EL PASO CORP/DE
Form 8-K
January 11, 2006

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

# FORM 8-K

## CURRENT REPORT

**Pursuant to Section 13 or 15(d) of the**
**Securities Exchange Act of 1934**

Date of Report:
**January 10, 2006**

(Date of Earliest Event Reported: January 9, 2006)

**EL PASO CORPORATION**
(Exact name of Registrant as specified in its charter)

| Delaware | 1-14365 | 76-0568816 |
|---|---|---|
| (State or other jurisdiction of incorporation or organization) | (Commission File Number) | (I.R.S. Employer Identification No.) |

El Paso Building
1001 Louisiana Street
Houston, Texas 77002

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code (713) 420-2600

Check the appropriate box below if the Form 8-K filing is intended to simultaneously satisfy the filing obligation of the registrant under any of the following provisions:

o Written communications pursuant to Rule 425 under the Securities Act (17 CFR 230.425)

o Soliciting material pursuant to Rule 14a-12 under the Exchange Act (17 CFR 240.14a-12)
o Pre-commencement communications pursuant to Rule 14d-2(b) under the Exchange Act (17 CFR 240.14d-2(b))
o Pre-commencement communications pursuant to Rule 13e-4(c) under the Exchange Act (17 CFR 240.13e-4(c))

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**Item 2.03. Creation of a Direct Financial Obligation.**

As previously disclosed (and as more fully described) in the Current Report on Form 8-K of El Paso Corporation, a Delaware corporation ("El Paso"), filed with the Securities and Exchange Commission (the "SEC") on January 4, 2006, (i) on December 28, 2005, El Paso successfully consummated the early settlement (the "Early Settlement") of its private exchange offers (the "Private Exchange Offers") to exchange all properly tendered and accepted notes (the "CGP Notes") of the series listed below, which were originally issued by El Paso's wholly-owned subsidiary, El Paso CGP Company, L.L.C., a Delaware limited liability company (formerly known as El Paso CGP Company, a Delaware corporation) ("CGP"), and the related solicitations of consents to the proposed amendments to the indentures governing such notes (collectively, the "CGP Indentures"), (ii) effective as of December 31, 2005, CGP transferred (the "Asset Transfer") substantially all of its properties and assets as an entirety (in the meaning of the CGP Indentures) to El Paso by means of a distribution on CGP's outstanding equity interests (100% of which are held by El Paso) and (iii) concurrently with the Asset Transfer, in accordance with the requirements of the CGP Indentures and pursuant to a series of supplemental indentures thereto, El Paso assumed and succeeded to all of CGP's rights, powers and obligations, and was substituted for CGP in all respects, under each CGP Indenture, such that El Paso became the sole obligor in respect of all CGP Notes not acquired in the Early Settlement (the "Assumed CGP Notes").

Immediately following 11:59 p.m., New York City time, on January 6, 2006, the Private Exchange Offers expired. On January 9, 2006, El Paso successfully consummated the final settlement (the "Final Settlement") of the Private Exchange Offers (and the related solicitations of consents) by:

(i) accepting all of the consents that had been properly given (and not validly revoked), and accepting for exchange all of the Assumed CGP Notes that had been properly tendered (and not validly withdrawn), in each case, after 12:00 noon, New York City time, on December 27, 2005, the deadline for inclusion in the Early Settlement (the "Early Settlement Deadline"), and prior to the expiration of the Private Exchange Offers;
(ii) issuing new El Paso notes (the "El Paso Notes"), in the aggregate principal amount of approximately $112.8 million (and in the series described in the second table immediately following this paragraph), to the eligible holders of Assumed CGP Notes who validly tendered (and did not validly withdraw) their Assumed CGP Notes after the Early Settlement Deadline and prior to the expiration of the Private Exchange Offers; and
(iii) paying the applicable consent payment listed in the first table immediately following this paragraph to the eligible holders of Assumed CGP Notes who validly delivered (and did not validly revoke) their consents after the Early Settlement Deadline and prior to the expiration of the Private Exchange Offers.

| CGP Notes | Total Outstanding | Outstanding Principal | Additional Outstanding | Percentage of Total | Consent Payment |
|---|---|---|---|---|---|

| | Principal Amount | Amount Tendered as of Early Settlement Deadline | Principal Amount Tendered as of Expiration | Outstanding Principal Amount Tendered as of Expiration | per $1,000 Principal Amount |
|---|---|---|---|---|---|
| 6.50% Notes due 2006 | $109,500,000 | $91,860,000 | $3,061,000 | 86.69% | $1.25 |
| 7½% Notes due 2006 | $204,910,000 | $182,525,000 | $52,000 | 89.10% | $1.25 |
| 6.50% Senior Debentures due June 1, 2008 | $200,000,000 | $188,682,000 | $2,524,000 | 95.60% | $2.50 |
| 7.625% Notes due 2008 | $215,000,000 | $206,596,000 | $315,000 | 96.24% | $2.50 |
| 6.375% Senior Debentures due February 1, 2009 | $200,000,000 | $189,443,000 | $3,334,000 | 96.39% | $2.50 |
| 7.75% Notes due 2010 | $400,000,000 | $369,729,000 | $8,999,000 | 94.68% | $2.50 |
| 10¾% Senior Debentures due October 1, 2010 | $56,573,000 | $39,755,000 | $1,930,000 | 73.68% | $2.50 |
| 9 % Senior Debentures due May 15, 2012 | $150,000,000 | $136,118,000 | $1,805,000 | 91.95% | $2.50 |
| 6.70% Senior Debentures due February 15, 2027 | $200,000,000 | $161,913,000 | $20,850,000 | 91.38% | $2.50 |
| 6.95% Senior Debentures due June 1, 2028 | $200,000,000 | $197,080,000 | $20,000 | 98.55% | $2.50 |
| 7.75% Senior Debentures due October 15, 2035 | $150,000,000 | $112,440,000 | $36,685,000 | 99.42% | $2.50 |
| 7.42% Senior Debentures due February 15, 2037 | $200,000,000 | $165,642,000 | $33,265,000 | 99.45% | $2.50 |

| El Paso Notes | CUSIP Numbers | | Principal Amount of El Paso Notes Issued in Early Settlement | Principal Amount of El Paso Notes Issued in Final Settlement |
|---|---|---|---|---|
| | 144A | Regulation S | | |
| 6.50% Senior Notes due 2006 | 28336L AJ 8 | U53248 AC 1 | $91,860,000 | $3,061,000 |
| 7½% Senior Notes due 2006 | 28336L AL 3 | U53248 AD 9 | $182,525,000 | $52,000 |
| 6.50% Senior Notes due 2008 | 28336L AN 9 | U53248 AE 7 | $188,682,000 | $2,524,000 |
| 7.625% Senior Notes due 2008 | 28336L AQ 2 | U53248 AF 4 | $206,596,000 | $315,000 |
| 6.375% Senior Notes due 2009 | 28336L AS 8 | U53248 AG 2 | $189,443,000 | $3,334,000 |
| 7.75% Senior Notes due 2010 | 28336L AU 3 | U53248 AH 0 | $369,729,000 | $8,999,000 |
| 10¾% Senior Notes due 2010 | 28336L AW 9 | U53248 AJ 6 | $39,755,000 | $1,930,000 |
| 9 % Senior Notes due 2012 | | | $136,118,000 | $1,805,000 |

| | | | | |
|---|---|---|---|---|
| | 28336L AY 5 | U53248 AK 3 | | |
| 6.70% Senior Notes due 2027 | 28336L BA 6 | U53248 AL 1 | $161,913,000 | $20,850,000 |
| 6.95% Senior Notes due 2028 | 28336L BC 2 | U53248 AM 9 | $197,080,000 | $20,000 |
| 7.75% Senior Notes due 2032 | 28336L BJ 7 | U53248 AQ 0 | $112,440,000 | $36,685,000 |
| 7.42% Senior Notes due 2037 | 28336L BG 3 | U53248 AP 2 | $165,642,000 | $33,265,000 |
| **TOTALS** | | | **$2,041,783,000** | **$112,840,000** |

The Private Exchange Offers and the related consent solicitations were made, and the El Paso Notes were offered and issued, only (a) to holders of CGP Notes (including Assumed CGP Notes) who are "qualified institutional buyers," as defined in Rule 144A under the Securities Act of 1933, as amended (the "Securities Act"), and (b) outside the United States to holders of CGP Notes (including Assumed CGP Notes) who are persons other than U.S. persons, in reliance upon Regulation S under the Securities Act. The new El Paso Notes issued in connection with the Private Exchange Offers have not been registered under the Securities Act and may not be offered or sold in the United States absent registration or an applicable exemption from registration requirements.

The new El Paso Notes issued in connection with the Final Settlement were issued pursuant to an indenture dated as of May 10, 1999 between El Paso and HSBC Bank USA, National Association (as successor-in-interest to JPMorgan Chase Bank, formerly The Chase Manhattan Bank), as trustee, as amended and supplemented by the Tenth Supplemental Indenture thereto dated as of December 28, 2005 (as so amended and supplemented, the "El Paso Indenture"). The holders of the El Paso Notes are entitled to the benefits of the Registration Rights Agreement, dated as of December 28, 2005 (the "Registration Rights Agreement"), by and among El Paso and the dealer managers named therein.

El Paso did not receive any cash proceeds from the sale of the new El Paso Notes issued in the Final Settlement, which were issued in exchange for the surrender and cancellation of an equal principal amount of Assumed CGP Notes.

The terms of the El Paso Notes of each series issued in connection with the Final Settlement are substantially identical to the terms of the El Paso Notes of such series issued in connection with the Early Settlement. The material terms of the El Paso Indenture, each series of El Paso Notes and the Registration Rights Agreement have been previously disclosed (and are more fully described) in El Paso's Current Report on Form 8-K filed with the SEC on January 4, 2006, which such descriptions are incorporated herein in their entirety by this reference.

**Item 8.01. Other Events.**

On January 10, 2006, El Paso and CGP issued a joint press release announcing the successful Final Settlement described in Item 2.03 of this Current Report on Form 8-K. A copy of the joint press release is attached hereto as Exhibit 99.A and is incorporated herein in its entirety by this reference.

**Item 9.01. Financial Statements and Exhibits.**

(d) Exhibits.

| Exhibit Number | Description |
|---|---|

99.A Press Release dated January 10, 2006.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**EL PASO CORPORATION**

**By:** ***/s/ John R. Sult***
**John R. Sult**
**Senior Vice President and Controller**
**(Principal Accounting Officer)**

**Dated: January 10, 2006**

**EXHIBIT INDEX**

| Exhibit Number | Description |
|---|---|
| 99.A | Press Release dated January 10, 2006. |

ed to shares granted in previous years was $29,000. As of May 4, 2009, there was approximately $336,000 of total unrecognized compensation cost related to non-vested share-based compensation granted under the Company s 2001 Plan. The cost is expected to be recognized over a weighted-average period of five years.

**Note 5. Supplemental Balance Sheet Information**

*Inventories*

| | May 4, 2009 | July 31, 2008 |
|---|---|---|
| Raw material and component parts | **$ 6,155** | $ 5,440 |
| Work-in-progress | **3,478** | 2,529 |
| Finished goods | **6,696** | 6,599 |
| | **$ 16,329** | $ 14,568 |

*Property and equipment*

| | May 4, 2009 | July 31, 2008 |
|---|---|---|
| Land | **$ 730** | $ 730 |
| Building and improvements | **5,751** | 5,720 |
| Machinery and equipment | **5,226** | 4,959 |
| Furniture and fixtures | **716** | 680 |
| Software | **333** | 332 |
| Construction in process | **255** | 30 |
| | **13,011** | 12,451 |
| Less accumulated depreciation | **4,980** | 4,292 |
| | **$ 8,031** | $ 8,159 |

*Other Intangible Assets*

Information regarding the Company s other intangible assets is as follows:

| | Gross Carrying Value | Accumulated Amortization May 4, 2009 | Net |
|---|---|---|---|
| Proprietary know-how | $ 4,057 | $ 1,226 | $ 2,831 |
| Trademark | 5,923 | | 5,923 |
| Licensing agreements | 5,834 | 1,250 | 4,584 |
| Patents | 1,419 | 394 | 1,025 |

| | | | |
|---|---|---|---|
| | $ 17,233 | $ 2,870 | $ 14,363 |

| | | July 31, 2008 | |
|---|---|---|---|
| Proprietary know-how | $ 4,057 | $ 1,017 | $ 3,040 |
| Trademark | 5,923 | | 5,923 |
| Licensing agreements | 5,834 | 851 | 4,983 |
| Patents | 1,315 | 324 | 991 |
| | $ 17,129 | $ 2,192 | $ 14,937 |

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Goodwill of $10,660,000 and proprietary know-how of $4,057,000 are a result of the reverse merger transaction completed on September 21, 2005. Proprietary know-how is related to the patented technology which is included in one of the Company s core products, bipolar electrosurgical generators. As the proprietary technology is a distinguishing feature of the Company s products, it represented a valuable intangible asset.

Estimated amortization expense on other intangibles for the remaining three months of the fiscal year ending July 31, 2009 and the next four years thereafter is as follows (dollars in thousands):

| **Periods Ending July 31:** | **Amount** |
|---|---|
| Fiscal Year 2009 (remaining 3 months) | $220 |
| Fiscal Year 2010 | 849 |
| Fiscal Year 2011 | 626 |
| Fiscal Year 2012 | 572 |
| Fiscal Year 2013 | 570 |

Amortization expense for the nine months ended May 4, 2009 was $678,000.

*Pledged assets; short and long-term debt (excluding revenue bonds payable)*

Short-term debt as of May 4, 2009 and July 31, 2008 consisted of the following:

*Revolving Credit Facility:* The Company has a credit facility with Regions Bank ( Regions ) which allows for borrowings of up to $9.5 million with interest at an interest rate based on either the one-, two- or three-month LIBOR plus 2.00 percent and adjusting each quarter based upon our leverage ratio. As of May 4, 2009, interest under the facility is charged at 2.43 percent. The unused portion of the facility is charged at a rate of 0.20 percent. Borrowings under this facility at May 4, 2009, were $7.0 million. Outstanding amounts are collateralized by the Company s domestic receivables and inventory. This credit facility expires on November 30, 2009.

The facility has two financial covenants: a maximum leverage ratio of 3.75 times and a minimum fixed charge coverage ratio of 1.1 times. As of May 4, 2009, the leverage ratio was 1.68 times and the minimum fixed charge coverage ratio was 1.79 times. Collateral availability under the line as of May 4, 2009, was approximately $939,000. The facility restricts the payment of dividends if, following the distribution, the fixed charge coverage ratio would fall below the required minimum.

*Non-U.S. Receivables Revolving Credit Facility*: On June 4, 2009, the Company amended this line of credit. The credit facility with Regions now allows for borrowings of up to $1.75 million; and, the interest rate, which, at May 4, 2009, was based on the bank s prime lending rate, is now one-month LIBOR plus three percent. Pursuant to the terms of the non-U.S. receivables revolving credit facility, under no circumstances shall the rate be less than three and one-half percent per annum. The facility is charged an administrative fee of 1%. There were no borrowings under this facility at May 4, 2009. Outstanding amounts are collateralized by the Company s non-U.S. receivables. The line matures on June 3, 2010, and has no financial covenants. Current collateral availability under the line was approximately $1.3 million at May 4, 2009.

*Equipment Line of Credit*: On June 5, 2009, the Company amended this line of credit. Under this amended credit facility, the Company may borrow up to $1.0 million, with interest now being LIBOR plus three percent . Pursuant to the terms of the equipment line of credit, under no circumstances shall the rate be less than three and one-half percent per annum. The unused portion of the facility is not charged a fee. The borrowings under this facility as of May 4, 2009, were $263,000. The equipment line of credit has a maturity date of November 30, 2009.

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Long-term debt as of May 4, 2009 and July 31, 2008 consisted of the following:

| | May 4, 2009 | July 31, 2008 |
|---|---|---|
| Note payable to bank, due in monthly installments of $41,022 beginning August 2008 plus interest at a rate of 5.0 percent, remaining balance due July 31, 2011, collateralized by substantially all assets of the Company | $ 1,108 | $ 1,477 |
| Note payable to the estate of the late Dr. Leonard I. Malis, due in quarterly installments of $159,904 which includes interest at an imputed rate of 6.00 percent, remaining balance of $1,758,944, including contractual interest payments, due December 2011, collateralized by the Malis® trademark | 1,610 | 2,006 |
| Settlement obligation to Iridex Corporation, due in annual installments of $800,000 which includes interest at an imputed rate of 8.00 percent, remaining balance of $2,400,000 including the effects of imputing interest, due April 15, 2012 | 2,062 | 2,649 |
| | 4,780 | 6,132 |
| Less current maturities | 1,848 | 1,823 |
| Long-term portion | $ 2,932 | $ 4,309 |

**Note 6. Commitments and Contingencies**

The Company entered into three-year employment agreements with its Chief Operating Officer and its Chief Scientific Officer, which expired on September 22, 2008. On August 1, 2007, the Company entered into a three-year employment agreement with its Executive Vice President and Chief Financial Officer. In the event such executive officer is terminated without cause, or if such executive officer resigns for good reason, such executive officer shall be entitled to her base salary and health care benefits for fifteen additional months.

On July 31, 2008, the Company s Board of Directors formally accepted the resignation of Gregg Scheller who was the President, Chief Executive Officer and Chairman of the Board. The Company believes, based on the judgment of its legal counsel, that the non-compete covenant contained in Mr. Scheller s employment agreement survives until July 31, 2010 and the non-solicitation covenant survives until July 31, 2009.

On January 29, 2009, the Company entered into a change of control agreement with its new CEO, David M. Hable, which provides that if employment is terminated within one year following a Change in Control for Cause or Disability (as each term is defined in the change in control agreement), as a result of his death or by the CEO other than as Involuntary Termination (as defined in the change in control agreement), the Company shall pay the CEO all compensation earned or accrued through his employment termination date, including (i) base salary; (ii) reimbursement for reasonable and necessary expenses; (iii) vacation pay; (iv) bonuses and incentive compensation; and (v) all other amounts to which he is entitled under any compensation or benefit plan of the Company ( Standard Compensation Due ).

If the CEO s employment is terminated within one year following a Change in Control without cause and for any reason other than death or disability, including involuntary termination, and provided he enters into a separation agreement within 30 days of his employment termination, he shall receive the following in a lump sum ( Early Severance ): (i) all Standard Compensation Due; (ii) an amount equal to one-half times his annual base salary at the rate in effect immediately prior to the Change in Control; and (iii) as compensation for certain lost benefits, an amount equal to 10% of his base salary at the rate in effect immediately prior to the Change in Control. If such termination

occurs during the period that is 6 to 12 months after the CEO s start date (as defined in the change in control agreement), he shall receive in a lump sum the Early Severance and an additional amount equal to the sum of one-twelfth times his base salary for each month of employment completed between 7 and 12 months after his Start Date. If the CEO is terminated at any time after the first anniversary of his start date, he shall receive the following ( Ordinary Severance ): (i) all Standard Compensation Due; (ii) an amount equal to one times his annual base salary at the rate in effect immediately prior to the Change in Control; and (iii) any amount payable as of the termination date under the Company s objectives-

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based incentive plan. Such Ordinary Severance shall be paid in 12 equal monthly installments beginning in the month following the CEO s employment termination. Furthermore, all of the CEO s awards of shares or options shall immediately vest and be exercisable for one year after the date of his employment termination.

Various claims, incidental to the ordinary course of business, are pending against the Company. In the opinion of management, after consultation with legal counsel, resolution of these matters is not expected to have a material effect on the accompanying financial statements.

The Company is subject to regulatory requirements throughout the world. In the normal course of business, these regulatory agencies may require companies in the medical industry to change their products or operating procedures, which could affect the Company. The Company regularly incurs expenses to comply with these regulations and may be required to incur additional expenses. Management is not able to estimate any additional expenditure outside the normal course of operations which will be incurred by the Company in future periods in order to comply with these regulations.

**Note 7. Entity Wide Information**

The following tables present the entity wide disclosures for net sales:

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | **May 4, 2009** | **April 30, 2008** | **May 4, 2009** | **April 30, 2008** |
| Product Line: | | | | |
| Ophthalmic | **$ 7,476** | $ 7,293 | **$ 22,326** | $ 20,521 |
| Neurosurgical | **3,588** | 3,368 | **10,357** | 8,911 |
| OEM (Codman, Stryker and Iridex) | **1,957** | 2,612 | **6,003** | 5,528 |
| Other (ENT and Dental) | **140** | 227 | **373** | 646 |
| Total | **$ 13,161** | $ 13,500 | **$ 39,059** | $ 35,606 |
| Region Specific: | | | | |
| Domestic | **$ 8,636** | $ 9,724 | **$ 26,578** | $ 25,679 |
| International | **4,525** | 3,776 | **12,481** | 9,927 |
| Total | **$ 13,161** | $ 13,500 | **$ 39,059** | $ 35,606 |

Revenues are attributed to countries based upon the location of end-user customers or distributors.

**Note 8. Recent Accounting Pronouncements**

In September 2006, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards ( SFAS ) No. 157 Fair Value Measurements ( SFAS 157 ) which related to the definition of fair value, the methods used to estimate fair value and the requirement of expanded disclosures about estimates of fair value. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. In February 2008, the FASB issued FASB Staff Positions ( FSP ) FSP 157-1 and FSP 157-2. FSP 157-1 amends SFAS 157 to exclude FASB Statement No. 13 Accounting for Leases and other accounting pronouncements that address fair value measurements of leases from the provision of SFAS 157. FSP 157-2 delays the effective date of SFAS 157 for most non-financial assets and non-financial liabilities to fiscal years beginning after November 15, 2008. In October 2008, the FASB issued FSP 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active. FSP 157-3 clarifies the application of SFAS 157 in an inactive market and illustrates how an entity would determine fair value when the market for a financial asset is not active. SFAS 157 will be adopted by the Company on August 1, 2009. We have not completed our evaluation of the potential impact, if any, of the adoption of SFAS 157 on our consolidated financial position, results of operations and cash flows.

In December 2007, the FASB issued SFAS No. 141 (R), Business Combinations ( SFAS 141 (R) ), which replaced SFAS No. 141, Business Combinations. SFAS 141 (R) establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, liabilities assumed, any non-controlling interests in the acquiree and the goodwill acquired. SFAS 141 (R) also establishes disclosure requirements that will enable users of the financial statements to better evaluate the nature and financial effects of the business

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combination. SFAS 141 (R) is effective as of the beginning of an entity s fiscal year that begins after December 15, 2008 and will be applied if we consummate an acquisition on or after August 1, 2009.

In December 2007, the FASB issued SFAS No. 160, Non-controlling interests in Consolidated Financial Statements an amendment of ARB No. 51 ( SFAS 160 ). SFAS 160 establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the non-controlling interest, changes in a parent s ownership interest and the valuation of retained non-controlling equity investments when a subsidiary is deconsolidated. The statement also establishes reporting standards that require the provision of sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the non-controlling owners. SFAS 160 is effective for fiscal years as of the beginning of an entity s fiscal year that begins after December 15, 2008. We have not completed our evaluation of the potential impact, if any, of the adoption of SFAS 160 on our consolidated financial position, results of operations and cash flows.

In May 2008, FASB issued FSP APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion. The FSP required entities with cash settled convertibles to bifurcate the securities into a debt component and an equity component and accrete the debt component to par over the expected life of the convertible. Early adoption will not be permitted, and the FSP must be applied retrospectively to all instruments. We have not completed our evaluation of the potential impact, if any, of the adoption of FSP APB 14-1 on our consolidated financial position, results of operations and cash flows.

In June 2008, the FASB issued FSP EITF 03-6-1, Determining Whether Instruments Granted in Share Based Payment Transactions are Participating Securities. This FSP states that unvested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. The FSP is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those years. Upon adoption, a company is required to retrospectively adjust its earnings per share data (including any amounts related to interim periods, summaries of earnings and selected financial data) to conform with the provisions in this FSP. Earlier adoption is prohibited. We have not completed our evaluation of the potential impact, if any, of adoption of FSP EITF 03-6-1 on our consolidated financial position, results of operations and cash flows.

In April 2009, the FASB issued FSP No. 107-1 and APB 28-1, Interim Disclosures about Fair Value of Financial Instruments. FSP 107-1 amends FASB Statement No. 107, Disclosures about Fair Value of Financial Instruments, and Accounting Principles Board Opinion No. 28, Interim Financial Reporting, to require disclosures about fair value of financial instruments for interim periods of publicly traded companies as well as in annual financial statements. FSP 107-1 is effective for interim reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. We have not completed our evaluation of the potential impact, if any, of the adoption of FSP 107-1 on our interim financial statement disclosures.

On May 2009, the FASB issued SFAS No. 165, Subsequent Events ( SFAS 165 ), which is intended to establish general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. It requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date that is, whether that date represents the date the financial statements were issued or were available to be issued. This disclosure should alert all users of financial statements that an entity has not evaluated subsequent events after that date in the set of financial statements being presented. In particular, SFAS 165 sets forth (1) the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements; (2) the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements; (3) the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. SFAS 165 is effective for interim and annual periods ending after June 15, 2009. We have not completed our evalution of the potential impact, if any, of the adoption of SFAS 165 on our interim financial statement disclosures.

We have reviewed all other recently issued, but not yet effective, accounting pronouncements and do not believe any such pronouncements will have a material impact on our financial statements.

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**Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations**

STATEMENT REGARDING FORWARD-LOOKING INFORMATION

*The Private Securities Litigation Reform Act of 1995 and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act ), provide a safe harbor for forward-looking statements made by or on behalf of the Company. The Company and its representatives may from time to time make written or oral statements that are forward-looking, including statements contained in this report and other filings with the Securities and Exchange Commission ( SEC ) and in our reports to stockholders. In some cases forward-looking statements can be identified by words such as believe, expect, anticipate, plan, potential, continue or similar expressions. Such forward-look statements include risks and uncertainties and there are important factors that could cause actual results to differ materially from those expressed or implied by such forward-looking statements. These factors, risks and uncertainties can be found in Part I, Item 1A, Risk Factors section of the Company s Form 10-K for the fiscal year ended July 31, 2008.*

*Although we believe the expectations reflected in our forward-looking statements are based upon reasonable assumptions, it is not possible to foresee or identify all factors that could have a material effect on the future financial performance of the Company. The forward-looking statements in this report are made on the basis of management s assumptions and analyses, as of the time the statements are made, in light of their experience and perception of historical conditions, expected future developments and other factors believed to be appropriate under the circumstances.*

*In addition, certain market data and other statistical information used throughout this report are based on independent industry publications. Although we believe these sources to be reliable, we have not independently verified the information and cannot guarantee the accuracy and completeness of such sources.*

*Except as otherwise required by the federal securities laws, we disclaim any obligation or undertaking to publicly release any updates or revisions to any forward-looking statement contained in this quarterly report on Form 10-Q and the information incorporated by reference in this report to reflect any change in our expectations with regard thereto or any change in events, conditions or circumstances on which any statement is based.*

**Overview**

Synergetics USA, Inc. ( Synergetics USA or the Company ) is a medical device company. Through continuous improvement and development of our people, our mission is to design, manufacture and market innovative microsurgical instruments, capital equipment, accessories and disposables of the highest quality in order to assist and enable surgeons who perform microsurgery around the world to provide a better quality of life for their patients. The Company s primary focus is on the microsurgical disciplines of ophthalmology and neurosurgery. Our distribution channels include a combination of direct and independent sales organizations and important strategic alliances with market leaders. The Company s product lines focus upon precision engineered, microsurgical, hand-held instruments and the delivery of laser energy, ultrasound, electrosurgery, illumination and irrigation, often delivered in multiple combinations. Entity wide information is included in Note 7 to the unaudited condensed consolidated financial statements.

The Company is a Delaware corporation incorporated on June 2, 2005 in connection with the reverse merger of Synergetics, Inc. ( Synergetics ) and Valley Forge Scientific Corp. ( Valley Forge ). Synergetics was founded in 1991. Valley Forge was incorporated in 1980 and became a publicly-held company in November 1989. Prior to the merger of Synergetics and Valley Forge, Valley Forge s common stock was listed on The NASDAQ Small Cap Market (now known as The NASDAQ Capital Market) and the Boston Stock Exchange under the ticker symbol VLFG. On September 21, 2005, Synergetics Acquisition Corporation, a wholly-owned Missouri subsidiary of Valley Forge, merged with and into Synergetics, and Synergetics thereby became a wholly-owned subsidiary of Valley Forge. On September 22, 2005, Valley Forge reincorporated from a Pennsylvania corporation to a Delaware corporation and changed its name to Synergetics USA. Upon consummation of the merger, the Company s securities began trading on The NASDAQ Capital Market under the ticker symbol SURG, and its shares were voluntarily delisted from the Boston Stock Exchange.

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Revenues from our ophthalmic products constituted 57.2 percent and 56.0 percent of our total revenues for the nine months ended May 4, 2009, and for the fiscal year ended July 31, 2008, respectively. Revenues from our neurosurgical products represented 26.5 percent and 25.8 percent for the nine months ended May 4, 2009, and for the fiscal year ended July 31, 2008, respectively. Revenues from our marketing partners (i.e. Original Equipment Manufacturer relationships ( OEM )) represented 15.4 percent and 16.7 percent of our total revenues for the nine months ended May 4, 2009, and the fiscal year ended July 31, 2008, respectively. In addition, other revenue was 0.9 percent of our total revenues for the nine months ended May 4, 2009, and 1.5 percent of our total revenues for the fiscal year ended July 31, 2008.

International revenues of $12.5 million constituted 32.0 percent of our total revenues for the nine months ended May 4, 2009, as compared to 28.4 percent for the fiscal year ended July 31, 2008. We expect that the relative revenue contribution of our international sales will continue to rise for the remainder of fiscal 2009 and fiscal 2010 as a result of our continued efforts to expand our international distribution and direct sales.

The Company initially engineered and produced instruments designed to assist retinal surgeons in treating acute subretinal pathologies such as histoplasmosis and age-related macular degeneration. The Company developed a number of specialized lines of precision engineered microsurgical instruments, which today have grown to comprise a product catalogue of over 1,400 retinal surgical items including scissors, fiber optics, cannulas, forceps and other reusable and disposable surgical instruments.

The Company has a neurosurgical product line which includes the Omni® ultrasonic aspirator, Malis® electrosurgical generators and precision neurosurgical instruments. Our neurosurgical product catalogue consists of over 700 neurosurgical items including energy source devices, disposable and reusable instruments and other disposable and reusable accessories.

The primary use of the Company s Omni® ultrasonic aspirator in neurosurgery is tumor removal. The Company distributes the Omni® control module, handpieces, soft-tissue and bone cutting tips and accessories in georgraphies including the United States, Canada, Australia, New Zealand, a portion of Latin and South Americas and in all but two countries in Europe, Spain and Portugal. The control module and handpieces are manufactured by Mutoh Co. Ltd. of Japan. The tips and certain accessories are manufactured at the Company s facility in O Fallon, Missouri.

In intracranial neurosurgery, a bipolar electrosurgical system is the modality of choice for tissue coagulation and cutting as compared to monopolar products. The popularity of the bipolar system is largely due to the efforts of the late Dr. Leonard I. Malis, who designed and developed the first commercial bipolar coagulator in 1955 and pioneered the use of bipolar electrosurgery for use in the brain. The Company manufactures several bipolar electrosurgical generators under the Malis® brand name.

The Company s sales of its core neurosurgical products grew 16.2 percent during the nine months ended May 4, 2009, compared to the prior year period.

*Recent Developments*

On March 19, 2009, the Company announced that Mr. Dave Dallam s position of Executive Vice President of Sales and Marketing of the Company was eliminated as a result of the Company s ongoing efforts to streamline and eliminate duplicative job responsibilities in the sales and marketing functions. In connection with Mr. Dallam s departure, the Company terminated the Letter Agreement between the Company and Mr. Dallam dated as of December 10, 2007, which governed the terms of Mr. Dallam s compensation and provided for an annual salary, eligibility for bonuses, participation in the Company s benefits programs and certain payments in the event of a change of control.

On April 2, 2009, the Company announced the signing of a new, three-year agreement with Codman retroactively effective to January 1, 2009. Under the terms of the new agreement, Codman will continue to market and distribute certain bipolar generators and related disposables and accessories supplied by the Company. Additionally, the Company and Codman extended the license agreement providing for the continued licensing of Synergetics Malis® trademark to Codman for use with certain of its products, including those covered by the distribution agreement.

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*New Product Sales*

The Company s ongoing business strategy is the development, manufacture and marketing of new technologies for microsurgery applications including the ophthalmic and neurosurgical markets. New products, which management defines as products first available for sale within the prior 24-month period, accounted for approximately 10.9 percent of total sales for the Company for the nine months ended May 4, 2009, or approximately $4.3 million. The Company s past revenue growth has been closely aligned with the adoption by surgeons of new technologies introduced by the Company. In the last 24-month period, the Company has introduced 47 new items to the ophthalmic and neurosurgical markets. We expect adoption rates for the Company s new products in the future to have a similar effect on its operating performance.

*Growth in Minimally Invasive Surgery Procedures*

Minimally invasive surgery is a surgical procedure performed without making a major incision or opening. Minimally invasive surgery generally results in less patient trauma, decreased likelihood of complications related to the incision and a shorter recovery time. A growing number of surgical procedures are performed using minimally invasive techniques, creating a multi-billion dollar market for the specialized devices used in the procedures. Based on our micro-instrumentation capability, we believe we are ideally positioned to take advantage of this growing market. The Company has developed scissors having a single activating shaft as small as 30 gauge (0.012 inch, 0.3 millimeter in diameter). We are a leader in microfiber illumination technology as we believe our light sources can transmit more light through a fiber of 300 micron diameter or smaller than any other light source in the world. These products were developed for ophthalmology and neurosurgery but have wide ranging minimally invasive surgical applications.

*Demand Trends*

Increased international volume and domestic ophthalmology price increases contributed to the majority of sales growth for the Company during the nine months ended May 4, 2009. Ophthalmic and neurosurgical procedures volume on a global basis continues to rise at an estimated 3.0 to 4.0 percent growth rate driven by an aging global population, new technologies, advances in surgical techniques and a growing global market resulting from ongoing improvements in healthcare delivery in third world countries, among other factors. In addition, the demand for high quality products and new technologies, such as the Company s innovative instruments and disposables, to support development in procedure volume, continues to positively impact growth. The Company believes innovative surgical approaches will continue to significantly impact the ophthalmic and neurosurgical market. Further, economic conditions may continue to negatively impact capital expenditures at the hospital or surgical center and doctor level.

*Pricing and Volume Trends*

Through its strategy of delivering new and higher quality technologies, the Company has generally been able to maintain the average selling prices for its disposable products in the face of downward pressure in the healthcare industry. However, increased competition in the market for the Advantage™ electrosurgical generator has negatively impacted the Company s selling prices on these devices. Further, economic conditions in the U.S. are negatively impacting the volume of the Company s capital equipment sales.

*Results Overview*

During the fiscal quarter ended May 4, 2009, we had net sales of $13.2 million, which generated $7.4 million in gross profit, operating income of $879,000 and net income of approximately $458,000, or $0.02 earnings per share. The Company had approximately $603,000 in cash and $15.7 million in interest-bearing debt and revenue bonds as of May 4, 2009. Management anticipates that cash flows from operations, together with available borrowings under our existing credit facilities, will be sufficient to meet working capital, capital expenditure and debt service needs for the remainder of fiscal 2009.

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**Our Business Strategy**

Our mission is to design, manufacture and market innovative microsurgical instruments, capital equipment, accessories and disposables of the highest quality in order to assist and enable surgeons who perform microsurgery around the world to provide a better quality of life for their patients. Our goal is to become a global leader through:

continuous improvement and development of our people,

continuous improvement and development of our manufacturing processes,

continuous improvement of our information systems; and

continuous improvement of our research and development initiatives.

During August 2008, the Company began to introduce lean manufacturing philosophies into the production environment. These philosophies have been applied to four of our largest volume disposable product families which comprise over 20 percent of our disposable unit volumes. We have been able to cut manufacturing times and required floor space approximately in half. We plan to continue to apply the lean philosophy to one value stream at a time according to the value stream s financial importance to the Company. We will also be applying this philosophy to other departments in our organization, including purchasing, accounting and administration. In addition, the Company s most recent acquisition, Medimold LLC, an injection-molding business, is producing components which were previously supplied by outside vendors. Through the remainder of 2009 and over the next fiscal year, select high volume plastic components will be introduced to this lower cost, injection-molding process. Our annual savings from this process is now projected to be over $300,000.

During August 2008, the Company began to utilize its Material Requirements Planning ( MRP ) within its information system to more efficiently schedule production work flow and priorities in its vertically integrated manufacturing processes. The Company will use this capability to manage its inventory more efficiently and gain additional benefits from its master production plan. These improvements to the information system will give the Company the tools to measure its manufacturing performance against planned costs as well as provide enhanced budgeting capabilities and build more effective monitoring controls over inventory. In February 2009, the Company began to upgrade its current Enterprise Resource Planning ( ERP ) system with a focus on its sales and order entry system, lot traceability, inventory bar coding and permit monthly closing with simultaneous reporting of monthly information as necessary to provide management with the tools for more timely decisions.

In October 2008, the Company initiated a thorough review and reprioritization of its research and development projects, leading to a decision to focus available resources on high priority projects with a concurrent reduction in the total number of projects. The Company s product development pipeline included 43 active projects as of May 4, 2009. In addition, the Company is developing a uniform policies and procedures manual for its research and development initiatives.

**Results of Operations**

*Three Month Period Ended May 4, 2009 Compared to Three Month Period Ended April 30, 2008*

*Net Sales*

The following table presents net sales by category (dollars in thousands):

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| | Quarter Ended | | % Increase |
|---|---|---|---|
| | **May 4, 2009** | April 30, 2008 | (Decrease) |
| Ophthalmic | **$ 7,476** | $ 7,293 | 2.5% |
| Neurosurgical | **3,588** | 3,368 | 6.5% |
| OEM (Codman, Stryker and Iridex) | **1,957** | 2,612 | (25.1%) |
| Other | **140** | 227 | (38.3%) |
| Total | **$ 13,161** | $ 13,500 | (2.5%) |

Ophthalmic sales grew 2.5 percent in the third quarter of fiscal 2009 compared to the third quarter of fiscal 2008. Domestic ophthalmic sales decreased 8.1 percent, while international sales increased by 21.3 percent. Domestic ophthalmic sales decreased primarily due to a 37.5 percent decrease in capital equipment sales.

Neurosurgical sales for the three months ended May 4, 2009, increased 6.5 percent as compared to the three months ended April 30, 2008. Domestic neurosurgical sales decreased 4.4 percent and international sales increased 18.3 percent. Domestic neurosurgical sales decreased primarily due to a 56.1 percent decrease in capital equipment sales. The Company expects that sales of its neurosurgical disposables will continue to have a positive impact on net sales for the remainder of fiscal 2009.

OEM sales during the third fiscal quarter of 2009 decreased 25.1 percent compared to the third fiscal quarter of 2008. Sales to Codman decreased 30.7 percent compared to the third fiscal quarter of 2008. This decrease was a result of above average shipments to Codman during the third quarter of fiscal 2008 as they increased their inventory position based on the announcement made by Synergetics to move the production of the generators from King of Prussia to its O Fallon facility and slower domestic capital equipment sales. Sales to Stryker also declined by 10.0 percent for the current fiscal quarter based on strong sales in the third quarter of fiscal 2008. Sales to Iridex Corporation ( Iridex ) of $181,000 partially offset the decline in sales to Codman and Stryker.

The following table presents domestic and international net sales (dollars in thousands):

| | **Quarter Ended** | | |
|---|---|---|---|
| | **May 4, 2009** | **April 30, 2008** | **% Increase** |
| United States (including OEM sales) | **$ 8,636** | $ 9,724 | (11.2%) |
| International (including Canada) | **4,525** | 3,776 | 19.8% |
| Total | **$ 13,161** | $ 13,500 | (2.5%) |

Domestic sales for the third quarter of fiscal 2009 compared to the same period of fiscal 2008 decreased 11.2 percent. Domestic sales decreased for our ophthalmology, neurosurgery and OEM product lines because we experienced lower capital equipment sales during the quarter. The international sales growth of 19.8 percent resulted from a 21.3 percent growth rate in ophthalmology and an 18.3 percent growth rate in neurosurgery products.

*Gross Profit*

Gross profit as a percentage of net sales was approximately 56.2 percent in the third quarter of fiscal 2009, compared to 60.5 percent for the same period in fiscal 2008. Gross profit as a percentage of net sales for the third quarter of fiscal 2009 compared to the third quarter of fiscal 2008 decreased approximately four percentage points, primarily due to the change in mix toward higher international sales, decreased OEM capital equipment sales and pricing pressure on both ophthalmic and neurosurgical capital equipment.

*Operating Expenses*

Research and development ( R&D ) as a percentage of net sales was 5.6 percent and 5.5 percent for the third quarter of fiscal 2009 and 2008, respectively. R&D costs decreased to $741,000 in the third quarter of fiscal 2009 from $748,000 in the same period in fiscal 2008, reflecting a slight decrease in spending on active, new product development projects focused on areas of strategic significance. The Company s pipeline included approximately 43 active projects in various stages of completion as of May 4, 2009. The Company s R&D headcount decreased by 3.7 percent from April

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30, 2008, to May 4, 2009. The Company has strategically targeted R&D spending as a percentage of net sales to be approximately 5.0 to 7.0 percent.

Sales and marketing expenses increased by approximately $463,000 to $3.6 million, or 27.0 percent of net sales, for the third fiscal quarter of 2009, compared to $3.1 million, or 22.9 percent, for the third fiscal quarter of 2008. The increase in sales and marketing expenses as a percentage of net sales was primarily due to commissions paid on a 2.9 percent increase in commissionable sales (i.e. excluding OEM sales) and an increase in sales and marketing headcount by 6.9 percent from April 30, 2008 to May 4, 2009. However, in March 2009, the Company eliminated two positions within sales and marketing.

General and administrative ( G&A ) expenses increased by $51,000 during the third fiscal quarter of 2009 and as a percentage of net sales were 16.9 percent for the third fiscal quarter of 2009 as compared to 16.1 percent for the third fiscal quarter ended April 30, 2008. The Company s legal expenses increased by approximately $115,000 and outside consulting costs, specifically those related to Sarbanes-Oxley compliance efforts, decreased approximately $100,000 due to further internalization of the documentation processes and procedures.

*Other Expenses*

Other expenses for the third quarter of fiscal 2009 decreased 37.0 percent to $218,000 from $346,000 for the third quarter of fiscal 2008. The decrease was primarily due to a lower interest rate on the Company s working capital line of credit borrowings.

*Operating Income, Income Taxes and Net Income*

Operating income for the third quarter of fiscal 2009 was $879,000 as compared to operating income of $2.2 million in the comparable 2008 fiscal period. The decrease in operating income was primarily the result of a 2.5 percent decrease in sales, an increase in the cost of sales of $430,000, a $463,000 increase in sales and marketing expenses and an increase of $51,000 in G&A expense.

The Company recorded a $203,000, or 30.7 percent, tax provision, on pre-tax income of $661,000 in the quarter ended May 4, 2009. In the quarter ended April 30, 2008, the Company recorded a $692,000, or 38.3 percent, tax provision on a pre-tax income of $1.8 million. The decrease in the effective tax rate during the third quarter was primarily attributed to the manufacturing deduction and the research and experimentation credit comprising a larger percentage on reduced pre-tax income.

Net income decreased by $659,000 to $458,000 for the third quarter of fiscal 2009, compared to net income of $1.1 million for the same period in fiscal 2008. Basic and diluted earnings per share for the third quarter of fiscal 2009 decreased to $0.02 from $0.05 for the third quarter of fiscal 2008. Basic weighted-average shares outstanding increased from 24,321,274 at April 30, 2008 to 24,470,755 at May 4, 2009.

*Nine Month Period Ended May 4, 2009 Compared to Nine Month Period Ended April 30, 2008*

*Net Sales*

The following table presents net sales by category (dollars in thousands):

| | **Nine Months Ended** | | |
|---|---|---|---|
| | **May 4, 2009** | **April 30, 2008** | **% Increase (Decrease)** |
| Ophthalmic | **$ 22,326** | $ 20,521 | 8.8% |
| Neurosurgical | **10,357** | 8,911 | 16.2% |
| OEM (Codman, Stryker and Iridex) | **6,003** | 5,528 | 8.6% |
| Other | **373** | 646 | (42.3%) |
| Total | **$ 39,059** | $ 35,606 | 9.7% |

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Ophthalmic sales grew 8.8 percent in the first nine months of fiscal 2009 compared to the same period of fiscal 2008. Domestic ophthalmic sales decreased 1.4 percent, while international sales increased 28.6 percent. Domestic ophthalmic sales decreased primarily due to a 14.3 percent decrease in capital equipment sales.

Neurosurgical sales growth for the nine months ended May 4, 2009 increased 16.2 percent as compared to the nine months ended April 30, 2008. Domestic neurosurgical sales increased 7.9 percent and international sales increased 19.3 percent. The Company expects that sales of its neurosurgical disposables will continue to have a positive impact on net sales for the remainder of fiscal 2009.

OEM sales during the first nine months of fiscal 2009 increased 8.6 percent compared to the first nine months of fiscal 2008. Sales to Codman decreased 15.5 percent compared to the first nine months of fiscal 2008. This decrease was impacted by the decision to defer the consolidation of the King of Prussia operations into the O Fallon operations, as this changed the timing of requested inventory deliveries. In addition, sales to Stryker increased during the first nine months of fiscal 2009 compared to the first nine months of fiscal 2008, as the new generator we now produce for Stryker had not been released in the first six months of fiscal 2008 and was not available until April of 2008. Sales to Iridex of $387,000 added to the OEM sales growth.

The following table presents domestic and international net sales (dollars in thousands):

| | Nine Months Ended | | |
|---|---|---|---|
| | **May 4, 2009** | **April 30, 2008** | **% Increase** |
| United States (including OEM sales) | **$ 26,578** | $ 25,679 | 3.5% |
| International (including Canada) | **12,481** | 9,927 | 25.7% |
| Total | **$ 39,059** | $ 35,606 | 9.7.% |

Domestic sales for the first nine months of fiscal 2009 compared to the same period of fiscal 2008 increased 3.5 percent. Domestic ophthalmology sales decreased as sales of capital equipment decreased, partially offset by increased sales of disposable products. Domestic neurosurgery sales have increased as sales of disposable products increased partially offset by decreased sales of capital equipment. Both the ophthalmology and neurosurgery product lines contributed to the international sales growth of 25.7 percent for the first nine months of fiscal 2009 compared to the first nine months of fiscal 2008.

*Gross Profit*

Gross profit as a percentage of net sales was 57.1 percent in the first nine months of fiscal 2009, compared to 59.3 percent for the same period in fiscal 2008. Gross profit as a percentage of net sales for the first nine months of fiscal 2009 compared to the first nine months of fiscal 2008 decreased approximately two percentage points, primarily due to the change in mix to higher international sales, pricing pressure on both ophthalmic and neurosurgical capital equipment and additional costs experienced in manufacturing some of the Company s products. The Company implemented a cost reduction initiative during the second quarter of fiscal 2009.

*Operating Expenses*

R&D as a percentage of net sales was 5.8 percent and 5.3 percent for the first nine months of fiscal 2009 and 2008, respectively. R&D costs increased $353,000 to $2.2 million in the nine months of fiscal 2009 from $1.9 million in the same period in fiscal 2008, reflecting an increase in spending on active, new product development projects focused on areas of strategic significance. The Company s pipeline included approximately 43 active projects in various stages of completion as of May 4, 2009. The Company s R&D headcount decreased by 3.7 percent from April 30, 2008 to May 4, 2009. The Company has strategically targeted R&D spending as a percentage of net sales to be approximately 5.0 to 7.0 percent.

Sales and marketing expenses increased by approximately $1.3 million to $10.7 million, or 27.5 percent of net sales, for the first nine months of fiscal 2009, compared to $9.4 million, or 26.5 percent for the first nine months of fiscal 2008. The increase in sales and marketing expenses as a percentage of net sales was primarily due to commission paid on a 9.9 percent increase in commissionable sales (i.e. excluding OEM sales) and an increase in

sales and marketing

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headcount by 6.9 percent from April 30, 2008 to May 4, 2009. However, in March 2009, the Company eliminated two positions within sales and marketing.

G&A expenses decreased by $242,000 during the first nine months of fiscal 2009 and as a percentage of net sales were 16.3 percent for the first nine months of fiscal 2009 as compared to 18.6 percent for the nine months ended April 30, 2008. The Company experienced a decrease of approximately $350,000 in outside consulting costs on the Company s Sarbanes-Oxley compliance efforts, primarily due to efforts that further internalize the documentation processes and procedures. Directors fees increased $175,000 due to each independent Director serving as the principal executive officer of the Company on a weekly rotating basis for the first six months of the fiscal year while searching for a new CEO. In addition, the directors serving as the principal executive officer also caused salaries and benefits to decrease by approximately $150,000.

*Other Expenses*

Other expenses for the first nine months of fiscal 2009 decreased 30.2 percent to $620,000 from $888,000 for the first nine months of fiscal 2008. The decrease was primarily due to a lower interest rate on the Company s working capital line of credit borrowings.

*Operating Income, Income Taxes and Net Income*

Operating income for the first nine months of fiscal 2009 was $2.9 million as compared to operating income of $3.2 million in the comparable 2008 fiscal period. The decrease in operating income was primarily the result of a 9.7 percent increase in sales, an increase in the cost of sales of $2.2 million, a $1.3 million increase in sales and marketing expenses and a $353,000 increase in R&D expenses, partially offset by a decrease of $242,000 in G&A expense.

The Company recorded an $820,000 tax provision on pre-tax income of $2.3 million, a 35.2 percent tax provision, in the first nine months ended May 4, 2009. In the first nine months ended April. 30, 2008, the Company recorded an $824,000 tax provision on pre-tax income of $2.3 million, a 36.1 percent tax provision.

Net income increased by $49,000 to $1.5 million for the first nine months of fiscal 2009, from $1.5 million for the same period in fiscal 2008. Basic and diluted earnings per share for the first nine months of fiscal 2009 remained stable at $0.06. Basic weighted-average shares outstanding increased from 24,310,211 at April 30, 2008 to 24,454,483 at May 4, 2009.

**Liquidity and Capital Resources**

The Company had $603,000 in cash and total interest-bearing debt and revenue bonds payable of $15.7 million as of May 4, 2009.

Working capital, including the management of inventory and accounts receivable, is a key management focus. At May 4, 2009, the Company had an average of 59 days of sales outstanding ( DSO ) in accounts receivable for the three month period ending May 4, 2009, unfavorable to July 31, 2008 by five days and to February 3, 2009 by 3 days. The Company utilized the three month period to calculate DSO. The collection time for non-U.S. receivables is generally longer than comparable U.S. receivables, and as such, the increase in non-U.S. sales of 25.7 percent is unfavorably impacting the DSO calculation.

At May 4, 2009, the Company had 259 days of cost of sales in inventory on hand, unfavorable to July 31, 2008 by 41 days. However, the 259 days of cost of sales in inventory is 1 day favorable to February 3, 2009. The 242 days of sales in inventory on hand at May 4, 2009 is slightly lower than what the Company considers reasonable and is based on anticipated levels of 250 to 275 days of sales. The Company utilized the three month period to calculate inventory on hand as it included the current growth in cost of goods sold.

Cash flows used in operating activities were $2.0 million for the nine months ended May 4, 2009, compared to cash flows provided by operating activities of approximately $2.3 million for the comparable fiscal 2008 period. The decrease of $4.3 million was attributable to net decreases applicable to depreciation and amortization, deferred income

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taxes, income tax receivable, inventories, prepaid expenses, accounts payable, accrued expenses and income tax payable of $4.9 million, offset by net increases applicable to net receivables of approximately $600,000.

Cash flows used in investing activities were $662,000 for the nine months ended May 4, 2009, compared to cash used in investing activities of $979,000 for the comparable fiscal 2008 period. During the nine months ended May 4, 2009, cash additions to property and equipment were $560,000, compared to $779,000 for the first nine months of fiscal 2008. Decreases in cash additions in fiscal 2009 to property and equipment were lower as the Company completed its purchases of machinery and equipment for the R&D space in fiscal 2008.

Cash flows provided by financing activities were $2.8 million for the nine months ended May 4, 2009, compared to cash used in financing activities of $1.3 million for the nine months ended April 30, 2008. The increase of $4.1 million was attributable primarily to an increase in the excess of outstanding checks over the bank balance, net borrowings on the lines-of-credit and principal payments on long-term debt of $4.1 million.

The Company had the following committed financing arrangements as of May 4, 2009:

*Revolving Credit Facility:* The Company has a credit facility with Regions which now allows for borrowings of up to $9.5 million with interest at an interest rate based on either the one-, two- or three-month LIBOR plus 2.00 percent and adjusting each quarter based upon our leverage ratio. As of May 4, 2009, interest under the facility is charged at 2.43 percent. The unused portion of the facility is charged at a rate of 0.20 percent. Borrowings under this facility at May 4, 2009 were $7.0 million. Outstanding amounts are collateralized by the Company s domestic receivables and inventory. This credit facility expires on November 30, 2009.

The facility has two financial covenants: a maximum leverage ratio of 3.75 times and a minimum fixed charge coverage ratio of 1.1 times. As of May 4, 2009, the leverage ratio was 1.68 times and the minimum fixed charge coverage ratio was 1.79 times. Collateral availability under the line as of May 4, 2009 was approximately $939,000. The facility restricts the payment of dividends if, following the distribution, the fixed charge coverage ratio would fall below the required minimum.

*Non-U.S. Receivables Revolving Credit Facility*: On June 4, 2009, the Company amended this line of credit. The credit facility with Regions allows for borrowings of up to $1.75 million; however, the interest rate, which was based on the bank s prime lending rate, is now one-month LIBOR plus three percent. Under no circumstances shall the rate be less than three and one-half percent per annum. The facility is charged an administrative fee of 1%. There were no borrowings under this facility at May 4, 2009. Outstanding amounts are collateralized by the Company s non-U.S. receivables. The line matures on June 3, 2010 and has no financial covenants. Current collateral availability under the line was approximately $1.3 million at May 4, 2009.

*Equipment Line of Credit*: On June 5, 2009, the Company amended this line of credit. Under this amended credit facility, the Company may borrow up to $1.0 million, with interest now being LIBOR plus three percent (3.00%). Under no circumstances shall the rate be less than three and fifty one-hundredths percent (3.50%) per annum. The unused portion of the facility is not charged a fee. The borrowings under this facility as of May 4, 2009 were $263,000. The equipment line of credit has a maturity date of November 30, 2009.

Management believes that cash flows from operations, together with available borrowings under its new credit facilities, will be sufficient to meet the Company s working capital, capital expenditure and debt service needs for the next twelve months.

**Critical Accounting Policies**

The Company s significant accounting policies which require management s judgment are disclosed in our Annual Report on Form 10-K for the year ended July 31, 2008. In the first nine months of fiscal 2009, there were no changes to the significant accounting policies.

**Item 3 Quantitative and Qualitative Disclosures about Market Risk**

The Company s primary market risks include fluctuations in interest rates and exchange rate variability.

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The Company has two revolving credit facilities and an equipment line of credit facility in place. The primary revolving credit facility had an outstanding balance of $7.0 million at May 4, 2009 bearing interest based on either the one-, two- or three-month LIBOR plus 2.00 percent. The non-U.S. receivables revolving credit facility had no outstanding balance at May 4, 2009. Balances on this credit facility bear interest at the bank s prime lending rate. The equipment line of credit facility had a $263,000 outstanding balance at May 4, 2009, bearing interest at an effective interest rate now being LIBOR plus three percent (3.00%). Interest expense from these credit facilities is subject to market risk in the form of fluctuations in interest rates. Assuming the current levels of borrowings at variable rates and a two-percentage-point increase in the average interest rate on these borrowings, it is estimated that our interest expense would have increased by approximately $144,000. The Company does not perform any interest rate hedging activities related to these three facilities.

Additionally, the Company has exposure to non-U.S. currency fluctuations through export sales to international accounts. As only approximately 15 percent of our sales revenue is denominated in non-U.S. currencies, we estimate that a change in the relative strength of the dollar to non-U.S. currencies would not have a material impact on the Company s results of operations. The Company does not conduct any hedging activities related to non-U.S. currency.

**Item 4 Controls and Procedures**

*Evaluation of Disclosure Controls and Procedures*

Our management, under the supervision and with the participation of our chief executive officer and chief financial officer, has reviewed and evaluated the effectiveness of the Company s disclosure controls and procedures as of May 4, 2009. Based on such review and evaluation, our chief executive officer and chief financial officer have concluded that, as of May 4, 2009, the disclosure controls and procedures were effective to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934, as amended, (a) is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms and (b) is accumulated and communicated to the Company s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Based on this evaluation, management has concluded that its disclosure controls and procedures were effective at the reasonable assurance level as of May 4, 2009.

*Changes in Internal Control over Financial Reporting*

During the quarter ended May 4, 2009, there was no change in the Company s internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

**Part II Other Information**

**Item 1 Legal Proceedings**

On April 17, 2008, the Company filed a lawsuit in the United States District Court for the Southern District of New York against Swiss-based Alcon, Inc. and its primary operating subsidiary in the U.S., Alcon Laboratories, Inc. (collectively Alcon ). This suit is captioned Synergetics USA, Inc. v. Alcon Laboratories, Inc. and Alcon, Inc., Case No. 08-CIV-003669. The Company s attorneys in this matter have agreed to represent the Company on a contingency-fee basis. In the complaint, the Company alleges that Alcon has used its monopoly power in the market for vitrectomy machines to control its customers purchasing decisions in favor of Alcon s surgical illumination sources and associated accessories, for example by tying sales of its light pipes to sales of its patented fluid collection cassettes, which are required for each vitreoretinal surgery using Alcon s market-dominant vitrectomy machine. The complaint describes further anti-competitive behaviors, which include commercial disparagement of the Company s products; payment of grant monies to surgeons, hospitals and clinics in order to influence purchasing decisions; the maintenance of a large surgeon advisory board, many of the surgeons on which receive benefits far beyond their advisory contributions and are required to buy Alcon s products; predatory pricing; an unlawful rebate program; and a threat to further lock out the Company from an associated market unless granted a license to use some of our key patented technologies. The Company requested both monetary damages and injunctive relief. On June 23, 2008, Alcon filed a pleading responsive to the complaint, denying all counts and asserting affirmative defenses. On June 4, 2009, the Court ruled in the Company s favor, denying a motion by Alcon to dismiss the complaint. The Court ruled that the Company s allegations present a legitimate legal claim for which damages may be awarded. Pre-trial activities

in this suit are scheduled through January 2010.

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In its pleading on June 23, 2008, Alcon also made a counterclaim in which they allege that the Company misappropriated trade secrets from Infinitech, a company acquired by Alcon in 1998. The Company believes it has meritorious defenses to the counterclaim and has filed with the Court a Motion for Summary Judgment asking the Court to adjudge the counterclaim barred by the statute of limitations. We are awaiting a ruling on this motion.

On October 9, 2008, Alcon Research, Ltd. ( Alcon Research ) filed a lawsuit against the Company and Synergetics in the Northern District of Texas, Case No. 4-08CV-609-Y, alleging infringement of United States Patent No. 5,603,710, as such patent is amended by the Reexamination Certificate issued July 19, 2005. On March 20, 2009, Alcon Research amended its complaint to add claims further alleging infringement of United States Patent No. 5,318,560 and infringement of and unfair competition with respect to three trademarks, namely Alcon®, Accurus® and Grieshaber®. Alcon Research has requested enhanced damages based on an allegation of willful infringement, and has requested an injunction to stop the alleged acts of infringement. Because the complaint fails to identify a single product as infringing, at this stage the Company is unable to determine at the basis, if any, for the patent infringement claims. On April 6, 2009, the Company answered the amended complaint with a general denial of the claims, as well as affirmative defenses and a request for the Court to make declarations of non-infringement with respect to the patents and trademarks at issue. The Company believes its defenses and counterclaims to be meritorious with respect to all claims in the suit. In one affirmative defense, the Company alleges that both patents at issue are invalid. On such grounds, the Company also has submitted documents to the United States Patent and Trademark Office ( USPTO ) requesting that both patents be reexamined and all claims therein be held unpatentable. At this time, the USPTO has requested additional information from the Company, but has made no determination on patentability. Corresponding to the Company s request for reexamination in the USPTO, the Company has asked the Court to stay all proceedings in this case until the USPTO has made its final patentability determination, which may take 18-24 months or more. The Court has not ruled yet on the Company s request for a stay.

On February 25, 2009, Alcon and Alcon Research filed a lawsuit against the Company and Synergetics in the Northern District of Texas, Case No. 4-09CV-127-A, alleging infringement of United States Patent No. 5,318,560, and infringement of and unfair competition with respect to three trademarks, namely Alcon®, Accurus® and Grieshaber®. Alcon and Alcon Research voluntarily dismissed this suit upon the amendment of the above-described suit (Case No. 4-08CV-609-Y) with claims similar to those made in this case.

In addition, from time to time we may become subject to litigation claims that may greatly exceed our product liability insurance limits. An adverse outcome of such litigation may adversely impact our financial condition, results of operations or liquidity. We record a liability when a loss is known or considered probable and the amount can be reasonably estimated. If a loss is not probable, a liability is not recorded. As of May 4, 2009, the Company had no litigation reserve recorded.

**Item 1A Risk Factors**

The Company s business is subject to certain risks and events that, if they occur, could adversely affect our financial condition and results of operations and the trading price of our common stock. For a discussion of these risks, please refer to the Risk Factors section of the Company s Annual Report on Form 10-K for the fiscal year ended July 31, 2008. In connection with its preparation of this quarterly report, management has reviewed and considered these risk factors and has determined that, there have been no material changes to the Company s risk factors since the date of filing the Annual Report on Form 10-K for the fiscal year ended July 31, 2008.

**Item 2 Unregistered Sales of Equity Securities and Use of Proceeds**

None

**Item 3 Defaults Upon Senior Securities**

None

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**Item 4 Submission of Matters to a Vote of Security Holders**

None

**Item 5 Other Information**

There have been no material changes to the procedures by which security holders may recommend nominees to the Company s Board of Directors since the filing of the Company s Quarterly Report on Form 10-Q for the fiscal quarter ended February 3, 2009.

**Item 6 Exhibits**

| Exhibit No. | Description |
|---|---|
| 31.1 | Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

**Trademark Acknowledgements**

Malis, the Malis waveform logo, Omni, Bident, Bi-Safe, Gentle Gel and Finest Energy Source for Surgery are our registered trademarks. Synergetics, the Synergetics logo, PHOTON, DualWave, COAG, Advantage, Microserrated, Microfiber, Solution, Tru-Micro, DDMS, Kryptonite, Diamond Black, Bullseye, Spetzler Claw, Spetzler Micro Claw, Spetzler Open Angle Micro Claw, Spetzler Barracuda, Spetzler Pineapple, Axcess, Veritas, Lumen and Lumenator product names are our trademarks. All other trademarks or tradenames appearing in this Form 10-Q are the property of their respective owners.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SYNERGETICS USA, INC.
(Registrant)

June 15, 2009

/s/ David M. Hable
Chief Executive Officer

June 15, 2009

/s/ Pamela G. Boone
Pamela G. Boone, Executive Vice President, Chief Financial Officer, Secretary and Treasurer (Principal Financial and Principal Accounting Officer)