UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the Quarterly Period Ended September 30, 2006

Commission File Number 1-13165

CRYOLIFE, INC.

(Exact name of registrant as specified in its charter)

Florida	**59-2417093**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1655 Roberts Boulevard, NW
Kennesaw, Georgia 30144
(Address of principal executive offices)
(zip code)

(770) 419-3355
(Registrant's telephone number, including area code)

Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES ☒ NO ☐

Indicate by check mark 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 ☒ Non-accelerated filer ☐

Indicate by check mark whether the registrant is a shell company (as defined in the Rule 12b-2 of the Exchange Act).

YES ☐ NO ☒

The number of shares of common stock, par value $0.01 per share, outstanding on November 1, 2006 was 24,899,477.

Part I – FINANCIAL INFORMATION

Item 1. Financial Statements

CRYOLIFE, INC. AND SUBSIDIARIES
SUMMARY CONSOLIDATED STATEMENTS OF OPERATIONS
(IN THOUSANDS, EXCEPT PER SHARE DATA)

	Three Months Ended September 30, 2006	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005
	(Unaudited)		(Unaudited)	
Revenues:				
Products	$ 9,687	$ 9,129	$ 30,308	$ 29,102
Human tissue preservation services	10,319	7,329	29,839	22,219
Research grants	12	—	74	—
Total revenues	20,018	16,458	60,221	51,321
Costs and expenses:				
Products	1,576	1,940	5,581	6,135
Human tissue preservation services (Including write-downs of $815 for the three months and $1,568 for the nine months ended September 30, 2006 and $626 for the three months and $1,298 for the nine months ended September 30, 2005)	6,954	6,015	20,751	17,984
General, administrative, and marketing	8,549	11,085	30,106	42,726
Research and development	826	894	2,572	2,744
Interest expense	169	77	504	220
Interest income	(94)	(166)	(304)	(408)
Change in valuation of derivative	44	(412)	111	372
Other expense, net	4	37	348	212
Total costs and expenses	18,028	19,470	59,669	69,985
Earnings (loss) before income taxes	1,990	(3,012)	552	(18,664)
Income tax expense	12	106	137	190
Net income (loss)	$ 1,978	$ (3,118)	$ 415	$ (18,854)
Effect of preferred stock	(243)	(243)	(730)	(533)
Net income (loss) applicable to common shares	$ 1,735	$ (3,361)	$ (315)	$ (19,387)
Income (loss) per common share:				
Basic	$ 0.07	$ (0.14)	$ (0.01)	$ (0.81)
Diluted	$ 0.07	$ (0.14)	$ (0.01)	$ (0.81)
Weighted average common shares outstanding:				
Basic	24,847	24,161	24,804	23,839
Diluted	25,118	24,161	24,804	23,839

See accompanying notes to summary consolidated financial statements.

CRYOLIFE, INC. AND SUBSIDIARIES
SUMMARY CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS)

	September 30, 2006 (Unaudited)	December 31, 2005
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 4,606	$ 6,631
Marketable securities, at market	2,986	4,968
Restricted securities	565	560
Trade receivables, net	11,754	10,153
Other receivables	4,087	1,934
Deferred preservation costs, net	19,509	13,959
Inventories	5,013	4,609
Prepaid expenses and other assets	3,055	2,387
Total current assets	51,575	45,201
Property and equipment, net	22,396	24,375
Patents, net	4,337	4,877
Other long-term assets	2,156	2,356
TOTAL ASSETS	$ 80,464	$ 76,809
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$ 3,404	$ 2,239
Accrued expenses and other current liabilities	8,441	8,578
Accrued compensation	2,014	1,467
Accrued procurement fees	4,203	3,797
Notes payable	826	—
Derivative liability	225	114
Line of credit	4,504	4,530
Current maturities of capital lease obligations	232	554
Total current liabilities	23,849	21,279
Capital lease obligations, less current maturities	135	—
Other long-term liabilities	4,760	4,909
Deferred income taxes	248	—
Total liabilities	28,992	26,188
Shareholders' Equity:		
Preferred stock (325 issued shares in 2006 and 325 in 2005)	3	3
Common stock (25,792 issued shares in 2006 and 25,582 in 2005)	258	256
Additional paid-in capital	114,758	113,507
Retained deficit	(58,884)	(58,569)
Accumulated other comprehensive income	88	123
Treasury stock at cost (904 shares in 2006 and 892 in 2005)	(4,751)	(4,699)
Total shareholders' equity	51,472	50,621
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 80,464	$ 76,809

See accompanying notes to summary consolidated financial statements.

CRYOLIFE, INC. AND SUBSIDIARIES
SUMMARY CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)

	Nine Months Ended September 30, 2006 (Unaudited)	Nine Months Ended September 30, 2005 (Unaudited)
Net cash from operating activities:		
Net income (loss)	$ 415	$ (18,854)
Adjustments to reconcile net income (loss) to net cash from operating activities:		
Gain on sale of marketable equity securities	—	(5)
Loss on sale or disposal of assets	385	146
Depreciation and amortization	3,646	3,816
Provision for doubtful accounts	72	72
Write-down of deferred preservation costs	1,568	1,298
Other non-cash adjustments	102	(138)
Non-cash compensation	853	166
Change in valuation of derivative	111	372
Changes in operating assets and liabilities:		
Receivables	(3,997)	(754)
Income taxes	(130)	66
Deferred preservation costs and inventories	(7,522)	(5,023)
Prepaid expenses and other assets	(460)	(940)
Accounts payable, accrued expenses, and other liabilities	2,088	4,809
Net cash used in operating activities	(2,869)	(14,969)
Net cash from investing activities:		
Capital expenditures	(1,409)	(664)
Net proceeds from sale of assets	13	—
Other assets	(59)	(173)
Purchases of marketable securities	(12,436)	(21,690)
Sales and maturities of marketable securities	14,562	18,847
Net cash provided by (used in) investing activities	671	(3,680)
Net cash from financing activities:		
Proceeds from debt issuance	585	3,765
Principal payments of debt	(428)	(265)
Payment of obligations under capital leases	(370)	(582)
Proceeds from financing of insurance policies	2,349	2,482
Principal payments on short-term notes payable	(1,523)	(1,613)
Proceeds from exercise of stock options and issuance of common stock	398	308
Payment of preferred stock dividends	(730)	(533)
Proceeds from equity offerings	—	19,098
Purchase of treasury stock	(50)	—
Net cash provided by financing activities	231	22,660
(Decrease) increase in cash and cash equivalents	(1,967)	4,011
Effect of exchange rate changes on cash	(58)	(124)
Cash and cash equivalents, beginning of period	6,631	4,713
Cash and cash equivalents, end of period	$ 4,606	$ 8,600

See accompanying notes to summary consolidated financial statements.

Note 1 – Basis of Presentation

The accompanying unaudited summary consolidated financial statements have been prepared in accordance with (i) accounting principles generally accepted in the United States for interim financial information and (ii) the instructions to Form 10-Q and Rule 10-01 of Regulation S-X of the United States Securities and Exchange Commission ("SEC"). Accordingly, the statements do not include all of the information and disclosures required by accounting principles generally accepted in the United States for a complete presentation of financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Certain prior year cash flow line items have been reclassified to conform to current year presentation. Operating results for the nine months ended September 30, 2006 are not necessarily indicative of the results that may be expected for the year ending December 31, 2006. For further information, refer to the consolidated financial statements and notes thereto included in the CryoLife Form 10-K for the year ended December 31, 2005.

The Company expects that the following will continue to have an adverse impact on earnings and cash flows during 2006:

- The anticipated lower preservation services revenues as compared to preservation revenues prior to the August 13, 2002 U.S. Food and Drug Administration ("FDA") Order, subsequent FDA activities, and related events (discussed in Note 2),
- The high cost of human tissue preservation services as a percent of revenue, as compared to the period prior to the FDA Order, as a result of lower tissue processing volumes and changes in processing methods, which have increased the cost of processing human tissue and decreased yields of implantable tissue per donor,
- An expected use of cash related to the defense and resolution of lawsuits and claims, and
- The legal and professional costs related to ongoing FDA compliance.

The Company believes the following should continue to have a favorable impact on cash flow from operations during the remainder of 2006, although there can be no assurance that these events will occur as and when currently anticipated:

- Expected increases in product revenues over levels experienced in 2005 due to increases in BioGlue® Surgical Adhesive ("BioGlue") list prices implemented in January and July 2006,
- Expected increases in preservation service revenues over levels experienced in 2005 for cardiovascular, vascular, and orthopaedic tissues due to fee increases implemented in January and July 2006, to reflect the higher cost of processing these tissues,
- Anticipated improvements in yields of implantable tissues per donor over the levels experienced in 2005 through process changes and process directives,
- Expected increases in procurement of human tissues for processing over the levels experienced in 2005, and
- Anticipated decreases in cash payments related to the defense and resolution of lawsuits and claims from the levels seen in 2003 through 2005.

The Company believes that the Company's existing cash, cash equivalents, marketable securities, and availability under the Credit Agreement (as defined in Note 6) will enable the Company to meet its liquidity needs through at least September 30, 2007.

The Company's long term liquidity and capital requirements will depend upon numerous factors, including:

- The success of the Company's strategic plan to enhance shareholder value, resulting from the conclusion of its strategic review with the assistance of Piper Jaffray & Co.,
- The success of BioGlue and other products using related technology,
- The Company's ability to increase the level of tissue procurement and demand for its tissue preservation services,
- The Company's ability to reestablish sufficient margins on its tissue preservation services, in the face of increased processing costs, by improving yields and increasing prices,
- The Company's spending levels on its research and development activities, including research studies, to develop and support its service and product pipeline,
- The timing and cost of resolving product liability lawsuits and other claims (see Note 13), and
- To a lesser degree, the Company's success at resolving the issues with the FDA regarding processing of human tissue using the SynerGraft® technology (see Note 2).

If the Company is unable to address these issues and continues to experience negative operating cash flows, the Company anticipates that it may require additional financing or seek to raise additional funds through bank facilities, debt or equity offerings, or other sources of capital to meet liquidity and capital requirements beyond September 30, 2007. Additional funds may not be available when needed or on terms acceptable to the Company, which could have a material adverse effect on the Company's business, financial condition, results of operations, and cash flows.

Note 2 – FDA Order on Human Tissue Preservation and Other FDA Correspondence and Notices

FDA Order

On August 13, 2002 the Company received an order from the Atlanta district office of the FDA regarding the non-valved cardiac, vascular, and orthopaedic tissues processed by the Company since October 3, 2001 (the "FDA Order"). Pursuant to the FDA Order, the Company placed non-valved cardiac, vascular, and orthopaedic tissue subject to the FDA Order (i.e. processed since October 3, 2001) on quality assurance quarantine and recalled the portion of those tissues that had been distributed but not implanted. In addition the Company ceased processing non-valved cardiac, vascular, and orthopaedic tissues.

The FDA allowed non-valved cardiac and vascular tissues covered by the recall to be distributed beginning in late September 2002, subject to specified conditions. The Company changed its processing procedures and took other actions intended to address the FDA's concerns, and now processes non-valved cardiac, vascular, and orthopaedic tissues.

Other FDA Correspondence and Notices

July 2005 483
An FDA Form 483 Notice of Observations ("483") was issued in August 2005 in connection with the FDA inspections of the Company's facilities in July 2005 ("July 2005 483"). The Company responded to the July 2005 483 in August 2005, in September 2005, and in October 2005. In April 2006 the FDA responded on the adequacy of the Company's responses. The Company responded to the FDA in June 2006. In response to the July 2005 483 the

Company has implemented new and revised existing systems and procedures. The FDA may require the Company to implement additional corrective actions, perform additional validation testing, or supply additional information related to the inspections, and has the authority to take other actions, which may be more burdensome. The Company has cooperated and will continue to cooperate with the FDA to review process improvements and address any outstanding observations.

SynerGraft

On February 20, 2003 the Company received a letter from the FDA stating that a 510(k) premarket notification should be filed for the Company's SynerGraft processed human cardiac tissues ("CryoValve® SG") and that premarket approval marketing authorization should be obtained for the Company's SynerGraft processed human vascular tissues ("CryoVein® SG") when marketed or labeled as an arteriovenous ("A-V") access graft. The agency's position is that use of the SynerGraft technology in the processing of allograft heart valves represents a modification to the Company's legally marketed CryoValve allograft and that vascular allografts labeled for use as A-V access grafts are medical devices that require premarket approval.

On November 3, 2003 the Company filed a 510(k) premarket notification with the FDA for the CryoValve SG. On February 4, 2004 the Company received a letter from the FDA requesting additional information. On August 24, 2004 the Company submitted an amendment to its original 510(k) submission providing clarification and additional information. The FDA requested further additional information in November 2004. On June 8, 2005 CryoLife responded to some of these additional requests. CryoLife also has initiated an appeal of other requests through administrative procedures. The FDA requested further additional information in January 2006. Since March 2006 the Company has had discussions with the FDA to address the outstanding requests for additional information and seek clearance for the CryoValve SG pulmonary valve. On July 21, 2006 the Company submitted an amendment to its 510(k) application addressing information requested by the FDA. The Company is currently undertaking further clinical and preclinical evaluations in response to requests by the FDA that will be included in an additional 510(k) amendment. The FDA may still require that additional studies be undertaken. Clearance of the 510(k) premarket notification with the FDA will be required before the Company can resume distribution of SynerGraft processed CryoValve SG.

On December 8, 2003 the Company received a letter from the FDA stating that it was the agency's position that cardiovascular tissues processed with the SynerGraft technology should be regulated as medical devices. On September 14, 2004 the Company met with the FDA to discuss the data to be used to support a formal Request for Designation ("RFD") filing for SynerGraft processed non-valved cardiac and vascular tissue, including the CryoVein SG. An RFD submission establishes the regulatory status of the tissue. The Company submitted the RFD on October 5, 2004. The FDA affirmed its original decision in letters received in December 2004. That decision was subject to an administrative appeal. On October 20, 2005 CryoLife was informed that the FDA had denied the appeal and that CryoLife will be unable to distribute CryoVein tissues with the SynerGraft technology until further submissions and FDA approvals are granted. The Company is evaluating whether it will file and seek approvals for CryoVein SG or discontinue the CryoVein SG.

In 2003 the Company suspended the use of the SynerGraft technology in the processing of allograft tissue and the distribution of tissues on hand previously processed with the SynerGraft technology until the regulatory issues associated with these tissues are resolved. Additionally, the Company discontinued labeling its vascular grafts for use as A-V access grafts. Until such time as the issues surrounding SynerGraft are resolved, the Company is employing its traditional processing methods on these tissues. As of September 30, 2006 the Company had no deferred preservation costs related to SynerGraft processed tissues on its Summary Consolidated Balance Sheets.

Note 3 – Cash Equivalents and Marketable Securities

The Company maintains cash equivalents and investments in several large, well-capitalized financial institutions, and the Company's policy excludes investment in any securities rated less than "investment-grade" by national rating services. Management determines the appropriate classification of its marketable securities at the time of purchase and reevaluates such designations quarterly.

Debt securities are classified as held-to-maturity when the Company has the positive intent and ability to hold the securities to maturity. Held-to-maturity securities are stated at amortized cost. Trading securities are securities that are acquired principally for the purpose of generating a profit from short-term fluctuations in price. Trading securities are stated at their fair values, with the realized and unrealized gains and losses, interest, and dividends included in investment income. Debt securities not classified as held-to-maturity or trading and marketable equity securities not classified as trading are classified as available-for-sale. Available-for-sale securities are stated at their fair values, with the unrealized gains and losses, net of applicable taxes, reported in a separate component of shareholders' equity. Interest, dividends, realized gains and losses, and declines in value judged to be other than temporary are included in investment income. The cost of securities sold is based on the specific identification method.

As of September 30, 2006 $3.0 million of marketable securities were designated as available-for-sale and $565,000 were designated as held-to-maturity. As of December 31, 2005 $5.0 million of marketable securities were designated as available-for-sale and $560,000 were designated as held-to-maturity. The held-to-maturity securities were designated as such due to a contractual commitment to hold the securities as pledged collateral relating to one of the Company's product liability insurance policies, and, therefore, they are reported as restricted securities on the September 30, 2006 and December 31, 2005 Summary Consolidated Balance Sheets.

The following is a summary of cash equivalents and marketable securities (in thousands):

September 30, 2006	Cost Basis	Unrealized Holding Gains (Losses)	Estimated Market Value
Cash equivalents:			
Money market funds	$ 3,837	$ —	$ 3,837
Marketable securities:			
Government entity sponsored debt securities	$ 2,985	$ 1	$ 2,986
Total marketable securities	$ 2,985	$ 1	$ 2,986
Restricted securities:			
Government entity sponsored debt securities	$ 565	$ —	$ 565

December 31, 2005	Cost Basis	Unrealized Holding Gains (Losses)	Estimated Market Value
Cash equivalents:			
Money market funds	$ 5,595	$ —	$ 5,595
Marketable securities:			
Government entity sponsored debt securities	$ 2,980	$ (2)	$ 2,978
US Treasury debt securities	1,990	—	1,990
Total marketable securities	$ 4,970	$ (2)	$ 4,968
Restricted securities:			
Government entity sponsored debt securities	$ 560	$ —	$ 560

There were no gross realized gains or losses on sales of available-for-sale securities for both the three and nine months ended September 30, 2006 and 2005. Differences between cost and market listed above, consisting of a net unrealized holding gain of $1,000 less deferred taxes of zero at September 30, 2006, and a net unrealized holding loss of $2,000 less deferred taxes of zero at December 31, 2005, are included as a separate component of other comprehensive income in the shareholders' equity section of the Summary Consolidated Balance Sheets.

At September 30, 2006 and December 31, 2005 all of the Company's marketable securities had a maturity date within 90 days.

Note 4 – Inventories

Inventories are comprised of the following (in thousands):

	September 30, 2006 (Unaudited)	December 31, 2005
Raw materials	$ 2,935	$ 3,083
Work-in-process	374	415
Finished goods	1,704	1,111
Total inventories	$ 5,013	$ 4,609

Note 5 – Income Taxes

Deferred income taxes reflect the net tax effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and tax return purposes. The Company generated deferred tax assets beginning in 2002 primarily as a result of write-downs of deferred preservation costs, accruals for product liability claims, and operating losses. These write-downs, accruals, and losses reflect reductions in revenues and additional professional fees, as a result of the FDA Order, subsequent FDA activities, and related events. The Company assesses the recoverability of its deferred tax assets, on an annual basis and on an interim basis, as necessary, when the Company experiences changes that could materially affect its determination of the recoverability of its deferred tax assets. Management provides a valuation allowance when, as a result of this analysis, management believes it is more likely than not that its deferred tax assets will not be realized. In assessing the recoverability of its deferred tax assets at December 31, 2005 the Company reviewed its historical operating results, including the reasons for its operating losses, uncertainties regarding projected future operating results, and the uncertainty of the outcome of litigation. Based on the results of this analysis, at December 31, 2005 the Company determined that it was more likely than not that the Company's deferred tax assets would not be realized. Therefore, as of December 31, 2005 the Company had a total of $26.4 million in valuation allowances against deferred tax assets and a net deferred tax asset balance of zero.

Based on the Company's results of operations for the nine months ended September 30, 2006, the Company does not expect to generate material deferred tax assets or utilize material amounts of its net operating loss carryforwards during the year ended December 31, 2006. For the nine months ended September 30, 2006 the Company did not experience any changes that would materially affect the Company's prior determination of the recoverability of its deferred tax assets. As of September 30, 2006 the Company had a total of $26.4 million in valuation allowances against deferred tax assets and a net deferred tax liability of $248,000 related to taxes in a foreign jurisdiction. The realizability of the Company's deferred tax assets could be limited in future periods as mandated by Internal Revenue Service Section 382.

As of September 30, 2006 the Company had income tax receivables related to federal income tax losses from the years ended December 31, 2005 and 2004 that can be carried back to prior years to offset income taxes paid and should result in approximately $453,000 in refunds to the Company during 2006.

Note 6 – Debt

On February 8, 2005 CryoLife and its subsidiaries entered into a credit agreement with Wells Fargo Foothill, Inc. as lender (the "Credit Agreement"). The Credit Agreement provides for a revolving credit facility in an aggregate amount equal to the lesser of $15.0 million (including a letter of credit subfacility of up to an aggregate of $2.0 million) or a borrowing base determined in accordance with the terms of the Credit Agreement. Generally, the borrowing base is 20% of the appraised value of the business of CryoLife, reduced by specified lender reserves. The Credit Agreement places limitations on the amount that the Company may borrow, and includes various affirmative and negative covenants, including financial covenants such as a requirement that CryoLife either (i) maintain quarterly a minimum aggregate borrowing availability under the Credit Agreement, less certain payables incurred outside the Company's historical practices, plus unrestricted cash and cash equivalents, as defined ("Availability"), of at least $12.5 million or (ii) achieve as of each quarter end a minimum level of earnings before extraordinary gains, interest, taxes, depreciation, and amortization ("EBITDA"), BioGlue gross margins of at least 70% for the preceding twelve months, as well as Availability of at least $5.0 million. While the Company currently expects that its aggregate borrowing capacity under the Credit Agreement will equal $15.0 million, there can be no assurance that the capacity will remain at this level. The Credit Agreement also includes customary conditions on incurring new indebtedness and limitations on cash dividends. Cash dividends on any class of capital stock are prohibited, provided that cash dividends on preferred stock may be paid so long as the Company maintains $7.5 million, in the aggregate, of cash, cash equivalents, and borrowing capacity, as defined. There is no restriction on the payment of stock dividends. Commitment fees are paid based on the unused portion of the facility. The Credit Agreement expires on February 7, 2008, at which time the outstanding principal balance will be due. Due to the terms of the Credit Agreement and due to the net losses and negative cash flows experienced by the Company since the FDA Order, the Company has classified amounts due under the Credit Agreement as short-term debt on the September, 2006 and December 31, 2005 Summary Consolidated Balance Sheets in accordance with the provisions of FASB Technical Bulletin No. 79-3 (As Amended).

Amounts borrowed under the Credit Agreement are secured by substantially all of the tangible and intangible assets of CryoLife and its subsidiaries and bear interest at the bank's prime rate plus 1%, which was 9.25% as of September 30, 2006. As of September 30, 2006 the outstanding balance of the Credit Agreement was $4.5 million and the remaining borrowing availability was $10.5 million.

The Company routinely enters into agreements to finance insurance premiums for periods not to exceed the terms of the related insurance policies. In the quarter ended June 30, 2005 the Company entered into two agreements to finance approximately $1.7 million and $761,000 in insurance premiums associated with the yearly renewal of certain Company insurance policies. The amounts financed accrued interest at 4.98% and 5.01%, respectively, and were payable in equal monthly payments over a nine month period and an eight month period, respectively. As of September 30, 2006 the outstanding balance under the agreements was zero.

In the second quarter of 2006 the Company entered into two agreements to finance approximately $1.6 million and $715,000 in insurance premiums associated with the yearly renewal of certain of the Company's insurance policies. The amounts financed accrue interest at 6.71% and 6.7%, respectively, and are payable in equal monthly payments over a nine month and an eight month period, respectively. As of September 30, 2006 the aggregate outstanding balance under the agreements was $826,000.

In September 2006 the Company's European subsidiary obtained a pre-approved credit facility with a bank in the United Kingdom for the financing of vehicles. This credit facility pre-approves the Company to enter into leases to finance vehicles, for which terms and interest rates are set for each individual lease agreement. The Company has accounted for the leases entered into under this credit facility as operating leases. The credit facility allows the Company to have a total exposure on outstanding leases, as defined by the bank, of £180,000 (or approximately $339,000 as of September 30, 2006). Per the bank, the Company had a total exposure of approximately £105,000 or $198,000 as of September 30, 2006, and the Company's total payment obligations related to these outstanding leases was $123,000 as of September 30, 2006.

Note 7 – Convertible Preferred Stock

On December 17, 2004 the Company announced that it had filed a shelf registration statement on Form S-3 with the SEC covering the sale from time to time of up to $50 million of its common stock, preferred stock, depositary shares, or any combination of these securities for its own account in one or more offerings.

On March 18 and April 19, 2005 the Company completed a public offering of 417,000 shares of 6% convertible preferred stock (the "Preferred Stock") at a price to the public of $50.00 per share. Net proceeds from the offering, after deducting underwriting discounts and offering-related expenses, totaled approximately $19.1 million.

Dividends on the Preferred Stock are cumulative from the date of original issue at the annual rate of 6% of the liquidation preference of the Preferred Stock, payable quarterly on the first day of January, April, July, and October, commencing July 1, 2005. Any dividends must be declared by the Company's board of directors and must come from funds that are legally available for dividend payments. On September 7, 2006 the Company declared a dividend of $0.75 per share on its Preferred Stock. The dividend of approximately $243,000 was paid on October 2, 2006 to shareholders of record on September 22, 2006.

The Preferred Stock is convertible at the option of the holder at any time into the Company's common stock at a conversion rate of approximately 6.2189 shares of common stock for each share of Preferred Stock, based on an initial conversion price of $8.04 per share of common stock. The initial conversion price is subject to adjustment in certain events. The Company reserved 4,600,000 shares of common stock for issuance upon conversion. Through September 30, 2006 holders had voluntarily converted 92,000 shares of Preferred Stock into 575,000 shares of common stock.

The Company may automatically convert the Preferred Stock into common stock if the closing price of the Company's common stock has exceeded $12.06, which is 150% of the conversion price of the Preferred Stock, for at least 20 trading days during any 30-day trading period, ending within five trading days prior to notice of automatic conversion.

If the Company elects to automatically convert, or the holder elects to voluntarily convert, some or all of the Preferred Stock into common stock prior to April 1, 2008, the Company will make an additional payment on the Preferred Stock equal to the aggregate amount of dividends that would have been payable on the Preferred Stock through and including April 1, 2008, less any dividends already paid on the Preferred Stock, the "Dividend Make-Whole Payment". The Dividend Make-Whole Payment is payable in cash or, at the Company's option, in shares of the Company's common stock, or a combination of cash and shares of common stock. Through September 30, 2006 the Company had issued 119,000 shares of common stock to converting holders in satisfaction of this additional payment.

The Preferred Stock has a liquidation preference of $50.00 per share, plus accrued and unpaid dividends. The liquidation preference of the Preferred Stock was approximately $16.2 million as of September 30, 2006, before the payment of the October 2006 dividend.

The Company may elect to redeem the Preferred Stock, in whole or in part, at declining redemption prices on or after April 7, 2008.

The Preferred Stock has no maturity date and no voting rights prior to conversion into common stock, except under limited circumstances and as required by law.

Note 8 – Derivative

In accordance with Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"), the Company is required to separate and account for the Dividend Make-Whole Payment feature of its Preferred Stock as an embedded derivative, (the "Derivative"). As an embedded derivative instrument, the Dividend Make-Whole Payment feature must be measured at fair value and reflected as a current liability on the Company's Summary Consolidated Balance Sheets. Changes in the fair value of the Derivative are recognized in the line item change in valuation of derivative as a non-operating income/expense on the Company's Summary Consolidated Statements of Operations. The Company determined the fair value of the Derivative to be $1.0 million on March 18, 2005, the date of issuance. The Company determined the fair value of the Derivative related to the issuance of additional Preferred Stock upon exercise of the underwriter's over allotment option to be $32,000 on April 19, 2005, the date of issuance. The proceeds from the Preferred Stock as recorded on the Summary Consolidated Balance Sheets were reduced by these amounts, which were allocated to the derivative liability.

Due to the quarterly revaluation of the derivative liability, the Company recorded other expense of $44,000 and $111,000 for the three and nine months ended September 30, 2006, respectively. At September 30, 2006 the derivative liability was valued at $225,000.

Note 9 – Comprehensive Income (Loss)

The following is a summary of comprehensive income (loss) (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
	(Unaudited)		(Unaudited)	
Net income (loss)	$ 1,978	$ (3,118)	$ 415	$ (18,854)
Unrealized gain (loss) on investments	1	(13)	3	(37)
Translation adjustment	(16)	20	(38)	(129)
Comprehensive income (loss)	$ 1,963	$ (3,111)	$ 380	$ (19,020)

The tax effect on the change in unrealized gain (loss) on investments is zero for both the three months ended September 30, 2006 and 2005. The tax effect on the change in unrealized gain (loss) on investments is zero and $11,000 for the nine months ended September 30, 2006 and 2005, respectively. The tax effect on the translation adjustment is zero for each period presented.

Components of accumulated other comprehensive income consist of the following, net of tax (in thousands):

	September 30, 2006 (Unaudited)	December 31, 2005
Unrealized gain (loss) on investments	$ 1	$ (2)
Translation adjustment	87	125
Total accumulated other comprehensive income	$ 88	$ 123

Note 10 – Income (Loss) per Common Share

The following table sets forth the computation of basic and diluted income (loss) per common share (in thousands, except per share data). The net income (loss) for the three and nine months ended September 30, 2006 and 2005 is adjusted by the effect of the Company's cumulative, convertible Preferred Stock to arrive at net income (loss) applicable to common shares in accordance with SFAS No. 128, "Earnings Per Share" ("SFAS 128"). The Company also considers the effect of its Preferred Stock, as discussed in Note 7, the Derivative, as discussed in Note 8, and common stock options, as discussed in Note 11, in the calculation of diluted weighted-average shares below.

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
	(Unaudited)		(Unaudited)	
Numerator for basic income (loss) per common share:				
Net income (loss)	$ 1,978	$ (3,118)	$ 415	$ (18,854)
Effect of preferred stock [a]	(243)	(243)	(730)	(533)
Net income (loss) applicable to common shares	$ 1,735	$ (3,361)	$ (315)	$ (19,387)
Denominator for basic income (loss) per common share:				
Basic weighted-average shares	24,847	24,161	24,804	23,839
Basic income (loss) per common share	$ 0.07	$ (0.14)	$ (0.01)	$ (0.81)

	Three Months Ended September 30, 2006	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005
	(Unaudited)		(Unaudited)	
Numerator for diluted income (loss) per common share:				
Net income (loss)	$ 1,978	$ (3,118)	$ 415	$ (18,854)
Effect of preferred stock(b)	(243)	(243)	(730)	(533)
Effect of stock options (c)	—	—	—	—
Net income (loss) applicable to common shares	$ 1,735	$ (3,361)	$ (315)	$ (19,387)
Denominator for diluted income (loss) per common share:				
Basic weighted-average shares	24,847	24,161	24,804	23,839
Effect of dilutive convertible preferred stock (b)	—	—	—	—
Effect of dilutive stock options (c)	271	—	—	—
Adjusted weighted-average shares	25,118	24,161	24,804	23,839
Diluted income (loss) per common share	$ 0.07	$ (0.14)	$ (0.01)	$ (0.81)

(a) The amount of the accumulated dividend on Preferred Stock reduced the net income applicable to common shares by $243,000 for the three months ended September 30, 2006. The amount of the accumulated dividend on Preferred Stock offset the Company's net income and resulted in a net loss applicable to common shares with a total unfavorable effect of $730,000 for the nine months ended September 30, 2006. The amount of the accumulated dividend on Preferred Stock increased the net loss applicable to common shares by $243,000 and $533,000 for the three and nine months ended September 30, 2005, respectively.

(b) The amount of the accumulated dividend on Preferred Stock reduced the net income applicable to common shares by $243,000 for the three months ended September 30, 2006. The amount of the accumulated dividend on Preferred Stock offset the Company's net income and resulted in a net loss applicable to common shares with a total unfavorable effect of $730,000 for the nine months ended September 30, 2006. The adjustment for the quarterly revaluation of the derivative liability, would have instead increased the net income applicable to common shareholders by $44,000 and $111,000 for the three and nine months ended September 30, 2006, respectively, and the common shares that would be issued to shareholders upon conversion of the remaining Preferred Stock and in payment of the remaining Dividend Make-Whole Payment would have increased the weighted-average shares by 2.3 million for both the three and nine months ended September 30, 2006. These adjustments were excluded from the calculation above, as they were anti-dilutive pursuant to the provisions of SFAS 128.

The amount of the accumulated dividend on the Preferred Stock increased the net loss applicable to common shares by $243,000 and $533,000 for the three and nine months ended September 30, 2005, respectively. The adjustment for the Dividend Make-Whole Payment on preferred shares converted during the period and the quarterly revaluation of the derivative liability would have increased the net loss applicable to common shareholders by $412,000 for the three months ended September 30, 2005 and decreased the net loss applicable to common shareholders by $372,000 for the nine months ended September 30, 2005, and the common shares that would be issued to shareholders upon conversion of the remaining Preferred Stock and in payment of the remaining Dividend Make-Whole Payment would have increased the weighted-average shares by 2.4 million and 1.9 million for the three and nine months ended September 30, 2005, respectively. These adjustments were excluded from the calculation above, as they were anti-dilutive pursuant to the provisions of SFAS 128.

(c) Outstanding options to purchase the Company's common stock resulted in 271,000 additional dilutive common shares for the three months ended September 30, 2006. Outstanding options to purchase the Company's common stock that would have resulted in 211,000 additional dilutive shares for the nine months ended September 30, 2006 were excluded from the calculation, as they were anti-dilutive pursuant to the provisions of SFAS 128.

Outstanding options to purchase the Company's common stock that would have resulted in 387,000 and 382,000 additional dilutive common shares, respectively for the three and nine months ended September 30, 2005, were excluded from the calculation, as these items were anti-dilutive pursuant to the provisions of SFAS 128.

In future periods the basic and diluted earnings (loss) per common share are expected to be affected by the declaration of dividends on Preferred Stock, the conversion of Preferred Stock, fluctuations in the fair value of the Company's common stock, issuance of additional stock options, and changes in the valuation of the Derivative.

Note 11 – Stock Compensation

In August 2006 the Company's Board of Directors authorized the grant of stock to its non-employee directors. The stock grants of 2,500 shares of common stock per non-employee director were valued at a total of $109,000 based on the stock price of $5.47 on the date of grant. The value of this stock grant will be recorded as director compensation over the 12-month vesting period. The Company also made cash payments totaling $38,000 to the non-employee directors to partially offset each individual's income tax liability as a result of the stock grant. The Company recorded $47,000 in expense related to these stock grants during the third quarter of 2006.

In February 2006 the Company's Board of Directors authorized the grant of stock to recognize the performance of certain Company executives. The stock grants totaled 34,000 shares of common stock, which were valued at $145,000 based on the stock price of $4.25 on the date of grant. The Company purchased $50,000 of Company stock from employees, based on the closing price on the New York Stock Exchange on the day the stock was transferred to the Company, to pay employee federal and state withholding taxes related to these stock grants. The Company recorded $145,000 in compensation expense related to these stock grants during the first quarter of 2006.

The Company has stock option and stock incentive plans that provide for grants of shares to employees and grants of options to employees and directors to purchase shares of the Company's common stock at exercise prices generally equal to the fair values of such stock at the dates of grant. The Company maintains a shareholder approved Employee Stock Purchase Plan (the "ESPP") for the benefit of its employees. The ESPP allows eligible employees the right to purchase common stock on a quarterly basis at the lower of 85% of the market price at the beginning or end of each three-month offering period. Pursuant to the adoption of SFAS 123 Revised "Share-Based Payment" ("SFAS 123R") both the Company's 15% discount on ESPP stock purchases and the lookback portion of ESPP stock purchases are considered components of stock compensation and must be expensed in the Company's financial statements. The lookback portion of the Company's ESPP constitutes an option and, as such, the expense is determined by performing a valuation as discussed below.

The Company adopted SFAS 123R as amended by SEC Rule 2005-57 "Commission Amends Compliance Dates For FASB Statement No. 123R on Employee Stock Options" for the period beginning October 1, 2005. SFAS 123R requires companies to recognize the cost of all share-based payments in the financial statements using a fair-value based measurement method. SFAS 123R applies to new awards and to awards modified, repurchased, or cancelled after the implementation date, as well as to the unvested portion of awards outstanding as of the implementation date. The Company uses the Black-Scholes model to value its stock option grants under SFAS 123R and expenses the related compensation cost using the straight-line method over the vesting period. The fair value of the Company's ESPP options is also determined using the Black-Scholes model and is expensed quarterly at the end of the purchase period, as the option is fully vested at that time. The fair value of stock options is determined on the grant date using assumptions for the expected term, expected volatility, dividend yield, and the risk free interest rate. The term assumption is primarily based on the contractual term of the option and historic data related to exercise and post-vesting cancellation history experienced by the Company, adjusted based on management's expectations of future results. The expected term is determined separately for options issued to the Company's directors and to employees. The Company's anticipated volatility level is primarily based on the historic volatility of the Company's common stock, adjusted to remove the effects of certain periods of unusual volatility not expected to recur, and adjusted based on management's expectations of future volatility, for the life of the option or option group. The Company's model includes a zero dividend yield assumption, as the Company has not historically paid nor does it anticipate paying dividends on its common stock. The risk free interest rate is based on recent U.S. Treasury note auction results with a similar life to that of the option. The Company's model does not include a discount for post-vesting restrictions, as the Company has not issued awards with such restrictions. The period expense is then determined based on the valuation of the options, and at that time an estimated forfeiture rate is used to reduce the expense recorded. The Company's estimate of pre-vesting forfeitures is primarily based on the recent historical experience of the Company, and is adjusted to reflect actual forfeitures at each vesting date.

The following weighted-average assumptions were used to determine the fair value of options under SFAS 123R:

	Three Months Ended September 30, 2006		Nine Months Ended September 30, 2006	
	Stock Options	ESPP Options	Stock Options	ESPP Options
	(Unaudited)		(Unaudited)	
Expected dividend yield	0%	0%	0%	0%
Expected stock price volatility	.650	.315	.650	.441
Risk-free interest rate	5.00%	4.69%	4.80%	4.34%
Expected life of options	4.0 Years	.24 Years	4.1 Years	.24 Years

The Company's expense for stock options and the Company's ESPP was approximately $156,000 and $698,000, for the three and nine months ended September 30, 2006, respectively, of which approximately $19,000 and $59,000, respectively, was capitalized into the Company's deferred preservation and inventory costs. These amounts were recorded as compensation expense and were subject to the Company's normal allocation of expenses to inventory and deferred preservation costs. The Company did not recognize a tax benefit, or a related operating cash outflow and financing cash inflow, related to the additional compensation expense recorded in the three months and nine months ended September 30, 2006, as the Company is currently maintaining a full valuation allowance on its deferred tax assets. See Note 5 for additional discussions of the Company's income tax valuation.

As of September 30, 2006 there was approximately $2.3 million in total unrecognized compensation costs related to nonvested share-based compensation arrangements, before considering the effect of expected forfeitures. This expense is expected to be recognized over a weighted average period of 2.2 years.

In periods prior to October 1, 2005 the Company elected to follow Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" and related interpretations ("APB 25") in accounting for its employee stock options. Under APB 25, because the exercise price of the Company's employee stock options equaled the market price of the underlying stock on the date of the grant, no compensation expense was recognized. In accordance with APB 25 the compensation recorded for employee stock grants was equal to the value of the grant on the measurement date, the date of the grant, as determined by the closing price of the Company's common stock on that date. Some employee stock grants vested in future periods based on a requirement of continued service to the Company. For these stock grants the amount of the stock grant was recorded as deferred compensation in the equity section of the Company's Summary Consolidated Balance Sheets, and was expensed on a straight-line basis over the vesting period.

Pro forma information regarding net loss and loss per share was required by SFAS 123 "Accounting for Stock-Based Compensation" ("SFAS 123") for options accounted for under ABP 25. SFAS 123 required that option valuation information be disclosed as if the Company accounted for its employee stock options granted under the fair value method of that statement. The fair values for these options were estimated at the dates of grant using a Black-Scholes option-pricing model.

The following weighted-average assumptions were used:

	Three Months Ended September 30, 2005 (Unaudited)	Nine Months Ended September 30, 2005 (Unaudited)
Expected dividend yield	0%	0%
Expected stock price volatility	.340	.519
Risk-free interest rate	3.17%	3.36%
Expected life of options	0.3 Years	3.2 Years

For purposes of pro forma disclosures, the estimated fair values of the options are amortized to expense over the options' vesting periods on a ratable basis. The Company's pro forma information follows (in thousands, except per share data):

	Three Months Ended September 30, 2005		Nine Months Ended September 30, 2005	
	Basic	Diluted	Basic	Diluted
	(Unaudited)		(Unaudited)	
Basic net loss applicable to commonshares – as reported	$ (3,361)	$ (3,361)	$ (19,387)	$ (19,387)
Stock-based employee compensation:				
Add expense included in net loss	51	51	166	166
Deduct expense determined under the fair value based method for all awards	(1,634)	(1,634)	(3,253)	(3,253)
Basic net loss applicable to common shares – pro forma	$ (4,944)	$ (4,944)	$ (22,474)	$ (22,474)
Basic weighted-average shares	24,161	24,161	23,839	23,839
Basic loss per common share:				
As reported	$ (0.14)	$ (0.14)	$ (0.81)	$ (0.81)
Pro forma	$ (0.20)	$ (0.20)	$ (0.94)	$ (0.94)

Note 12 – Segment Information

The Company has two reportable segments organized according to its products and services: Implantable Medical Devices and Human Tissue Preservation Services.

The Implantable Medical Devices segment includes external revenue from product sales of BioGlue and bioprosthetic devices, including stentless porcine heart valves and SynerGraft processed bovine vascular grafts. The Human Tissue Preservation Services segment includes external services revenue from cryopreservation of cardiac, vascular, and orthopaedic allograft tissues. There are no intersegment revenues.

The primary measure of segment performance, as viewed by the Company's management, is segment gross margin, or net external revenues less cost of products and preservation services. The Company does not segregate assets by segment, therefore, asset information is excluded from the segment disclosures below.

The following table summarizes revenues, cost of products and preservation services, and gross margins for the Company's operating segments (in thousands):

	Three Months Ended September 30, 2006	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005
	(Unaudited)		(Unaudited)	
Revenue:				
Implantable medical devices	$ 9,687	$ 9,129	$ 30,308	$ 29,102
Human tissue preservation services	10,319	7,329	29,839	22,219
All other (a)	12	—	74	—
	20,018	16,458	60,221	51,321
Cost of Products and Preservation Services:				
Implantable medical devices	1,576	1,940	5,581	6,135
Human tissue preservation services	6,954	6,015	20,751	17,984
All other (a)	—	—	—	—
	8,530	7,955	26,332	24,119
Gross Margin:				
Implantable medical devices	8,111	7,189	24,727	22,967
Human tissue preservation services	3,365	1,314	9,088	4,235
All other (a)	12	—	74	—
	$ 11,488	$ 8,503	$ 33,889	$ 27,202

(a) The "All other" designation includes grant revenue.

The following table summarizes net revenues by product (in thousands):

	Three Months Ended September 30, 2006	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2006	Nine Months Ended September 30, 2005
	(Unaudited)		(Unaudited)	
Products:				
BioGlue	$ 9,444	$ 8,917	$ 29,534	$ 28,340
Bioprosthetic devices	243	212	774	762
Total products	9,687	9,129	30,308	29,102
Human tissue preservation services:				
Cardiovascular tissue	4,189	3,139	11,550	10,407
Vascular tissue	4,468	2,825	13,066	8,281
Orthopaedic tissue	1,662	1,365	5,223	3,531
Total preservation services	10,319	7,329	29,839	22,219
Research grants	12	—	74	—
	$ 20,018	$ 16,458	$ 60,221	$ 51,321

Note 13 – Commitments and Contingencies

Product Liability Claims

In the normal course of business as a medical device and services company, the Company has product liability complaints filed against it. As of November 1, 2006 the Company was aware of four pending product liability lawsuits. The lawsuits are currently in the pre-discovery or discovery stages. Of these lawsuits, two allege product liability claims arising out of the Company's orthopaedic tissue services and two allege product liability claims arising out of the Company's allograft heart valve tissue services.

Two of the outstanding product liability lawsuits against the Company are not covered by insurance policies, as the claimed loss date was prior to the effective coverage date for the insurance policy. Additional uninsured claims may be filed in the future. Other product liability claims have been asserted against the Company that have not resulted in lawsuits as of November 1, 2006. The Company is monitoring these claims.

The Company performed an analysis as of September 30, 2006 of the settled but unpaid claims and the four pending product liability lawsuits based on settlement negotiations to date and advice from counsel. As of September 30, 2006 the Company had accrued a total of approximately $414,000 for settled but unpaid claims and pending product liability lawsuits. The $414,000 accrual is included as a component of accrued expenses and other current liabilities on the September 30, 2006 Summary Consolidated Balance Sheet. This amount represents the Company's estimate of the probable loss related to settled but unpaid claims and one of the four pending product liability lawsuits. The Company has not recorded an accrual for the remaining three product liability claims or any asserted lawsuits that have not resulted in a lawsuit because management has concluded that either a loss is remote or that, although a loss is reasonably possible or probable, a reasonable estimate of that loss or the range of losses cannot be made at this time. As of December 31, 2005 the Company had accrued a total of approximately $1.5 million for settled but unpaid claims and pending product liability lawsuits and recorded $244,000 representing amounts to be recovered from the Company's insurance carriers. The $1.5 million accrual is included as a component of accrued expenses and other current liabilities on the December 31, 2005 Summary Consolidated Balance Sheet.

If the Company is unable to settle one or more of the product liability lawsuits in which the Company is a defendant, and if any such lawsuit should be tried with a substantial verdict rendered in favor of the plaintiff(s), there can be no assurance that such verdict(s) would not exceed the Company's available liquid assets. Additionally, the Company does not have a reasonable method for estimating the amount of compensatory or punitive damages that could be assessed by a trial jury with respect to any lawsuit that it is unable to settle prior to trial, and the Company's product liability insurance policies do not include coverage for any punitive damages. Failure by the Company to resolve the outstanding product liability claims within its ability to pay would have a material adverse effect on the financial position, results of operations, and cash flows of the Company.

On April 1, 2006 the Company bound coverage for the 2006/2007 insurance policy year. This policy is a four-year claims-made insurance policy, i.e. claims incurred during the period April 1, 2003 through March 31, 2007 and reported during the period April 1, 2006 through March 31, 2007 are covered by this policy. Claims incurred prior to April 1, 2003 that have not been reported are uninsured.

The Company maintains claims-made insurance policies to mitigate its financial exposure to product liability claims. Claims-made insurance policies generally cover only those asserted claims and incidents that are reported to the insurance carrier while the policy is in effect. Thus, a claims-made policy does not generally represent a transfer of risk for claims and incidents that have been incurred but not reported to the insurance carrier during the policy period. The Company periodically evaluates its exposure to unreported product liability claims and records accruals as necessary for the estimated cost of unreported claims related to services performed and products used. In July 2006 the Company retained an independent actuarial firm to prepare revised estimates of the unreported claims as of June 30, 2006 and December 31, 2006. The independent firm estimated the unreported product loss liability using a frequency-severity approach, whereby projected losses were calculated by multiplying the estimated number of claims by the estimated average cost per claim. The estimated claims were calculated based on the reported claim development method and the Bornhuetter-Ferguson method using a blend of the Company's historical claim experience and industry data. The estimated cost per claim was calculated using a lognormal claims model blending the Company's historical average cost per claim with industry claims data. The independent actuarial firm used a number of assumptions in order to estimate the unreported product loss liability, including:

- A ceiling of $5.0 million was selected for actuarial purposes in determining the liability per claim given the uncertainty in projecting claim losses in excess of $5.0 million,

- The future claim reporting lag time would be a blend of the Company's experiences and industry data,

- The frequency of unreported claims for accident years 2001 through 2006 would be lower than the Company's experience since the 2002/2003 policy year, but higher than the Company's historical claim frequency prior to the 2002/2003 policy year,

- The average cost per claim would be lower than the Company's experience since the 2002/2003 policy year, but higher than the Company's historical cost per claim prior to the 2002/2003 policy year,

- The average cost per BioGlue claim would be consistent with the Company's overall historical exposures until adequate historical data is available on this product line, and

- The number of BioGlue claims per million dollars of BioGlue revenue would be 35% lower than non-BioGlue claims per million dollars of revenue. The 35% factor was selected based on BioGlue claims experience to-date and consultation with the actuary.

The Company believes that these assumptions provide a reasonable basis for the calculation of the unreported product liability loss, but the accuracy of the actuarial firm's estimates is limited by the general uncertainty that exists for any estimate of future activity due to uncertainties surrounding the assumptions used and due to Company specific conditions, including the FDA Order, the Company's recent levels of litigation activity, the Company's low volume of pre-FDA Order historical claims, and the scarcity of industry data directly relevant to the Company's business activities. Due to these factors, actual results may differ significantly from the assumptions used and amounts accrued.

Based on the actuarial valuation performed in July 2006 as of June 30, 2006 and December 31, 2006, the Company estimated that its liability for unreported product liability claims was $6.7 million and would be $7.5 million as of December 31, 2006. In accordance with Emerging Issues Task Force Issue 03-8, the Company has accrued a prorated amount of $7.1 million, representing the Company's best estimate of the total liability for unreported product liability claims related to services performed and products sold prior to September 30, 2006. The $7.1 million balance is included as a component of accrued expenses and other current liabilities of $3.6 million and other long-term liabilities of $3.5 million on the September 30, 2006 Summary Consolidated Balance Sheet. Further analysis indicated that the liability could be estimated to be as high as $13.0 million, after including a reasonable margin for statistical fluctuations calculated based on actuarial simulation techniques. Based on the actuarial valuation, the Company estimated that as of September 30, 2006, $2.5 million of the accrual for unreported liability claims would be recoverable under the Company's insurance policies. The $2.5 million insurance recoverable is included as a component of other receivables of $1.2 million and other long-term assets of $1.3 million on the September 30, 2006 Summary Consolidated Balance Sheet. These amounts represent management's estimate of the probable losses and anticipated recoveries for unreported product liability claims related to services performed and products sold prior to September 30, 2006. Actual results may differ from this estimate.

As of December 31, 2005 the Company accrued $7.5 million for unreported product liability claims and recorded a receivable of $2.5 million for unreported liability claims estimated to be recoverable under the Company's insurance policies. The $7.5 million balance is included as a component of accrued expenses and other current liabilities of $3.8 million and other long-term liabilities of $3.7 million on the December 31, 2005 Summary Consolidated Balance Sheet. The $2.5 million insurance recoverable is included as a component of other receivables of $1.1 million and other long-term assets of $1.4 million on the December 31, 2005 Summary Consolidated Balance Sheet.

Insurance Coverage Dispute

In September 2006 the Company settled an insurance coverage dispute with a former insurance carrier for $2.0 million, net of associated legal fees. The dispute involved losses stemming from approximately $11.25 million paid in 2005 by the Company. No party admitted any liability as part of the September settlement. The $2.0 million is included as a component of general, administrative, and marketing expenses on the Summary Consolidated Statements of Operations and other receivables on the Summary Consolidated Balance Sheet as of September 30, 2006. The net proceeds of $2.0 million were received in October 2006.

SEC Investigation

On August 19, 2002 the Company issued a press release announcing that on August 17, 2002, the Company received a letter from the Atlanta District Office of the SEC inquiring about certain matters relating to the Company's August 14, 2002 announcement of the FDA Order. The SEC notified the Company in July 2003 that the inquiry became a formal investigation in June 2003. CryoLife cooperated with this investigation both before and after the issuance of the formal order of investigation in June 2003 and intends to continue doing so. CryoLife voluntarily reported the names of six employees and former employees to the SEC in December 2002 after discovering they had apparently sold CryoLife shares on August 14, 2002, before trading was halted pending CryoLife's press release reporting the FDA Order. These individuals were not and are not executive officers of CryoLife. The formal order of investigation indicates that the SEC's scope includes whether, during 2002, among other things, CryoLife or others may have traded while in possession of material nonpublic information, made (or caused to be made) false or misleading statements or omissions in press releases and SEC filings, and failed to maintain accurate records and adequate controls. The investigation could also encompass matters not specifically identified in the formal order. On September 15, 2005 the SEC announced that it had commenced proceedings in federal district court against certain of the above-referenced former and current employees (and certain of their spouses) for alleged illegal insider trading arising out of their August 14, 2002 trading activities. Those proceedings resulted in settlements with the SEC. As of the date hereof, the SEC has had no discussions with CryoLife as to whether the SEC will seek relief against CryoLife, or the nature of any relief that may be sought. At present, CryoLife is unable to predict the ultimate focus or outcome of the investigation, or when it will be completed. An unfavorable outcome could have a material adverse effect on CryoLife's reputation, business, financial position, results of operations, and cash flows.

Note 14 – New Accounting Pronouncements

The Company will be required to adopt Financial Accounting Standards Board ("FASB") Interpretation No. 48 "Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109" ("Interpretation 48") for the fiscal year beginning January 1, 2007. Interpretation 48 establishes a threshold for recognizing tax benefits if they are "more-likely-than-not" to be upheld upon review by the appropriate taxing authority and the requirement that companies recognize the maximum amount of tax benefit that has a "greater than 50 percent likelihood" of ultimately being realized. The cumulative effect of adoption of this interpretation will be reported as an adjustment to the opening balance of retained earnings. The Company is in the process of evaluating the impact of Interpretation 48 on its results of operations and financial position.

The Company will be required to adopt FASB Statement of Financial Accounting Standards ("SFAS") No. 157 "Fair Value Measurements" ("SFAS 157") for the fiscal year beginning January 1, 2008. SFAS 157 provides a single definition of fair value and a hierarchical framework for measuring it, as well as establishing additional disclosure requirements about the use of fair value to measure assets and liabilities. The Company is in the process of evaluating the impact of SFAS 157 on its results of operations and financial position.

The Company will be required to adopt Staff Accounting Bulletin ("SAB") No. 108, codified as SAB Topic 1.N, "Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements" ("SAB 108") for the year ended December 31, 2006. SAB 108 requires the use of both a balance sheet approach and an income statement approach when quantifying and evaluating the materiality of a misstatement. Adjustment to the financial statements is required if either approach results in quantifying a misstatement that is material. The adoption of SAB 108 will not have an impact on the Company's results of operations and financial position.

Note 15 – Subsequent Events

In October 2006 CryoLife announced that it had signed a licensing and distribution agreement with BioForm Medical, Inc. ("BioForm"), for the development and commercialization of BioGlue for use in cosmetic and plastic surgery indications. The agreement calls for BioForm to fund the development and regulatory approval process for commercializing BioGlue for use in cosmetic and plastic surgery indications in the United States, Canada, and the

European Community. Under the terms of the agreement, CryoLife will receive an initial fee from BioForm, as well as a milestone payment upon achievement of FDA approval.

PART I - FINANCIAL INFORMATION

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

Overview

During the three months ended September 30, 2006 CryoLife, Inc. ("CryoLife" or the "Company") experienced its second consecutive quarter of profitability and also achieved profitability on a year-to-date basis. CryoLife's net income of $2.0 million during this quarter was largely impacted by the net gain of $2.0 million recorded during the quarter for the net settlement of an insurance coverage dispute. The net cash proceeds were received during October, following the close of the third quarter. The quarter ended September 30, 2006 was also a period of strong cardiovascular revenues, with a double-digit increase in cardiovascular revenues over the second quarter of 2006.

On November 1, 2006 the Company announced the successful conclusion of its strategic review begun in January 2006 at the request of the Company's Board of Directors and with the assistance of Piper Jaffray & Co. As a result of this review, the Board of Directors has directed management to actively pursue three key strategies in addition to continuing to focus on growing its business and leveraging its strengths and expertise in its core marketplaces. These strategies are designed to generate revenue and earnings growth: identify and evaluate acquisition opportunities of complimentary product lines and companies; license Company technology to third parties for non-competing uses; and analyze and identify underperforming assets for potential sale or disposal. Management's actions related to this Board directive are ongoing.

FDA Order and Subsequent FDA Activity

Pursuant to an FDA Order received on August 13, 2002, the Company quarantined tissue subject to that order, recalled the portion of the covered tissues that had been distributed but not implanted, and ceased processing them. The Company changed its processing and testing procedures and took other actions intended to address the FDA's concerns, and now processes and distributes those tissues. The FDA has inspected the Company's facilities several times since the FDA Order and issued Form 483 Notices of Observations, to which the Company has submitted responses. The process is ongoing.

In 2003 the Company received two letters from the FDA regarding its SynerGraft processed human tissues. The first letter stated that a 510(k) premarket notification was required for SynerGraft processed human cardiac tissues, known as CryoValve SG. The second stated that SynerGraft processed non-valved cardiac and vascular tissues (CryoVein SG) should be regulated as medical devices. The Company no longer processes these tissues using the SynerGraft technology. It has filed a 510(k) notification for CryoValve SG, but has not yet determined whether to file and seek approvals for CryoVein SG.

See Note 2 to the Company's summary consolidated financial statements at Part I, Item 1 to this Form 10-Q for additional details on the FDA Order and other FDA activity.

Critical Accounting Policies

A summary of the Company's significant accounting policies is included in Part II, Item 8, "Note 1 of the Notes to Summary Consolidated Financial Statements," contained in the Company's Form 10-K for the fiscal year ended December 31, 2005. Management believes that the consistent application of these policies enables the Company to provide users of the financial statements with useful and reliable information about the Company's operating results and financial condition. The summary consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States for interim financial information, which require the Company to make estimates and assumptions. The following are accounting policies that management believes are most important to the portrayal of the Company's financial condition and results and may involve a higher degree of judgment and complexity.

Product Liability Claims: In the normal course of business as a medical device and services company, the Company has product liability complaints filed against it. As of November 1, 2006 the Company was aware of four pending product liability lawsuits. The lawsuits are currently in the pre-discovery or discovery stages. Of these lawsuits, two allege product liability claims arising out of the Company's orthopaedic tissue services and two allege product liability claims arising out of the Company's allograft heart valve tissue services.

Two of the outstanding product liability lawsuits against the Company are not covered by insurance policies, as the claimed loss date was prior to the effective coverage date for the insurance policy. Additional uninsured claims may be filed in the future. Other product liability claims have been asserted against the Company that have not resulted in lawsuits as of November 1, 2006. The Company is monitoring these claims.

The Company performed an analysis as of September 30, 2006 of the settled but unpaid claims and the four pending product liability lawsuits based on settlement negotiations to date and advice from counsel. As of September 30, 2006 the Company had accrued a total of approximately $414,000 for settled but unpaid claims and pending product liability lawsuits. The $414,000 accrual is included as a component of accrued expenses and other current liabilities on the September 30, 2006 Summary Consolidated Balance Sheet. This amount represents the Company's estimate of the probable loss related to settled but unpaid claims and one of the four pending product liability lawsuits. The Company has not recorded an accrual for the remaining three product liability lawsuits or any asserted claims that have not resulted in a lawsuit because management has concluded that either a loss is remote or that, although a loss is reasonably possible or probable, a reasonable estimate of that loss or the range of losses cannot be made at this time. As of December 31, 2005 the Company had accrued a total of approximately $1.5 million for settled but unpaid claims and pending product liability lawsuits and recorded $244,000 representing amounts to be recovered from the Company's insurance carriers. The $1.5 million accrual is included as a component of accrued expenses and other current liabilities on the December 31, 2005 Summary Consolidated Balance Sheet.

If the Company is unable to settle one or more of the product liability lawsuits in which the Company is a defendant, and if any such lawsuit should be tried with a substantial verdict rendered in favor of the plaintiff(s), there can be no assurance that such verdict(s) would not exceed the Company's available liquid assets. Additionally, the Company does not have a reasonable method for estimating the amount of compensatory or punitive damages that could be assessed by a trial jury with respect to any lawsuit that it is unable to settle prior to trial, and the Company's product liability insurance policies do not include coverage for any punitive damages. Failure by the Company to resolve the outstanding product liability claims within its ability to pay would have a material adverse effect on the financial position, results of operations, and cash flows of the Company.

On April 1, 2006 the Company bound coverage for the 2006/2007 insurance policy year. This policy is a four-year claims-made insurance policy, i.e. claims incurred during the period April 1, 2003 through March 31, 2007 and reported during the period April 1, 2006 through March 31, 2007 are covered by this policy. Claims incurred prior to April 1, 2003 that have not been reported are uninsured.

The Company maintains claims-made insurance policies to mitigate its financial exposure to product liability claims. Claims-made insurance policies generally cover only those asserted claims and incidents that are reported to the insurance carrier while the policy is in effect. Thus, a claims-made policy does not generally represent a transfer of risk for claims and incidents that have been incurred but not reported to the insurance carrier during the policy period. The Company periodically evaluates its exposure to unreported product liability claims and records accruals as necessary for the estimated cost of unreported claims related to services performed and products used. In July 2006 the Company retained an independent actuarial firm to prepare revised estimates of the unreported claims as of June 30, 2006 and December 31, 2006. The independent firm estimated the unreported product loss liability using a frequency-severity approach, whereby projected losses were calculated by multiplying the estimated number of claims by the estimated average cost per claim. The estimated claims were calculated based on the reported claim development method and the Bornhuetter-Ferguson method using a blend of the Company's historical claim experience and industry data. The estimated cost per claim was calculated using a lognormal claims model blending the Company's historical average cost per claim with industry claims data. The independent actuarial firm used a number of assumptions in order to estimate the unreported product loss liability, including:

- A ceiling of $5.0 million was selected for actuarial purposes in determining the liability per claim given the uncertainty in projecting claim losses in excess of $5.0 million,

- The future claim reporting lag time would be a blend of the Company's experiences and industry data,

- The frequency of unreported claims for accident years 2001 through 2006 would be lower than the Company's experience since the 2002/2003 policy year, but higher than the Company's historical claim frequency prior to the 2002/2003 policy year,

- The average cost per claim would be lower than the Company's experience since the 2002/2003 policy year, but higher than the Company's historical cost per claim prior to the 2002/2003 policy year,

- The average cost per BioGlue claim would be consistent with the Company's overall historical exposures until adequate historical data is available on this product line, and

- The number of BioGlue claims per million dollars of BioGlue revenue would be 35% lower than non-BioGlue claims per million dollars of revenue. The 35% factor was selected based on BioGlue claims experience to-date and consultation with the actuary.

The Company believes that these assumptions provide a reasonable basis for the calculation of the unreported product liability loss, but the accuracy of the actuarial firm's estimates is limited by the general uncertainty that exists for any estimate of future activity due to uncertainties surrounding the assumptions used and due to Company specific conditions, including the FDA Order, the Company's recent levels of litigation activity, the Company's low volume of pre-FDA Order historical claims, and the scarcity of industry data directly relevant to the Company's business activities. Due to these factors, actual results may differ significantly from the assumptions used and amounts accrued.

Based on the actuarial valuation performed in July 2006 as of June 30, 2006 and December 31, 2006, the Company estimated that its liability for unreported product liability claims was $6.7 million and would be $7.5 million as of December 31, 2006. In accordance with Emerging Issues Task Force Issue 03-8, the Company has accrued a prorated amount of $7.1 million, representing the Company's best estimate of the total liability for unreported product liability claims related to services performed and products sold prior to September 30, 2006. The $7.1 million balance is included as a component of accrued expenses and other current liabilities of $3.6 million and other long-term liabilities of $3.5 million on the September 30, 2006 Summary Consolidated Balance Sheet. Further analysis indicated that the liability could be estimated to be as high as $13.0 million, after including a reasonable margin for statistical fluctuations calculated based on actuarial simulation techniques. Based on the actuarial valuation, the Company estimated that as of September 30, 2006, $2.5 million of the accrual for unreported liability claims would be recoverable under the Company's insurance policies. The $2.5 million insurance recoverable is included as a component of other receivables of $1.2 million and other long-term assets of $1.3 million on the September 30, 2006 Summary Consolidated Balance Sheet. These amounts represent management's estimate of the probable losses and anticipated recoveries for unreported product liability claims related to services performed and products sold prior to September 30, 2006. Actual results may differ from this estimate.

Deferred Preservation Costs: By federal law, human tissues cannot be bought or sold. Therefore, the tissues the Company preserves and further processes cannot be held as inventory. Tissue is procured from deceased human donors by organ and tissue procurement agencies, which consign the tissue to the Company for processing and preservation. Preservation costs consist primarily of direct labor and materials (including laboratory expenses, tissue procurement fees, freight-in charges, and fringe benefits) and indirect costs (including allocations of costs from departments that support processing activities and facility allocations). Although the Company cannot own human tissue, the preservation process is a manufacturing process that is accounted for in accordance with Accounting Research Bulletin #43 ("ARB 43") Chapter 4, Inventory Pricing. Preservation costs are stated at the lower of cost or market on a first-in, first-out basis and are deferred until revenue is recognized upon shipment of the tissue to the implanting facilities.

The calculation of deferred preservation costs includes a high degree of judgment and complexity. The costs included in deferred preservation costs contain several estimates due to the timing differences between the occurrence of the cost and receipt of final bills for services. Costs that contain estimates include tissue procurement fees, which are estimated based on the Company's contracts with independent procurement agencies, and freight-in charges, which are estimated based on the Company's prior experiences with these charges. These costs are adjusted for differences between estimated and actual fees when invoices for these services are received. Management believes that its estimates approximate the actual costs of these services, but estimates could differ from actual costs. Total deferred preservation costs are then allocated among the different tissues processed during the period based on specific cost drivers such as the number of donors and the number of tissues processed. At each balance sheet date a portion of the deferred preservation costs relates to tissues currently in active processing or held in quarantine pending release to implantable status. The Company applies a yield estimate to all tissues in process and in quarantine to estimate the portion of tissues that will ultimately become implantable. Management determines this estimate of quarantine yields based on its experience in prior periods and reevaluates this estimate periodically. Due to the nature of this estimate and the length of the processing times experienced by the Company, actual yields could differ from the Company's estimates. A significant change in quarantine yields could materially affect the deferred preservation costs per tissue, which could impact the amount of deferred preservation costs on the Company's Summary Consolidated Balance Sheets and the cost of preservation services, including the lower of cost or market write-down, described below, on the Company's Summary Consolidated Statements of Operations.

The Company regularly evaluates its deferred preservation costs to determine if the costs are appropriately recorded at the lower of cost or market value. The Company recorded $277,000 and $1.0 million, respectively, in the three and nine months ended September 30, 2006 and $626,000 and $1.3 million, respectively, in the three and nine months ended September 30, 2005 as an increase to cost of preservation services to write-down the value of certain deferred tissue preservation costs that exceeded market value. The amount of these write-downs are primarily due to excess current period tissue processing costs that exceeded market value based on recent average service fees. Actual results may differ from these estimates. The Company regularly evaluates its deferred preservation costs to determine if an impairment in the value of the deferred preservation costs is required when the value of these tissues is not expected to be fully recoverable. A write-down of $538,000 was recorded for the three and nine months ended September 30, 2006 due to the impairment of certain orthopaedic tissues.

As of September 30, 2006 deferred preservation costs consisted of $4.2 million for allograft heart valve tissues, $1.1 million for non-valved cardiac tissues, $9.5 million for vascular tissues, and $4.8 million for orthopaedic tissues.

Deferred Income Taxes: Deferred income taxes reflect the net tax effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and tax return purposes. The Company generated deferred tax assets beginning in 2002 primarily as a result of write-downs of deferred preservation costs, accruals for product liability claims, and operating losses. These write-downs, accruals, and losses reflect reductions in revenues and additional professional fees, as a result of the FDA Order, subsequent FDA activities, and related events. The Company assesses the recoverability of its deferred tax assets, on an annual basis and on an interim basis, as necessary, when the Company experiences changes that could materially affect its determination of the recoverability of its deferred tax assets. Management provides a valuation allowance when, as a result of this analysis, management believes it is more likely than not that its deferred tax assets will not be realized. In assessing the recoverability of its deferred tax assets at December 31, 2005 the Company reviewed its historical operating results, including the reasons for its operating losses, uncertainties regarding projected future operating results, and the uncertainty of the outcome of litigation. Based on the results of this analysis, at December 31, 2005 the Company determined that it was more likely than not that the Company's deferred tax assets would not be realized.

Based on the Company's results of operations for the nine months ended September 30, 2006, the Company does not expect to generate material deferred tax assets or utilize material amounts of its net operating loss carryforwards during the year ended December 31, 2006. For the nine months ended September 30, 2006 the Company did not experience any changes that would materially affect the Company's prior determination of the recoverability of its deferred tax assets. As of September 30, 2006 the Company had a total of $26.4 million in valuation allowances against deferred tax assets and a net deferred tax liability of $248,000 related to taxes in a foreign jurisdiction. The realizability of the Company's deferred tax assets could be limited in future periods as mandated by Internal Revenue Service Section 382.

Valuation of Long-lived and Intangible Assets: The Company assesses the impairment of its long-lived, identifiable intangible assets annually and whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors that management considers important that could trigger an impairment review include the following:

- Significant underperformance relative to expected historical or projected future operating results,

- Significant negative industry or economic trends,
- Significant decline in the Company's stock price for a sustained period, and
- Significant decline in the Company's market capitalization relative to net book value.

Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"), requires the write-down of a long-lived asset to be held and used if the carrying value of the asset or the asset group to which the asset belongs is not recoverable. The carrying value of the asset or asset group is not recoverable if it exceeds the sum of the undiscounted future cash flows expected to result from the use and eventual disposition of the asset or asset group. In applying SFAS 144 the Company defined the specific asset groups used to perform the cash flow analysis. The Company defined the asset groups at the lowest level possible, by identifying the cash flows from groups of assets that could be segregated from the cash flows of other assets and liabilities. Using this methodology the Company determined that its asset groups consisted of the long-lived assets related to the Company's two reporting segments. As the Company does not segregate assets by segment, the Company allocated assets to the two reporting segments based on factors including facility space and revenues. The undiscounted future cash flows related to these asset groups exceeded their carrying values as of December 31, 2005 and, therefore, management concluded that there was not an impairment of the Company's long-lived intangible assets and tangible assets related to the tissue preservation business or medical device business. However, depending on the Company's ability to rebuild demand for its tissue preservation services and the future effects of events surrounding the FDA Order, these assets may become impaired. Management will continue to evaluate the recoverability of these assets in accordance with SFAS 144. For the nine months ended September 30, 2006 the Company did not experience any changes that would materially affect the Company's analysis of and recoverability of its long-lived assets.

SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"), requires that goodwill resulting from business acquisitions and other intangible assets be subject to periodic impairment testing. The Company's intangible assets consist of patent costs, which are amortized over the expected useful lives of the patents (primarily 17 years) using the straight-line method, and trademarks, which are non-amortizing. As of December 31, 2005 the Company did not believe that an impairment existed related to the other intangible assets that were assessed in accordance with SFAS 144.

Derivative Instruments: The terms of the Company's first quarter of 2005 6% convertible Preferred Stock offering included a Dividend Make-Whole Payment. If the Company elects to automatically convert, or the holder elects to voluntarily convert, some or all of the Preferred Stock into common stock prior to April 1, 2008, the Company will make an additional payment on the Preferred Stock equal to the aggregate amount of dividends that would have been payable on the Preferred Stock through and including April 1, 2008, less any dividends already paid on the Preferred Stock. The Dividend Make-Whole Payment is payable in cash or, at the Company's option, in shares of the Company's common stock, or a combination of cash and shares of common stock. In accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133"), the Company is required to separate and account for, as an embedded derivative, the Dividend Make-Whole Payment feature of the Preferred Stock (the "Derivative"). As an embedded derivative instrument, the Dividend Make-Whole Payment feature must be measured at fair value and reflected as a current liability on the Company's Summary Consolidated Balance Sheets. Changes in the fair value of the Derivative are recognized as the line item change in valuation of derivative as non-operating income/expense on the Company's Summary Consolidated Statements of Operations.

The accounting for derivatives is complex, and requires significant judgments and estimates in determining the fair value in the absence of quoted market values. These estimates are based on valuation methodologies and assumptions deemed appropriate in the circumstances. The fair value of the Dividend Make-Whole Payment feature is based on various assumptions, including the estimated market volatility and discount rates. The use of different assumptions may have a material effect on the estimated fair value amount, which is reflected in the Company's results of operations and financial position.

New Accounting Pronouncements

The Company will be required to adopt Financial Accounting Standards Board ("FASB") Interpretation No. 48 "Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109" ("Interpretation 48") for the fiscal year beginning January 1, 2007. Interpretation 48 establishes a threshold for recognizing tax benefits if they are "more-likely-than-not" to be upheld upon review by the appropriate taxing authority and the requirement that companies recognize the maximum amount of tax benefit that has a "greater than 50 percent likelihood" of ultimately being realized. The cumulative effect of adoption of this interpretation will be reported as an adjustment to the opening balance of retained earnings. The Company is in the process of evaluating the impact of Interpretation 48 on its results of operations and financial position.

The Company will be required to adopt FASB Statement of Financial Accounting Standards ("SFAS") No. 157 "Fair Value Measurements" ("SFAS 157") for the fiscal year beginning January 1, 2008. SFAS 157 provides a single definition of fair value and a hierarchical framework for measuring it, as well as establishing additional disclosure requirements about the use of fair value to measure assets and liabilities. The Company is in the process of evaluating the impact of SFAS 157 on its results of operations and financial position.

The Company will be required to adopt Staff Accounting Bulletin ("SAB") No. 108, codified as SAB Topic 1.N, "Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements" ("SAB 108") for the year ended December 31, 2006. SAB 108 requires the use of both a balance sheet approach and an income statement approach when quantifying and evaluating the materiality of a misstatement. Adjustment to the financial statements is required if either approach results in quantifying a misstatement that is material. The adoption of SAB 108 will not have an impact on the Company's results of operations and financial position.

Results of Operations

Revenues
(Tables in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Total Revenues	$ 20,018	$ 16,458	$ 60,221	$ 51,321

Revenues increased 22% for the three months ended September 30, 2006 as compared to the three months ended September 30, 2005. Revenues increased 17% for the nine months ended September 30, 2006 as compared to the nine months ended September 30, 2005.

The increase in both the three and nine months ended September 30, 2006 was primarily due to an increase in tissue preservation service revenues, as well as an increase in BioGlue revenues as compared to the prior year period. A detailed discussion of the change in BioGlue revenues and in preservation service revenues for each of the three major tissue types processed by the Company is presented below.

BioGlue

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Revenues	$ 9,444	$ 8,917	$ 29,534	$ 28,340
BioGlue revenues as a percentage of total revenue	47%	54%	49%	55%

Revenues from the sale of BioGlue increased 6% for the three months ended September 30, 2006 as compared to the three months ended September 30, 2005. This increase was primarily due to an increase in average selling prices, which increased revenues by 5% and the effect of foreign currency exchange, which increased revenues by less than 1%.

Revenues from the sale of BioGlue increased 4% for the nine months ended September 30, 2006 as compared to the nine months ended September 30, 2005. This increase was primarily due to an increase in average selling prices, which increased revenues by 4%.

The increase in average selling prices for the three and nine months ended September 30, 2006 was primarily due to list price increases that went into effect in January and July 2006 domestically and in certain international markets.

Domestic revenues accounted for 76% and 75% of total BioGlue revenues for the three and nine months ended September 30, 2006, respectively, and 75% and 76% of total BioGlue revenues for the three and nine months ended September 30, 2005, respectively.

The Company anticipates that BioGlue revenues for the full year of 2006 will exceed the full year of 2005, primarily due to the domestic price increases discussed above.

Cardiovascular Preservation Services

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Revenues	$ 4,189	$ 3,139	$ 11,550	$ 10,407
Cardiovascular revenues as a percentage of total revenue	21%	19%	19%	20%

Revenues from cardiovascular preservation services increased 33% for the three months ended September 30, 2006 as compared to the three months ended September 30, 2005. This increase was primarily due to a 36% increase in unit shipments of cardiovascular tissues, which increased revenues by 17%, and an increase in average service fees, which increased revenues by 16%.

Revenues from cardiovascular preservation services increased 11% for the nine months ended September 30, 2006 as compared to the nine months ended September 30, 2005. This increase was primarily due to an increase in average service fees, which increased revenues by 8%, and a 14% increase in unit shipments of cardiovascular tissues, which increased revenues by 3%.

The increase in cardiovascular volume for the three months ended September 30, 2006 was primarily due to increased shipments of pulmonary valves and non-valved cardiac tissues. The increases in cardiac shipments were a result of increased availability of tissues due to improvements in procurement and tissue processing yields and due to strengthening demand for the Company's tissues, particularly in the pediatric cardiac market. This strong third quarter cardiovascular volume also had an affect on revenues for the nine months ended September 30, 2006, overcoming the slight volume declines experienced in the first half of 2006. The large increases in the number of tissue shipments did not result in a proportional increase in cardiovascular revenues due to a shift in product mix, as the increases were primarily experienced in products with smaller per unit revenues than the average cardiovascular tissue. The increase in average service fees for the three and nine months ended September 30, 2006 was primarily due to the fee increases that went into effect in January 2006 on all cardiac tissues and in July 2006 on certain non-valved cardiac tissues.

The Company's procurement of cardiac tissues, from which heart valves and non-valved cardiac tissues are processed, increased 9% during the three months ended September 30, 2006 as compared to the three months ended June 30, 2006. The Company's procurement of cardiac tissues increased 8% for the three months ended September 30, 2006 as compared to the three months ended September 30, 2005 and 11% for the nine months ended September 30, 2006 as compared to the nine months ended September 30, 2005.

The Company anticipates that cardiovascular service revenues for the full year of 2006 will exceed the full year of 2005 primarily due to the domestic fee increases discussed above, and due to growth in cardiovascular tissue shipments resulting from improvements in procurement, tissue processing yields, and demand for the Company's tissues.

Vascular Preservation Services

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Revenues	$ 4,468	$ 2,825	$ 13,066	$ 8,281
Vascular revenues as a percentage of total revenue	22%	17%	22%	16%

Revenues from vascular preservation services increased 58% for the three months ended September 30, 2006 as compared to the three months ended September 30, 2005. This increase was primarily due to a 37% increase in unit shipments of vascular tissues, which increased revenues by 43%, and an increase in average service fees, which increased revenues by 15%.

Revenues from vascular preservation services increased 58% for the nine months ended September 30, 2006 as compared to the nine months ended September 30, 2005. This increase was primarily due to a 38% increase in unit shipments of vascular tissues, which increased revenues by 47%, and an increase in average service fees, which increased revenues by 11%.

The increase in vascular volume for the three and nine months ended September 30, 2006 is primarily due to increases in shipments of saphenous veins, due in part to increased availability of tissues as a result of improvements in procurement levels and tissue processing yields, coupled with a strong demand for these tissues, primarily for use in peripheral vascular reconstruction surgeries to avoid limb amputations. The increase in shipments of saphenous veins is a continuation of the favorable trend that began in the fourth quarter of 2005. The increase in average service fees for the three and nine months ended September 30, 2006 was primarily due to the fee increases that went into effect in January 2006 on all vascular tissues.

The Company's procurement of vascular tissues increased 7% during the three months ended September 30, 2006 as compared to the three months ended June 30, 2006. The Company's procurement of vascular tissues increased 18% for the three months ended September 30, 2006 as compared to the three months ended September 30, 2005 and 38% for the nine months ended September 30, 2006 as compared to the nine months ended September 30, 2005.

The Company anticipates that vascular service revenues for the full year of 2006 will exceed the full year of 2005 primarily due to the domestic fee increases discussed above, and due to growth in vascular tissue shipments resulting from improvements in procurement, tissue processing yields, and demand for the Company's tissues.

Orthopaedic Preservation Services

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	**2005**	**2006**	**2005**
Revenues	$ 1,662	$ 1,365	$ 5,223	$ 3,531
Orthopaedic revenues as a percentage of total revenue	8%	8%	9%	7%

Revenues from orthopaedic preservation services increased 22% for the three months ended September 30, 2006 as compared to the three months ended September 30, 2005. This increase was primarily due to an increase in average service fees, which increased revenues by 18%, and an 11% increase in unit shipments of orthopaedic tissues, which increased revenues by 4%.

Revenues from orthopaedic preservation services increased 48% for the nine months ended September 30, 2006 as compared to the nine months ended September 30, 2005. This increase was primarily due to a 27% increase in unit shipments of orthopaedic tissues, which increased revenues by 35% and an increase in average service fees, which increased revenues by 13%.

The increase in average service fees for the three and nine months ended September 30, 2006 was primarily due to the fee increases that went into effect in January 2006 on all orthopaedic tissues and in July 2006 for certain orthopaedic tissues. The increase in orthopaedic volume for the three months ended September 30, 2006 was primarily due to an increase in shipments of boned and non-boned tendons, primarily due to the rebuilding of the Company's supply of tissues available for shipment. The increase in orthopaedic volume for the nine months ended September 30, 2006 was primarily due to an increase in shipments of osteochondral grafts, with smaller increases in boned and non-boned tendons and menisci, primarily related to the reestablishment of the Company's presence in the orthopaedic tissue business and the rebuilding of the Company's supply of tissues available for shipment.

The Company procures orthopaedic tissues, which include knees, from which osteochondral grafts, menisci, and boned tendons are processed, and individual tendons, which are primarily non-boned. The Company's procurement of all orthopaedic tissues increased 17% during the three months ended September 30, 2006 as compared to the three months ended June 30, 2006, 8% for the three months ended September 30, 2006 as compared to the three months ended September 30, 2005, and 19% for the nine months ended September 30, 2006 as compared to the nine months ended September 30, 2005. The Company's procurement of knees increased 23% during the three months ended September 30, 2006 as compared to the three months ended June 30, 2006, decreased 2% for the three months ended September 30, 2006 as compared to the three months ended September 30, 2005, and increased 25% for the nine months ended September 30, 2006 as compared to the nine months ended September 30, 2005.

The Company anticipates that orthopaedic service revenues for the full year of 2006 will exceed the full year of 2005 primarily due to growth in orthopaedic tissue shipments during 2006, driven by improvements in demand for the Company's tissues, procurement, and tissue processing yields. Additionally, the domestic fee increases discussed above have benefited and are expected to continue benefiting revenues for the full year of 2006 as compared to the full year of 2005.

Grant Revenues

Grant revenues were $12,000 and zero, respectively, for the three months ended September 30, 2006 and 2005 and $74,000 and zero, respectively, for the nine months ended September 30, 2006 and 2005. Grant revenues for the three and nine months ended September 30, 2006 are related to funding received under the 2005 Defense Appropriations Conference Report, the ("2005 DOD Grant"), which included $926,000 for the development of protein hydrogel technology for use on the battlefield. The Company applied for and was awarded the full $926,000 allocated under the 2005 DOD Grant in connection with its development of BioFoam™. The Company has received advances totaling $926,000 under this grant during 2005 and 2006, and began recognizing revenues for expenses incurred related to this grant during the fourth quarter of 2005. The Company is currently preparing for animal trials with the U.S. Army's Institute for Surgical Research.

The 2006 Defense Appropriations Conference Report included approximately $2.3 million for the continued development of protein hydrogel technology for use on the battlefield. CryoLife applied for funding for BioFoam development under this bill in July 2006. The 2007 Defense Appropriations Conference Report included approximately $1.0 million for the continued development of protein hydrogel technology for use on the battlefield. CryoLife anticipates applying for funding under this bill during 2007.

The Company anticipates that grant revenues will continue to be higher in 2006 than in the corresponding periods of 2005 due to the 2005 and possibly the 2006 Department of Defense funding.

Costs and Expenses

Cost of Products

Cost of products was $1.6 million and $1.9 million for the three months ended September 30, 2006 and September 30, 2005, representing 16% and 21%, respectively, of total product revenues during such periods. Cost of products was $5.6 million and $6.1 million for the nine months ended September 30, 2006 and 2005, respectively, representing 18% and 21%, respectively, of total product revenues during such periods.

The cost of products and cost of products as a percentage of total product revenues decreased for the three and nine months ended September 30, 2006, primarily due to improvements in BioGlue margins from period to period. These margin improvements were primarily due to improvements in BioGlue average selling prices due to the price increases which went into effect in January and July 2006 and greater manufacturing throughput, which reduced the per unit cost to produce BioGlue.

Cost of Human Tissue Preservation Services

Cost of human tissue preservation services was $7.0 million and $6.0 million for the three months ended September 30, 2006 and 2005, respectively, representing 67% and 82%, respectively, of total tissue preservation service revenues during such periods. Cost of human tissue preservation services for the three months ended September 30, 2006 includes the write-down of $277,000 of certain deferred preservation costs that exceeded market value and the write-down of $538,000 due to the impairment of certain orthopaedic tissues. Cost of human tissue preservation services for the three months ended September 30, 2005 includes the write-down of $626,000 of certain deferred preservation costs that exceeded market value.

Cost of human tissue preservation services was $20.8 million and $18.0 million for the nine months ended September 30, 2006 and 2005, respectively, representing 70% and 81%, respectively, of total tissue preservation service revenues during such periods. Cost of human tissue preservation services for the nine months ended September 30, 2006 includes the write-down of $1.0 million of certain deferred preservation costs that exceeded market value and the write-down of $538,000 due to the impairment of certain orthopaedic tissues. Cost of human tissue preservation services for the nine months ended September 30, 2005 includes the write-down of $1.3 million of certain deferred preservation costs that exceeded market value.

The write-down of deferred tissue preservation costs that exceeded market value in both years was primarily related to the Company's non-valved cardiac tissues and certain orthopaedic tissues. The Company implemented a fee increase effective July 1, 2006, in part to address these tissues, which have had costs in excess of the average service fees. The decrease of the write-down in the current year periods as compared to the prior year periods is primarily due to the effect of this fee increase on the Company's average service fees for the affected tissue types.

The increase in cost of human tissue preservation services for the three and nine months ended September 30, 2006 is primarily due to increased tissue preservation service volume as compared to the same period in 2005. The decrease in cost of tissue preservation services as a percentage of total tissue preservation service revenues is primarily due to improvements in tissue preservation margins as a result of improvements in the Company's tissue processing yields, an increase in average service fees due to fee increases in 2006, and to a lesser extent an increase in the amount of tissues processed.

The Company anticipates that aggregate cost of human tissue preservation services for the full year of 2006 will exceed the full year of 2005 due to volume increases in 2006. The Company anticipates that cost of human tissue preservation services as a percentage of tissue preservation service revenues will decrease for the full year of 2006 as compared to 2005 as a result of increases in yields of implantable tissue per donor, increases in average service fees due to fee increases implemented in 2006, and increases in the amount of tissues expected to be processed due to increased procurement.

General, Administrative, and Marketing Expenses

General, administrative, and marketing expenses decreased 23% to $8.5 million for the three months ended September 30, 2006, compared to $11.1 million for the three months ended September 30, 2005, representing 43% and 67%, respectively, of total revenues during such periods. General, administrative, and marketing expenses for the three months ended September 30, 2006 includes a favorable adjustment of $2.0 million related to the settlement of an insurance coverage dispute with an insurance company, net of associated legal fees, an unfavorable charge of $185,000 for stock based compensation expenses, and an unfavorable adjustment of $170,000 to unreported product liability accruals. General, administrative, and marketing expenses for the three months ended September 30, 2005 includes an accrual of approximately $741,000 in additional legal expenses and settlement accruals and an accrual of $701,000 for post employment benefits.

General, administrative, and marketing expenses decreased 30% to $30.1 million for the nine months ended September 30, 2006, compared to $42.7 million for the nine months ended September 30, 2005, representing 50% and 83%, respectively, of total revenues during such periods. General, administrative, and marketing expenses for the nine months ended September 30, 2006 includes a favorable adjustment of $2.0 million related to the settlement of an insurance coverage dispute with an insurance company, net of associated legal fees, an unfavorable charge of $832,000 for stock based compensation expenses, a favorable adjustment of $451,000 related to the adjustment of reserves for product liability losses, and an accrual of $448,000 for post employment benefits. General, administrative, and marketing expenses for the nine months ended September 30, 2005 includes an accrual of $11.8 million in expense related to the settlement of the shareholder class action lawsuit, an accrual of $701,000 for post employment benefits, and a favorable adjustment of approximately $403,000 to legal expenses and settlement accruals.

Excluding the items discussed above, general, administrative, and marketing expenses for the three months and nine months ended September 30, 2006 were consistent with the expenses in the respective prior year periods. General, administrative, and marketing expenses for the three and nine months ended September 30, 2006 were also impacted by lower insurance and professional fees and an increase in marketing commissions to support revenue growth.

Although several important components are difficult to estimate or control, the Company anticipates that general, administrative, and marketing expenses will be lower in the full year 2006 than in the full year 2005, due to the expense recorded in 2005 related to the resolution of the Company's class action and derivative lawsuits and the favorable adjustment to that expense that occurred in the third quarter of 2006. The Company will continue to evaluate the level of accruals for product liability claims and make adjustments as required based on periodic actuarial analyses and product liability claim status. Adjustments to these accruals may be required during the remainder of 2006, and the effect of these adjustments may be favorable or unfavorable to general, administrative, and marketing expenses.

Research and Development Expenses

Research and development expenses were $826,000 for the three months ended September 30, 2006, compared to $894,000 for the three months ended September 30, 2005, representing 4% and 5%, respectively, of total revenues during each such period. Research and development expenses were $2.6 million for the nine months ended September 30, 2006, compared to $2.7 million for the nine months ended September 30, 2005, representing 4% and 5%, respectively, of total revenues during each such period. The decrease in research and development expenses in both the three and nine month periods ended September 30, 2006 was due to timing delays for planned external research studies. Research and development spending in 2006 and 2005 was primarily focused on the Company's tissue preservation, SynerGraft, which includes allograft and xenograft heart valves, vascular grafts and surgical mesh, and Protein Hydrogel Technologies ("PHT"), which include BioGlue, BioFoam, BioDisc™, and related products.

Other Costs and Expenses

Interest expense increased to $169,000 for the three months ended September 30, 2006, compared to $77,000 for the three months ended September 30, 2005. Interest expense increased to $504,000 for the nine months ended September 30, 2006, compared to $220,000 for the nine months ended September 30, 2005. The increase in interest expense for the three and nine months ended September 30, 2006 is primarily due to higher borrowings under the Credit Agreement as compared to the same period in 2005 and higher interest rates on these borrowings as the bank's prime lending rate has increased since the prior year period. Interest expense for the three and nine months ended September 30, 2006 and 2005 included interest incurred related to the Credit Agreement, notes payable, and capital leases.

Interest income decreased to $94,000 for the three months ended September 30, 2006, compared to $166,000 for the three months ended September 30, 2005. Interest income decreased to $304,000 for the nine months ended September 30, 2006, compared to $408,000 for the nine months ended September 30, 2005. Interest income for the three and nine months ended September 30, 2006 and 2005 was primarily due to interest earned on the Company's cash, cash equivalents, and marketable securities.

The change in valuation of the Derivative was an expense of $44,000 for the three months ended September 30, 2006 as compared to income of $412,000 for the three months ended September 30, 2005. The change in valuation of the Derivative was an expense of $111,000 for the nine months ended September 30, 2006 as compared to $372,000 for the nine months ended September 30, 2005. The valuation of the Derivative in these periods was a function of several variables including the price and expected volatility of the Company's common stock, the number of shares of Preferred Stock outstanding, and the general level of US interest rates. The change in valuation of Derivative in the three and nine months ended September 30, 2005 also includes the amount of the Dividend Make-Whole Payment on preferred shares converted during the period.

The Company is unable to estimate the change in valuation of derivative for the remainder of 2006, as this amount is subject to several variables as discussed above. The change in valuation of derivative for the remainder of 2006 could differ significantly from the levels experienced in the corresponding period in 2005.

The Company's income tax expense of $12,000 for the three months ended September 30, 2006 was primarily due to foreign taxes on income of the Company's wholly owned European subsidiary. The Company's income tax expense of $137,000 for the nine months ended September 30, 2006 was primarily due to an expense of $248,000 to record a deferred tax liability related to a foreign jurisdiction, partially offset by the favorable effect of adjustments to estimated foreign taxes on income of the Company's wholly owned European subsidiary.

The Company's income tax expense of $106,000 and $190,000 for the three and nine months ended September 30, 2005, respectively, was related to foreign taxes on income of the Company's wholly owned European subsidiary.

Seasonality

The demand for BioGlue appears to be seasonal, with a flattening or slight decline in demand generally occurring in the third quarter followed by stronger demand in the fourth quarter. Management believes that this trend for BioGlue may be due to fewer surgeries being performed on adult patients in the summer months. The Company will continue to evaluate the seasonal nature of BioGlue sales.

The demand for the Company's cardiovascular tissue preservation services has historically been seasonal, with peak demand generally occurring in the second and third quarters. Management believes this trend for cardiovascular tissue preservation services is primarily due to the high number of surgeries scheduled during the summer months for school aged patients, who drive the demand for a large percentage of CryoLife's cardiovascular tissues. This seasonal trend has been obscured in recent years by the impact of the FDA Order and related events. The Company expects that this seasonal trend will be more apparent in future years.

The demand for the Company's orthopaedic tissue preservation services appears to be seasonal, with a flattening or slight decline in demand generally occurring in the summer months due to the scheduling of fewer elective orthopaedic surgeries during these months and due to the seasonal timing of certain sports that frequently result in the injuries treated by the Company's orthopaedic products. This seasonal trend has been obscured in recent years by the impact of the FDA Order and related events. The Company expects that this seasonal trend will be more apparent in future years.

The demand for the Company's human vascular tissue preservation services and bioprosthetic cardiovascular and vascular devices does not appear to be seasonal.

Liquidity and Capital Resources

Net Working Capital

At September 30, 2006 net working capital (current assets of $51.6 million less current liabilities of $23.9 million) was $27.7 million, with a current ratio (current assets divided by current liabilities) of 2 to 1, compared to net working capital of $23.9 million, with a current ratio of 2 to 1 at December 31, 2005.

The Company's primary capital requirements for the nine months ended September 30, 2006 arose out of general working capital needs, capital expenditures for facilities and equipment, and funding of research and development projects. In recent years the Company's operating activities have failed to generate sufficient cash to fund its business due to the increasing costs of operations, primarily costs related to the Company's tissue preservation services business, increases in general, administrative, and marketing costs over pre-FDA Order levels, and increased legal, professional, and litigation expenses. For the nine months ended September 30, 2006 the Company funded its operating cash requirements primarily through existing cash, cash equivalents, and marketable securities, and through bank credit facilities.

Overall Liquidity and Capital Resources

The Company expects that the following will continue to have an adverse impact on earnings and cash flows during the remainder or 2006:

- The anticipated lower preservation services revenues as compared to preservation revenues prior to the August 13, 2002 FDA Order, subsequent FDA activities, and related events (discussed in Part I, Item 1, "Note 2 of the Notes to Summary Consolidated Financial Statements"),

- The high cost of human tissue preservation services as a percent of revenue, as compared to the period prior to the FDA Order, as a result of lower tissue processing volumes and changes in processing methods, which have increased the cost of processing human tissue and decreased yields of implantable tissue per donor,

- An expected use of cash related to the defense and resolution of lawsuits and claims, and

- The legal and professional costs related to ongoing FDA compliance.

The Company believes the following should continue to have a favorable impact on cash flow from operations during the remainder of 2006, although there can be no assurance that these events will occur as and when currently anticipated:

- Expected increases in revenues over levels experienced in 2005 due to increases in BioGlue list prices implemented in January and July 2006,

- Expected increases in total preservation service revenues over levels experienced in 2005 due to fee increases implemented in January and July 2006, to reflect the higher cost of processing these tissues,

- Anticipated improvements in yields of implantable tissues per donor over the levels experienced in 2005 through process changes and process directives, and

- Anticipated decreases in cash payments related to the defense and resolution of lawsuits and claims from the levels seen in 2003 through 2005.

The Company believes that the Company's existing cash, cash equivalents, marketable securities, and availability under the Credit Agreement will enable the Company to meet its liquidity needs through at least September 30, 2007.

The Company's long term liquidity and capital requirements will depend upon numerous factors, including:

- The success of the Company's strategic plan to enhance shareholder value, resulting from the conclusion of its strategic review with the assistance of Piper Jaffray & Co.,

- The success of BioGlue and other products using related technology,

- The Company's ability to increase the level of tissue procurement and demand for its tissue preservation services,

- The Company's ability to reestablish sufficient margins on its tissue preservation services, in the face of increased processing costs, by improving yields and increasing prices,

- The Company's spending levels on its research and development activities, including research studies, to develop and support its service and product pipeline,

- The timing and cost of resolving product liability lawsuits and other claims (as discussed in Part I, Item 1, "Note 13 of the Notes to Summary Consolidated Financial Statements"), and

- To a lesser degree, the Company's success at resolving the issues with the FDA regarding processing of human tissue using the SynerGraft technology (as discussed in Part I, Item 1, "Note 2 of the Notes to Summary Consolidated Financial Statements").

If the Company is unable to address these issues and continues to experience negative operating cash flows, the Company anticipates that it may require additional financing or seek to raise additional funds through bank facilities, debt or equity offerings, or other sources of capital to meet liquidity and capital requirements beyond September 30, 2007. Additional funds may not be available when needed or on terms acceptable to the Company, which could have a material adverse effect on the Company's business, financial condition, results of operations, and cash flows.

On February 8, 2005 CryoLife and its subsidiaries entered into a credit agreement with Wells Fargo Foothill, Inc. as lender (the "Credit Agreement") to address some of its liquidity needs. As of September 30, 2006 the outstanding balance of the Credit Agreement was $4.5 million and the remaining borrowing availability was $10.5 million.

In January 2006 the Company engaged Piper Jaffray & Co. to assist the Company's management and Board of Directors in identifying and evaluating potential strategies to enhance shareholder value. As a result of this review, the Board of Directors has directed management to actively pursue three key strategies in addition to continuing to focus on growing its business and leveraging its strengths and expertise in its core marketplaces. These strategies are designed to generate revenue and earnings growth: identify and evaluate acquisition opportunities of complimentary product lines and companies; license Company technology to third parties for non-competing uses; and analyze and identify underperforming assets for potential sale or disposal. Management's actions related to this Board directive are ongoing.

Product Liability Claims

As discussed in Part I, Item 1, "Note 13 of the Notes to Summary Consolidated Financial Statements", as of September 30, 2006 the Company had accrued a total of $414,000 for settled but unpaid claims and pending product liability lawsuits. The $414,000 accrual is an estimate of the Company's portion of the costs required to resolve outstanding claims, and does not reflect actual settlement arrangements or actual judgments for all open claims, including punitive damages, which may be assessed by the courts. The $414,000 accrual is not a cash reserve. The timing and amount of actual future payments is dependent on when and if judgments are rendered, and/or settlements are reached. Should payments related to the accrual be required, the Company's portion of these monies would have to be paid from liquid assets. The Company continues to attempt to reach resolution of these outstanding claims in order to minimize the potential cash payout.

If the Company is unable to settle the outstanding claims for amounts within its ability to pay or one or more of the product liability claims in which the Company is a defendant should be tried with a substantial verdict rendered in favor of the plaintiff(s), there can be no assurance that such verdict(s) would not exceed the Company's available liquid assets. Failure by the Company to meet required future cash payments to resolve the outstanding product liability claims would have a material adverse effect on the financial position, results of operations, and cash flows of the Company.

As discussed in Part I, Item 1, "Note 13 of the Notes to Summary Consolidated Financial Statements", at September 30, 2006 the Company had accrued a total $7.1 million for the estimated costs of unreported product liability claims related to services performed and products sold prior to September 30, 2006 and had recorded a receivable of $2.5 million representing amounts to be paid by the Company's insurance carriers. Further analysis indicated that the liability could be estimated to be as high as $13.0 million, after including a reasonable margin for statistical fluctuations calculated based on actuarial simulation techniques. The $7.1 million accrual does not represent cash set aside. The timing of future payments related to the accrual is dependent on when and if claims are asserted, judgments are rendered, and/or settlements are reached. Should payments related to the accrual be required, these monies would have to be paid from insurance proceeds and liquid assets. Since the amount accrued is based on actuarial estimates, actual amounts required could vary significantly from this estimate.

Net Cash from Operating Activities

Net cash used in operating activities was $2.9 million for the nine months ended September 30, 2006 as compared to $15.0 million for the nine months ended September 30, 2005. The $2.9 million in current year cash used was primarily due to the Company's working capital needs, as reflected in the increases in deferred preservation costs, inventory, and accounts receivable on the Company's Summary Consolidated Balance Sheet.

The Company uses the indirect method to prepare its cash flow statement, and as such the operating cash flows are based on the Company's net income, which is then adjusted to remove non-cash items included that generated a book gain or loss during the period and for changes in operating assets and liabilities. For the nine months ended September 30, 2006 the Company's $415,000 net income included significant recurring non-cash items that generated favorable and unfavorable adjustments to net income. For the nine months ended September 30, 2006 these adjustments included a favorable $3.6 million in depreciation and amortization, a favorable $1.6 million in write-downs for impairment of deferred preservation costs, and a favorable $853,000 in non-cash compensation, primarily related to the implementation of SFAS 123R, including the expense for new and existing stock options, and the granting of annual stock awards to the board of directors during the second quarter. The Company's working capital needs, or changes in operating assets and liabilities, also affected cash from operations. For the nine months ended September 30, 2006 these changes included an unfavorable $7.5 million due to the buildup of deferred preservation costs and inventories for which vendors and employees have already been paid, an unfavorable $4.0 million due to the timing differences between the recording of receivables and the actual receipt of cash, largely a result of the gross $2.3 million legal settlement receivable ($2.0 million on a net basis) recorded in the third quarter as discussed above, and a favorable $2.1 million due to the timing differences between the recording of accounts payable and other accruals and the actual payment of cash.

Net Cash from Investing Activities

Net cash provided by investing activities was $671,000 for the nine months ended September 30, 2006, as compared to cash used of $3.7 million for the nine months ended September 30, 2005. The $671,000 in current year cash provided was primarily due to $14.6 million in sales and maturities of marketable securities partially offset by $12.4 million in purchases of marketable securities and $1.4 million in capital expenditures.

Net Cash from Financing Activities

Net cash provided by financing activities was $231,000 for the nine months ended September 30, 2006, as compared to $22.7 million for the nine months ended September 30, 2005. The $231,000 in current year cash provided was primarily due to $2.3 million in proceeds from the financing of insurance policies, $585,000 in proceeds from issuance of debt, including borrowing on the Company's line of credit and issuance of new capital leases, and $398,000 in proceeds from exercises of options and issuance of stock. These favorable effects were partially offset by $1.5 million in principal payments on notes payable, $730,000 in payments of Preferred Stock dividends, $428,000 in debt principal payments, and $370,000 in principal payments on capital leases.

Scheduled Contractual Obligations and Future Payments

Scheduled contractual obligations and the related future payments are as follows (in thousands):

	Total	Remainder of 2006	2007	2008	2009	2010	Thereafter
Operating leases	$ 19,891	$ 586	$ 2,282	$ 2,184	$ 2,066	$ 2,103	$ 10,670
Revolving line of credit	4,504	—	—	4,504	—	—	—
Insurance premium obligations	953	931	22	—	—	—	—
Capital lease obligations	393	204	53	52	53	31	—
Purchase commitments	659	657	1	1	—	—	—
Other obligations	733	134	420	179	—	—	—
Total contractual obligations	$ 27,133	$ 2,512	$ 2,778	$ 6,920	$ 2,119	$ 2,134	$ 10,670

The Company's operating lease obligations result from the lease of land and buildings that comprise the Company's corporate headquarters and manufacturing facilities, leases related to additional office and warehouse space rented by the Company, leases on Company vehicles, leases on housing for expatriates, and leases on a variety of office equipment.

The line of credit obligation results from the Company's borrowing of funds under its Credit Agreement. The timing of the obligation in the above table is based on the February 7, 2008 Credit Agreement expiration date, at which time the outstanding principal balance will be due. Due to the terms of the Credit Agreement, and due to the net losses and negative cash flows experienced by the Company since the FDA Order, the Company has classified amounts due under the Credit Agreement as short-term debt on the September 30, 2006 Summary Consolidated Balance Sheet in accordance with the provisions of FASB Technical Bulletin No. 79-3 (As Amended). Assuming the Company's level of borrowings and the interest rate on the line of credit remain the same, the Company would have additional contractual obligations for interest expense and fees of $122,000, $485,000, and $56,000 for the remainder of 2006, for 2007, and for 2008, respectively, which are not included in the table above.

The Company's insurance premium obligations represent installment payments related to payment plans and notes payable from the renewal and financing of certain Company insurance policies.

The Company's capital lease obligations result from the financing of certain of the Company's equipment and leasehold improvements. The liability for the remainder of 2006 includes a lump sum payment due at the termination of certain of the Company's capital leases.

The Company's purchase commitments generally result from agreements with suppliers to stock certain custom raw materials needed for the Company's processing and production.

The Company's other obligations contain various items including minimum required royalty payments, payments to support research and development activities, litigation settlement obligations, and other items as appropriate.

Stock Repurchases

In the first quarter of 2006 the Company's Board of Directors authorized the purchase of shares of its common stock from employees to fund the payment of employee federal and state withholding taxes in association with the grant of stock to employees in February 2006. These repurchases of stock from employees totaled $50,000. No further purchases will be made related to these employee stock grants.

Capital Expenditures

Capital expenditures for the nine months ended September 30, 2006 were $1.4 million. The Company does not expect to have significant capital expenditures during the remainder of 2006. Planned capital expenditures for 2006 are primarily related to the upgrade of the Company's accounting software and related hardware purchases, largely procured in the first half of 2006, and routine purchases of tissue processing, manufacturing, computer, and office equipment needed to support the Company's business.

FORWARD-LOOKING STATEMENTS

This Form 10-Q contains forward-looking statements and information made or provided by the Company that are based on the beliefs of its management as well as estimates and assumptions made by and information currently available to management. The words "could," "may," "will," "would," "should," "pro forma," "potential," "pending," "intend," "believe," "expect," "anticipate," "estimate," "plan," "future," and other similar expressions generally identify forward-looking statements, including, in particular, statements regarding anticipated revenues, cost savings, insurance coverage, regulatory activity, available funds and capital resources, and pending litigation. These forward-looking statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Investors are cautioned not to place undue reliance on these forward-looking statements, which are as of their respective dates. Such forward-looking statements reflect the views of our management at the time such statements are made and are subject to a number of risks, uncertainties, estimates, and assumptions, including, without limitation, in addition to those identified in the text surrounding such statements, those identified under "Risks and Uncertainties" and elsewhere in this filing.

All statements, other than statements of historical facts, included herein that address activities, events, or developments that the Company expects or anticipates will or may occur in the future, are forward-looking statements, including statements regarding:

- Expected improvements in 2006 revenues over 2005,
- The impact of recent accounting pronouncements,
- Adequacy and availability of product liability insurance to defend against lawsuits,
- The outcome of lawsuits filed and claims made against the Company,
- The expected continuing adverse impact of the FDA Order, subsequent FDA activity, and measures taken by the Company as a result, and the resolution of lawsuits and claims on anticipated future revenues, profits, and business operations,
- Factors impacting the Company's long-term liquidity,
- Anticipated continuing revenue increases,
- Possible 2006 and 2007 Department of Defense funding,
- The expected continuing favorable impact of price and fee increases, anticipated processing yield and procurement improvements, and anticipated decreases in the annual cost of lawsuit and claim resolution,
- Expected future impact of continuing demand, price and fee increases, added sales personnel, and costs on revenues and gross margins,
- Potential resolution of the issues raised by the FDA Order and the FDA's Form 483 Notice of Observation,
- Potential clearance of the 510(k) application for CryoValve SG,
- The estimates of the amounts accrued for product liability claims incurred but not reported and expected amounts receivable under insurance policies,
- Changes in liquidity and capital resources,
- Statements regarding the expected 2006 performance of the Company and its business segments, including increased revenues, relative to that of 2005,
- The Company's expectations regarding the adequacy of current liquidity and financing arrangements and anticipated capital expenditures,
- Product demand and market growth,
- Anticipated seasonal trends in future periods,
- The impact of future fluctuations in the value of the Dividend Make-Whole Payment feature of the Company's 6% convertible Preferred Stock, and
- Other statements regarding future plans and strategies, anticipated events, or trends.

These statements are based on certain assumptions and analyses made by the Company in light of its experience and its perception of historical trends, current conditions, and expected future developments as well as other factors it believes are appropriate in the circumstances. However, whether actual results and developments will conform with the Company's expectations and predictions is subject to a number of risks and uncertainties which could cause actual results to differ materially from the Company's expectations, including without limitation, in addition to those specified in the text surrounding such statements, the risk factors set forth below, the risks set forth under "Risk Factors" in Part I, Item 1A of the Company's Form 10-K for the year ended December 31, 2005 and other factors, many of which are beyond the control of the Company. Consequently, all of the forward-looking statements made in this Form 10-Q are qualified by these cautionary statements and there can be no assurance that the actual results or developments anticipated by the Company will be realized or, even if substantially realized, that they will have the expected consequences to or effects on the Company or its business or operations. The Company assumes no obligation to update publicly any such forward-looking statements, whether as a result of new information, future events, or otherwise.

RISKS AND UNCERTAINTIES

The risks and uncertainties which might impact the forward-looking statements and the Company, its ability to continue as a going concern, and the trading value of its common and Preferred Stock include concerns that:

- The Company may be unable to sufficiently reduce costs of processing tissues, to obtain increased yields of implantable tissue, and to increase fees for tissue preservation services,
- If the Company is unable to address the causes of its historical operating losses and negative cash flows, it will need to raise additional capital which may not be available or may not be available on acceptable terms,
- The ability of the Company to successfully implement its strategic plans following the conclusion of its strategic alternatives analysis is uncertain,
- The Company's revolving credit facility imposes restrictions on its ability to borrow, which could make it more difficult to borrow needed funds,
- The Company is significantly dependent on its revenues from BioGlue and is subject to a variety of risks affecting this product,
- The FDA Order and subsequent FDA activity continue to adversely impact CryoLife's business, including reducing demand for its services and increasing processing costs relative to pre-FDA Order levels,
- Revenue from orthopaedic tissue preservation services may not return to acceptable levels,
- Physicians may be reluctant to implant CryoLife's preserved tissues,
- CryoLife's products and the tissues it processes allegedly have caused and may in the future cause injury to patients using its products or tissues and the Company has been and may be exposed to product liability claims and additional regulatory scrutiny as a result,
- Adverse publicity may reduce demand for products and services not affected by the FDA recall,
- CryoLife may be unable to address the concerns raised by the FDA in its Form 483 Notices of Observations,
- The FDA has notified CryoLife of its belief that marketing of CryoValve SG and CryoVein SG require additional regulatory submissions and/or approvals, and CryoLife may be unable to obtain such approvals,
- Regulatory action outside of the U.S. has affected CryoLife's business in the past and may also affect CryoLife's business in the future,
- Violation of government regulations could result in loss of revenues and customers and additional expense to attain compliance,
- CryoLife is the subject of an ongoing SEC investigation,
- CryoLife's insurance coverage has been and in the future may be either insufficient or unavailable by its terms,
- Satisfactory levels of insurance coverage may be difficult or impossible to obtain in the future and if obtained, could be very expensive,
- Intense competition affects CryoLife's ability to recover from the FDA Order,
- CryoLife may not be successful in obtaining necessary clinical results and regulatory approvals for products and services in development, and such products and services may not achieve market acceptance,
- Investments in new technologies or distribution rights may not be successful,
- SynerGraft processed tissues may not demonstrate expected benefits,
- If CryoLife is not successful in expanding its business activities in international markets, it will not be able to pursue one of its strategies for increasing its revenues,
- CryoLife is dependent on its key personnel,
- Extensive government regulation may adversely affect the ability to develop and sell products and services,
- Uncertainties related to patents and protection of proprietary technology may adversely affect the value of CryoLife's intellectual property,
- Future health care reimbursement methods and policies may affect the availability, amount and timing of revenues,
- Future grant funding will depend on a multitude of factors outside of CryoLife's control, and there can be no guarantee that it can be obtained,
- Rapid technological change could cause services and products to become obsolete,
- Anti-takeover provisions may discourage or make more difficult an attempt to obtain control of CryoLife,

- Efforts by existing stockholders or others to gain influence or control over CryoLife may divert management's attention from the Company's operational recovery or otherwise be detrimental to the interests of its other stockholders,
- CryoLife could be left with no choice other than to engage in costly litigation if stockholders or others make inaccurate or misleading proposals or statements that are detrimental to the interests of its other stockholders,
- Common stock dividends are not likely to be paid in the foreseeable future,
- CryoLife may not be able to pay cash dividends on its capital stock due to legal and contractual restrictions and lack of liquidity, and
- Future fluctuations in the value of the Dividend Make-Whole Payment feature of the Company's 6% convertible Preferred Stock may have a material impact on the Company's results of operations.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Interest Rate Risk

The Company’s interest income and expense are sensitive to changes in the general level of United States interest rates. In this regard, changes in United States interest rates affect the interest earned on the Company’s cash and cash equivalents of $4.6 million and the interest incurred on the line of credit balance of $4.5 million as of September 30, 2006. The Company’s short-term investments in marketable securities of $3.0 million as of September 30, 2006 can also be affected by changing interest rates to the extent that these items contain variable interest rates or are subject to maturity or sale during a period of changing interest rates. A 10% adverse change in interest rates affecting the Company’s cash equivalents and short-term investments or borrowings under the Company’s Credit Agreement would not have a material impact on the Company’s financial position, results of operations, or cash flows.

Derivative Valuation Risk

The terms of the Company’s March 18, 2005 6% convertible Preferred Stock offering include a Dividend Make-Whole Payment feature. This feature is considered an embedded derivative instrument. Due to the quarterly revaluation of the derivative liability, the Company recorded other expense of $44,000 and $111,000 for the three and nine months ended September 30, 2006, respectively. At September 30, 2006 the derivative liability was valued at $225,000. The fair value of this derivative is based on various factors, including the market price of the Company’s common stock and discount rates used in determination of fair value. Changes in these factors could cause the fair value of this derivative to fluctuate significantly from period to period. These resulting changes in valuation may have a significant impact on the Company’s results of operations.

Item 4. Controls and Procedures.

The Company’s management, including the Company’s President and Chief Executive Officer (“CEO”) and the Company’s Executive Vice President, Chief Operating Officer, and Chief Financial Officer (“CFO”), does not expect that its disclosure controls will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been or will be detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdown can occur because of simple error or mistake.

Based upon the Company’s most recent disclosure controls evaluation as of September 30, 2006, the CEO and CFO have concluded that the Company’s disclosure controls were effective at the reasonable assurance level to satisfy their objectives and to ensure that the information required to be disclosed by the Company in its periodic reports is accumulated and communicated to management, including the CEO and CFO, as appropriate, to allow timely decisions regarding disclosure and is recorded, processed, summarized, and reported within the time periods specified in the United States Securities and Exchange Commission’s rules and forms.

During the quarter ended September 30, 2006 there were no changes in the Company’s internal control over financial reporting that materially affected or that are reasonably likely to materially affect the Company’s internal control over financial reporting.

Part II - OTHER INFORMATION

Item 1. Legal Proceedings.

See “Note 13 of Notes to Summary Consolidated Financial Statements” at Part I, Item 1, “Financial Statements”, which is incorporated herein by reference.

Item 1A. Risk Factors.

The Company’s most recent Form 10-K was filed February 23, 2006. There have been no material changes from the risk factors previously disclosed in the Company’s Form 10-K in response to Part I, Item 1A of Form 10-K.

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

(c) The following table provides information about purchases by the Company during the quarter ended September 30, 2006 of equity securities that are registered by the Company pursuant to Section 12 of the Exchange Act:

Issuer Purchases of Equity Securities

Common Stock

Period	Total Number of Common Shares Purchased	Average Price Paid per Common Share	Total Number of Common Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Common Shares That May Yet Be Purchased Under the Plans or Programs
07/01/06 – 07/31/06	—	$ —	—	—
08/01/06 – 08/31/06	—	—	—	—
09/01/06 – 09/30/06	343	6.40	—	—
Total	343	$ 6.40	—	—

The Company currently has no stock repurchase program, publicly announced or otherwise. The common shares shown were tendered to the Company in payment of the exercise price of outstanding options.

6% Convertible Preferred Stock

The Company did not repurchase any shares of its 6% convertible preferred stock in the quarter ended September 30, 2006.

Item 3. Defaults Upon Senior Securities.
None.

Item 4. Submission of Matters to a Vote of Security Holders.
None.

Item 5. Other information.
None.

Item 6. Exhibits.

The exhibit index can be found below.

Exhibit Number	Description
3.1	Restated Articles of Incorporation of the Company. (Incorporated herein by reference to Exhibit 3.1 to the Registrant's Form 10-Q for the quarter ended March 31, 2003.)
3.2	Certificate of Amendment to the Amended and Restated Articles of Incorporation of CryoLife, Inc., classifying and designating Series A Junior Participating Preferred Stock. (Incorporated herein by reference to Exhibit 3.1 to the Registrant's Current Report on Form 8-K filed on November 3, 2005.)
3.3	Preferred Stock Articles of Amendment to the Articles of Incorporation of the Registrant. (Incorporated herein by reference to Exhibit 3.4 to the Registrant's Form 8-A/A filed on March 15, 2005.)
3.4	Amended and Restated By-Laws. (Incorporated herein by reference to Exhibit 3.2 to the Registrant's Current Report on Form 8-K filed December 28, 2005.)
4.1	Form of Certificate for the Company's Common Stock. (Incorporated by reference to Exhibit 4.1 to the Registrant's Registration Statement on Form S-1 (No. 33-56388).)
10.1	Settlement Agreement and Release between the Company and St. Paul Mercury Insurance Company dated September 25, 2006.
10.2	Form of Non-Employee Director Restricted Stock Agreement (Incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K Filed on August 7, 2006).
10.3	Form of Employment Agreement, dated as of May 4, 2006, entered into with Dr. Al Heacox, as Senior Vice President, Research and Development, and Mr. Dave Fronk, as Vice President, Regulatory Affairs and Quality Assurance.
31.1	Certification by Steven G. Anderson pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification by D. Ashley Lee pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
32	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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.

CRYOLIFE, INC.
(Registrant)

/s/ STEVEN G. ANDERSON	/s/ DAVID ASHLEY LEE
STEVEN G. ANDERSON Chairman, President, and Chief Executive Officer (Principal Executive Officer)	DAVID ASHLEY LEE Executive Vice President, Chief Operating Officer, and Chief Financial Officer (Principal Financial Officer)

/s/ AMY D. HORTON

AMY D. HORTON
Chief Accounting Officer
(Principal Accounting Officer)

November 3, 2006

DATE

Exhibit 10.1

SETTLEMENT AGREEMENT AND RELEASE

This Settlement Agreement and Release ("Agreement") is entered into by CryoLife, Inc. ("CryoLife") and St. Paul Mercury Insurance Company ("St. Paul"). CryoLife and St. Paul are collectively referred to herein as the "Parties."

RECITALS

WHEREAS, St. Paul issued Excess Policy No. 590CM0484 to CryoLife, with effective dates of coverage from May 1, 2002 to May 1, 2003 (the "Policy");

WHEREAS, the Policy was excess of $10 million in underlying coverage provided by the primary policy issued by National Union Fire Insurance Company ($5 million) and a first-layer excess policy issued by Zurich Insurance Company ($5 million) (collectively, the "Underlying Policies");

WHEREAS, CryoLife also had a third layer of excess coverage, excess of the Underlying Policies, provided by Royal Indemnity Company ("Royal"), in the amount of $5 million ("Royal Policy");

WHEREAS, in July 2002, a securities class action lawsuit styled *In re CryoLife, Inc. Securities Litigation*; Civil Action No. 1:02-CV-1868-BBM in the United States District Court for the Northern District of Georgia Atlanta Division (the "Securities Lawsuit") was filed against CryoLife and several of its directors and officers;

WHEREAS, in January 2003, a shareholder derivative lawsuit styled *Farley v. Anderson, et al.*, Case No. 2003-CV-64109 in the Superior Court of Fulton County, Georgia (the "Derivative Lawsuit") was filed against several of CryoLife's directors and officers;

WHEREAS, CryoLife submitted the Securities Lawsuit and Derivative Lawsuit for coverage consideration under the Underlying Policies, the Policy, and the Royal Policy;

WHEREAS, following mediation in July 2004, CryoLife demanded that its insurers settle the Securities Lawsuit for $16 million;

WHEREAS, St. Paul declined to tender its excess policy's limits of liability to settle the Securities Lawsuit for $16 million;

WHEREAS, the settlement offer in the Securities Lawsuit was withdrawn soon thereafter;

WHEREAS, on April 4, 2005, CryoLife settled the Derivative Lawsuit for $3.5 million;

WHEREAS, on July 21, 2005, CryoLife settled the Securities Lawsuit for $23.25 million, consisting of $19.5 million in cash and $3.75 million in CryoLife stock;

WHEREAS, the Parties dispute whether St. Paul acted properly by not tendering the Policy's limits of liability to settle the Securities Lawsuit in July 2004 (the "Coverage Dispute");

WHEREAS, the Parties participated in mediation of the Coverage Dispute on May 18, 2006, but were unable to reach agreement;

WHEREAS, the Parties desire to avoid the cost, expense and uncertainty of litigation and/or mediation and therefore enter into this Agreement to discharge all claims, controversies or disputes between or among them arising from the Securities Lawsuit, the Derivative Lawsuit, the Coverage Dispute and the Policy, according to the following terms and conditions contained in this Agreement.

AGREEMENTS AND RELEASES

Now, therefore, in consideration of the foregoing recitals and the mutual covenants and promises hereafter set forth, this Agreement is hereby made and confirmed between the Parties as follows:

1. PAYMENT BY ST. PAUL

In consideration of the releases set forth below, St. Paul agrees to pay CryoLife TWO MILLION, TWO HUNDRED FIFTY THOUSAND DOLLARS and No/100 ($2,250,000.00) (the "Settlement Amount"). St. Paul shall remit the Settlement Amount to CryoLife in the form of a check payable to "Bondurant, Mixson & Elmore, LLP, in Trust for CryoLife, Inc." to the offices of Bondurant, Mixson & Elmore, LLP, 3900 One Atlantic Center, 1201 West Peachtree Street, N.W., Atlanta, Georgia 30309 within five (5) days of the undersigned parties executing and delivering this Agreement to Neil Dilloff, DLA Piper US LLP, 6225 Smith Avenue, Baltimore, MD 21209-3600 and Darren Summerville, Bondurant, Mixson & Elmore, LLP, 3900 One Atlanta Center, 1201 West Peachtree Street, N.W., Atlanta, Georgia 30309.

2. FULL COMPLIANCE OF ALL OBLIGATIONS

CryoLife hereby confirms, stipulates and agrees that upon execution of and performance of the obligations set forth in this Agreement, St. Paul will have fully and completely satisfied all obligations, requirements and duties owed to CryoLife and all other Insureds under the Policy, under common law, statute, or otherwise, relating to the matters released herein, including without limitation the Securities Lawsuit, the Derivative Lawsuit, the Coverage Dispute and the Policy.

3. MUTUAL RELEASES

In consideration of the recitals set forth herein, execution of this Agreement, payment of the Settlement Amount and other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, CryoLife, on its behalf and on behalf of any and all other insured persons, entities or organizations who claim or who may claim any right under the Policy, covenants not to sue St. Paul and releases, acquits and forever discharges St. Paul, its present, former and future parent companies, managers, divisions, subsidiaries, affiliates, associates, representatives, predecessors, successors, heirs, owners, assigns, directors, agents, attorneys, third party administrators, partners, principals, officers, employees, trustees, representatives, insurers, reinsurers and all other persons, natural and corporate, in privity with it, separately or severally, from any and all past, present or future claims, demands, suits or causes of action of any kind whatsoever, including but not limited to claims for coverage and indemnification, at common law, statutory, or otherwise, which CryoLife has or might have, known or unknown, arising out of the Securities Lawsuit, the Derivative Lawsuit, the Coverage Dispute or the Policy, specifically including all claims for reimbursement or indemnification of all fees or costs arising from or related in any way to the defense and settlement of the Securities Lawsuit, the Derivative Lawsuit or the Coverage Dispute.

This Agreement specifically includes, but is not limited to, any claims or causes of action for compensatory, punitive or statutory damages based upon any alleged breach of the duty of good faith and fair dealing, unfair claims settlement practices, violation of any statute, including without limitation O.C.G.A. § 33-4-6, and any other applicable provision of the Georgia Insurance Code, or any other acts, omissions, obligations, requirements and duties in any way arising out of, relating to, or in consequence of the Securities Lawsuit, the Derivative Lawsuit, the Coverage Dispute and the Policy.

In consideration of the recitals set forth herein, execution of this Agreement, and other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, St. Paul, on its behalf and on behalf of all persons released in CryoLife's foregoing release of St. Paul, covenants not to sue and releases, acquits and forever discharges CryoLife and all persons giving releases in CryoLife's foregoing release of St. Paul, separately or severally, from any and all past, present or future claims, demands, suits or causes of action of any kind whatsoever, known or unknown, arising out of the Securities Lawsuit, the Derivative Lawsuit, the Coverage Dispute or the Policy, specifically including all claims for reimbursement or recoupment of any amounts paid by St. Paul in the Securities Lawsuit or the Derivative Lawsuit.

4. INDEMNITY AGREEMENT

CryoLife agrees to defend, indemnify, and hold harmless St. Paul and all persons released by CryoLife pursuant to Paragraph 3 , from any future claims, demands, suits or causes of action of any kind whatsoever that arise as a result of CryoLife's prosecution of any claim or claims against Royal for its actions or omissions in connection with the Securities Lawsuit, the Derivative Lawsuit, the Coverage Dispute or the Policy.

5. OWNERSHIP OF CLAIMS

The Parties warrant and represent that they have actual authority to release the claims they purport to release and that they have not and will not assign any interest in the claims, demands, obligations or causes of action referred to in this Agreement or any rights arising out of the Policy to any other person or entity.

6. CONFIDENTIALITY

This Agreement, and the terms and information contained herein, and all negotiations and communications in connection herewith (collectively, the "Confidential Material") shall be kept confidential and shall not be disclosed to anyone under any circumstances except as required by law or order of a court. The Parties shall keep each other fully and promptly advised of any efforts to require the disclosure of the Confidential Material. In the event that either party receives any subpoena, discovery request or similar document which could result in disclosure of the Confidential Material, before any Confidential Material is disclosed, notice of the information request shall be given to the other party in sufficient time to give that party an opportunity to file a Motion to Quash, or, in the alternative, a Motion for Protective Order, and in no event later than seven (7) days after receipt of the subpoena, discovery request, or similar document. Notice shall be given by both certified mail and facsimile as follows:

To St. Paul:
Neil J. Dilloff
DLA Piper US LLP
6225 Smith Avenue
Baltimore, MD 21209-3600
Fax: (410) 580-3138

To CryoLife, Inc.:
Darren Summerville
Bondurant, Mixson & Elmore, LLP
1201 West Peachtree Street, NW
Suite 3900
Atlanta, GA 30309
Fax: (404) 881-4111

This Confidential Material shall be deemed to fall within the protection afforded compromises and offers to compromise by the Georgia Rules of Evidence and the Federal Rules of Evidence.

The Parties further acknowledge and agree that CryoLife, notwithstanding the confidentiality provisions of this section, has reporting obligations under securities law to acknowledge receipt of the Settlement Amount as a “material” event. The Parties agree to collaborate and agree on disclosure language sufficient to protect the Parties’ mutual interest in confidentiality, while simultaneously satisfying CryoLife’s independent reporting obligations. The agreement of the disclosure language shall be in writing. No party shall unreasonably withhold its agreement to the disclosure language.

Willful violation of the confidentiality provisions of this Agreement, if proven by clear and convincing evidence, shall subject the violating party to liquidated damages in the amount of Twenty-Five Thousand and no/100 ($25,000) Dollars, plus reasonable attorneys’ fees and costs associated with proving the violation. These liquidated damages provisions shall not apply to any of mandatory reporting requirements referenced in the preceding paragraph.

7. NO ADMISSION OF COVERAGE

In executing this Agreement, the Parties do not admit or concede any issues regarding coverage under the Policy. Further, no action by St. Paul in handling the claims alleged in the Securities Lawsuit and the Derivative Lawsuit and in executing this Agreement or otherwise will be construed by the Parties as demonstrating or evidencing in any way that the Policy or any other identical or similar insurance policy issued by St. Paul or its related companies provides coverage for any of the matters or claims released herein or any similar matters or claims. The Parties also agree that this Settlement is a compromise of disputed claims and that the payment made and other consideration given in settlement thereof are not to be construed as an admission of any fact, law, wrongdoing or liability on the part of any Party released in Paragraph 3 of this Agreement.

8. SUCCESSORS

It is understood and agreed that this Agreement shall be binding upon the Parties and their respective heirs, representatives, successors and assigns, including without limitation any other insurers for CryoLife.

9. ENTIRE AGREEMENT

This Agreement constitutes the entire agreement between the Parties and supersedes any and all prior agreements, arrangements, or understandings. No other understandings, statements, promises, compromises, representations or inducements contrary to the terms set forth herein exist.

10. SEVERABILITY

In the event that any of the provisions of this Agreement are deemed to be invalid and unenforceable, those provisions shall be severable from the remainder of this Agreement.

11. CHANGE IN KNOWN FACTS

The Parties understand, acknowledge and agree that if any fact now believed to be true is found hereafter to be other than or different from that which is now believed, each party hereto expressly assumes the risk of such difference in fact and agrees that this Agreement shall be and will remain effective notwithstanding any such difference in fact.

12. AUTHORITY

The Parties warrant and represent that they have agreed to the terms of this Agreement, are authorized to enter into this Agreement and are competent to execute this Agreement.

13. ACKNOWLEDGEMENT OF LEGAL ADVICE

The Parties acknowledge that they have read and fully and completely understand each and every term of this Agreement, and execute the Agreement of their own free will and accord for the purposes of the consideration set forth. Furthermore, the Parties confirm, with respect to each of the terms and provisions of this Agreement, that they have conferred with their respective attorneys concerning the effect and obligations imposed thereby and that they fully understand them.

14. AGREEMENT NOT TO PROSECUTE CLAIMS

CryoLife further agrees that it will not prosecute or assist in the prosecution of any legal proceeding against St. Paul or any other persons, natural and corporate, in privity with them, or any one of them, separately or severally, which has as a purpose the recovery of any matter released or waived under this Agreement, including losses arising in any way out of the facts and circumstances giving rise to the Securities Lawsuit and the Derivative Lawsuit. CryoLife further warrants that it will not assist any insurance company or syndicate in any claim of contribution, indemnity, subrogation, allocation and/or apportionment against St. Paul arising out of the Securities Lawsuit, the Derivative Lawsuit, the Coverage Dispute or the Policy.

15. ATTORNEYS' FEES AND COSTS

The Parties agree and acknowledge that they will bear their own attorneys' fees and costs arising from or relating to the Securities Lawsuit, the Derivative Lawsuit, the Coverage Dispute, this Agreement and all matters referenced herein, except as provided in Paragraph 6 of this Agreement in the event of a proven willful violation of the confidentiality provisions of this Agreement.

16. GOVERNING LAW

The laws of the State of Georgia shall govern any dispute concerning the terms and enforceability of this Agreement.

17. HEADINGS

The Parties agree and acknowledge that all headings contained in this Agreement are used solely for the convenience of the Parties and are not to be interpreted as part of this Agreement.

18. MULTIPLE COUNTERPARTS

This Agreement may be executed by the Parties in multiple counterparts, each of which shall be deemed an original and all of which together shall constitute the same agreement.

Date: September 25, 2006

CRYOLIFE, INC.

By: /s/ D. Ashley Lee
Authorized Representative

Printed Name: D. Ashley Lee

STATE OF GEORGIA §
§
COUNTY OF Cobb §

BEFORE ME, the undersigned Notary Public, on this day personally appeared D. Ashley Lee, authorized representative for CryoLife, Inc., who after being duly sworn by me, stated on oath that he/she read and executed this Settlement Agreement and Release for the purposes and consideration herein expressed.

SIGNED this 25th day of September, 2006.

/s/ Suzanne K. Gabbert
Notary Public in and for the
State of Georgia

My Commission Expires: Notary Public, Cobb County, Georgia
My Commission Expires Sept. 13, 2006

Date: 9/22/06

ST. PAUL MERCURY INSURANCE COMPANY

By: /s/ William J. Kobokovich
Authorized Representative

Printed Name: William J. Kobokovich, Jr.

STATE OF MARYLAND §
§
COUNTY OF BALTIMORE §

BEFORE ME, the undersigned Notary Public, on this day personally appeared William J. Kobokovich, Jr., the authorized representative for St. Paul Mercury Insurance Company, who after being duly sworn by me, stated on oath that he/she read and executed this Settlement Agreement and Release for the purposes and consideration herein expressed.

SIGNED this 22nd day of September, 2006.

LORI D. MYERS
NOTARY PUBLIC
CARROLL COUNTY
MARYLAND

/s/ Lori D. Myers
Notary Public in and for the
State of Maryland

My Commission Expires: 1/1/08

EXHIBIT 10.3

EMPLOYMENT AGREEMENT

This Agreement ("the Agreement") dated as of the [as to Mr. Heacox, 4th, and as to Mr. Fronk, 4th] day of May, 2006 (the "Effective Date"), is by and between CryoLife, Inc., a Florida corporation ("CryoLife") and **[Executive's Name]** (the "Employee").

WITNESSETH:

WHEREAS, CryoLife desires, in the best interests of CryoLife and its shareholders, to enter into this Employment Agreement in order to assure the Employee of CryoLife's commitment and, in so doing, to motivate the Employee to continue in Employee's dedicated service to CryoLife even in circumstances such as a possible future threat or occurrence of a Change of Control (defined below) of CryoLife; and,

WHEREAS, the Employee desires to remain employed by CryoLife in the capacity and upon the terms set forth in this Employment Agreement.

NOW, THEREFORE, in consideration of the premises, the promises hereinafter set forth and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, it is hereby agreed as follows:

1. Employment.

(a) CryoLife hereby employs Employee in the capacity of [as to Mr. Heacox, Senior Vice President, Research and Development, and as to Mr. Fronk, Vice President, Regulatory Affairs and Quality Assurance] and Employee hereby accepts such duties as are customarily performed and exercised by such officer subject to the supervision of the President of CryoLife. The duties of Employee shall include those duties more specifically described on Exhibit A attached hereto together with such additional duties as are assigned by the President of CryoLife.

(b) CryoLife agrees to continue the Employee in its employ, and the Employee hereby agrees to remain in the employ of CryoLife subject to the terms and conditions of this Agreement, for the period commencing on the Effective Date and ending on the second anniversary of such date (the "Employment Period"). Unless either party elects not to extend the term of this Agreement by so notifying the other in writing at least 30 days prior to the first anniversary of the Effective Date, the Employment Period shall automatically extend for an additional one year.

2. Employment Duties.

(a) During the Employment Period, (A) the Employee's position (including status, offices, titles and reporting requirements), authority, duties and responsibilities shall be at least commensurate in all material respects with the most significant of those held, exercised and assigned at any time during the 120-day period immediately preceding the Effective Date and (B) the Employee's services shall be performed at the location where the Employee was employed immediately preceding the Effective Date.

(b) During the Employment Period, and excluding any periods of vacation and sick leave to which the Employee is entitled, the Employee agrees to devote reasonable attention and time to the business and affairs of CryoLife and, to the extent necessary to discharge the responsibilities assigned to the Employee hereunder, to use the Employee's reasonable best efforts to perform faithfully and efficiently such responsibilities.

(c) During the Employment Period, the Employee will not, without the prior written consent of CryoLife, directly or indirectly other than in the performance of the duties hereunder, render services of a business, professional or commercial nature to any other person or firm, whether for compensation or otherwise, except with respect to any noncompetitive family businesses of the Employee for which the rendering of such services will not have an adverse effect upon Employee's performance of his duties and obligations hereunder.

3. Compensation, Benefits and Business Expenses.

(a) For all services which Employee renders to CryoLife or any of its subsidiaries or affiliates during the term hereof, CryoLife agrees to pay the Employee the salary and bonus compensation as set by the Compensation Advisory Committee of the Board of Directors. Employee shall be entitled to participate in all compensation and bonus plans made available to CryoLife's executive employees. Employee's salary at the Effective Date is set forth on Exhibit A.

(b) CryoLife shall pay all reasonable expenses incurred by the Employee directly related to performance of his responsibilities and duties for CryoLife hereunder. Employee shall submit to CryoLife statements that justify in reasonable detail all reasonable expenses so incurred. Subject to such audits as CryoLife may deem necessary, CryoLife shall reimburse Employee the full amount of any such expenses advanced by Employee.

(c) Employee shall be entitled to a vacation each year of his employment with CryoLife, according to the standard vacation policy, as well as insurance and other employment benefits, as more particularly described on Exhibit A. Vacations not taken shall be cumulative and carried over to a subsequent year.

4. Change of Control.

(a) In consideration and recognition of the Employee's continued employment and his contribution to protecting and enhancing shareholder value in any future sale of CryoLife that may occur and to provide incentive to Employee as an executive to remain with CryoLife through any future sale or merger of CryoLife, CryoLife has provided in Section 6(a) to increase the severance payment amount upon the occurrence of a Severance Increase Event. A Severance Increase Event shall occur upon the happening of a Change of Control (as defined below) if Employee remains employed by CryoLife at such time or if Employee's employment was terminated by CryoLife without Cause within the six (6) months immediately preceding a Change of Control.

(b) For the purposes of this Agreement, the term "Change of Control" shall mean a change in the beneficial ownership of CryoLife's voting stock or a change in the composition of the Board of the Directors of CryoLife (the "Board") that occurs as follows:

(i) any "person," including a "syndicate" or "group" as those terms are used in Section 13(d)(3) of the Securities Exchange Act of 1934, is or becomes the beneficial owner, directly or indirectly, of securities of CryoLife representing 20% or more of the combined voting power of CryoLife's then outstanding "Voting Securities," which is any security which ordinarily possesses the power to vote in the election of the Board of Directors of a corporation without the happening of any precondition or contingency;

(ii) CryoLife is merged or consolidated with another corporation and immediately after giving effect to the merger or consolidation less than 60% of the outstanding Voting Securities of the surviving or resulting entity are then beneficially owned in the aggregate by (x) the shareholders of CryoLife immediately prior to such merger or consolidation, or (y) if a record date has been set to determine the shareholders of CryoLife entitled to vote on such merger or consolidation, the shareholders of CryoLife as of such record date;

(iii) the following individuals cease for any reason to constitute a majority of the number of directors then serving: individuals who, on the date hereof, constitute the Board and any new director (other than a director whose initial assumption of office is in connection with an actual or threatened election contest, including but not limited to a consent solicitation, relating to the election of directors of CryoLife) whose appointment or election by the Board or nomination for election by CryoLife's stockholders was approved or recommended by a vote of at least two-thirds (2/3) of the directors then still in office who either were directors on the date hereof or whose appointment, election or nomination for election was previously so approved or recommended; or

(iv) CryoLife transfers substantially all of its assets to another corporation which is a less than 60% owned subsidiary of CryoLife.

5. Termination of Employment.

(a) Disability or Death. If CryoLife determines in good faith that the Disability of the Employee has occurred during the Employment Period (pursuant to the definition of Disability set forth below), it may give to the Employee written notice in accordance with Section 12(b) of this Agreement of its intention to terminate the Employee's employment. In such event, the Employee's employment with CryoLife shall terminate effective on the 30th day after receipt of such notice by the Employee (the "Disability Effective Date"), provided that, within the 30 days after such receipt, the Employee shall not have returned to full-time performance of the Employee's duties. For purposes of this Agreement, "Disability" shall mean the absence of the Employee from the Employee's duties with CryoLife on a full-time basis for 180 consecutive days as a result of incapacity due to mental or physical illness or determination by a physician selected by CryoLife or its insurers and acceptable to the Employee or the Employee's legal representative that the Employee is unable to perform the essential functions of his position as a result of incapacity due to mental or physical illness. The Employee's employment shall terminate automatically upon the Employee's death during the Employment Period.

(b) Cause. CryoLife may terminate the Employee's employment during the Employment Period for Cause. For purposes of this Agreement, "Cause" shall mean:

(i) the willful and continued failure of the Employee to perform substantially the Employee's duties with CryoLife (other than any such failure resulting from incapacity due to physical or mental illness), after a written demand for substantial performance is delivered to Employee by the Board or the Chief Executive Officer of CryoLife which specifically identifies the manner in which CryoLife believes that the Employee has not substantially performed the Employee's duties, or

(ii) the willful engaging by the Employee in illegal conduct or gross misconduct which is materially and demonstrably injurious to CryoLife.

For purposes of this provision, no act or failure to act, on the part of the Employee, shall be considered "willful" unless it is done, or omitted to be done, by the Employee in bad faith or without reasonable belief that the Employee's action or omission was in the best interests of CryoLife. Any act, or failure to act, based upon authority given pursuant to a resolution duly adopted by the Board or upon the instructions of the Chief Executive Officer or a senior officer of CryoLife or based upon the advice of counsel for CryoLife shall be conclusively presumed to be done, or omitted to be done, by the Employee in good faith and in the best interests of CryoLife.

(c) Good Reason. The Employee's employment may be terminated by the Employee for Good Reason. For purposes of this Agreement, "Good Reason" shall mean:

(i) the assignment to the Employee of any duties inconsistent in any respect with the Employee's position (including status, offices, titles and reporting requirements), authority, duties or responsibilities as contemplated by Section 1(a) of this Agreement, or any other action by CryoLife which results in a diminution in such position, authority, duties or responsibilities, excluding for this purpose an isolated, insubstantial and inadvertent action not taken in bad faith and which is remedied by CryoLife promptly after receipt of notice thereof given by the Employee;

(ii) any failure by CryoLife to comply with any of the provisions of Section 3(a) or 3(b) of this Agreement, other than an isolated, insubstantial or inadvertent failure not occurring in bad faith and which is remedied by CryoLife promptly after receipt of notice thereof given by the Employee;

(iii) any threatened termination by CryoLife of the Employee's employment other than for Cause, Death or Disability; or

(iv) any failure by CryoLife to comply with and satisfy Section 11(c) of this Agreement.

For purposes of this Section 5(c), any good faith determination of "Good Reason" made by the Employee shall be conclusive. Anything in this Agreement to the contrary notwithstanding, a termination by the Employee for any reason at least 90 days but not more than 120 days following consummation of a Change of Control or during the 30 day period immediately following the first anniversary of a Change of Control shall be deemed to be a termination for Good Reason for all purposes of this Agreement.

(d) Notice of Termination. Any termination by CryoLife for Cause, or by the Employee for Good Reason, shall be communicated by Notice of Termination to the other party hereto given in accordance with Section 12(b) of this Agreement. For purposes of this Agreement, a "Notice of Termination" means a written notice which (i) indicates the specific termination provision in this Agreement relied upon, (ii) to the extent applicable, sets forth in reasonable detail the facts and circumstances claimed to provide a basis for termination of the Employee's employment under the provision so indicated and (iii) if the Date of Termination (as defined below) is other than the date of receipt of such notice, specifies the termination date (which date shall be not more than 30 days after the giving of such notice). The failure by the Employee or CryoLife to set forth in the Notice of Termination any fact or circumstance which contributes to a showing of Good Reason or Cause shall not waive any right of the Employee or CryoLife, respectively, hereunder or preclude the Employee or CryoLife, respectively, from asserting such fact or circumstance in enforcing the Employee's or CryoLife's rights hereunder.

(e) Date of Termination. "Date of Termination" means (i) if the Employee's employment is terminated by CryoLife for Cause, or by the Employee for Good Reason, the date of receipt of the Notice of Termination, or any later date specified therein, as the case may be, (ii) if the Employee's employment is terminated by CryoLife other than for Cause or Disability, the Date of Termination shall be the date on which the Employee receives the Notice of Termination, and (iii) if the Employee's employment is terminated by reason of death or Disability, the Date of Termination shall be the date of death of the Employee or the Disability Effective Date, as the case may be.

(f) Non-Compete Commitment. During the term of this Agreement and for a period of one year after any termination of this Agreement, the Employee agrees not to accept any position as [as to Mr. Heacox, Senior Vice President, Research and Development, and as to Mr. Fronk, Vice President, Regulatory Affairs and Quality Assurance] to any competitor of CryoLife in the cardiac, vascular or orthopedic tissue processing business or biological glue business within the United States. Payments of amounts owing under any Severance Payment (defined in Section 6(a)) obligation, shall be conditioned upon Employee's continued compliance with this non-compete commitment.

(g) Agreement Not to Solicit. During the term of this Agreement and for a period of one year after any termination of this Agreement, the Employee agrees he will not, without the prior written consent of CryoLife, either directly or indirectly, on his own behalf or in the service or on behalf of others, solicit or attempt to solicit, divert or hire away any person then employed by CryoLife.

6. Obligations of CryoLife upon Termination.

(a) Good Reason; Other Than for Cause, Death or Disability. If, during the Employment Period, (i) CryoLife shall terminate the Employee's employment other than for Cause, Death or Disability or (ii) the Employee shall terminate employment for Good Reason, then CryoLife shall pay to Employee as severance compensation an amount equal to one time the aggregate of Employee's annual salary and bonus compensation for the year in which the termination of employment occurs except, however, if a Severance Increase Event has occurred, the severance compensation shall be increased to an amount equal to two times the aggregate of Employee's annual salary and bonus compensation for the year in which the termination of employment occurs (the "Severance Payment"). Such payment shall be in addition to sums due to Employee through the Date of Termination and shall be subject to normal withholding requirements of CryoLife. The Severance Payment shall be payable in cash by CryoLife in 24 equal monthly installments commencing on the date thirty (30) days after Employee's Date of Termination (the "Severance Period"); *provided, however*, that, to the extend required under Section 409A of the Code to avoid the imposition of additional tax to Employee under the Section, any payment of the Severance Payment shall commence on the six-month anniversary of Employee's separation from service with CryoLife (or, if earlier, the date of Employee's death) and continue in equal monthly installments over the remainder of the Severance Period, *provided further*, that, to the extent permitted under Section 409A of the Code without the imposition of additional tax to Employee under that Section, the Severance Payment shall be paid (i) in an immediate lump-sum in the event the Employee's separation from service occurs on or after a Change of Control or (ii) in an immediate lump sum at the time of a Change of Control (less amounts previously paid to Employee) in the event the separation from service occurs within six months prior to a

Change of Control. Payment of any Severance Payment or Retention Payment will be subject to normal withholding. If the employment termination occurs before the awarding of bonuses in the year in which the employment termination occurs, the bonus compensation component of the Severance Payment shall be computed based on the prior year's bonus. Bonus compensation shall include cash bonus payments and the present value of non-cash bonuses such as options or restricted stock.

(b) Death. If the Employee's employment is terminated by reason of the Employee's death during the Employment Period, this Agreement shall terminate without further obligations to the Employee's legal representatives under this Agreement, other than for payment of obligations accruing through the Date of Termination.

(c) Disability. If the Employee's employment is terminated by reason of the Employee's Disability during the Employment Period, this Agreement shall terminate without further obligations to the Employee, other than for payment obligations accruing through the Date of Termination.

(d) Cause; Other than for Good Reason. If the Employee's employment shall be terminated by CryoLife for Cause or by the Employee without Good Reason during the Employment Period, this Agreement shall terminate without further obligations to the Employee other than the obligation to pay to the Employee his salary through the Date of Termination.

7. Non-exclusivity of Rights. Nothing in this Agreement shall prevent or limit the Employee's continuing or future participation in any plan, program, policy or practice provided by CryoLife or any of its affiliated companies and for which the Employee may qualify, nor shall anything herein limit or otherwise affect such rights as the Employee may have under any contract or agreement with CryoLife or any of its affiliated companies. Amounts which are vested benefits or which the Employee is otherwise entitled to receive under any plan, practice or program of or any contract or agreement with CryoLife or any of its affiliated companies at or subsequent to the Date of Termination shall be payable in accordance with such plan, policy, practice or program or contract or agreement except as explicitly modified by this Agreement.

8. Full Settlement. In no event shall the Employee be obligated to seek other employment or take any other action by way of mitigation of the amounts payable to the Employee under any of the provisions of this Agreement and such amounts shall not be reduced whether or not the Employee obtains other employment. CryoLife agrees to pay as incurred, to the full extent permitted by law, all legal fees and expenses which the Employee may reasonably incur as a result of any contest (regardless of the outcome thereof) by CryoLife, the Employee or others of the validity or enforceability of, or liability under, any provision of this Agreement.

9. Limitation or Expansion of Benefits.

(a) In the event it shall be determined that any benefit, payment or distribution by CryoLife to or for the benefit of the Employee (whether payable or distributable pursuant to the terms of this Agreement or otherwise) would, if paid, be subject to the excise tax imposed by Section 4999 of the Internal Revenue Code of 1986, as amended (the "Code"; such excise tax, the "Excise Tax"), then CryoLife shall pay to Employee an additional amount of cash (a "Gross-Up Payment") equal to the amount necessary to cause the amount of the aggregate after-tax compensation and benefits received by the Employee hereunder (after payment of the excise tax under Section 4999 of the Code with respect to any excess parachute payment, and any state and federal income and employment taxes with respect to the Gross-Up Payment) to equal the aggregate after-tax compensation and benefits the Employee would have received if Sections 280G and 4999 of the Code had not been enacted. A nationally recognized public accounting firm selected by CryoLife shall initially determine, at CryoLife's expense, whether an "excess parachute payment" will be made to Employee, and if so, the amount of the Gross-Up Payment. In the event of a subsequent claim by the Internal Revenue Service that, if successful, would result in Employee's liability for an Excise Tax under Section 4999 of the Code in excess of the amount covered by any previous Gross-Up Payment, the Employee shall promptly notify CryoLife in writing of such claim. If CryoLife elects to contest such claim, it shall so notify the Employee and shall bear and pay directly or indirectly all costs and expenses of contesting the claim (including additional interest and penalties incurred in connection with such action), and shall indemnify and hold Employee harmless, on an after-tax basis, for any excise, income, or employment tax, including interest and penalties with respect thereto, imposed as a result of CryoLife's payment of costs of the contest. Employee shall cooperate fully with CryoLife in the defense of any such IRS claim. If, as a result of CryoLife's action with respect to a claim, Employee receives a refund of any amount paid by CryoLife with respect to such claim, Employee shall promptly pay such refund to CryoLife. In the event the IRS claim is finally determined to result in the imposition of additional excise tax under Section 280G of the Code on Employee, CryoLife shall make an additional Gross-Up Payment with respect to any such additional excise tax.

(b) Anything in this Agreement to the contrary notwithstanding, severance, separation and/or similar payments made to the Employee shall be limited to the equivalent of three years salary, including bonuses and guaranteed benefits. If necessary, any Gross-Up Payment will be reduced in order to comply with this provision.

10. Confidential Information. The Employee and CryoLife are parties to one or more separate agreements respecting confidential information, trade secrets, inventions and non-competition (collectively, the "IP Agreements"). The parties agree that the IP Agreements shall not be superceded or terminated by this Agreement and shall survive any termination of this Agreement.

11. Successors.

(a) This Agreement is personal to the Employee and without the prior written consent of CryoLife shall not be assignable by the Employee otherwise than by will or the laws of descent and distribution. This Agreement shall inure to the benefit of and be enforceable by the Employee's legal representatives.

(b) This Agreement shall inure to the benefit of and be binding upon CryoLife and its successors and assigns.

(c) CryoLife will require any successor (whether direct or indirect, by purchase, merger, consolidation or otherwise) to all or substantially all of the business and/or assets of CryoLife to assume expressly and agree to perform this Agreement in the same manner and to the same extent that CryoLife would be required to perform it if no such succession had taken place. As used in this Agreement, "CryoLife" shall mean CryoLife as hereinbefore defined and any successor to its business and/or assets as aforesaid which assumes and agrees to perform this Agreement by operation of law, or otherwise.

12. Miscellaneous.

(a) This Agreement shall be governed by and construed in accordance with the laws of the State of Georgia, without reference to principles of conflict of laws. The captions of this Agreement are not part of the provisions hereof and shall have no force and effect. This Agreement may not be amended or modified otherwise than by a written agreement executed by the parties hereto or their respective successors and legal representatives.

(b) All notices and other communications hereunder shall be in writing and shall be given by hand delivery to the other party or by registered or certified mail, return receipt requested, postage prepaid, addressed as follows:

If to the Employee:

[Employee name and address]

If to CryoLife:

CryoLife, Inc.
1655 Roberts Boulevard, N.W,
Kennesaw, Georgia 30144
Attention: President

or to such other address as either party shall have furnished to the other in writing in accordance herewith. Notice and communications shall be effective when actually received by the addressee.

(c) The invalidity or unenforceability or any provision of this Agreement shall not affect the validity or enforceability of any other provision of this Agreement.

(d) CryoLife may withhold from any amounts payable under this Agreement such Federal, state, local or foreign taxes as shall be required to be withheld pursuant to any applicable law or regulation.

(e) From and after the Effective Date this Agreement shall supersede any other agreement between the parties with respect to the subject matter hereof.

(f) The provisions of this Agreement are intended to satisfy the applicable requirements of Section 409A of the Code and shall be performed and interpreted consistent with such intent. If any provision of this Agreement does not satisfy such requirements or could otherwise cause Employee to be subject to the interest and penalties under Section 409A of the Code, Employee and CryoLife agree to negotiate in good faith an appropriate modification to maintain, to the maximum extent practicable, the original intent of the applicable provision without violating the requirements of Section 409A of the Code (or causing the imposition of additional tax to Employee under Section 409A of the Code).

IN WITNESS WHEREOF, the Employee has hereunder set the Employee's hand and, pursuant to the authorization from its Board, CryoLife has caused these presents to be executed in its name on its behalf, all as of the day and year first above written.

____
[Employee Name]

CRYOLIFE, INC.

By: ________________________________
Steven G. Anderson
Chairman, President and CEO

Exhibit A

Duties and Responsibilities of [Employee Name]:

All duties of [as to Mr. Heacox, Senior Vice President, Research and Development, and as to Mr. Fronk, Vice President, Regulatory Affairs and Quality Assurance] and duties not inconsistent with such duties that are assigned by the President.

Compensation:

Salary of [Mr. Heacox—$265,650 , and Mr. Fronk—$240,000] and bonus set by the Compensation Committee. Salary & Bonus subject to yearly review by the Compensation Committee of the Board of Directors:

Vacation and Employee Benefits:

See attached CryoLife vacation plan, standard CryoLife medical plan and contributory

401K plan.

CryoLife Business:

The development, marketing, sale and distribution of tissue preservation services and biomedical and medical products including cardiac, vascular or orthopedic tissue processing business and biological glues.

Exhibit 31.1

CERTIFICATIONS

I, Steven G. Anderson, certify that:

1. I have reviewed this quarterly report on Form 10-Q of CryoLife, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report.

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 3, 2006

/s/STEVEN G. ANDERSON
Chairman, President, and
Chief Executive Officer

Exhibit 31.2

I, David Ashley Lee, certify that:

1. I have reviewed this quarterly report on Form 10-Q of CryoLife, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report.

4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 3, 2006

/s/DAVID ASHLEY LEE
Executive Vice President,
Chief Operating Officer, and
Chief Financial Officer

Exhibit 32

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of CryoLife Inc. (the “Company”) on Form 10-Q for the quarter ending September 30, 2006, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), each of Steven G. Anderson, the Chairman, President, and Chief Executive Officer of the Company, and David Ashley Lee, the Executive Vice President, Chief Operating Officer, and Chief Financial Officer of the Company, hereby certifies, pursuant to and for purposes of 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to his knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ STEVEN G. ANDERSON	/s/ DAVID ASHLEY LEE
STEVEN G. ANDERSON Chairman, President, and Chief Executive Officer November 3, 2006	DAVID ASHLEY LEE Executive Vice President, Chief Operating Officer, and Chief Financial Officer November 3, 2006