF BUSINESS

Edwards Lifesciences Corporation is a global provider of products and technologies that are designed to treat advanced cardiovascular disease. Edwards Lifesciences' sales are categorized in five main product areas: cardiac surgery, critical care, vascular, perfusion and other distributed products. Edwards Lifesciences focuses on four main cardiovascular disease states: heart valve disease, coronary artery disease, peripheral vascular disease and congestive heart failure.

Edwards Lifesciences Corporation was incorporated under the original name of CVG Controlled Inc. in Delaware on September 10, 1999, as a subsidiary of Baxter International Inc. ("Baxter"). On March 31, 2000 (the "Distribution Date"), Baxter transferred its cardiovascular business (the "Edwards Lifesciences Business") to Edwards Lifesciences in connection with a tax-free spin-off by Baxter of the Edwards Lifesciences Business. The spin-off was effected on the Distribution Date through a distribution of 58.1 million shares of Edwards Lifesciences' common stock (the "Distribution") to Baxter stockholders of record on March 29, 2000, resulting in Edwards Lifesciences operating as an independent entity commencing April 1, 2000 with publicly traded common stock. Unless the context indicates otherwise, references to the "Company" and "Edwards Lifesciences" refer to Edwards Lifesciences Corporation and its subsidiaries.

*Joint Venture in Japan* Subsequent to the Distribution, the cardiovascular business in Japan was being operated pursuant to a joint venture under which a Japanese subsidiary of Baxter retained ownership of the Japanese business assets, but a subsidiary of Edwards Lifesciences held a 90% profit interest. From April 1, 2000 to September 30, 2002, Edwards Lifesciences (a) recognized its shipments into the joint venture as sales at distributor price at the time the joint venture sold to the end customer, and (b) utilized the equity method of accounting to record its 90% profit interest in the operations of the joint venture in Other Operating Income. Commencing October 1, 2002, the Company acquired from Baxter the cardiovascular business in Japan and began reporting Japan's results on a fully consolidated basis. See Note 3 for more information.

### Note 2.

#### SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**PRINCIPLES OF CONSOLIDATION** The consolidated financial statements have been prepared using Baxter's historical bases in the assets and liabilities and the historical results of operations of the Edwards Lifesciences Business prior to the Distribution, operated primarily as a division of Baxter, and continuing as a separate legal entity, Edwards Lifesciences Corporation and its subsidiaries, subsequent to the Distribution. All material intercompany balances have been eliminated. Certain reclassifications of previously reported amounts have been made to conform to classifications used in the current year.

**USE OF ESTIMATES** The consolidated financial statements of Edwards Lifesciences have been prepared in accordance with Generally Accepted Accounting Principles in the United States ("GAAP") and have been applied consistently in all material respects. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements. Actual results could differ from those estimates. Estimates are used in accounting for, among other items, sales returns and reserves, rebate reserves, allowances for doubtful accounts, excess and obsolete inventory, investments in unconsolidated affiliates, workers compensation, employee benefits, income taxes, asset impairment, anticipated transactions to be hedged, litigation reserves and contingencies.

**FISCAL YEAR OF INTERNATIONAL OPERATIONS** Prior to 2001, certain operations outside the United States had been included in the consolidated financial statements on the basis of fiscal years ending November 30 in order to facilitate timely consolidation. This one-month lag was eliminated as of the beginning of 2001 for these international operations as it was no longer required to achieve a timely consolidation. The December 2000 net loss from operations of \$3.8 million for these entities was recorded as an adjustment to retained earnings on January 1, 2001.

**FOREIGN CURRENCY TRANSLATION** The Company follows the principles of Statement of Financial Accounting Standards ("SFAS") No. 52, "Foreign Currency Translation." Accordingly, when the local currency of its foreign entities is the functional currency, all assets and liabilities are translated into United States dollars at the rate of exchange in effect at the balance sheet date. Income and expense items are translated at the weighted average exchange rate prevailing during the period. The effects of foreign currency translation adjustments for these entities are deferred and included as a component of stockholders' equity. The effects of foreign currency transactions denominated in a currency other than its foreign entities' functional currency are included in Other (Income) Expense, net.

**NOTES TO CONSOLIDATED  
FINANCIAL STATEMENTS**

**REVENUE RECOGNITION** The Company recognizes revenue for sales when all of the following have occurred: an agreement of sale exists, product delivery and acceptance has occurred or services have been rendered, and collection is reasonably assured. In the case of certain products where the Company maintains consigned inventory at customer locations, revenue is recognized at the time the Company is notified that the customer has used the inventory. The Company enters into certain arrangements in which it commits to provide multiple elements to its customers. Revenue related to an individual element is deferred unless delivery of the element represents a separate earnings process. Total revenue for these arrangements is allocated among the elements based on the fair value of the individual elements, with the relative fair values determined based on objective evidence (generally based on sales of the individual element to other third parties).

The Company adopted Emerging Issues Task Force 01-9 as of January 1, 2002 and presents the cost of certain vendor considerations as reductions of revenue. Adoption of this standard did not have a material impact on the Company's consolidated financial statements. When the Company recognizes revenue from the sale of its products, an estimate of various sales returns and allowances is recorded which reduces product sales and accounts receivable. These adjustments include estimates for charge backs, rebates, returns, and other sales allowances. These provisions are estimated based upon historical payment experience, historical relationship to revenues, estimated customer inventory levels and current contract sales terms with wholesale and indirect customers. If the historical data and inventory estimates used to calculate these provisions does not properly reflect future activity, the Company's financial position, results of operations and cash flows could be impacted. The Company's estimates are subject to inherent limitations of estimates that rely on third-party data, as certain third-party information was itself in the form of estimates, and reflect other limitations.

**CASH EQUIVALENTS** The Company considers highly liquid investments with maturities of three months or less from the date of purchase to be cash equivalents. These investments are valued at cost, which approximates fair value.

**ACCOUNTS RECEIVABLE SECURITIZATION** The Company accounts for the securitization of accounts receivable in accordance with SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." When the Company sells accounts receivable in securitizations, a subordinated residual interest in the securitized portfolio is retained by the Company and recorded in Other Current Assets. Gain or loss on sale of the accounts receivable depends in part on the previous carrying amount of the financial assets involved in the transfer, allocated between the assets sold and the residual interests based on their relative fair value at the date of transfer. Because quoted market prices are generally not available to determine the Company's fair value of the residual interest, the Company estimates the fair value of the residual interest by estimating future expected credit losses to determine the future expected cash flows, which generally approximate fair value given the securitized portfolio's short-term weighted average life. At the time the receivables are sold, the balances are removed from the Consolidated Balance Sheets. Costs associated with the sale of receivables, primarily related to the discount and loss on sale, are included in Other (Income) Expense, net.

**INVENTORIES** Inventories are stated at the lower of cost (first-in, first-out method) or market value. Market value for raw materials is based on replacement costs, and for other inventory classifications is based on net realizable value.

December 31, (in millions)	2003	2002
Raw materials	\$ 20.4	\$ 17.4
Work in process	16.7	14.7
Finished products	83.4	79.7
	<u>\$ 120.5</u>	<u>\$ 111.8</u>

Inventory reserves result from inventory, which is obsolete, is nearing its expiration date (generally triggered at six months prior to expiration), or is damaged or slow moving (defined as quantities in excess of a two year supply). Reserves for excess and obsolete inventory were approximately \$8.5 million and \$9.6 million at December 31, 2003 and 2002, respectively. During the years ended December 31, 2003, 2002 and 2001, the Company allocated \$9.8 million, \$9.8 million and \$8.4 million, respectively, of general and administrative costs to inventory. General and administrative costs included in both the December 31, 2003 and 2002 inventory balances were \$3.5 and \$2.8 million, respectively.

**NOTES TO CONSOLIDATED  
FINANCIAL STATEMENTS**

**PROPERTY, PLANT AND EQUIPMENT** Property, plant and equipment are recorded at cost. Depreciation and amortization are principally calculated for financial reporting purposes on the straight-line method over the estimated useful lives of the related assets, which range from 20 to 40 years for buildings and improvements and from 3 to 11 years for machinery and equipment. Leasehold improvements are amortized over the life of the related facility leases or the asset, whichever is shorter. Straight-line and accelerated methods of depreciation are used for income tax purposes.

December 31, <i>(in millions)</i>	<b>2003</b>	<b>2002</b>
Land	\$ 30.1	\$ 32.6
Buildings and leasehold improvements	67.4	70.0
Machinery and equipment	204.6	192.8
Equipment with customers	104.8	101.5
Construction in progress	17.2	8.5
	424.1	405.4
Accumulated depreciation and amortization	(214.2)	(196.0)
	<u>\$ 209.9</u>	<u>\$ 209.4</u>

Depreciation expense was \$34.6 million, \$29.6 million and \$27.0 million for the years ended December 31, 2003, 2002 and 2001, respectively. Repairs and maintenance expense was \$12.1 million, \$9.1 million and \$11.1 million for the years ended December 31, 2003, 2002 and 2001, respectively.

**IMPAIRMENT OF LONG-LIVED ASSETS** On January 1, 2002, the Company adopted SFAS No. 142, *"Goodwill and Other Intangible Assets,"* whereby goodwill is no longer amortized, but instead is subject to a periodic impairment review. As the Company's operations are comprised of one reporting unit, the Company reviews the recoverability of its goodwill by comparing the Company's fair value to the net book value of its assets. If the book value of the Company's assets exceeds the Company's fair value, the goodwill is written down to its implied fair value.

Additionally, management reviews the carrying amounts of goodwill and other intangibles whenever events and circumstances indicate that the carrying amounts of an asset may not be recoverable. Impairment indicators include, among other conditions, cash flow deficits, historic or anticipated declines in revenue or operating profit and adverse legal or regulatory developments. If it is determined that such indicators are present and the review indicates that the assets will not be fully recoverable, based on undiscounted estimated cash flows over the remaining amortization periods, their carrying values are reduced to estimated fair market value. Estimated fair market value is determined primarily using the anticipated cash flows discounted at a rate commensurate with the risk involved. For the purposes of identifying and measuring impairment, long-lived assets are grouped with other assets and liabilities at the lowest level for which identifiable cash flows are largely independent of the cash flows of other assets and liabilities.

**PATENT COSTS** The Company expenses legal costs incurred for patent preparation and applications. The Company capitalizes legal costs related to the defense and enforcement of issued patents for which success is deemed probable. The related costs are amortized over the remaining useful lives of the patents using the straight-line method. Such deferred costs are periodically reviewed for impairment and recoverability. To the extent the Company is successful in its defense and enforcement of its patents and receives compensation for past infringement, costs capitalized in connection with the specific defense or enforcement are expensed as an offset against any gain received.

**INVESTMENTS IN UNCONSOLIDATED AFFILIATES** The Company has made investments in the equity instruments of other companies. These investments in unconsolidated affiliates are designated as available-for-sale in accordance with the provisions of SFAS No. 115, *"Accounting for Certain Investments in Debt and Equity Securities."* These investments are carried at fair market value, with unrealized gains and losses reported in stockholders' equity as Accumulated Other Comprehensive Income. Gains or losses on investments sold are based on the specific identification method. The fair values of certain investments are based on quoted market prices. For other investments, various methods are used to estimate fair value, including external valuations and discounted cash flows. When the fair value of a certain investment declines below cost, management uses the following criteria to determine if such a decline should be considered other than temporary and result in a realized loss:

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- the duration and extent to which the market value has been less than cost;
- the financial condition and near term prospects of the investee;
- the reasons for the decline in market value;
- the investee's performance against product development milestones; and
- the Company's ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value.

As of December 31, 2003, the Company had a \$7.3 million unrealized loss related to a \$12.6 million investment in a publicly traded company. Although the trading value of the Company's investment has been less than the Company's original cost for greater than one year, the Company believes that this unrealized loss is temporary in nature due to the investee's successful performance against its product development milestones and the historical high volatility of its stock price. Additionally, the Company has the ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value.

**INCOME TAXES** The Company accounts for income taxes in accordance with SFAS No. 109, "Accounting for Income Taxes." Under this method, deferred tax assets and liabilities are recognized for the expected future tax consequences of events that have been recognized in the Company's financial statements or tax returns. The Company evaluates annually the realizability of its deferred tax assets by assessing its valuation allowance and by adjusting the amount of such allowance, if necessary. The factors used to assess the likelihood of realization are the Company's forecast of future taxable income and available tax planning strategies that could be implemented to realize the net deferred tax assets. Failure to achieve forecasted taxable income in the applicable taxing jurisdictions could affect the ultimate realization of deferred tax assets and could result in an increase in the Company's effective tax rate on future earnings.

**RESEARCH AND DEVELOPMENT COSTS** Research and development costs are charged to expense when incurred.

**EARNINGS PER SHARE** Earnings per share are calculated in accordance with SFAS No. 128, "Earnings per Share," which requires the Company to report both basic earnings per share, based on the weighted-average number of common shares outstanding, and diluted earnings per share, based on the weighted-average number of common shares outstanding adjusted to include the potentially dilutive effect of outstanding stock options.

A reconciliation of the shares used in the basic and diluted per share computations is as follows:

Years Ended December 31, (in millions)	2003	2002	2001
Basic shares outstanding	59.1	59.0	58.9
Dilutive effect of employee stock options	2.0	2.3	–
Diluted shares outstanding	61.1	61.3	58.9

Diluted earnings per share excludes 3.2 million, 2.1 million and 0.3 million shares related to options for the years ended December 31, 2003, 2002 and 2001, respectively. These options were excluded because the exercise price per share was greater than the average market price, resulting in an anti-dilutive effect on diluted earnings per share. The effect of approximately 2.7 million common shares relating to the Company's \$150.0 million convertible debentures due 2033 has been excluded from the computation of diluted earnings per share for the year ended December 31, 2003 because none of the conditions that would permit the debentures to be converted to the common shares had been satisfied.

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**EMPLOYEE STOCK OPTION AND STOCK PURCHASE PLANS** The Company applies the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," in accounting for its fixed stock option and employee stock purchase plans. In accordance with this intrinsic value method, no compensation expense is recognized for these plans. The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123, "Accounting for Stock Based Compensation":

Years Ended December 31, (in millions, except per share amounts)	2003	2002	2001
Net income (loss), as reported	\$ 79.0	\$ 55.7	\$ (11.4)
Deduct: total stock-based employee compensation expense determined under fair value based method for all awards, net of tax	(16.0)	(15.3)	(10.8)
Pro forma net income (loss)	<u>\$ 63.0</u>	<u>\$ 40.4</u>	<u>\$ (22.2)</u>
Earnings per basic share:			
Reported net income (loss)	\$ 1.34	\$ 0.94	\$ (0.19)
Pro forma net income (loss)	1.07	0.68	(0.38)
Earnings per diluted share:			
Reported net income (loss)	1.29	0.91	(0.19)
Pro forma net income (loss)	<u>1.03</u>	<u>0.66</u>	<u>(0.38)</u>

The per share weighted-average fair value for options granted during 2003, 2002 and 2001 was \$10.93, \$11.64, and \$7.00, respectively. The fair value of each option was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

	2003	2002	2001
Average risk-free interest rate	2.5%	4.4%	5.8%
Expected dividend yield	None	None	None
Expected volatility	42%	44%	45%
Expected life (years)	4	5	5

The pro forma expense for employee stock purchase subscriptions was calculated with the following weighted-average assumptions for grants during the following periods:

	2003	2002	2001
Average risk-free interest rate	1.3%	2.1%	4.1%
Expected dividend yield	None	None	None
Expected volatility	42%	45%	44%
Expected life (years)	1	1	1

The expected volatility assumptions for the stock option and stock purchase plans used in the Black-Scholes option pricing model is estimated on the date of each grant.

**DERIVATIVES** Edwards Lifesciences maintains an overall risk management strategy that incorporates the use of a variety of interest rate and currency derivative financial instruments to mitigate its exposure to significant unplanned fluctuations in earnings caused by volatility in interest rate and currency exchange rates. Derivative instruments that are used as part of the Company's interest and foreign exchange rate management strategy include interest rate swaps, option-based products and forward exchange contracts. These instruments are designated as cash flow hedges. Edwards Lifesciences does not use any of these instruments for trading or speculative purposes.

The Company uses interest rate swaps to convert floating-rate debt to fixed-rate debt. The Company's interest rate swap agreements involve agreements to pay a fixed rate and receive a floating rate, at specified intervals, calculated on an agreed-upon notional amount. The debt and amounts that the Company hedges are determined based on prevailing market conditions and the current shape of the yield curve. Interest rate swap agreements are executed as an integral part of specific debt transactions.

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The Company utilizes forward exchange contracts and option contracts to hedge a portion of its exposure to forecasted intercompany foreign currency transactions. These contracts provide for the purchase or sale of foreign currencies at specified future dates at specified exchange rates. These contracts are entered into to reduce the risk that the Company's earnings and cash flows resulting from certain forecasted intercompany transactions will be adversely affected by changes in foreign currency exchange rates.

Derivative instruments used by Edwards Lifesciences involve, to varying degrees, elements of credit risk, in the event a counterparty should default, and market risk, as the instruments are subject to rate and price fluctuations. Credit risk is managed through the use of credit standard guidelines, counterparty diversification, monitoring of counterparty financial condition and International Swap Dealers Association master netting agreements in place with all derivative counterparties. All derivative financial instruments are with commercial banks and investment banking firms assigned investment grade ratings of "AA" or better with national rating agencies.

All derivatives are recognized on the balance sheet at their fair value. On the date that the Company enters into a derivative contract, it designates the derivative as either (a) a hedge of a forecasted transaction or the variability of cash flows that are to be received or paid in connection with a recognized asset or liability (a "cash flow" hedge), or (b) a hedge of an exposure to changes in the fair value of an asset, liability, or an unrecognized firm commitment (a "fair value" hedge). Changes in the fair value of a derivative that is highly effective, and that is designated and qualifies as a cash flow hedge to the extent that the hedge is effective, are recorded in Accumulated Other Comprehensive Income until earnings are affected by the variability of cash flows of the hedged transaction (e.g., until periodic settlements of a variable asset or liability are recorded in earnings). Any hedge ineffectiveness (which represents the amount by which the changes in the fair value of the derivative exceed the variability in the cash flows of the forecasted transaction) is recorded in current-period earnings. Changes in the fair value of a derivative that is highly effective, and that is designated and qualifies as a foreign-currency hedge, are recorded in either current-period earnings or Accumulated Other Comprehensive Income, depending on whether the hedging relationship satisfies the criteria for a fair-value or cash flow hedge.

The Company formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives that are designated as cash flow hedges or specific firm commitments or forecasted transactions. The Company also formally assesses (both at the hedge's inception and on an ongoing basis) whether the derivatives that are used in hedging transactions have been highly effective in offsetting changes in the cash flows of hedged items and whether those derivatives may be expected to remain highly effective in future periods. All components of each derivative's gain or loss are included in the assessment of hedge effectiveness.

When it is determined that a derivative is not, or has ceased to be, highly effective as a hedge, the Company discontinues hedge accounting prospectively. A derivative ceases to be highly effective when (a) the Company determines that the derivative is no longer effective in offsetting changes in the cash flows of a hedged item such as firm commitments or forecasted transactions, (b) it is no longer probable that the forecasted transaction will occur, (c) the derivative expires or is sold, terminated, or exercised, or (d) management determines that designating the derivative as a hedging instrument is no longer appropriate.

When the Company discontinues hedge accounting because it is no longer probable that the forecasted transaction will occur in the originally expected period, the gain or loss on the derivative remains in Accumulated Other Comprehensive Income and is reclassified into earnings when the forecasted transaction affects earnings. However, if it is probable that a forecasted transaction will not occur by the end of the originally specified time period or within an additional two-month period of time thereafter, the gains and losses that were accumulated in Accumulated Other Comprehensive Income will be recognized immediately in earnings. In a situation in which hedge accounting is discontinued and the derivative remains outstanding, the Company will carry the derivative at its fair value on the balance sheet, recognizing changes in the fair value in current-period earnings.

**COMPREHENSIVE INCOME** Comprehensive income encompasses all changes in equity other than those arising from transactions with stockholders, and consists of net income, currency translation adjustments, pension adjustments, unrealized net gains and losses on cash flow hedges and investments in unconsolidated affiliates.

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**EFFECTS OF RECENT ACCOUNTING PRONOUNCEMENTS** Effective January 1, 2001, Edwards Lifesciences adopted the provisions of SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended. SFAS No. 133 requires companies to record derivatives on the balance sheet as assets and liabilities, measured at fair value. Accounting for the gain or loss due to changes in fair value of the derivative instrument depends on whether the derivative qualifies as a hedge. If the derivative instrument does not qualify as a hedge, the gains or losses are reported in earnings when they occur. If the derivative instrument qualifies as a hedge, the accounting varies based upon the type of risk being hedged. Adopting the provisions of SFAS No. 133 on January 1, 2001 resulted in a one-time cumulative after-tax increase in net loss of \$1.5 million. In addition, the Company recorded the following one-time cumulative after-tax adjustments in Accumulated Other Comprehensive Income:

<i>(in millions)</i>	<b>Unrealized Gain (Loss)</b>
Related to previously designated cash flow hedging relationships:	
Fair value of hedging instruments	\$ (6.9)
Previously deferred hedging gains and losses	1.5
Total cumulative effect of adoption on Other Comprehensive Income, net of tax	\$ (5.4)

Effective January 1, 2001, Edwards Lifesciences adopted the provisions of SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities." This statement replaces SFAS No. 125 and revises the standards for accounting for securitizations and other transfers of financial assets and collateral. SFAS No. 140 is effective for transfers and servicing of financial assets and extinguishments of liabilities occurring after March 31, 2001. This statement was effective for recognition and reclassification of collateral and for disclosures relating to securitization transactions and collateral for fiscal years ending after December 15, 2000. Adoption of this standard did not have a material impact on the Company's consolidated financial statements.

In June 2001, the FASB issued SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 142, which changes the accounting for goodwill from an amortization method to an impairment-only approach, is effective for fiscal years beginning after December 15, 2001. No transition adjustment was recorded upon adoption of this standard on January 1, 2002. However, adoption of this standard resulted in the elimination of goodwill amortization commencing January 1, 2002. See Note 8 for more information.

In June 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143, which changes the accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated retirement costs, is effective for fiscal years beginning after June 15, 2002. Adoption of this standard did not have a material impact on the Company's consolidated financial statements.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long Lived Assets." SFAS No. 144, which changes the accounting and reporting for the impairment of long-lived assets, is effective for fiscal years beginning after December 15, 2001. Adoption of this standard did not have a material impact on the Company's consolidated financial statements.

In July 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." SFAS No. 146 changes the accounting and reporting for costs associated with exit or disposal activities, termination benefits and other costs to exit an activity, including certain costs incurred in a restructuring. The provisions of this statement are effective for exit or disposal activities that are initiated after December 31, 2002. Adoption of this standard did not have a material impact on the Company's consolidated financial statements.

In December 2002, the FASB issued SFAS No. 148, "Accounting for Stock-Based Compensation-Transition and Disclosure." This standard amends SFAS No. 123, "Accounting for Stock-Based Compensation," to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this Standard amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. This standard is effective for financial statements for fiscal years ending after December 15, 2002. The Company has adopted this standard and has made the necessary changes to its financial statement disclosures.

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In January 2003, the FASB issued and in December 2003, revised, FASB Interpretation No. 46 "Consolidation of Variable Interest Entities—an interpretation of ARB No. 51." This interpretation addresses consolidation by business enterprises of variable interest entities which have certain characteristics. The effective date of this interpretation varies based on certain criteria. The Company is required to apply all of this interpretation no later than the end of the first reporting period that ends after March 15, 2004. The Company is evaluating one entity to determine if it qualifies as a variable interest entity and if the entity will need to be consolidated. This entity had \$10.1 million of assets as of September 30, 2003 and had \$0.4 million of net income for the nine months ended September 30, 2003.

In April 2003, the FASB issued, SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." SFAS No. 149 amends and clarifies financial accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts and for hedging activities under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." This standard is effective for contracts entered into or modified after June 30, 2003, with exception for specified transactions. Adoption of this standard did not have a material impact on the Company's consolidated financial statements.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." SFAS No. 150 establishes how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. Adoption of this standard did not impact the Company's consolidated financial statements. On October 1, 2002, the Company acquired from Baxter for \$19.0 million, net, the cardiovascular business in Japan. The purchase price excluded approximately \$30 million of securitized accounts receivable. In the three months ended September 30, 2002, the Company recorded a \$3.3 million charge for legal, administrative and regulatory expenses related to the acquisition reflected in special charges on the Statement of Operations for the year ended December 31, 2002. Commencing October 1, 2002, the Company began reporting the results of the Japan business on a fully consolidated basis. The acquisition did not materially impact the Company's net income as the terms of the joint venture agreement enabled Edwards Lifesciences to record substantially all of the net profit generated by the Japan business (see Note 1)

### **Note 3.**

#### **ACQUISITION OF JOINT VENTURE IN JAPAN**

The acquisition of the cardiovascular business in Japan was accounted for using the predecessor basis of accounting, whereby acquired assets and liabilities are recorded at their historical balances. The impact to the Company's balance sheet on October 1, 2002 from the acquisition was as follows:

<i>(in millions)</i>	<b>Net Assets Acquired</b>	<b>Other</b>	<b>Net Impact</b>
Current assets			
Accounts and other receivables, net	\$ 18.8	\$ (14.8) <sup>(b)</sup>	\$ 4.0
Inventories, net	36.0	—	36.0
Prepaid expenses and other current assets	1.6	—	1.6
Total current assets	56.4	(14.8)	41.6
Property, plant and equipment, net	15.3	—	15.3
Deferred income taxes	42.7 <sup>(a)</sup>	—	42.7
Other assets	3.1	—	3.1
	<u>\$ 117.5</u>	<u>\$ (14.8)</u>	<u>\$ 102.7</u>
Accounts payable and accrued liabilities	\$ 29.6	\$ (14.8) <sup>(b)</sup>	\$ 14.8
Long-term debt	—	19.0 <sup>(c)</sup>	19.0
Other liabilities	5.9	—	5.9
Stockholders' equity			
Additional contributed capital	129.8	(19.0)	110.8
Accumulated other comprehensive income	(47.8)	—	(47.8)
Total stockholders' equity	82.0	(19.0)	63.0
	<u>\$ 117.5</u>	<u>\$ (14.8)</u>	<u>\$ 102.7</u>

(a) Deferred tax asset relates to a tax basis step-up in connection with the acquisition.

(b) To reflect the elimination of receivables and payables between Edwards Lifesciences and the joint venture in Japan which are considered intercompany balances after the acquisition.

(c) To reflect the incurrence of \$19.0 million of long-term debt to effect the transaction.

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The following unaudited pro forma consolidated statement of operations for the year ended December 31, 2002 presents the results of Edwards Lifesciences assuming that the acquisition of the cardiovascular business in Japan had been completed as of January 1, 2002:

<i>(in millions, except per share information)</i>	Pro Forma Adjustments			
	Historical	Japan Operating Results <sup>(a)</sup>	Other <sup>(b)</sup>	Pro Forma
Net sales	\$ 704.0	\$ 77.2	\$ —	\$ 781.2
Cost of goods sold	299.1	31.0	—	330.1
Gross profit	404.9	46.2	—	451.1
Selling, general and administrative expenses	227.9	34.0	—	261.9
Research and development expenses	65.2	2.5	—	67.7
Disposition of assets and other charges, net	67.4	—	—	67.4
Non-recurring spin-off expenses	3.3	—	—	3.3
Equity earnings in Japan operations	(11.0)	11.0	—	—
Interest expense, net	11.5	—	0.8	12.3
Other income, net	(15.4)	(1.5)	—	(16.9)
Income (loss) before provision for income taxes	56.0	0.2	(0.8)	55.4
Provision (benefit) for income taxes	0.3	0.1	(0.2)	0.2
Net income (loss)	\$ 55.7	\$ 0.1	\$ (0.6)	\$ 55.2
Share information:				
Earnings per basic share	\$ 0.94			\$ 0.94
Earnings per diluted share	0.91			0.90

(a) To reflect Edwards Lifesciences' Japanese business on a consolidated basis for the full year ended December 31, 2002.

(b) To reflect estimated interest expense that would have been incurred by the Company based on incurrence of \$19.0 million of debt at an effective interest rate of 5%.

On a pro forma basis, assuming that the acquisition of the cardiovascular business in Japan had been completed as of January 1, 2001, the following unaudited amounts would have been recorded for the year ended December 31, 2001:

Net sales	\$ 801.2
Loss before cumulative effect of change in accounting principle	10.0
Net loss	11.5
Basic and diluted loss per share:	
Loss before cumulative effect of change in accounting principle	0.17
Cumulative effect of change in accounting	0.02
Net loss	0.20

## **Note 4.**

### **LOSS ON SALE OF STOCK**

Effective June 30, 2001, the Company sold the stock of Edwards Lifesciences Cardiovascular Resources, Inc. ("ELCR") to Fresenius Medical Care AG for cash proceeds of \$45.0 million (the "ELCR Sale"), resulting in a loss of \$68.2 million (including the write-off of \$83.0 million of goodwill). ELCR provided and managed perfusionists, monitoring systems, capital equipment and disposable material on a contract service basis to hospitals in the United States and Puerto Rico.

The following unaudited pro forma consolidated condensed statement of operations gives effect to the ELCR Sale as if it had occurred on January 1, 2001, and excludes the \$68.2 million loss on the sale. The unaudited pro forma consolidated condensed statement of operations does not purport to be indicative of either the results of future operations or the results of operations that would have occurred had the ELCR Sale been consummated on January 1, 2001.

<i>Year Ended December 31, (in millions, except per share information)</i>	<b>2001</b>
Net sales	\$ 631.1
Net income	45.9
Net income per share:	
Basic	0.78
Diluted	0.75

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**Note 5.**

**ASSET IMPAIRMENTS**

In September 2002, the Company recorded a \$67.4 million charge related to the impairment of its investment in preferred stock of World Heart Corporation ("WorldHeart"). The investment was written down to \$6.2 million, which represented the value of the Company's preferred stock investment had it been converted into common stock at October 15, 2002 (the closing date of September's books). The decision to record the charge was based primarily on WorldHeart's September 2002 decision to refocus its product development efforts by adopting a new design concept for a next generation product that resulted in a significant delay (approximately two years) in its product development timeline (with a revised commercial launch date of 2007) and impaired WorldHeart's competitive position. Accordingly, the Company concluded that sufficient risk existed that WorldHeart may be unable to fully liquidate the Company's investment in WorldHeart's preferred stock. The Company believed that the best objective indicator of the then fair value of its investment in WorldHeart's preferred stock was the market price of WorldHeart's common stock based upon the Company's expectation that the value of its preferred stock investment would be realized through the common stock, as opposed to redemption of the preferred stock.

Based upon the non-strategic nature and declining profitability of certain products in the Company's portfolio (including certain distributed products), the Company decided during the quarter ended June 30, 2001 to discontinue its sales effort of these products. The long-lived assets and the investments related to these products were evaluated to determine whether any impairment in their recoverability existed at the determination date. As a result, Edwards Lifesciences assessed whether the estimated cash flows of the products or investments over the estimated lives of the related assets were sufficient to recover their costs. Where such cash flows were insufficient, the Company utilized a discounted cash flow model to estimate the fair value of assets or investments and recorded an impairment charge to adjust the carrying values to estimated fair values. As a result of this evaluation, Edwards Lifesciences recorded a \$14.8 million charge related to the impairment of intangible assets (\$8.3 million), the impairment of an investment (\$5.5 million) and the write-down of non-productive assets (\$1.0 million).

**Note 6.**

**SPECIAL CHARGES**

During the years ended December 31, 2003 and 2002, Edwards Lifesciences recorded special charges comprised of the following:

	<b>2003</b>	<b>2002</b>
Purchased in-process research and development expenses	\$ 13.6	\$ —
Severance charge	13.0	—
Resolution of Baxter arbitration	5.3	—
Loss on sale of business	3.3	—
Pension curtailment	1.9	—
Spin-off expenses	—	3.3
Total special charges	\$ 37.1	\$ 3.3

**PURCHASED IN-PROCESS RESEARCH AND DEVELOPMENT EXPENSES** On February 18, 2003, the Company acquired the endovascular mitral valve repair program of Jomed N.V., a European-based provider of products for minimally invasive vascular intervention, for \$20.0 million in cash. The acquisition included all technology and intellectual property associated with the program. At the acquisition date, the program, which was less than 50% complete, was involved in testing proprietary prototypes prior to initiating required animal studies and human clinicals. Additional design improvements, bench testing, animal studies and human clinical studies must be successfully completed prior to selling the product in Europe (expected in 2005) and in the United States (expected in 2006). The risks and uncertainties associated with completing development within a reasonable period of time include those related to the design, development and manufacturability of the product, the success of animal and clinical studies and the timing of European and United States regulatory approvals. The fair market value of the assets acquired consisted primarily of patents that are being amortized over their estimated economic life of 17 years. Approximately \$11.8 million of the purchase price has been charged to in-process research and development. The value of the in-process research and development was calculated using cash flow projections discounted for the risk inherent in such projects. The discount rate used was 30%. The valuation assumed approximately \$20 million of additional research and development expenditures would be incurred prior to the date of product introduction. In the valuation, material net cash inflows were forecasted to commence in 2008.

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On December 5, 2003, the Company acquired the stock of Whitland Research Limited ("Whitland") for \$3.2 million in cash, although achievement of future milestones through 2006 could increase the total price to \$5.6 million. Whitland was focused on the development of critical care monitoring technologies. The \$3.2 million purchase price was allocated to acquired in-process research and development (\$1.8 million) and patents (\$1.4 million) based upon their estimated fair values. The patents will be amortized over their estimated useful life of 10 years.

**SEVERANCE CHARGE** In July 2003, the Company recorded a charge of \$13.0 million associated with a decision to streamline operations. The charge was primarily related to the severance costs associated with reducing the Company's worldwide workforce by 136 employees, primarily in the United States and Europe. As of December 31, 2003, \$4.1 million of the charge remained unpaid.

**BAXTER ARBITRATION SETTLEMENT** In January 2004, the Company concluded a dispute resolution proceeding with Baxter. Each company sought reimbursement from the other for a variety of claims arising from the Company's spin-off from Baxter in April 2000. The resolution resulted in a \$5.3 million charge primarily related to the valuation of receivables at the date of spin-off, and a \$5.4 million increase to Additional Contributed Capital related to the true-up of the beginning balance of equity.

**LOSS ON SALE OF BUSINESS** Effective July 4, 2003, the Company sold its German perfusion services subsidiary to WKK GmbH, a German-based provider of hospital services, for a nominal amount. Sales generated by the German perfusion services subsidiary were approximately \$3.5 million during the six months ended June 30, 2003 and \$6.6 million for the year 2002. In accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," and Staff Accounting Bulletin No. 100, "Restructuring and Impairment Charges," the Company recorded a pre-tax impairment charge of \$3.3 million in the second quarter of 2003 to reduce the carrying value of the subsidiary's assets to fair value based upon the proceeds from the sale.

**PENSION CURTAILMENT** On November 4, 2003, the Company suspended its defined benefit pension plan in Puerto Rico ("the Plan"). Effective December 31, 2003, employees do not earn additional defined benefits for future services. To mitigate the Puerto Rico employees' reduced benefits from the Plan's suspension, effective January 1, 2004, the Company increased its contributions to the Puerto Rico 1165(e) defined contribution plan. In accordance with SFAS No. 88, "Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits," the Company recorded a curtailment loss of \$1.9 million during the fourth quarter 2003. As of December 31, 2003, the Plan's accumulated benefit obligation exceeded the fair value of its assets by \$2.4 million.

**SPIN-OFF EXPENSES** The Company recorded a \$3.3 million charge for legal, administrative and regulatory expenses related to the October 2002 acquisition of the cardiovascular business in Japan (see "Joint Venture in Japan").

### **Note 7.**

#### **ACCOUNTS RECEIVABLE SECURITIZATION**

Edwards Lifesciences has two agreements (the "Japan Receivables Facility" and the "U.S. Receivables Facility," or the "Facilities") with financial institutions whereby it securitizes, on a continuous basis, an undivided interest in certain eligible trade account receivables. In December 2002, the Company entered into the Japan Receivables Facility whereby the Company's Japanese subsidiary (Edwards Lifesciences Japan Limited) sells eligible accounts receivable directly to a financial institution. Under the U.S. Receivables Facility, the Company sells eligible accounts receivable to a wholly-owned, special purpose, bankruptcy-remote subsidiary formed for the purpose of buying and selling these receivables, which then sells the participating interests in the receivables to a financial institution.

The transactions under both Facilities are accounted for as sales of accounts receivable. The Company retained servicing responsibilities and subordinated residual interests in the accounts receivables. The Company receives annual servicing fees approximating one percent of the outstanding balance and rights to future cash flows arising after the investors in the securitization trust have received their contractual return. No servicing asset or liability has been recorded as the Company's compensation for servicing the assets approximates the cost of its servicing responsibilities. The investors and the securitization trust have no recourse to the Company's other assets for failure of debtors to pay when due. The Company's residual interests are subordinate to the investors' interests. The U.S. Receivables Facility is renewable for one-year periods at the Company's option and will expire on December 21, 2004. The Japan Receivables Facility will expire on December 3, 2005.

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Sales of receivables under these programs result in a reduction of accounts receivable on the Company's Consolidated Balance Sheets. Residual interests of \$14.2 million and \$9.2 million as of December 31, 2003 and 2002, respectively, are included in Other Current Assets. The interests are carried at their fair value, estimated as the net realizable value, which considers the relatively short liquidation period and includes an estimated provision for credit losses. Pursuant to the terms of the Facilities, the Company had sold \$91.2 million and \$76.5 million of trade accounts receivable as of December 31, 2003 and 2002, respectively, resulting in a reduction of accounts receivable on the Company's Consolidated Balance Sheets, and received funding of \$76.9 million and \$67.1 million, respectively. Costs associated with the sale of receivables, primarily related to the discount and loss on sale, were \$0.8 million, \$1.6 million and \$1.4 million in 2003, 2002 and 2001, respectively, and are included in Other (Income) Expense, net.

**Note 8.**

**GOODWILL AND OTHER INTANGIBLE ASSETS**

On January 1, 2002, the Company adopted SFAS No. 142, "Goodwill and Other Intangible Assets," whereby goodwill is no longer amortized, but instead is subject to a periodic impairment review, performed by the Company in the fourth quarter of each year. As the Company's operations are comprised of one reporting unit, the Company reviews the recoverability of its goodwill by comparing the Company's fair value to the net book value of its assets. If the book value of the Company's assets exceeds the Company's fair value, the goodwill is written down to its implied fair value. The impairment analyses were completed in the fourth quarters of 2003 and 2002 and resulted in no impairments.

Pursuant to SFAS No. 142, the results for periods prior to adoption are not to be restated. If SFAS No. 142 had been effective January 1, 2001, net loss and earnings per basic and diluted share would have been as follows:

<i>Year Ended December 31, (in millions, except per share information)</i>	<b>2001</b>
Reported net loss	\$ (11.4)
Goodwill amortization, net of tax	17.7
Adjusted net income	<u>\$ 6.3</u>
 Earnings per basic share:	
Reported net loss	\$ (0.19)
Adjusted net income	0.11
Earnings per diluted share:	
Reported net loss	(0.19)
Adjusted net income	0.10

In April 2003, the Company purchased the technology and intellectual property associated with Embol-X Inc.'s surgically placed, intra-aortic embolic management system. The total consideration for Embol-X Inc. was \$13.6 million, comprised of \$8.0 million cash, a deferred payment of \$2.0 million cash payable upon the completion of the technology transfer (which was completed during August 2003), stock in an unconsolidated affiliated company valued at \$3.0 million and \$0.6 million of capitalized transaction costs. In accordance with the guidance provided in Emerging Issues Task Force 98-3, "Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or of a Business," the transaction was accounted for as a purchased business combination. The purchase price was allocated to the acquired assets at their estimated fair value as follows (in millions):

Developed technology	\$ 6.5
Goodwill	4.4
Patents	1.7
Trademarks and trade names	0.5
Machinery and equipment	0.2
Inventory	0.3
	<u>\$ 13.6</u>

If prior to April 16, 2008, the Company's sales of medical devices from the transferred technology are at least \$20.0 million in any consecutive 12-month period, the Company will pay an additional \$5.0 million to Embol-X Inc. This contingent obligation has not been recorded in the Company's balance sheet as of December 31, 2003. Forecasted sales of medical devices from the transferred technology are expected to be less than \$2.0 million for 2004.

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Other intangible assets subject to amortization consisted of the following:

December 31, 2003 <i>(in millions)</i>	Patents	Unpatented Technology	Other	Total
Cost	\$ 116.9	\$ 36.3	\$ 14.3	\$ 167.5
Accumulated amortization	(64.8)	(18.0)	(3.7)	(86.5)
Net carrying value	<u>\$ 52.1</u>	<u>\$ 18.3</u>	<u>\$ 10.6</u>	<u>\$ 81.0</u>

December 31, 2002 <i>(in millions)</i>	Patents	Unpatented Technology	Other	Total
Cost	\$ 96.8	\$ 36.3	\$ 8.9	\$ 142.0
Accumulated amortization	(58.2)	(15.5)	(3.3)	(77.0)
Net carrying value	<u>\$ 38.6</u>	<u>\$ 20.8</u>	<u>\$ 5.6</u>	<u>\$ 65.0</u>

Amortization expense related to other intangible assets for the years ended December 31, 2003 and 2002 was \$9.5 million and \$9.5 million, respectively. Estimated amortization expense for each of the years ending December 31 is as follows (in millions):

2004	\$ 9.7
2005	9.9
2006	9.9
2007	9.9
2008	9.9

## **Note 9.**

### **ACCOUNTS PAYABLE AND ACCRUED LIABILITIES**

December 31, <i>(in millions)</i>	2003	2002
Accounts payable	\$ 67.3	\$ 69.5
Employee compensation and withholdings	39.2	38.4
Property, payroll and other taxes	13.6	19.3
Derivative liability (Note 11)	12.4	16.3
Other accrued liabilities	34.7	33.8
	<u>\$ 167.2</u>	<u>\$ 177.3</u>

## **Note 10.**

### **LONG-TERM DEBT, CREDIT FACILITIES AND LEASE OBLIGATIONS**

As of December 31, 2003, the Company had two unsecured revolving credit agreements providing for up to an aggregate of \$530.0 million in one- to six-month borrowings in multiple currencies. Borrowings currently bear interest at the London interbank offering rate (LIBOR) plus 0.75%, which includes a facility fee. One of the credit agreements provides for long-term borrowings up to an aggregate of \$430.0 million and expires on March 30, 2005 (the "Five Year Credit Facility"). The other credit agreement provides for borrowings up to an aggregate of \$100.0 million through March 25, 2004 (the "364 Day Facility"). As the 364 Day Facility has not been used recently, the Company does not plan to renew this credit agreement when it expires. As of December 31, 2003, borrowings of \$105.8 million were outstanding under the Five Year Credit Facility and no borrowings were outstanding under the 364 Day Facility. Edwards Lifesciences pays a facility fee, regardless of available or outstanding borrowings, currently at an annual rate of 0.15% for the \$430 million credit agreement, and 0.125% for the \$100 million credit agreement. All amounts outstanding under the Five Year Credit Facility have been classified as long-term obligations, as these borrowings will continue to be refinanced pursuant to that credit agreement. In March 2004, the Company will reclassify any balance outstanding on the Five Year Credit Facility to short-term as the agreement will expire within one year. The credit facilities contain various financial and other covenants, all of which the Company was in compliance with at December 31, 2003.

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In May 2003, the Company issued \$150.0 million of convertible senior debentures, issued at par, bearing an interest rate of 3.875% per annum due May 15, 2033 (the "Notes"). Interest is payable semi-annually in May and November. Issuance costs of approximately \$3.6 million are being amortized to interest expense over 5 years. The Notes are convertible into 18.29 shares of the Company's common stock for each \$1,000 principal amount of Notes (conversion price of \$54.66 per share), subject to adjustment. The Notes may be converted, at the option of the holders, on or prior to the final maturity date under any of the following circumstances:

- during any fiscal quarter, if the closing sale price per share of the Company's common stock exceeds 120% of the conversion price;
- if the Notes have been called for redemption; or
- upon the occurrence of specified corporate events.

Holders of the Notes have the right to require the Company to purchase all or a portion of their Notes at a price equal to 100% of the principal amount of the Notes plus any accrued and unpaid interest on May 15, 2008, 2013, and 2018. The Company will pay cash for all Notes so purchased on May 15, 2008. For any Notes purchased by the Company on May 15, 2013 or 2018, the Company may, at its option, choose to pay the purchase price in cash, in shares of the Company's common stock, or any combination thereof. The Company must pay all accrued and unpaid interest in cash.

The Company may redeem for cash all or part of the Notes at any time on or after May 15, 2008, at a redemption price equal to 100% of the principal amount of the Notes to be redeemed, plus any accrued and unpaid interest.

Beginning with the six-month interest period commencing May 15, 2008, holders of the Notes will receive contingent interest at a rate of 0.25% if the trading price of the Notes equals or exceeds 120% of the principal amounts of the Notes. This contingent interest payment feature represents an embedded derivative. Based on the immaterial value associated with this feature, no value has been assigned to the derivative at issuance or at December 31, 2003.

Edwards Lifesciences utilizes interest rate swap agreements in managing its exposure to interest rate fluctuations. Interest rate swap agreements are executed as an integral part of specific debt transactions. Edwards Lifesciences' interest rate swap agreements involve agreements to receive a floating rate and pay a fixed rate, at specified intervals, calculated on an agreed-upon notional amount. As of December 31, 2003, Edwards Lifesciences had in place four interest rate swaps with a total notional amount of \$155.8 million to swap floating rate United States dollar and Yen denominated debt obtained under the Company's revolving credit facilities for fixed rates. The original maturities of the interest rate swap agreements are between three and five years.

The weighted average interest rate under the Credit Facilities was 5.6% at December 31, 2003, including the effect of interest rate swap agreements. The rates have been calculated using rates in effect at December 31, 2003.

Future minimum lease payments (including interest) under noncancelable operating leases and aggregate debt maturities at December 31, 2003 were as follows:

<i>(in millions)</i>	Operating Leases	Aggregate Debt Maturities
2004	\$ 11.1	\$ —
2005	8.2	105.8
2006	6.4	—
2007	5.1	—
2008	3.7	—
Thereafter	2.1	150.0
Total obligations and commitments	<u>\$ 36.6</u>	<u>\$ 255.8</u>

Included in debt at December 31, 2003 and 2002 were unsecured notes denominated in various foreign currencies as follows:

<i>December 31, (in millions)</i>	2003	2002
Japanese Yen	6,000.0	13,700.0
Euro	—	15.0
Swiss Franc	—	5.0

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Certain facilities and equipment are leased under operating leases expiring at various dates. Most of the operating leases contain renewal options. Total expense for all operating leases was \$12.3 million, \$6.8 million, and \$6.1 million for the years 2003, 2002 and 2001, respectively.

**Note 11.**

**FINANCIAL INSTRUMENTS AND RISK MANAGEMENT**

**FAIR VALUES OF FINANCIAL INSTRUMENTS** The consolidated financial statements include financial instruments whereby the fair market value of such instruments may differ from amounts reflected on a historical basis. Financial instruments of the Company consist of cash deposits, accounts and other receivables, investments in unconsolidated affiliates, accounts payable, certain accrued liabilities and debt. The fair values of certain investments in unconsolidated affiliates are estimated based on quoted market prices. For other investments, various methods are used to estimate fair value, including external valuations and discounted cash flows. The carrying amount of the Company's long-term debt approximates fair market value based on prevailing market rates. The Company's other financial instruments generally approximate their fair values based on the short-term nature of these instruments.

**DERIVATIVE FINANCIAL INSTRUMENTS** The Company utilizes a variety of derivative financial instruments to manage its currency exchange rate and interest rate risk as summarized below. The Company does not enter into these arrangements for trading or speculation purposes.

<i>(in millions)</i>	December 31,			
	2003		2002	
	Notional Amount	Fair Value	Notional Amount	Fair Value
Interest rate swap agreements	\$ 155.8	\$ (6.9)	\$ 199.4	\$ (11.0)
Option-based products	189.1	(3.0)	162.7	(2.7)
Forward currency agreements	222.7	(2.5)	226.1	(2.6)

The fair value of financial instruments was estimated by discounting expected cash flows using quoted market interest rates and foreign exchange rates as of December 31, 2003 and 2002. Notional amounts are stated in United States dollar equivalents at spot exchange rates at the respective dates. Considerable judgment was employed in interpreting market data to develop estimates of fair value; accordingly, the estimates presented herein are not necessarily indicative of the amounts that the Company could realize in a current market exchange. The use of different market assumptions or valuation methodologies could have a material effect on the estimated fair value amounts.

At December 31, 2003, the fair value of option-based products, forward currency and interest rate swap agreements is recorded in Accrued Liabilities. During the year ended December 31, 2003 and 2002, the Company reclassified from Accumulated Other Comprehensive Income a net loss of \$9.3 million and a net gain of \$5.9 million, respectively, to Cost of Goods Sold, and a net loss of \$5.7 million and \$5.0 million, respectively, to Interest Expense, Net. The Company expects that during the next 12 months it will reclassify to earnings a \$6.2 million loss currently recorded in Accumulated Other Comprehensive Income. For the year ended December 31, 2003 and 2002, the Company expensed \$1.1 million and \$1.3 million, respectively, related to the time value of option-based products.

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**Note 12.  
COMMON STOCK**

The Edwards Lifesciences Corporation Long-Term Stock Incentive Compensation Program (the "Program") provides for the grant of incentive and non-qualified stock options, restricted stock and other stock-based incentive awards for eligible employees and contractors of the Company. Under the Program, these grants are generally awarded at a price equal to the fair market value at the date of grant based upon the closing price on the date immediately preceding the grant date. Options to purchase shares of the Company's common stock granted under the Program generally vest over predetermined periods and expire 7 years after the date of grant. An aggregate of 15.5 million shares of the Company's common stock has been reserved for issuance under the Program.

On April 3, 2000, the Company granted options to purchase shares of Edwards Lifesciences' common stock under the Program. The grants include two types of stock options: Founders Options and Conversion Options. The Founders Options were awarded to all salaried employees of the Company and permit the purchase of approximately 5.7 million shares at an exercise price of \$13.88, the fair market value at the date of grant. The Founders Options vested 30% on April 3, 2002, and the balance vested on April 3, 2003. The Founders Options included approximately 634,000 options granted to non-employees of the Company in Japan (employees of Baxter dedicated to the joint venture as described in Notes 1 and 3). In accordance with SFAS No. 123, "Accounting for Stock-Based Compensation," the \$4.0 million value of these options was amortized over the three-year vesting period on a straight-line basis. The Conversion Options permitted the purchase of approximately 2.2 million shares at an exercise price based upon an equitable conversion of the exercise price under the Baxter stock option plan, with reference to the when-issued price of the Company's stock and the closing price of Baxter's common stock on March 31, 2000. The Conversion Options retained the vesting periods under the Baxter stock option plan, resulting in various vesting periods. All of the Conversion Options were vested as of the end of September 2002.

The Company also maintains the Nonemployee Directors and Consultants Stock Incentive Program (the "Nonemployee Program"). Under the Nonemployee Program, each non-employee director annually receives 10,000 stock options. Additionally, each non-employee director may elect to receive all or a portion of the cash retainer to which the director is otherwise entitled through the issuance of stock options. As of December 31, 2003, 208,293 options were issued under the Nonemployee Program.

Stock option activity under the Program and the Nonemployee Program was as follows:

	2003		2002		2001	
	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
<i>(options in thousands)</i>						
Outstanding, beginning of year	9,794	\$ 17.97	7,716	\$ 14.79	7,686	\$ 13.59
Options granted	3,884	30.35	2,784	26.03	1,123	22.01
Options exercised	(2,085)	14.73	(552)	14.17	(481)	12.14
Options cancelled	(601)	24.89	(154)	18.17	(612)	14.33
Outstanding, end of year	<u>10,992</u>	22.65	<u>9,794</u>	17.97	<u>7,716</u>	14.79
Exercisable, end of year	5,346	14.52	3,251	14.52	1,857	13.46

The following table summarizes stock options outstanding at December 31, 2003:

Range of Exercise Prices <i>(options in thousands)</i>	Outstanding		Exercisable		
	Number of Options	Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Number of Options	Weighted Average Exercise Price
\$13.88 (Founders Options)	2,750	6.25	\$ 13.88	2,750	\$ 13.88
\$10.20-\$15.71 (Conversion options)	1,089	4.40	12.18	1,089	12.18
\$15.44-\$32.36 (Other options)	7,153	8.75	27.61	1,507	21.75
	<u>10,992</u>	7.70	22.65	<u>5,346</u>	14.52

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**RESTRICTED STOCK** A one-time grant of 5,000 shares of restricted stock was made to each of the non-employee directors pursuant to the Non-employee Program. These grants vest 50% after one year and the balance vests after two years from the date of grant. An aggregate of 300,000 shares of the Company's common stock has been authorized for issuance pursuant to the Non-Employee Program. Grants of restricted stock to non-employees are charged to unearned compensation in Stockholders' Equity at their intrinsic value and recognized as expense over the vesting period. Compensation expense recognized for such grants was approximately \$0.1 million for each of 2003 and 2002, and \$0.2 million for 2001.

**EMPLOYEE STOCK PURCHASE PLAN** The Company has two employee stock purchase plans ("ESPP") for eligible employees to purchase shares of the Company's common stock at 85% of the lower of the fair market value of Edwards Lifesciences common stock on the effective date of subscription or the date of purchase. Under the ESPP, employees can authorize the Company to withhold up to 12% of their compensation for common stock purchases, subject to certain limitations. The ESPP is available to all active employees of the Company paid from the United States payroll and to eligible employees of the Company outside the United States to the extent permitted by local law. The ESPP for United States employees is qualified under Section 423 of the Internal Revenue Code. The Board of Directors authorized an aggregate of 2,150,000 shares of the Company's common stock for issuance under the ESPP. As of December 31, 2003, 731,606 shares have been issued under the plans.

**STOCKHOLDER RIGHTS PLAN** The Company has adopted a Stockholder Rights Plan to protect stockholders' rights in the event of a proposed or actual acquisition of 15% or more of the outstanding shares of the Company's common stock. As part of this plan, each share of the Company's common stock carries a right to purchase one one-hundredth (1/100) of a share of Series A Junior Participating Preferred Stock (the "Rights"), par value \$0.01 per share, subject to adjustment, which becomes exercisable only upon the occurrence of certain events. The Rights are subject to redemption at the option of the Board of Directors at a price of \$0.01 per right until the occurrence of certain events. The Rights expire on March 31, 2010, unless earlier redeemed or exchanged by the Company.

**TREASURY STOCK** In November 2001, the Company's Board of Directors approved a stock repurchase program authorizing the Company to purchase on the open market and in privately negotiated transactions up to 2.0 million shares of the Company's outstanding common stock. In addition, on May 6, 2003, the Company's Board of Directors approved a second stock repurchase program authorizing the Company to purchase an additional 2.0 million shares of the Company's outstanding common stock through December 31, 2005. Stock repurchased under these programs will primarily be used to offset obligations under the Company's employee stock option programs. During 2003 and 2002, the Company repurchased 1,766,300 and 1,298,300 shares at an aggregate cost of \$49.4 and \$30.8 million, respectively. The timing and size of any future stock repurchases are subject to a variety of factors, including market conditions, stock prices and other cash requirements.

### **Note 13.**

#### **EMPLOYEE BENEFIT PLANS**

**DEFINED BENEFIT PLANS** Prior to the Distribution, Edwards Lifesciences employees participated in Baxter-sponsored defined benefit pension plans covering substantially all employees in the United States and Puerto Rico and employees in certain European countries. The benefits were based on years of service and the employees' compensation during five of the last 10 years of employment as defined by the plans. Effective as of the Distribution, Edwards Lifesciences' employees ceased to be eligible to accrue any additional benefits under the Baxter plan for United States employees. Edwards Lifesciences did not adopt a pension plan for United States employees to replace the Baxter plan in the United States. The pension liability related to Edwards Lifesciences' United States employees' service prior to the Distribution remains with Baxter. With respect to the Puerto Rico and certain European plans, Baxter transferred the assets and liabilities relating to Edwards Lifesciences' employees to Edwards Lifesciences as of the Distribution. Edwards Lifesciences has adopted a defined benefit pension plan in Puerto Rico and in certain European countries. On November 4, 2003, the Company suspended its defined benefit pension plan in Puerto Rico ("the Plan"). Effective December 31, 2003, employees do not earn additional defined benefits for future services. To mitigate the Puerto Rico employees' reduced benefits from the Plan's suspension, the Company increased its contributions to the Puerto Rico 1165(e) defined contribution plan.

On October 1, 2002, the Company completed its spin-off from Baxter and acquired the cardiovascular business in Japan (see Notes 1 and 3). As part of the transaction, the Company acquired the defined benefit plan that covered the Japan employees and the related pension assets and liabilities.

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Information regarding the Company's defined benefit pension plans in Puerto Rico, Japan and certain European countries is as follows:

Years Ended December 31, <i>(in millions)</i>	2003	2002
<b>BENEFIT OBLIGATIONS:</b>		
Beginning of period	\$ 44.7	\$ 28.1
Service cost	3.3	1.6
Interest cost	2.2	1.7
Participant contributions	0.4	0.2
Actuarial loss	2.3	4.1
Addition of Japan plan	–	8.6
Curtailement gains	(8.7)	(0.2)
Benefits paid	(2.0)	(0.3)
Currency exchange rate changes and other	3.7	0.9
End of year	<u>\$ 45.9</u>	<u>\$ 44.7</u>
<b>FAIR VALUE OF PLAN ASSETS:</b>		
Beginning of period	\$ 22.9	\$ 20.3
Actual return on plan assets	2.7	(0.7)
Employer contributions	3.6	1.6
Participant contributions	0.6	0.2
Addition of Japan plan	–	1.1
Benefits paid	(2.0)	(0.3)
Currency exchange rate changes and other	2.0	0.7
End of year	<u>\$ 29.8</u>	<u>\$ 22.9</u>
<b>FUNDED STATUS OF PLANS:</b>		
Funded status of plans	\$ (16.1)	\$ (21.8)
Unrecognized net transition obligation	0.7	0.6
Unrecognized net actuarial losses	6.6	13.5
Unrecognized prior service cost	(0.9)	1.6
Net liability on balance sheet	<u>\$ (9.7)</u>	<u>\$ (6.1)</u>
<b>NET LIABILITY ON BALANCE SHEET CONSISTS OF:</b>		
Accrued benefit liability	\$ (10.4)	\$ (11.8)
Prepaid benefit cost	–	0.1
Intangible asset	–	3.1
Accumulated other comprehensive loss	0.4	1.6
Deferred tax asset	0.3	0.9
Net liability on balance sheet	<u>\$ (9.7)</u>	<u>\$ (6.1)</u>

The components of net periodic benefit cost are as follows:

Years Ended December 31, <i>(in millions)</i>	2003	2002	2001
Service cost	\$ 3.3	\$ 1.6	\$ 1.5
Expected employee contributions	(0.2)	–	–
Interest cost	2.2	1.7	1.7
Expected return on plan assets	(1.6)	(1.5)	(1.5)
Curtailement loss	1.9	–	–
Amortization of prior service cost and other	0.8	0.1	0.3
Net periodic pension benefits cost	<u>\$ 6.4</u>	<u>\$ 1.9</u>	<u>\$ 2.0</u>

**NOTES TO CONSOLIDATED  
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Significant assumptions used in determining benefit obligations and net periodic benefit cost are summarized as follows:

Years Ended December 31, <i>(in weighted averages)</i>	<b>2003</b>	<b>2002</b>
Discount Rate	4.24%	4.96%
Expected return on plan assets	6.77%	6.77%
Rate of compensation increase	3.05%	3.66%

**DEFINED CONTRIBUTION PLANS** The Company's employees in the United States and Puerto Rico are eligible to participate in a qualified 401(k) and 1165(e) plan, respectively. In the United States, participants may contribute up to 25% of their annual compensation (subject to tax code limitation) to the plan. Edwards Lifesciences matches the first 3 percent of the participant's annual eligible compensation contributed to the plan on a dollar-for-dollar basis. Edwards Lifesciences matches the next 2 percent of the participant's annual eligible compensation to the plan on a 50% basis. In Puerto Rico, participants may contribute up to 10% of their annual compensation (subject to tax code limitation) to the plan. Edwards Lifesciences matches the first 6 percent of the participant's annual eligible compensation contributed to the plan on a 50% basis. Matching contributions relating to Edwards Lifesciences employees were \$4.4 million, \$4.4 million and \$3.9 million in 2003, 2002 and 2001, respectively.

The Company has a nonqualified deferred compensation plan for a select group of management that provides the opportunity to defer a specified percentage of their cash compensation. Participants may elect to defer up to 100% of bonus and 25% of total annual compensation. The Company's obligations under this plan are unfunded. The amount accrued under this plan was \$5.5 million and \$3.3 million at December 31, 2003 and 2002, respectively.

The Edwards Lifesciences Corporation Executive Option Plan (the "Executive Plan") became effective for participation by eligible employees in 2001. Eligible employees who participate in the Executive Plan may not participate in the Company's nonqualified deferred compensation plan. Under the Executive Plan, executive officers and certain other key employees may elect to forgo a portion of their annual salary and bonus for an option to purchase shares of mutual funds or the Company's common stock. The options are granted quarterly with an initial exercise price equal to 25% of the fair market value per share (as defined in the Executive Plan) of the respective security on the grant date. The number of shares subject to each option is determined such that the difference between the aggregate fair market value (as defined in the Executive Plan) and the aggregate exercise price under the option is equal to the amount of forgone compensation attributable to the option. A total of 95,000 shares of the Company's common stock have been registered for issuance under the Executive Plan.

## **Note 14.**

### **RELATED PARTY TRANSACTIONS**

Effective on the Distribution, Baxter and Edwards Lifesciences entered into a series of administrative services agreements pursuant to which Baxter and Edwards Lifesciences continued to provide, for a specified period of time, certain administrative services (primarily information systems support, payroll, accounting and warehousing and logistics support) that each entity historically provided to the other. These agreements required the parties to pay each other a fee that approximated the actual costs of these services. Additionally, subsequent to March 31, 2000, Edwards Lifesciences had continuing relationships with Baxter as a customer and supplier for certain products, and used Baxter as a distributor of the Company's products in certain regions of the world. Substantially all of these service agreements and relationships had been terminated as of December 31, 2002.

Sales to Baxter, acting in the capacity of the Company's distributor subsequent to the Distribution, represented approximately 8% and 11% of the Company's total net sales for 2002 and 2001, respectively.

In December 2001, the Chief Executive Officer of the Company received a \$2.5 million loan pursuant to his employment agreement with the Company as approved by the Board of Directors. The loan was used for the purchase of his primary residence in connection with his relocation. The loan is non-interest bearing and is due in December 2006 or upon resignation or the termination of employment. The loan is collateralized by the Chief Executive Officer's primary residence.

NOTES TO CONSOLIDATED  
FINANCIAL STATEMENTS

**Note 15.**

**OTHER (INCOME) EXPENSE, NET**

Years Ended December 31, <i>(in millions)</i>	2003	2002	2001
Foreign exchange (gain) loss	\$ (10.6)	\$ (4.1)	\$ 5.0
Legal settlement, net	–	(14.7)	–
Asset dispositions and write downs	3.6	2.3	6.5
Accounts receivable securitization costs	0.8	1.5	1.4
Investment write-offs	–	1.4	–
Other	1.5	(1.8)	(2.3)
	<u>\$ (4.7)</u>	<u>\$ (15.4)</u>	<u>\$ 10.6</u>

**Note 16.**

**INCOME TAXES**

The Company's income (loss) before provision for income taxes was generated from United States and international operations as follows:

Years Ended December 31, <i>(in millions)</i>	2003	2002	2001
United States	\$ 0.7	\$ 3.5	\$ (66.7)
International	92.1	52.5	58.3
	<u>\$ 92.8</u>	<u>\$ 56.0</u>	<u>\$ (8.4)</u>

The provision (benefit) for income taxes consists of the following:

Years Ended December 31, <i>(in millions)</i>	2003	2002	2001
<b>CURRENT</b>			
United States:			
Federal	\$ –	\$ 0.6	\$ –
State and local	0.2	0.3	0.7
International, including Puerto Rico	6.3	10.6	30.9
Current income tax expense	<u>6.5</u>	<u>11.5</u>	<u>31.6</u>
<b>DEFERRED</b>			
United States:			
Federal	4.4	(7.4)	(15.3)
State and local	(1.4)	(0.9)	(5.1)
International, including Puerto Rico	4.3	(2.9)	(9.7)
Deferred income tax expense (benefit)	<u>7.3</u>	<u>(11.2)</u>	<u>(30.1)</u>
Total income tax expense	<u>\$ 13.8</u>	<u>\$ 0.3</u>	<u>\$ 1.5</u>

**NOTES TO CONSOLIDATED  
FINANCIAL STATEMENTS**

The components of deferred tax assets and liabilities are as follows:

December 31, <i>(in millions)</i>	<b>2003</b>	<b>2002</b>
<b>DEFERRED TAX ASSETS</b>		
Net operating loss carryforwards	\$ 32.0	\$ 19.0
Investments in unconsolidated affiliates	19.3	29.7
Tax credit carryforwards	17.5	6.4
Compensation and benefits	8.6	5.6
Accrued liabilities	6.5	14.3
Allowance for doubtful accounts	5.5	5.6
Other intangible assets	5.4	10.5
Inventories	2.1	2.4
Other	11.0	9.9
Total deferred tax assets	<u>107.9</u>	<u>103.4</u>
<b>DEFERRED TAX LIABILITIES</b>		
Property, plant and equipment	(14.6)	(15.8)
Other	(2.6)	(1.3)
Total deferred tax liabilities	(17.2)	(17.1)
Valuation allowance	(19.5)	(19.9)
Net deferred tax assets	<u>\$ 71.2</u>	<u>\$ 66.4</u>

At December 31, 2003, the Company had deferred tax assets of \$107.9 million, partially offset by deferred tax liabilities of \$17.2 million. The valuation allowance of \$19.5 million as of December 31, 2003 reduces certain deferred tax assets to amounts that are more likely than not to be realized. This allowance primarily relates to the deferred tax assets established for certain investments and the net operating loss carryforwards of certain non-United States subsidiaries.

During 2003, the Company recapitalized its Japan subsidiary. As a result, a deemed dividend occurred for U.S. tax purposes resulting in an incremental tax provision of \$6.2 million, net of foreign tax credits. The recapitalization was a one-time event and all of the future earnings of the Company's Japan subsidiary are intended to be permanently reinvested.

Deferred income taxes have not been provided on the undistributed earnings of the Company's foreign subsidiaries of approximately \$121.7 million as of December 31, 2003 since these amounts are intended to be permanently reinvested in foreign operations. It is not practicable to calculate the deferred taxes associated with these earnings; however, foreign tax credits would likely be available to reduce federal income taxes in the event of distribution.

A reconciliation of the United States federal statutory income tax rate to the Company's effective income tax rate is as follows:

Years Ended December 31, <i>(in millions)</i>	<b>2003</b>	<b>2002</b>	<b>2001</b>
Income tax expense (benefit) at U.S. federal statutory rate	\$ 32.5	\$ 19.6	\$ (2.9)
Foreign income tax at different rates	(11.9)	(10.6)	(6.8)
Deemed dividend from Japan, net of foreign tax credit	6.2	-	-
Tax credits	(2.1)	(1.9)	(1.6)
(Benefit) from Brazil reorganization	(13.7)	-	-
State and local taxes, net of federal tax benefit	1.0	(0.1)	(3.0)
(Benefit) loss on sale of perfusion services business	-	(20.1)	11.0
Valuation allowance for loss on investment	-	13.8	-
Nondeductible goodwill	-	-	6.0
Other	1.8	(0.4)	(1.2)
Income tax expense	<u>\$ 13.8</u>	<u>\$ 0.3</u>	<u>\$ 1.5</u>

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

The Company has manufacturing operations outside the United States, primarily in Puerto Rico, Switzerland and The Dominican Republic, which benefit from reductions in local tax rates under various tax incentives.

During 2003, the Company commenced a legal reorganization of its Brazil subsidiary to improve its balance sheet and to enhance its ability to conduct business in Brazil. Since being acquired a number of years ago, this subsidiary has incurred net operating losses primarily due to the devaluation of the local currency and interest expense incurred on inter-company debt. In addition, the reorganizing allowed the Company to recognize the accumulated losses and inter-company debt write-off under United States tax law, resulting in federal and state tax benefits of \$13.7 million.

As a result of tax law developments in 2002, the Company recorded a \$20.1 million tax benefit during 2002 related to the loss on sale of its United States perfusion services business in June 2001.

In exchange for the sale of the Novacor mechanical cardiac assist product line to WorldHeart in June 2000, the Company received WorldHeart preferred stock. In 2002, the investment in the WorldHeart preferred stock was deemed to be impaired and written down to its fair market value. Due to the uncertainty of using any potential tax benefit for the loss, a valuation allowance of \$13.8 million was established.

As of December 31, 2003, the Company has approximately \$42.9 million of U.S. federal and state tax net operating losses and \$17.9 million of tax credits available for carry-forward that will begin to expire in 2008 if not utilized. The Company also has approximately \$54.3 million of foreign tax net operating losses available for carry-forward that will begin to expire in 2005 if not utilized and approximately \$0.9 million of non-expiring tax credits that are available for carry-over. A valuation allowance of \$5.7 million has been provided on certain foreign net operating losses.

The U.S. federal income tax return filed by Edwards for the short period ended December 31, 2000 is being examined by the Internal Revenue Service. Management believes that adequate amounts of tax and related interest, if any, have been provided for any adjustments that may result for the short period ended December 31, 2000.

### **Note 17.**

#### **LEGAL PROCEEDINGS**

On June 29, 2000, Edwards Lifesciences filed a lawsuit against St. Jude Medical, Inc. alleging infringement of three Edwards Lifesciences United States patents. This lawsuit was filed in the United States District Court for the Central District of California, seeking monetary damages and injunctive relief. St. Jude has answered and asserted various affirmative defenses and counterclaims with respect to the lawsuits. On April 9, 2002, a fourth Edwards Lifesciences United States patent was added to the lawsuit. Discovery is proceeding.

On August 18, 2003, Edwards Lifesciences filed a lawsuit against Medtronic, Inc., Medtronic AVE, Cook, Inc. and W.L. Gore & Associates alleging infringement of a patent exclusively licensed to the Company. The lawsuit was filed in the United States District Court for the Northern District of California, seeking monetary damages and injunctive relief. Each of the defendants has answered and asserted various affirmative defenses and counterclaims. Discovery is proceeding.

In addition, Edwards Lifesciences is, or may be, a party to, or may be otherwise responsible for, pending or threatened lawsuits related primarily to products and services currently or formerly manufactured or performed, as applicable, by Edwards Lifesciences. Such cases and claims raise difficult and complex factual and legal issues and are subject to many uncertainties and complexities, including, but not limited to, the facts and circumstances of each particular case or claim, the jurisdiction in which each suit is brought, and differences in applicable law. Upon resolution of any pending legal matters, Edwards Lifesciences may incur charges in excess of presently established reserves. While such a charge could have a material adverse impact on Edwards Lifesciences' net income or net cash flows in the period in which it is recorded or paid, management believes that no such charge would have a material adverse effect on Edwards Lifesciences' consolidated financial position.

Edwards Lifesciences is also subject to various environmental laws and regulations both within and outside of the United States. The operations of Edwards Lifesciences, like those of other medical device companies, involve the use of substances regulated under environmental laws, primarily in manufacturing and sterilization processes. While it is difficult to quantify the potential impact of compliance with environmental protection laws, management believes that such compliance will not have a material impact on Edwards Lifesciences' financial position, results of operations or liquidity.

**NOTES TO CONSOLIDATED  
FINANCIAL STATEMENTS**

**Note 18.**

**SEGMENT INFORMATION**

Edwards Lifesciences manages its business on the basis of one reportable segment. Refer to Note 1 for a description of the Company's business. The Company's products and services share similar distribution channels and customers and are sold principally to hospitals and physicians. Management evaluates its various global product portfolios on a revenue basis, which is presented below, and profitability is evaluated on an enterprise-wide basis due to shared infrastructures. Edwards Lifesciences' principal markets are the United States, Europe and Japan.

Geographic area data includes net sales based on product shipment destination and long-lived asset data is presented based on physical location.

As of or for the years ended December 31, (in millions)

	2003	2002	2001
<b>NET SALES BY GEOGRAPHIC AREA</b>			
United States	\$ 384.3	\$ 383.3	\$ 420.8
Europe	193.5	157.3	145.4
Japan	197.9	94.8	62.0
Other countries	84.8	68.6	63.9
	<u>\$ 860.5</u>	<u>\$ 704.0</u>	<u>\$ 692.1</u>
<b>NET SALES BY MAJOR PRODUCT AND SERVICE AREA</b>			
Cardiac Surgery	\$ 426.6	\$ 365.9	\$ 329.0
Critical Care	278.8	230.3	209.9
Vascular	55.9	51.3	49.3
Perfusion	54.8	43.2	102.1
Other Distributed Products	44.4	13.3	1.8
	<u>\$ 860.5</u>	<u>\$ 704.0</u>	<u>\$ 692.1</u>
<b>LONG-LIVED TANGIBLE ASSETS BY GEOGRAPHIC AREA</b>			
United States	\$ 201.9	\$ 187.4	
Other countries	60.8	59.2	
	<u>\$ 262.7</u>	<u>\$ 246.6</u>	

**Note 19.**

**SUBSEQUENT EVENT**

On January 27, 2004, the Company acquired Percutaneous Valve Technologies, Inc. ("PVT") for \$125.0 million in cash, plus up to an additional \$30.0 million upon the achievement of key milestones through 2007. The Company expects to take an initial in-process research and development charge related to this transaction in the first quarter of 2004, estimated between \$60.0 million and \$90.0 million. The remainder of the purchase price will be allocated to patents involving PVT's proprietary technology. PVT, located in Fort Lee, NJ, with a subsidiary in Israel, is a leader in the development of an innovative, catheter-based (percutaneous) approach for replacing aortic heart valves. PVT's technology is a combination balloon-expandable stent technology integrated with a percutaneously delivered tissue heart valve. Unlike conventional open-heart valve replacement surgery, this less-invasive procedure is designed to be performed in a cardiac catheterization laboratory under local anesthesia.

NOTES TO CONSOLIDATED  
FINANCIAL STATEMENTS

**Note 20.**

**QUARTERLY FINANCIAL RESULTS AND MARKET FOR THE COMPANY'S STOCK (UNAUDITED)**

Years ended December 31, <i>(in millions, except per share data)</i>	First quarter	Second quarter	Third quarter	Fourth quarter	Total year
<b>2003</b>					
Net sales	\$ 212.5	\$ 217.8	\$ 206.1	\$ 224.1	\$ 860.5
Gross profit	123.4	128.2	119.2	130.3	501.1
Net income	14.5	21.1	24.5	18.9	79.0
Earnings per common share					
Basic	0.25	0.36	0.41	0.32	1.34
Diluted	0.24	0.34	0.40	0.31	1.29
Market price					
High	27.64	33.60	32.65	31.56	33.60
Low	24.40	26.95	25.77	26.90	24.40
<b>2002</b>					
Net sales	\$ 162.3	\$ 172.8	\$ 165.8	\$ 203.1	\$ 704.0
Gross profit	93.2	98.4	95.9	117.4	404.9
Net income (loss) <sup>(a)</sup>	20.8	30.6	(17.4)	21.7	55.7
Earnings (loss) per common share					
Basic	0.35	0.52	(0.30)	0.37	0.94
Diluted	0.34	0.50	(0.30)	0.36	0.91
Market price					
High	29.60	28.05	25.75	27.50	29.60
Low	25.00	22.18	18.40	23.81	18.40

(a) The third quarter 2002 includes a \$67.4 million pretax charge related to the impairment of the Company's investment in WorldHeart preferred stock and a \$20.1 million tax benefit related to the loss on sale of its United States perfusion services business in June 2001 resulting from tax law developments and the filing of the Company's 2001 tax return.

**Number of Stockholders** On February 27, 2004, there were 34,175 stockholders of record of Edwards Lifesciences' common stock.

**Dividends** Edwards Lifesciences has never paid any cash dividends on its capital stock and has no current plans to pay any cash dividends. The current policy of Edwards Lifesciences is to retain any future earnings for use in the business of the Company.

## CORPORATE INFORMATION

### *Corporate Headquarters*

Edwards Lifesciences Corporation  
One Edwards Way  
Irvine, CA 92614  
(949) 250-2500  
(800) 4-A-HEART  
www.edwards.com

### *Annual Meeting*

The Annual Meeting of Shareholders will be held on May 12, 2004 at 10:00 a.m. (Pacific) at the offices of Edwards Lifesciences Corporation, One Edwards Way, Irvine, CA 92614.

### *SEC Form 10-K*

A copy of Edwards Lifesciences' annual report to the Securities and Exchange Commission on Form 10-K is available upon request to our Investor Relations department. It is also available on our Web site at www.edwards.com.

### *Stock Symbol*

Edwards Lifesciences stock is traded on The New York Stock Exchange (NYSE) under the symbol EW.

**EW**  
**LISTED**  
**NYSE**

### *Information on the Internet*

Edwards Lifesciences' Web site at www.edwards.com provides access to a wide range of information for our customers, patients and shareholders. Persons interested in investing in Edwards Lifesciences are invited to visit the "Investor Information" section of our Web site to access our press releases, SEC filings and other company information.

### *Investor Information*

Shareholders, securities analysts and investors seeking additional information about Edwards Lifesciences should contact:

David K. Erickson  
Vice President,  
Investor Relations  
(949) 250-2806 Phone  
(949) 250-2248 Fax  
investor\_relations@edwards.com

### *Corporate Public Relations*

Members of the news media should call: (949) 250-5070

### *Transfer Agent*

Correspondence about share ownership, account status, the transfer or exchange of shares, lost stock certificates, duplicate mailings or change of address may be directed to: EquiServe Trust Company, N.A.  
P.O. Box 43069  
Providence, RI 02940-3069  
(800) 756-8200  
Hearing impaired # TDD: (800) 952-9245  
www.equiserve.com

### *Independent Auditors*

PricewaterhouseCoopers LLP  
Orange County, CA

### *Firms Following and/or Regularly Reporting on Edwards Lifesciences*

A.G. Edwards & Sons, Inc.  
Banc of America Securities  
Bear, Stearns & Co. Inc.  
First Albany  
FTN Midwest Research  
Fulcrum Global Partners  
GARP Research Corporation  
Goldman Sachs  
J.P. Morgan Chase & Co.  
Lazard Frères & Co. L.L.C.  
Leerink Swann & Co.  
Merrill Lynch  
Oppenheimer & Co. Inc.  
Stifel, Nicolaus & Co.  
UBS  
U.S. Bancorp Piper Jaffray  
Wedbush Morgan Securities  
William Blair & Company, L.L.C.

*Edwards Lifesciences is an affirmative action, equal opportunity employer.*

### *Board of Directors*

**Michael A. Mussallem**  
Chairman of the Board  
and Chief Executive Officer,  
Edwards Lifesciences  
Corporation

**Mike R. Bowlin**  
Former Chairman  
and Chief Executive Officer,  
Atlantic Richfield Company

**Robert A. Ingram**  
Vice Chairman, Pharmaceuticals,  
GlaxoSmithKline plc

**Vernon R. Loucks Jr.**  
Chairman,  
The Aethena Group, LLC

**Philip M. Neal**  
Chairman and  
Chief Executive Officer,  
Avery Dennison Corporation

**David E.I. Pyott**  
Chairman, Chief Executive  
Officer and President,  
Allergan, Inc.

### *Executive Management*

**Michael A. Mussallem**  
Chairman and  
Chief Executive Officer

**Thomas M. Abate**  
Corporate Vice President  
and Controller

**André-Michel Ballester**  
Corporate Vice President,  
Europe and Intercontinental

**Anita B. Bessler**  
Corporate Vice President,  
Global Franchise Management

**Stuart L. Foster**  
Corporate Vice President,  
Technology & Discovery

**Bruce P. Garren**  
Corporate Vice President,  
General Counsel and Secretary

**Patricia L. Garvey, Ph.D.**  
Corporate Vice President,  
Regulatory, Quality &  
Clinical Affairs

**John H. Kehl, Jr.**  
Corporate Vice President,  
Corporate Strategy and Business  
Development

**Corinne H. Lyle**  
Corporate Vice President,  
Chief Financial Officer  
and Treasurer

**Robert C. Reindl**  
Corporate Vice President,  
Human Resources

**Keith A. Reisinger**  
Corporate Vice President,  
Technology

**Stanton J. Rowe**  
President,  
Percutaneous Valve Interventions

**Huimin Wang, M.D.**  
Corporate Vice President,  
Japan

**Randel W. Woodgrift**  
Corporate Vice President,  
Manufacturing

Thank you to the patients and Edwards Lifesciences employees who contributed their time, stories, and images in the creation of this Annual Report.

This Annual Report contains forward-looking statements that involve risks and uncertainties that could cause the Company's future business, financial condition, results of operations or performance to differ materially from that expressed or implied by the forward-looking statements. All statements other than statements of historical fact in this Annual Report or referred to or incorporated by reference into this Annual Report are "forward-looking statements." You are encouraged to refer to the discussion of Risk Factors that may be found in the Company's filings with the Securities and Exchange Commission.

### Trademarks

Edwards Lifesciences, Edwards, the stylized E logo, Carpentier-McCarthy-Adams IMR ETlogix, IMR ETlogix, Life is Now, Magna, PERIMOUNT Magna, PreSep and Tricentrix are trademarks of Edwards Lifesciences Corporation. Carpentier-Edwards, Cosgrove-Edwards, EMBOL-X, Fogarty, Lifepath AAA, PERIMOUNT, PERIMOUNT Plus, Starr-Edwards and Swan-Ganz are trademarks of Edwards Lifesciences Corporation and are registered in the United States Patent and Trademark Office. LifeStent and Lifestent NT are trademarks of Edwards Lifesciences AG; LifeStent is registered in the United States Patent and Trademark Office.

Design: Stoyan Design, Costa Mesa, California Printing: ColorGraphics Photography: Jeff Zaruba

EXECUTIVE MANAGEMENT



:: pictured left to right ::

André-Michel Ballester :: Bruce Garren :: Stan Rowe :: John Kehl :: Patricia Garvey  
Randy Woodgrift :: Keith Reisinger :: Corinne Lyle :: Mike Mussallem :: Anita Bessler  
Rob Reindl :: Huimin Wang :: Stu Foster :: Tom Abate

## Our Credo

At Edwards Lifesciences, we are dedicated to providing innovative solutions for people fighting cardiovascular disease.

Through our actions, we will become trusted partners with customers, colleagues, and patients — creating a community unified in its mission to improve the quality of life around the world. Our results will benefit customers, patients, employees, and shareholders.

We will celebrate our successes, thrive on discovery, and continually expand our boundaries. We will act boldly, decisively, and with determination on behalf of people fighting cardiovascular disease.

Helping patients is our life's work, and

*life is now*

**Edwards Lifesciences Corporation**

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