ATRION CORP
Form 10-Q
August 08, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q

[ X ] Quarterly Report Pursuant To Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Quarterly Period Ended June 30, 2006

or

[ ] Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the Transition Period from ______ to ______

Commission File Number 0-10763

Atrion Corporation
(Exact Name of Registrant as Specified in its Charter)

| Delaware | 63-0821819 |
|---|---|
| (State or Other Jurisdiction of Incorporation or Organization) | (I.R.S. Employer Identification No.) |

One Allentown Parkway, Allen, Texas 75002
(Address of Principal Executive Offices) (Zip Code)

(972) 390-9800
(Registrant's Telephone Number, Including Area Code)

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

Indicate by check whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act (Check one):

Large accelerated filer [ ] Accelerated filer [X] Non-accelerated filer [ ]

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| Title of Each Class | Number of Shares Outstanding at July 26, 2006 |
|---|---|
| Common stock, Par Value $0.10 per share | 1,857,156 |

ATRION CORPORATION AND SUBSIDIARIES

TABLE OF CONTENTS

| | |
|---|---|
| PART I. Financial Information | 2 |
| Item 1. Financial Statements | |
| Consolidated Statements of Income (Unaudited) For the Three and Six Months Ended June 30, 2006 and 2005 | 3 |
| Consolidated Balance Sheets June 30, 2006 (Unaudited) and December 31, 2005 | 4 |
| Consolidated Statements of Cash Flows (Unaudited) For the Six Months Ended June 30, 2006 and 2005 | 5 |
| Notes to Consolidated Financial Statements (Unaudited) | 6 |
| Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations | 10 |
| Item 3. Quantitative and Qualitative Disclosures About Market Risk | 15 |
| Item 4. Controls and Procedures | 15 |
| PART II. Other Information | 16 |
| Item 4. Submission of Matters to a Vote of Security Holders | 16 |
| Item 6. Exhibits and Reports on 8-K | 16 |
| SIGNATURES | 17 |
| Exhibits | 18 |



PART I

FINANCIAL INFORMATION

Item 1. Financial Statements

ATRION CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited)

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| | (in thousands, except per share amounts) | | | |
| Revenues | $ 20,849 | $ 18,102 | $ 40,351 | $ 36,7 |
| Cost of goods sold | 12,076 | 10,896 | 24,230 | 21,9 |
| Gross profit | 8,773 | 7,206 | 16,121 | 14,8 |
| Operating expenses: | | | | |
| Selling | 1,600 | 1,448 | 3,215 | 2,8 |
| General and administrative | 2,348 | 2,002 | 4,352 | 4,2 |
| Research and development | 700 | 625 | 1,376 | 1,2 |
| | 4,648 | 4,075 | 8,943 | 8,2 |
| Operating income | 4,125 | 3,131 | 7,178 | 6,5 |
| Other income: | | | | |
| Interest income | 11 | 9 | 20 | |
| Interest expense | -- | (21) | -- | ( |
| Other income (expense), net | (21) | -- | (21) | |
| | (10) | (12) | (1) | |
| Income from continuing operations before provision for income taxes | 4,115 | 3,119 | 7,177 | 6,5 |
| Provision for income taxes | (1,295) | (1,012) | (2,251) | (2,1 |
| Income from continuing operations | 2,820 | 2,107 | 4,926 | 4,4 |
| Gain on disposal of discontinued operations, net of income taxes | 165 | 165 | 165 | 1 |
| Net income | $ 2,985 | $ 2,272 | $ 5,091 | $ 4,5 |
| Income per basic share: | | | | |
| Income from continuing operations | $ 1.53 | $ 1.18 | $ 2.68 | $ 2. |
| Gain on disposal of discontinued operations | 0.09 | 0.09 | 0.09 | 0. |
| | $ 1.62 | $ 1.27 | $ 2.77 | $ 2. |

| | | | | |
|---|---|---|---|---|
| Weighted average basic shares outstanding | 1,845 | 1,789 | 1,840 | 1,7 |
| Income per diluted share: | | | | |
| Income from continuing operations | $ 1.45 | $ 1.09 | $ 2.53 | $ 2. |
| Gain on disposal of discontinued operations | 0.08 | 0.09 | 0.08 | 0. |
| | $ 1.53 | $ 1.18 | $ 2.61 | $ 2. |
| Weighted average diluted shares outstanding | 1,949 | 1,925 | 1,947 | 1,8 |
| Dividends per common share | $ 0.17 | $ 0.14 | $ 0.34 | $ 0. |

The accompanying notes are an integral part of these statements.



ATRION CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands)

| Assets | June 30, 2006 (unaudited) | December 31, 2005 |
|---|---|---|
| Current assets: | | |
| Cash and cash equivalents | $ 185 | $ 525 |
| Accounts receivable | 9,911 | 8,291 |
| Inventories | 17,694 | 17,705 |
| Prepaid expenses | 1,441 | 832 |
| Other | 620 | 620 |
| | 29,851 | 27,973 |
| Property, plant and equipment | 76,726 | 63,041 |
| Less accumulated depreciation and amortization | 29,739 | 27,787 |
| | 46,987 | 35,254 |
| Other assets and deferred charges: | | |
| Patents | 2,418 | 2,331 |
| Goodwill | 9,730 | 9,730 |
| Other | 3,005 | 3,182 |
| | 15,153 | 15,243 |

| | | |
|---|---|---|
| | $ 91,991 | $ 78,470 |
| **Liabilities and Stockholders' Equity** | | |
| Current liabilities: | | |
| Accounts payable and accrued liabilities | $ 7,156 | $ 7,128 |
| Accrued income and other taxes | 1,538 | 1,098 |
| | 8,694 | 8,226 |
| Line of credit | 11,001 | 2,529 |
| Other non-current liabilities | 5,909 | 5,820 |
| Stockholders' equity: | | |
| Common shares, par value $0.10 per share; authorized 10,000 shares, issued 3,420 shares | 342 | 342 |
| Paid-in capital | 13,764 | 12,508 |
| Retained earnings | 86,782 | 82,318 |
| Treasury shares,1,563 at June 30, 2006 and 1,586 at December 31, 2005, at cost | (34,501) | (33,273) |
| Total stockholders' equity | 66,387 | 61,895 |
| | $ 91,991 | $ 78,470 |

The accompanying notes are an integral part of these statements.



ATRION CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

| | Six Months Ended June 30, | |
|---|---|---|
| | 2006 | 2005 |
| | (In thousands) | |
| Cash flows from operating activities: | | |
| Net income | $ 5,091 | $ 4,567 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Gain on disposal of discontinued operations | (165) | (165) |
| Depreciation and amortization | 2,341 | 2,149 |
| Deferred income taxes | 105 | 273 |
| Tax benefit related to stock options | -- | 1,051 |
| Other | 52 | 11 |

| | | |
|---|---|---|
| | 7,424 | 7,886 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (1,620) | (534) |
| Inventories | 11 | (3,442) |
| Prepaid expenses | (608) | (316) |
| Other non-current assets | (73) | (762) |
| Accounts payable and current liabilities | 28 | 3 |
| Accrued income and other taxes | 440 | (914) |
| Other non-current liabilities | (16) | (9) |
| Net cash provided by continuing operations | 5,586 | 1,912 |
| Net cash provided by discontinued operations | 165 | 165 |
| | 5,751 | 2,077 |
| Cash flows from investing activities: | | |
| Property, plant and equipment additions | (13,939) | (7,522) |
| Deposit on land purchase | -- | 3,750 |
| Property, plant and equipment sales | -- | 6 |
| | (13,939) | (3,766) |
| Cash flows from financing activities: | | |
| Net change in line of credit | 8,472 | 357 |
| Exercise of stock options | 948 | 1,938 |
| Purchase of treasury stock | (1,594) | -- |
| Tax benefit related to stock options | 649 | -- |
| Dividends paid | (627) | (496) |
| | 7,848 | 1,799 |
| Net change in cash and cash equivalents | (340) | 110 |
| Cash and cash equivalents at beginning of period | 525 | 255 |
| Cash and cash equivalents at end of period | $ 185 | $ 365 |
| Cash paid for: | | |
| Interest (net of capitalization) | $ -- | $ 43 |
| Income taxes | $ 1,195 | $ 1,754 |

The accompanying notes are an integral part of these statements.

5

ATRION CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(1) Basis of Presentation

In the opinion of management, all adjustments necessary for a fair presentation of results of operations for the periods presented have been included in the accompanying unaudited consolidated financial statements of Atrion Corporation and its subsidiaries (the "Company"). Such adjustments consist of normal recurring items. The accompanying financial statements have been prepared in accordance with the instructions to Form 10-Q and include the information and notes required by such instructions. Accordingly, the consolidated financial statements and notes thereto should be read in conjunction with the financial statements and notes included in the Company's 2005 Annual Report on Form 10-K.

(2) Inventories

Inventories are stated at the lower of cost or market. Cost is determined by using the first-in, first-out method. The following table details the major components of inventories (in thousands):

| | June 30, 2006 | December 31, 2005 |
|---|---|---|
| Raw materials | $ 6,919 | $ 6,898 |
| Work in process | 4,599 | 4,291 |
| Finished goods | 6,176 | 6,516 |
| Total inventories | $ 17,694 | $ 17,705 |

(3) Income per share

The following is the computation for basic and diluted income per share:

| | Three months ended June 30, | | Six mon Jun |
|---|---|---|---|
| | 2006 | 2005 | 2006 |
| | (in thousands, except per share a | | |
| Income from continuing operations | $ 2,820 | $ 2,107 | $ 4,926 |
| Weighted average basic shares outstanding | 1,845 | 1,789 | 1,840 |
| Add: Effect of dilutive securities (options) | 104 | 136 | 107 |
| Weighted average diluted shares outstanding | 1,949 | 1,925 | 1,947 |
| Earnings per share from continuing operations: | | | |
| Basic | $ 1.53 | $ 1.18 | $ 2.68 |
| Diluted | $ 1.45 | $ 1.09 | $ 2.53 |

There were no outstanding options to purchase shares of common stock that were not included in the diluted income per share calculations because their effect would be anti-dilutive for the three-month and six-month periods ended June 30, 2006 and 2005.

ATRION CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

(4) Stock-Based Compensation

At June 30, 2006, the Company had three stock-based employee compensation plans. Prior to January 1, 2006, the Company accounted for those plans under the recognition and measurement provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. No stock-based employee compensation cost was reflected in net income, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant.

Effective January 1, 2006, the Company adopted the provisions of SFAS No. 123R, "Accounting for Stock-based Compensation" ("SFAS No. 123R") using the modified-prospective transition method and the disclosures that follow are based on applying SFAS No. 123R. Under this transition method, compensation expense recognized during the three and six months ended June 30, 2006, included compensation expense for all share-based awards granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, "Accounting for Stock-Based Compensation". In accordance with the modified-prospective transition method, results for the prior periods have not been restated. The Company recorded compensation expense in the amount of approximately $10,000 for the three-month period and $24,000 for the six-month period ended June 30, 2006.

The Company's 1997 Stock Incentive Plan provides for the grant to key employees of incentive and nonqualified stock options, stock appreciation rights, restricted stock and performance shares. In addition, under the 1997 Stock Incentive Plan, outside directors (directors who are not employees of the Company or any subsidiary) received automatic annual grants of nonqualified stock options to purchase 2,000 shares of common stock. The 1997 Stock Incentive Plan was amended in 2005 to provide that no additional stock options may be granted to outside directors thereunder. Under the 1997 Stock Incentive Plan, 624,425 shares, in the aggregate, of common stock were reserved for grants. The purchase price of shares issued on the exercise of incentive options must be at least equal to the fair market value of such shares on the date of grant. The purchase price for shares issued on the exercise of nonqualified options and restricted and performance shares is fixed by the Compensation Committee of the Board of Directors. The options granted become exercisable as determined by the Compensation Committee and expire no later than 10 years after the date of grant.

During 1998, the Company's stockholders approved the adoption of the Company's 1998 Outside Directors Stock Option Plan which, as amended, provided for the automatic grant on February 1, 1998 and February 1, 1999 of nonqualified stock options to the Company's outside directors. Although no additional options may be granted under the 1998 Outside Directors Stock Option Plan, all outstanding options under this plan continue to be governed by the terms and conditions of the plan and the existing option agreements for those grants.

During 2006, the Company's stockholders approved the adoption of the Company's 2006 Equity Incentive Plan which provides for the grant to key employees and consultants of incentive and nonqualified stock options, restricted stock, restricted stock units, deferred stock units, stock appreciation rights and performance shares. Under the 2006 Equity Incentive Plan, 100,000 shares, in the aggregate, of common stock were reserved for awards. The purchase price of shares issued on the exercise of options must be at least equal to the fair market value of such shares on the date of grant. The purchase price for restricted and performance shares is fixed by the Compensation Committee of the Board of Directors. The options granted become exercisable and expire as determined by the Compensation Committee except that incentive options expire no later than 10 years after the date of grant.





Option transactions for the three and six months ended June 30, 2006 are as follows:

| | Three months ended June 30, 2006 | | Six months June 30, |
|---|---|---|---|
| | Shares | Weighted Average Exercise Price | Shares |
| Options outstanding at the beginning of the period | 191,301 | $ 26.14 | 225,100 |
| Granted | - | $ - | - |
| Expired | - | $ - | - |
| Exercised | (15,250) | $ 31.92 | (49,049) |
| Options outstanding at the end of the period | 176,051 | $ 25.64 | 176,051 |
| Exercisable options at June 30, 2006 | | | 176,051 |

The Company estimates the fair value of stock options granted using the Black-Scholes option-pricing formula and a single option award approach. This fair value is then amortized on a straight-line basis over the requisite service periods of the awards, which is generally the vesting period. The Company's expected life represents the period that the Company's stock-based awards are expected to be outstanding and was determined based on historical experience of similar awards, giving consideration to the contractual terms of the stock-based awards, vesting schedules and expectations of future employee behavior. Stock-based payments made prior to January 1, 2006 were accounted for using the intrinsic value method under APB 25. The fair value of stock-based payments made subsequent to January 1, 2006 would be valued using the Black-Scholes valuation method with a volatility factor based on the Company's historical stock trading history. The Company bases the risk-free interest rate using the Black-Scholes valuation method on the implied yield currently available on U. S. Treasury securities with an equivalent term. The Company bases the dividend yield used in the Black-Scholes valuation method on the Company's stock dividend history.

The total intrinsic value of options exercised during the three and six months ended June 30, 2006 was $0. The total intrinsic values of options outstanding and options currently exercisable at June 30, 2006 were $0 and $0, respectively. The weighted-average remaining contractual life for options outstanding and options currently exercisable at June 30, 2006 was 2.82 and 2.82 years, respectively.

As of June 30, 2006 there was no unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the plans. The total fair value of options vested during the three months ended June 30, 2006 was $0. At June 30, 2006 there were no nonvested stock options.



ATRION CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

The Company has a policy of utilizing existing treasury shares to satisfy stock option exercises.

The following table illustrates the effect on net income and income per share if the Company had applied the fair value recognition provisions of SFAS No. 123R to stock-based employee compensation in the 2005 periods (in thousands, except per share amounts):

| | Three Months ended June 30, 2005 | Six Months ended June 30, 2005 |
|---|---|---|
| Net income, as reported | $ 2,272 | $ 4,567 |
| Deduct: Total stock-based employee compensation expense determined under fair value-based methods for all awards, net of tax effects | 10 | 111 |
| Pro forma net income | $ 2,262 | $ 4,456 |
| Income per share: | | |
| Basic - as reported | $ 1.27 | $ 2.60 |
| Basic - pro forma | $ 1.26 | $ 2.54 |
| Diluted - as reported | $ 1.18 | $ 2.41 |
| Diluted - pro forma | $ 1.18 | $ 2.35 |

(5) Pension Benefits
The components of net periodic pension cost are as follows for the three and six months ended June 30, 2006 and June 30, 2005 (in thousands):

| | Three Months ended June 30, 2006 | Three Months ended June 30, 2005 | Six Mon Jun 2006 |
|---|---|---|---|
| Service cost | $ 69 | $ 67 | $ 138 |
| Interest cost | 83 | 80 | 166 |
| Expected return on assets | (111) | (114) | (222) |
| Prior service cost amortization | (9) | (9) | (18) |
| Actuarial loss | 29 | 27 | 58 |
| Transition amount amortization | - | (11) | - |
| Net periodic pension cost | $ 61 | $ 40 | $ 122 |

In 2006, the Company expects to contribute approximately $250,000 to its pension plan to satisfy minimum funding requirements for the year. As of June 30, 2006, contributions of $250,000 have been made to this plan.

9

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

Overview

The Company designs, develops, manufactures, sells and distributes products and components, primarily for the medical and healthcare industry. The Company markets components to other equipment manufacturers for incorporation in their products and sells finished devices to physicians, hospitals, clinics and other treatment centers. The Company's medical products primarily serve the fluid delivery, cardiovascular, and ophthalmology markets. The Company's other medical and non-medical products include obstetrics products, instrumentation and disposables used in dialysis, contract manufacturing and valves and inflation devices used in marine and aviation safety products.

The Company's products are used in a wide variety of applications by numerous customers. The Company encounters competition in all of its markets and competes primarily on the basis of product quality, price, engineering, customer service and delivery time.

The Company's strategy is to provide a broad selection of products in the areas of its expertise. Research and development efforts are focused on improving current products and developing highly-engineered products that meet customer needs and have the potential for broad market applications and significant sales. Proposed new products may be subject to regulatory clearance or approval prior to commercialization and the time period for introducing a new product to the marketplace can be unpredictable. The Company also focuses on controlling costs by investing in modern manufacturing technologies and controlling purchasing processes. The Company has been successful in consistently generating cash from operations and has used that cash to reduce indebtedness, to fund capital expenditures, to repurchase stock and, starting in 2003, to pay dividends.

The Company's strategic objective is to further enhance its position in its served markets by:

- Focusing on customer needs;
- Expanding existing product lines and developing new products;
- Maintaining a culture of controlling cost; and
- Preserving and fostering a collaborative, entrepreneurial management structure.

For the three months ended June 30, 2006, the Company reported revenues of $20.8 million, operating income of $4.1 million and net income of $3.0 million, up 15 percent, 32 percent and 31 percent, respectively, from the three months ended June 30, 2005. For the six months ended June 30, 2006, the Company reported revenues of $40.4 million, operating income of $7.2 million and net income of $5.1 million, up 10 percent, 10 percent and 11 percent, respectively, from the six months ended June 30, 2005.



Results for the three months ended June 30, 2006

Consolidated net income totaled $3.0 million, or $1.62 per basic and $1.53 per diluted share, in the second quarter of 2006. This is compared with consolidated net income of $2.3 million, or $1.27 per basic and $1.18 per diluted share, in the second quarter of 2005. The income per basic share computations are based on weighted average basic shares outstanding of 1,844,857 in the 2006 period and 1,789,220 in the 2005 period. The income per diluted share computations are based on weighted average diluted shares outstanding of 1,949,319 in the 2006 period and 1,925,320 in the 2005 period.

Consolidated revenues of $20.8 million for the second quarter of 2006 were 15 percent higher than revenues of $18.1 million for the second quarter of 2005. This 15 percent increase in revenues was primarily attributable to an approximate 36 percent increase in the revenues from the Company's fluid delivery products, an approximate 29 percent increase in the revenues from the Company's cardiovascular products and an approximate 5 percent increase in the revenues from the Company's other products. These increases, which were generally attributable to higher sales volumes, were partially offset by an approximate 12 percent decrease in the revenues from the Company's ophthalmic products.

Revenues by product line are as follows (in thousands):

| | Three Months ended June 30, 2006 | Three Months ended June 30, 2005 |
|---|---|---|
| Fluid Delivery | $ 6,623 | $ 4,887 |
| Cardiovascular | 5,716 | 4,439 |
| Ophthalmology | 3,572 | 4,079 |
| Other | 4,938 | 4,697 |
| Total | $ 20,849 | $ 18,102 |

Cost of goods sold of $12.1 million for the second quarter of 2006 was 11 percent higher than in the comparable 2005 period. Increased sales volume was the primary contributor to the increase in cost of goods sold for the second quarter of 2006.

Gross profit of $8.8 million in the second quarter of 2006 was $1.6 million, or 22 percent, higher than in the comparable 2005 period. The Company's gross profit percentage in the second quarter of 2006 was 42.1 percent of revenues compared with 39.8 percent of revenues in the second quarter of 2005. The increase in gross profit percentage in the 2006 period compared to the 2005 period was primarily related to improved manufacturing efficiencies.

The Company's second quarter 2006 operating expenses of $4.6 million were $573,000 higher than the operating expenses for the second quarter of 2005, resulting primarily from a $346,000 increase in General and Administrative (G&A) expenses, a $152,000 increase in selling (Selling) expenses, and a $75,000 increase in Research and Development (R&D) expenses. The increase in G&A for the second quarter of 2006 was primarily related to increased compensation costs and increased outside services. The increase in Selling expenses for the second quarter of 2006 was principally attributable to increased compensation costs and advertising and promotion costs. The increase in R&D costs was primarily related to prototype expenses, new product testing costs, and process enhancements. Operating income in the second quarter of 2006 increased $994,000, or 32 percent, to $4.1 million from $3.1 million in the second quarter of 2005. Operating income was 19.8 percent of revenues in the second quarter of 2006 compared to 17.3 percent of revenues in the second quarter of 2005. The change in operating income for the second quarter of 2006 as compared with the second quarter of 2005 was primarily attributable to the previously mentioned increased gross profit offset by the increased operating expenses.



Interest charges of $174,000 for the second quarter of 2006 were capitalized as part of the construction costs for a new facility for a subsidiary, Halkey-Roberts Corporation ("Halkey-Roberts") because all of the debt was obtained in conjunction with the construction. Income tax expense for the second quarter of 2006 was $1.3 million compared to income tax expense of $1.0 million for the same period in the prior year. The effective tax rate for the second quarter of 2006 was 31.5 percent compared with 32.4 percent for the second quarter of 2005.

The Company recorded a gain on the disposal of discontinued operations relating to the 1997 sale of its natural gas operations of $165,000 after tax, or $0.09 per basic and $0.08 per diluted share, for the second quarter of 2006 and $165,000 after tax, or $0.09 per basic and $0.09 per diluted share, for the second quarter of 2005, resulting from the receipt of contingent deferred payments in each year. No additional payments are due in future periods under the terms of the 1997 agreement pursuant to which the Company sold its natural gas operations.

Results for the six months ended June 30, 2006

Consolidated net income totaled $5.1 million, or $2.77 per basic and $2.61 per diluted share, for the six months ended June 30, 2006. This is compared with consolidated net income of $4.6 million, or $2.60 per basic and $2.41 per diluted share, for the six months ended June 30, 2005. The income per basic share computations are based on weighted average basic shares outstanding of 1,840,119 in the 2006 period and 1,756,392 in the 2005 period. The income per diluted share computations are based on weighted average diluted shares outstanding of 1,946,983 in the 2006 period and 1,895,008 in the 2005 period.

Consolidated revenues of $40.4 million for the six months ended June 30, 2006 were 10 percent higher than revenues of $36.7 million for the six months ended June 30, 2005. This 10 percent increase in revenues was primarily attributable to an approximate 30 percent increase in the revenues from the Company's fluid delivery products and an approximate 26 percent increase in the revenues from the Company's cardiovascular products. These increases, which were generally attributable to higher sales volumes, were partially offset by an approximate 18 percent decrease in the revenues from the Company's ophthalmic products and an approximate 3 percent decrease in the revenues from the Company's other products.

Revenues by product line are as follows (in thousands):

| | Six Months ended June 30, 2006 | Six Months ended June 30, 2005 |
|---|---|---|
| Fluid Delivery | $ 13,059 | $ 10,050 |
| Cardiovascular | 11,440 | 9,101 |
| Ophthalmology | 6,384 | 7,807 |
| Other | 9,468 | 9,789 |
| Total | $ 40,351 | $ 36,747 |

12

Cost of goods sold of $24.2 million for the six months ended June 30, 2006 was 11 percent higher than in the comparable 2005 period. Increased sales volume, increased manufacturing overhead costs, and a temporary production curtailment due to reduced orders from certain ophthalmic and related kitting business customers were the primary contributors to the increase in cost of goods sold for the six months ended June 30, 2006.

Gross profit of $16.1 million for the six months ended June 30, 2006 was $1.3 million, or 9 percent, higher than in the comparable 2005 period. The Company's gross profit percentage for the six months ended June 30, 2006 was 40.0 percent of revenues compared with 40.3 percent of revenues for the six months ended June 30, 2005. The decrease in gross profit percentage in the 2006 period compared to the 2005 period was primarily related to the previously mentioned manufacturing cost increases and temporary production curtailment.

The Company's second quarter 2006 operating expenses of $8.9 million were $665,000 higher than the operating expenses for the six months ended June 30, 2005, resulting primarily from a $362,000 increase in Selling expenses, a $171,000 increase in R&D expenses and a $132,000 increase in G&A expenses. The increase in Selling expenses for the six months ended June 30, 2006 was principally attributable to increased compensation costs, advertising and promotion costs and travel-related expenses. The increase in R&D costs was primarily related to prototype expenses, new product testing costs, and process enhancements. The increase in G&A for the six months ended June 30, 2006 was primarily related to increased compensation costs and increased outside services partially offset by a decrease in insurance costs. Operating income for the six months ended June 30, 2006 increased $629,000, or 10 percent, to $7.2 million from $6.5 million in the six months ended June 30, 2005. Operating income was 17.8 percent of revenues for the six months ended June 30, 2006 compared to 17.8 percent of revenues for the six months ended June 30, 2005.

Interest charges of $214,000 for the six months ended June 30, 2006 were capitalized as part of the construction costs for the new Halkey-Roberts facility because all of the debt was obtained in conjunction with the construction. Income tax expense for the six months ended June 30, 2006 was $2.3 million compared to income tax expense of $2.1 million for the same period in the prior year. The effective tax rate for the six months ended June 30, 2006 was 31.4 percent compared with 32.7 percent for the six months ended June 30, 2005.

The Company recorded a gain on the disposal of discontinued operations relating to the 1997 sale of its natural gas operations of $165,000 after tax, or $0.09 per basic and $0.08 per diluted share, for the first six months of 2006 and $165,000 after tax, or $0.09 per basic and $0.09 per diluted share, for the first six months of 2005, resulting from the receipt of contingent deferred payments in each year. No additional payments are due in future periods under the terms of the 1997 agreement pursuant to which the Company sold its natural gas operations.

13

Liquidity and Capital Resources

At June 30, 2006, the Company had cash and cash equivalents of $185,000 compared with $525,000 at December 31, 2005. The Company had outstanding borrowings of $11.0 million under its $25.0 million revolving credit facility ("Credit Facility") at June 30, 2006 and $2.5 million at December 31, 2005. The increase in the outstanding balance under the Credit Facility in the first six months of 2006 was primarily attributable to borrowings to fund the construction of the new Halkey-Roberts facility. The Credit Facility, which expires November 12, 2009, and may be extended under certain circumstances, contains various restrictive covenants, none of which is expected to impact the Company's liquidity or capital resources. At June 30, 2006, the Company was in compliance with all financial covenants.

As of June 30, 2006, the Company had working capital of $21.2 million, including $185,000 in cash and cash equivalents. The $1.4 million increase in working capital during the first six months of 2006 was primarily related to an increase in accounts receivable partially offset by an increase in accrued income and other taxes. The increase in accounts receivable during the first six months of 2006 was primarily related to the increase in revenues for the second quarter of 2006 as compared to the fourth quarter of 2005. Cash flows from continuing operations generated $5.6 million for the six months ended June 30, 2006 as compared to $1.9 million for the six months ended June 30, 2005. The 2005 period was heavily impacted by a $3.4 million increase in inventories. During the first six months of 2006, the Company expended $13.9 million for the purchase of property and equipment. Of this amount, $11.5 million was expended for the construction of the new Halkey-Roberts facility. The Company received net proceeds of $948,000 from the exercise of employee stock options during the first six months of 2006. During the first six months of 2006, the Company repurchased 24,000 shares of its common stock for approximately $1.6 million and paid dividends totaling $627,000 to its stockholders.

The Company believes that its existing cash and cash equivalents, cash flows from operations, borrowings available under the Company's credit facility, supplemented, if necessary, with equity or debt financing, which the Company believes would be available, will be sufficient to fund the Company's cash requirements for the foreseeable future.

Forward-Looking Statements

The statements in this Management's Discussion and Analysis that are forward-looking are based upon current expectations, and actual results may differ materially. Therefore, the inclusion of such forward-looking information should not be regarded as a representation by the Company that the objectives or plans of the Company would be achieved. Such statements include, but are not limited to, the Company's expectations regarding future liquidity and capital resources. Words such as "anticipates," "believes," "expects," "estimated" and variations of such words and similar expressions are intended to identify such forward-looking statements. Forward-looking statements contained herein involve numerous risks and uncertainties, and there are a number of factors that could cause actual results or future events to differ materially, including, but not limited to, the following: changing economic, market and business conditions; acts of war or terrorism; the effects of governmental regulation; the impact of competition and new technologies; slower-than-anticipated introduction of new products or implementation of marketing strategies; implementation of new manufacturing processes or implementation of new information systems; the Company's ability to protect its intellectual property; changes in the prices of raw materials; changes in product mix; intellectual property and product liability claims and product recalls; the ability to attract and retain qualified personnel; the loss of, or any material reduction in sales to, any significant customers; and problems in the relocation of the Halkey-Roberts operations. In addition, assumptions relating to budgeting, marketing, product development and other management decisions are subjective in many respects and thus susceptible to interpretations and periodic review which may cause the Company to alter its marketing, capital expenditures or other budgets, which in turn may affect the Company's results of operations and financial condition.



Item 3. Quantitative and Qualitative Disclosures About Market Risk

For the quarter ended June 30, 2006, the Company did not experience any material changes in market risk exposures that affect the quantitative and qualitative disclosures presented in the Company's 2005 Annual Report on Form 10-K.

Item 4. Controls and Procedures

The Company's management, with the participation of the Company's Chief Executive Officer and its Chief Financial Officer, evaluated the Company's disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of June 30, 2006. Based upon this evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures are effective. There were no changes in our internal control over financial reporting for the quarter ended June 30, 2006 that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.



PART II

OTHER INFORMATION

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The Company held its 2006 Annual Meeting of Stockholders on May 22, 2006 at its offices in Allen, Texas. At such meeting, the Company's stockholders ratified the appointment of Grant Thornton LLP as independent accountants with 1,445,843 shares voted for ratification, 3,145 voted against, 400 abstentions and 981 broker non-votes and approved the Atrion Corporation 2006 Equity Incentive Plan with 1,037,385 shares voted for approval, 126,278 against, 6,800 abstentions and 279,906 broker non-votes. The voting with respect to the nominee for election as director was as follows:

| Nominee | Votes For | Votes Withheld |
|---|---|---|
| Hugh J. Morgan, Jr. | 1,381,119 | 68,269 |

The terms of the following directors continued after the meeting: Emile A. Battat, Ronald N. Spaulding, Roger F. Stebbing, and John P. Stupp, Jr.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits

10.1 Atrion Corporation 2006 Equity Incentive Plan (1)

31.1 Sarbanes-Oxley Act Section 302 Certification of Chief Executive Officer

31.2 Sarbanes-Oxley Act Section 302 Certification of Chief Financial Officer

32.1 Certification Pursuant To 18 U.S.C. Section 1350, As Adopted Pursuant To Section 906 of The Sarbanes - Oxley Act Of 2002

32.2 Certification Pursuant To 18 U.S.C. Section 1350, As Adopted Pursuant To Section 906 of The Sarbanes - Oxley Act Of 2002

(b) Reports on Form 8-K

On May 8, 2006, the Company filed a report on Form 8-K with the SEC regarding the public dissemination of a press release announcing its financial results for the first quarter ended March 31, 2006 (Item 12).

Notes:

(1) Incorporated by reference to Schedule 14A filed April 6, 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.

Atrion Corporation
------------------
(Registrant)

Date: August 8, 2006

/s/ Emile A. Battat
-----------------------------
Emile A. Battat
Chairman, President and
Chief Executive Officer

Date: August 8, 2006

/s/ Jeffery Strickland
-----------------------------
Jeffery Strickland
Vice President and
Chief Financial Officer