

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

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

For the Quarterly Period Ended March 31, 2002
Commission File Number 0-21104

CRYOLIFE, INC.
(Exact name of registrant as specified in its charter)

Florida
(State or other jurisdiction
of incorporation or organization)

59-2417093
(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

The number of shares of common stock, par value \$0.01 per share, outstanding on May 12, 2002 was 19,532,297.

THIS FILING INCLUDES UNAUDITED FINANCIAL STATEMENTS THAT HAVE NOT BEEN REVIEWED IN ACCORDANCE WITH RULE 10-01(d) OF REGULATION S-X PROMULGATED BY THE SECURITIES AND EXCHANGE COMMISSION. CRYOLIFE, INC. HAS ELECTED NOT TO OBTAIN SUCH A REVIEW FROM ITS PRIOR AUDITOR, ARTHUR ANDERSEN LLP. SEE "INFORMATION WITH RESPECT TO FINANCIAL STATEMENTS" IN THIS FILING FOR MORE INFORMATION.

Part I - FINANCIAL INFORMATION

INFORMATION WITH RESPECT TO FINANCIAL STATEMENTS

This filing includes unaudited financial statements that have not been reviewed in accordance with Rule 10-01(d) of Regulation S-X promulgated by the Securities and Exchange Commission. CryoLife, Inc. has elected not to obtain such a review from its prior auditor, Arthur Andersen LLP. No independent auditor has reviewed the financial statements set forth below or opined that such statements present fairly, in all material aspects, the financial position, results of operations, and cash flows of CryoLife, Inc. for the quarterly period ended March 31, 2002.

On April 11, 2002 CryoLife, Inc. filed a form 8-K, indicating that the Board of Directors, upon the recommendation of the audit committee, had dismissed the accounting firm Arthur Andersen LLP as the Company's auditors effective April 9, 2002. On May 10, 2002 CryoLife, Inc. filed a form 8-K, indicating that the Board of Directors, upon the recommendation of the audit committee, had appointed Deloitte & Touche, LLP as the Company's independent auditors effective May 7, 2002. Deloitte & Touche, LLP will review the financial statements for the quarterly period ended March 31, 2002 in accordance with Rule 10-01(d) and, if in the opinion of such accountants, any changes are required, the Company will

Item 1. Financial statements

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

	Three Months Ended March 31,	
	2002	2001
	(Unaudited)	
Revenues:		
Human tissue preservation services	\$ 20,238	\$ 18,566
Products	5,065	2,641
Distribution and grant	168	225
	-----	-----
	25,471	21,432
Costs and expenses:		
Human tissue preservation services	8,063	7,673
Products	2,235	1,432
General, administrative and marketing	9,478	8,159
Research and development	1,153	1,086
Interest expense	192	--
Interest income	(298)	(562)
Other (income) expense, net	(56)	747
	-----	-----
	20,767	18,535
Income before income taxes	4,704	2,897
Income tax expense	1,600	927
	-----	-----
Net income	\$ 3,104	\$ 1,970
	=====	=====
Earnings per share:		
Basic	\$ 0.16	\$ 0.11
	=====	=====
Diluted	\$ 0.16	\$ 0.10
	=====	=====
Weighted average shares outstanding:		
Basic	19,096	18,749
	=====	=====
Diluted	19,796	19,508
	=====	=====

See accompanying notes to summary consolidated financial statements.

Item 1. Financial Statements

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

	March 31, 2002	December 31, 2001
ASSETS	-----	
	(Unaudited)	
	-	
Current Assets:		
Cash and cash equivalents	\$ 6,566	\$ 7,204
Marketable securities, at market	25,057	26,483
Trade receivables, net	16,893	13,305
Other receivables, net	2,127	2,820
Note receivable, net	885	1,169
Deferred preservation costs, net	26,828	24,199
Inventories	6,484	6,259
Prepaid expenses and other assets	2,156	2,341
Deferred income taxes	155	688

Total current assets	87,151	84,468

Property and equipment, net	39,544	39,246
Goodwill, net	1,399	1,399
Patents, net	3,436	2,919
Other, net	1,136	1,278

TOTAL ASSETS	\$ 132,666	\$ 129,310
	=====	
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	\$ 1,653	\$ 555
Accrued expenses and other current liabilities	1,662	1,491
Accrued compensation	1,353	2,560
Accrued procurement fees	6,948	6,592
Current maturities of capital lease obligations	1,086	609
Current maturities of long-term debt	1,600	1,600
Convertible debenture	--	4,393

Total current liabilities	14,302	17,800

Capital lease obligations, less current maturities	2,514	3,140
Bank loan, less current maturities	5,200	5,600
Deferred income taxes	238	449
Other long-term liabilities	931	882

Total liabilities	23,184	27,871

Shareholders' equity:		
Preferred stock	---	---
Common stock (issued 20,793 shares in 2002 and 20,172 shares in 2001)	208	202
Additional paid-in capital	72,389	66,828
Retained earnings	43,649	40,547
Deferred compensation	(30)	(33)
Accumulated other comprehensive income	(256)	(145)
Less: Treasury stock at cost (1,308 shares in 2002 and 1,286 shares in 2001)	(6,479)	(5,960)

Total shareholders' equity	109,481	101,439

TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 132,666	\$ 129,310
	=====	

See accompanying notes to summary consolidated financial statements.

	Three Months Ended March 31,	
	2002	2001
	(Unaudited)	
Net cash from operating activities:		
Net income	\$ 3,104	\$ 1,970
Adjustments to reconcile net income to net cash provided by operating activities:		
Gain on sale of marketable equity securities	(10)	--
Depreciation and amortization	1,230	1,009
Provision for doubtful accounts	24	24
Other non-cash adjustments to income	--	748
Deferred income taxes	365	(411)
Tax effect of nonqualified option exercises	306	72
Changes in operating assets and liabilities:		
Receivables	(3,513)	(1,553)
Income Taxes	594	1,245
Deferred preservation costs and inventories	(2,854)	(671)
Prepaid expenses and other assets	185	(165)
Accounts payable, accrued expenses, and other liabilities	380	(927)
Net cash flows (used in) provided by operating activities	(189)	1,341
Net cash flows from investing activities:		
Capital expenditures	(1,398)	(4,924)
Other assets	(412)	17
Purchases of marketable securities	(11,725)	(2,613)
Sales and maturities of marketable securities	13,036	3,932
Proceeds from note receivable	284	237
Net cash flows used in investing activities	(215)	(3,351)
Net cash flows from financing activities:		
Principal payments of debt	(400)	--
Payment of obligations under capital leases	(149)	(43)
Proceeds from exercise of stock options and issuance of common stock	348	244
Net cash (used in) provided by financing activities	(201)	201
Decrease in cash	(605)	(1,809)
Effect of exchange rate changes on cash	(33)	(3)
Cash and cash equivalents, beginning of period	7,204	17,480
Cash and cash equivalents, end of period	\$ 6,566	\$ 15,668

See accompanying notes to summary consolidated financial statements.

CRYOLIFE, INC. AND SUBSIDIARIES
NOTES TO SUMMARY CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 - BASIS OF PRESENTATION

The accompanying unaudited condensed 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. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial presentations. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Certain prior year balances have been reclassified to conform to the 2002 presentation. CryoLife, Inc.'s unaudited prior year quarterly results of operations have been

revised from the data originally presented in the Form 10-Q for the quarter ended March 31, 2001, as indicated in Note 20 to the consolidated financial statements included in the CryoLife, Inc. Form 10-K for the year ended December 31, 2001. Operating results for the three months ended March 31, 2002 are not necessarily indicative of the results that may be expected for the year ending December 31, 2002. For further information, refer to the consolidated financial statements and notes thereto included in the CryoLife, Inc. ("CryoLife" or the "Company") Form 10-K for the year ended December 31, 2001.

NOTE 2 - CASH EQUIVALENTS AND MARKETABLE SECURITIES

The Company maintains cash equivalents and investments in several large, well-capitalized financial institutions, and the Company's policy disallows investment in any securities rated less than "investment-grade" by national rating services.

Management determines the appropriate classification of debt securities at the time of purchase and reevaluates such designations as of each balance sheet date. 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. Debt securities not classified as held-to-maturity or trading and marketable equity securities not classified as trading are classified as available-for-sale. At March 31, 2002 and December 31, 2001, all marketable equity securities and debt securities were designated as available-for-sale.

Available-for-sale securities are stated at their fair values, with the unrealized gains and losses, net of tax, reported in a separate component of shareholders' equity. Interest income, 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.

The following is a summary of cash equivalents and marketable securities, all of which are classified as available-for-sale (in thousands):

March 31, 2002	Cost Basis	Adjustments to Cost Basis	Adjusted Cost Basis	Unrealized Holding Gains/(Losses)	Estimated Market Value
Cash equivalents:					
Money market funds	\$ 1,575	\$ --	\$ 1,575	\$ --	\$ 1,575
Municipal obligations	3,454	--	3,454	--	3,454
	<u>\$ 5,029</u>	<u>\$ --</u>	<u>\$ 5,029</u>	<u>\$ --</u>	<u>\$ 5,029</u>
Marketable securities:					
Municipal obligations	\$ 17,670	\$ --	\$ 17,670	\$ 77	\$ 17,747
Debt securities	6,227	(1,217)	5,010	(19)	4,991
Equity securities	2,625	(343)	2,282	(26)	2,256
Certificates of deposit	63	--	63	--	63
	<u>\$ 26,585</u>	<u>\$ (1,560)</u>	<u>\$ 25,025</u>	<u>\$ 32</u>	<u>\$ 25,057</u>

December 31, 2001	Cost Basis	Adjustments to Cost Basis	Adjusted Cost Basis	Unrealized Holding Gains/(Losses)	Estimated Market Value
Cash equivalents:					
Money market funds	\$ 1,301	\$ --	\$ 1,301	\$ --	\$ 1,301
Municipal obligations	500	--	500	--	500
	<u>\$ 1,801</u>	<u>\$ --</u>	<u>\$ 1,801</u>	<u>\$ --</u>	<u>\$ 1,801</u>
Marketable securities:					
Municipal obligations	\$ 17,696	\$ --	\$ 17,696	\$ 147	\$ 17,843
Debt securities	6,227	(1,217)	5,010	--	5,010
Equity securities	3,900	(343)	3,557	10	3,567
Certificates of deposit	63	--	63	--	63
	<u>\$ 27,886</u>	<u>\$ (1,560)</u>	<u>\$ 26,326</u>	<u>\$ 157</u>	<u>\$ 26,483</u>

The Adjustments to Cost Basis column includes a \$1.6 million loss recorded in 2001 for an other than temporary decline in the market value of debt and equity securities. Differences between cost and market listed above, consisting of a net unrealized holding gain less deferred taxes of \$11,000 at March 31, 2001 and \$50,000 as of December 31, 2001, are included as a separate component of shareholders' equity.

At March 31, 2002 and December 31, 2001 approximately \$4.6 million and \$3.4 million, respectively, of marketable securities had a maturity date between 90 days and 1 year, approximately \$13.2 million and \$14.5 million of marketable securities mature between 1 and 5 years, and approximately \$7.3 million and \$8.6 million of marketable securities mature in more than 5 years or do not have a maturity date.

NOTE 3 - INVENTORIES

Inventories are comprised of the following (in thousands):

	March 31, 2002	December 31, 2001

(Unaudited)		
Raw materials	\$ 1,943	\$ 1,987
Work-in-process	990	1,183
Finished goods	3,551	3,089
	-----	-----
	\$ 6,484	\$ 6,259
	=====	=====

NOTE 4 - EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share (in thousands, except per share data):

	Three Months Ended March 31,	
	2002	2001

(Unaudited)		
Numerator for basic and diluted earnings per share - income available to common shareholders	\$ 3,104	\$ 1,970
	=====	=====
Denominator for basic earnings per share - weighted-average basis	19,096	18,749
Effect of dilutive stock options	700	759
	-----	-----
	7	
Denominator for diluted earnings per share - adjusted weighted-average shares	19,796	19,508
	=====	=====
Earnings per share:		
Basic	\$ 0.16	\$ 0.11
	=====	=====
Diluted	\$ 0.16	\$ 0.10
	=====	=====

NOTE 5 - DEBT

On April 25, 2000 the Company entered into a loan agreement, permitting the Company to borrow up to \$8 million under a line of credit during the expansion of the Company's corporate headquarters and manufacturing facilities. Borrowings

under the line of credit accrued interest equal to Adjusted LIBOR plus 2% adjusted monthly. On June 1, 2001, the line of credit was converted to a term loan (the "Term Loan") to be paid in 60 equal monthly installments of principal plus interest computed at Adjusted LIBOR plus 1.5% (3.37% at March 31, 2002). The Term Loan contains certain restrictive covenants including, but not limited to, maintenance of certain financial ratios and a minimum tangible net worth requirement. The Term Loan is secured by substantially all of the Company's assets. As of March 31, 2002 the Company was in compliance with these covenants.

In March 1997 the Company issued a \$5.0 million convertible debenture in connection with the Ideas for Medicine, Inc. acquisition. The debenture accrued interest at 7% and was convertible into common stock of the Company at any time prior to the due date of March 2002 at \$8.05 per common share. On March 30, 1998 \$607,000 of the convertible debenture was converted into 75,000 shares of the Company's common stock, and on March 4, 2002 the remaining \$4.4 million was converted into 546,000 shares of the Company's common stock.

NOTE 6 - DERIVATIVES

The Company's Term Loan, which accrues interest computed at Adjusted LIBOR plus 1.5%, exposes the Company to changes in interest rates going forward. On March 16, 2000, the Company entered into a \$4 million notional amount forward-starting interest swap agreement, which took effect on June 1, 2001 and expires in 2006. This swap agreement was designated as a cash flow hedge to effectively convert a portion of the Term Loan balance to a fixed rate basis, thus reducing the impact of interest rate changes on future income. This agreement involves the receipt of floating rate amounts in exchange for fixed rate interest payments over the life of the agreement, without an exchange of the underlying principal amounts. The differential to be paid or received is recognized in the period in which it accrues as an adjustment to interest expense on the Term Loan.

At March 31, 2002 the notional amount of this swap agreement was \$3.4 million, and the fair value of the interest rate swap agreement, as estimated by the bank based on its internal valuation models, was a liability of \$291,000. The fair value of the swap agreement is recorded as part of long-term liabilities and is recorded net of tax as part of accumulated other comprehensive income within the Statement of Shareholders' Equity.

NOTE 7 - ACCUMULATED OTHER COMPREHENSIVE INCOME

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

Three months ended:	Net Income	Unrealized Gain/(Loss) on Investments	Change in Fair Value of Interest Rate Swap	Translation Adjustment	Comprehensive Income
March 31, 2002	\$ 3,104	\$ (86)	\$ 8	\$ (33)	\$ 2,993
March 31, 2001	\$ 1,970	\$ 702	\$ (163)	\$ (3)	\$ 2,506

The tax effect on the change in unrealized gain/loss on investments is \$39,000, and \$339,000 for the three months ended March 31, 2002 and 2001, respectively. The tax effect on the change in fair value of the interest rate swap is \$5,000 and \$84,000 for the three months ended March 31, 2002 and 2001, respectively. The translation adjustment is not currently adjusted for income taxes as it relates to a permanent investment in a foreign subsidiary.

NOTE 8 - ACCOUNTING PRONOUNCEMENTS

On January 1, 2002 the Company was required to adopt SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"), and SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"). SFAS 142 specifies that goodwill and certain other intangible assets will no longer be amortized but instead will be subject to periodic impairment testing. SFAS 144 clarifies accounting and reporting for assets held for sale, scheduled for abandonment or other disposal, and recognition of impairment loss related to the carrying value

of long-lived assets. The Company has completed its impairment testing as required by FAS 142. The adoption of these statements did not have a material effect on the consolidated financial statements of the Company. However, the adoption of SFAS 142 will increase the Company's pretax income by approximately \$100,000 in 2002 due to the cessation of goodwill amortization.

The Company will be required to adopt SFAS No. 143, "Accounting for Asset Retirement Obligations" ("SFAS 143") on January 1, 2003. SFAS 143 addresses accounting and reporting for asset retirement costs of long-lived assets resulting from legal obligations associated with acquisition, construction, or development transactions. The Company has determined that the adoption of SFAS 143 will not have a material effect on the results of operations or financial position of the Company.

NOTE 9 - SEGMENT INFORMATION

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

The HUMAN TISSUE PRESERVATION SERVICES segment includes external revenue from cryopreservation services of cardiovascular, vascular, and orthopaedic human tissue. The IMPLANTABLE MEDICAL DEVICES segment includes external revenue from product sales of BioGlue Surgical Adhesive and bioprosthetic devices, including stentless porcine heart valves, SynerGraft treated porcine heart valves, and SynerGraft treated bovine vascular grafts. There are no intersegment sales.

The primary measure of segment performance, as viewed by the Company's management, is segment gross margin, or net external revenues less cost of preservation services and products. 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 preservation services and products, and gross margin for the Company's operating segments (in thousands):

March 31, 2002	Revenue	Cost of Preservation Services and Products	Gross Margin
Human tissue preservation services	\$ 20,238	\$ 8,063	\$ 12,175
Implantable medical devices	5,065	2,235	2,830
All other (a)	168	--	168
	\$ 25,471	\$ 10,298	\$ 15,173
=====			
March 31, 2001			
Human tissue preservation services	\$ 18,566	\$ 7,673	\$ 10,893
Implantable medical devices	2,641	1,432	1,209
All other (a)	225	--	225
	\$ 21,432	\$ 9,105	\$ 12,327
=====			

(a) The All Other designation includes 1) grant revenue and 2) distribution revenue.

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

Revenue	March 31, 2002	March 31, 2001
Human tissue preservation services:		
Cardiovascular tissue	\$ 7,307	\$ 6,911
Vascular tissue	7,017	6,412
Orthopaedic tissue	5,914	5,243

Total preservation services	20,238	18,566
BioGlue surgical adhesive	4,873	2,442
Bioprosthetic devices	192	199
Distribution and grant	168	225

	\$ 25,471	\$ 21,432
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PART I - FINANCIAL INFORMATION

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

CRITICAL ACCOUNTING POLICIES

A summary of the Company's significant accounting policies is included in Note 1 to the consolidated financial statements, as filed in the Form 10-K for the fiscal year ended December 31, 2001. Management believes that the consistent application of these policies enables the Company to provide the users of the financial statements with useful and reliable information about the Company's operating results and financial condition. The consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States, 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.

REVENUE RECOGNITION: The Company recognizes revenue in accordance with SEC Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" ("SAB 101"), which provides guidance on applying generally accepted accounting principles to revenue recognition issues. Revenues for human tissue preservation services are recognized when services are completed and tissue is delivered to the customer. Revenues for products are recognized at the time the product is shipped, at which time title passes to the customer. There are no further performance obligations and delivery occurs upon shipment. Revenues from research grants are recognized in the period the associated costs are incurred. The Company assesses the likelihood of collection based on a number of factors, including past transaction history with the customer and the credit-worthiness of the customer.

DEFERRED PRESERVATION COSTS: Tissue is procured from deceased human donors by organ procurement agencies and tissue banks which consign the tissue to the Company for processing and preservation. Preservation costs related to tissue held by the Company are deferred until revenue is recognized upon shipment of the tissue to the implanting hospital. Deferred preservation costs consist primarily of laboratory expenses, tissue procurement fees, fringe and facility allocations, and freight-in charges, and are stated, net of reserve, on a first-in, first-out basis.

INTANGIBLE ASSETS: Goodwill resulting from business acquisitions is not amortized, but is instead subject to periodic impairment testing in accordance with FAS 142. Patent costs are amortized over the expected useful lives of the patents (primarily 17 years) using the straight-line method. Other intangibles, which consist primarily of manufacturing rights and agreements, are amortized over the expected useful lives of the related assets (primarily five years). The Company periodically evaluates the recoverability of noncurrent tangible and intangible assets and measures the amount of impairment, if any.

NEW ACCOUNTING PRONOUNCEMENTS

On January 1, 2002 the Company was required to adopt SFAS No. 142, "Goodwill and Other Intangible Assets" ("SFAS 142"), and SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS 144"). SFAS 142 specifies that goodwill and certain other intangible assets will no longer be amortized but instead will be subject to periodic impairment testing. SFAS 144 clarifies accounting and reporting for assets held for sale, scheduled for abandonment or other disposal, and recognition of impairment loss related to the carrying value of long-lived assets. The Company has completed its impairment testing as required by FAS 142. The adoption of these statements did not have a material

effect on the consolidated financial statements of the Company. However, the adoption of SFAS 142 will increase the Company's pretax income by approximately \$100,000 in 2002 due to the cessation of goodwill amortization.

The Company will be required to adopt SFAS No. 143, "Accounting for Asset Retirement Obligations" ("SFAS 143") on January 1, 2003. SFAS 143 addresses accounting and reporting for asset retirement costs of long-lived assets resulting from legal obligations associated with acquisition, construction, or development transactions. The Company has determined that the adoption of SFAS 143 will not have a material effect on the results of operations or financial position of the Company.

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RESULTS OF OPERATIONS

Revenues increased 19% to \$25.5 million for the three months ended March 31, 2002 from \$21.4 million for the same period in 2001. The increase in revenues was primarily due to increased sales of BioGlue Surgical Adhesive and growth in the Company's preservation services. The increases are primarily attributable to the receipt of FDA approval for BioGlue in December 2001, a greater acceptance of these products by the surgical community and the Company's ability to procure greater amounts of tissue.

Revenues from the sale of BioGlue Surgical Adhesive increased 100% to \$4.9 million for the three months ended March 31, 2002 from \$2.4 million for the three months ended March 31, 2001, representing 19% and 11%, respectively, of total revenues during such periods. The increase in revenues is due to a 77% increase in the number of milliliter shipments of BioGlue. The increase in shipments was primarily due to the receipt of FDA approval in December 2001 for the use of BioGlue in the U.S. as an adjunct in open surgical repair of large vessels for adult patients. Domestic revenues accounted for 80% and 66% of total BioGlue revenues for the three months ended March 31, 2002 and 2001, respectively.

Quarter over quarter statistics presented for tissues procured and processed for human tissue preservation services are from the period beginning in November of the prior year through January of the year presented, as such procurement and processing of tissues received during this time period is the primary generator of first quarter revenues. During the time period for which procurement statistics are discussed, the Company benefited from significant increases in procurement due to new relationships with tissue banks and competitive wins of tissue bank contracts. Additionally, the Company has changed certain tissue acceptance guidelines, which has resulted in an increase in tissues procured and processed. These increases in procurement surpassed the Company's expectations during this period. Although the Company expects this increase in procurement to continue, there can be no assurance that these procurement levels can be maintained. Due to a variety of factors, including the time required to process these greater amounts of tissue, the increase in processing time and complexity for tissues processed using the SynerGraft technology, and the focus of the Company on the marketing and roll-out of BioGlue, these increases did not directly translate into equivalent increases in revenues from preservation services. As a result of this increased procurement, the level of deferred preservation costs increased in all of the Company's main tissue service categories: cardiac, vascular, and orthopaedic. These higher levels of deferred preservation costs are expected to drive some revenue growth in the short term as the Company provides services related to the more critical implant needs. The Company expects that the majority of this increase in procurement will generate more modest increases in service revenues over a longer period of time, as less critical need tissues and tissues of various sizes are properly matched with recipients.

Revenues from cardiovascular preservation services increased 6% to \$7.3 million for the three months ended March 31, 2002 from \$6.9 million for the three months ended March 31, 2001, representing 29% and 32%, respectively, of total revenues during such periods. This increase in revenues resulted from a 4% increase in the number of cardiovascular allograft shipments as a result of a 27% increase in cardiovascular tissues procured and processed quarter over quarter.

Revenues from human vascular tissue preservation services increased 9% to \$7.0 million for the three months ended March 31, 2002 from \$6.4 million for the three months ended March 31, 2001, representing 28% and 30%, respectively, of total revenues during such periods. This increase in revenues was primarily due to a 10% increase in average service fees in 2002 as compared to 2001 despite a

1% decrease in the number of vascular allograft shipments. Average service fees were higher during the first quarter of 2002 due to an increase in longer singular vascular grafts shipped per case relative to shorter multiple grafts, used as composite grafts, shipped per case in the first quarter of 2001. The number of cases for which vascular grafts were shipped increased over the first quarter of 2001. Vascular tissues procured and processed increased 41% quarter over quarter.

Revenues from human orthopaedic tissue preservation services increased 13% to \$5.9 million for the three months ended March 31, 2002 from \$5.2 million for the three months ended March 31, 2001, representing 23% and 24%, respectively, of total revenues during such periods. This increase in revenues was primarily due to a 9% increase in the number of orthopaedic allograft shipments. The increase in orthopaedic shipments, primarily boned tendons, resulted from a 47% increase in orthopaedic allograft tissues procured and processed quarter over quarter and an increasing acceptance of these tissues in the orthopaedic surgeon community. Shipments of boned tendons increased 66% in 2002 due to increased availability

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of these higher demand tissues, which resulted in a \$500,000 increase in revenues in 2002 as compared to 2001. Additional increases in revenues are due to a more favorable product mix, with increased shipments of hemi-osteochondral grafts, which carry higher average service fees than other orthopaedic tissues.

Revenues from bioprosthetic cardiovascular devices decreased 4% to \$192,000 for the three months ended March 31, 2002 from \$199,000 for the three months ended March 31, 2001, representing 1% of total revenues during such periods.

Distribution and grant revenues decreased to \$168,000 for the three months ended March 31, 2002 from \$225,000 for the three months ended March 31, 2001. The decrease in grant revenues is due to the completion of one of the Company's federal grant award programs in December 2001, partially offset by \$141,000 of distribution revenues for orthopaedic grafts. Grant revenues both years are primarily attributable to the SynerGraft research and development programs.

Cost of human tissue preservation services aggregated \$8.1 million for the three months ended March 31, 2002 compared to \$7.7 million for the three months ended March 31, 2001, representing 40% and 41%, respectively, of total human tissue preservation service revenues during each such periods. Cost of products aggregated \$2.2 million for the three months ended March 31, 2002 compared to \$1.4 million for the three months ended March 31, 2001, representing 44% and 54%, respectively, of total product revenues during such periods. The decrease in the 2002 cost of products as a percentage of total product revenues is due to a more favorable product mix during 2002. The product mix was impacted by an increase in revenues from BioGlue Surgical Adhesive, which carries higher gross margins than bioprosthetic devices.

General, administrative, and marketing expenses increased 16% to \$9.5 million for the three months ended March 31, 2002, compared to \$8.2 million for the three months ended March 31, 2001, representing 37% and 38%, respectively, of total revenues during such periods. The increase in expenditures in 2002 was primarily due to an increase in marketing and general expenses to support revenue growth and increased overhead costs in connection with the expansion of the corporate headquarters and manufacturing facility, which was substantially complete in the first quarter of 2002.

Research and development expenses increased 6% to \$1.2 million for the three months ended March 31, 2002, compared to \$1.1 million for the three months ended March 31, 2001, representing 5% of total revenues during each such period. Research and development spending in the first quarter of 2002 was primarily focused on the Company's SynerGraft and Protein Hydrogel Technologies.

Interest income, net of interest expense, was \$106,000 and \$562,000 for the three months ended March 31, 2002 and 2001, respectively. The 2002 decrease in net interest income is due to reduced interest rates in 2002 as compared to 2001 and the lack of interest expense capitalized in 2002 in connection with the expansion of the corporate headquarters and manufacturing facility, which was substantially completed in the first quarter of 2002.

Other income was \$56,000 for the three months ended March 31, 2002 as compared to other expense of \$747,000 for the three months ended March 31, 2001. Other expense in the first quarter of 2001 consisted of a \$747,000 loss related to an other than temporary decline in the market value of marketable securities

previously recorded in comprehensive income as a component of shareholder's equity.

The effective income tax rate was 34% and 32% for the periods ended March 31, 2002 and 2001, respectively.

SEASONALITY

The demand for the Company's cardiovascular tissue preservation services is 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. However, the demand for the Company's human vascular and orthopaedic tissue preservation services, BioGlue Surgical Adhesive, and bioprosthetic cardiovascular and vascular devices does not appear to experience seasonal trends.

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LIQUIDITY AND CAPITAL RESOURCES

At March 31, 2002 net working capital was \$72.8 million, compared to \$66.7 million at March 31, 2001, with a current ratio of 6 to 1. The Company's primary capital requirements arise out of general working capital needs, capital expenditures and lease payments for facilities and equipment, and funding of research and development projects. The Company historically has funded these requirements through bank credit facilities, cash generated by operations, and equity offerings.

Net cash used in operating activities was \$189,000 for the three months ended March 31, 2002, as compared to cash provided of \$1.3 million for the three months ended March 31, 2001. This decrease in cash was primarily due to an increase in working capital requirements due to sales growth and expansion of product lines, partially offset by an increase in net income before depreciation, taxes, and non cash items.

Net cash used in investing activities was \$215,000 for the three months ended March 31, 2002, as compared to \$3.4 million for the three months ended March 31, 2001. This decrease in cash used was primarily attributable to a reduction in capital expenditures in 2002 as the expansion and renovation of the Company's corporate headquarters and manufacturing facilities approached completion, partially offset by an increase in patent costs.

Net cash used by financing activities was \$201,000 for the three months ended March 31, 2002, as compared to cash provided of \$201,000 for the three months ended March 31, 2001. This decrease was primarily due to the principal payments on the term loan made during the current quarter. As repayment of the term loan began in June 2001, no principle payments were made in the prior year quarter.

On March 4, 2002 the \$4.4 million convertible debenture due on March 5, 2002 was converted into approximately 546,000 shares of common stock at \$8.05 per common share.

The Company's Term Loan contains certain restrictive covenants including, but not limited to, maintenance of certain financial ratios and a minimum tangible net worth requirement. The Term Loan is secured by substantially all of the Company's assets. As of March 31, 2002 the Company was in compliance with these covenants.

The Company's Term Loan, which accrues interest computed at Adjusted LIBOR plus 1.5%, exposes the Company to changes in interest rates going forward. On March 16, 2000, the Company entered into a \$4 million notional amount forward-starting interest swap agreement, which took effect on June 1, 2001 and expires in 2006. This swap agreement was designated as a cash flow hedge to effectively convert a portion of the Term Loan balance to a fixed rate basis, thus reducing the impact of interest rate changes on future income. This agreement involves the receipt of floating rate amounts in exchange for fixed rate interest payments over the life of the agreement, without an exchange of the underlying principal amounts. The differential to be paid or received is recognized in the period in which it accrues as an adjustment to interest expense on the Term Loan.

On January 1, 2001 the Company adopted SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" ("SFAS 133") as amended. SFAS 133 requires the Company to recognize all derivative instruments on the balance sheet at fair

value, and changes in the derivative's fair value must be recognized currently in earnings or other comprehensive income, as applicable. The adoption of SFAS 133 impacts the accounting for the Company's forward-starting interest rate swap agreement. Upon adoption of SFAS 133, the Company recorded an unrealized loss of approximately \$175,000 related to the interest rate swap, which was recorded as part of long-term liabilities and accumulated other comprehensive income within the Statement of Shareholders' Equity.

At March 31, 2002 the notional amount of this swap agreement was \$3.4 million, and the fair value of the interest rate swap agreement, as estimated by the bank based on its internal valuation models, was a liability of \$291,000. The fair value of the swap agreement is recorded as part of long-term liabilities and is recorded net of tax as part of accumulated other comprehensive income within the Statement of Shareholders' Equity.

Since October 1998 management has been seeking to enter into a corporate collaboration or to complete a potential private placement of equity or equity-oriented securities to fund the commercial development of its Activation Control Technology ("ACT"). This technology is now held by the Company's wholly-owned subsidiary AuraZyme Pharmaceutical, Inc., which was formed on February 26, 2001. This strategy, if successful, will allow an affiliated entity

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to fund the ACT and should expedite the commercial development of its oncology, fibrin olysis (blood clot dissolving), and surgical sealant product applications without additional research and development expenditures by the Company (other than through the affiliated company). This strategy, if successful, will favorably impact the Company's liquidity going forward. However, if the Company is unable to obtain funds for the commercial development of the ACT and/or if the Company decides to fund the technology itself, the expenses required to fund the ACT could adversely impact the Company's liquidity going forward.

The Company anticipates that current cash, marketable securities and cash generated from operations will be sufficient to meet its operating and development needs for at least the next 12 months. However, the Company's future liquidity and capital requirements beyond that period will depend upon numerous factors, including the timing of the Company's receipt of FDA approvals to begin clinical trials for its products currently in development, the resources required to further develop its marketing and sales capabilities if and when those products gain approval, the resources required for any additional expansion of its corporate headquarters and manufacturing facility, the extent to which the Company's products generate market acceptance and demand, and the outcome of the litigation described at Item 3 of the Form 10-K for the fiscal year ended December 31, 2001. There can be no assurance the Company will not require additional financing or will not seek to raise additional funds through bank facilities, debt or equity offerings, or other sources of capital to meet future requirements. These 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, and results of operations.

FORWARD LOOKING STATEMENTS

Statements made in this Form 10-Q that look forward in time or that express management's beliefs, expectations or hopes regarding future occurrences, including the possible requirement to file an amended Form 10-Q because no independent auditor has reviewed the financial statements set forth herein, continuation of procurement increases, the effect of changes in interest rates on the Company's income, the effect of new accounting pronouncements, funding to continue development of ACT, future expenses related to this technology, the sufficiency of funds to meet operating and development needs over the next 12 months and other statements regarding future plans and strategies, anticipated events or trends and similar expressions concerning matters that are not historical facts are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These future events may not occur when expected, if at all, and are subject to various risks and uncertainties. Such risks and uncertainties include the timing of the Company's receipt of FDA approvals to begin clinical trials for its products currently in development, potential loss of relationships with tissue banks or other tissue providers, the resources required to further develop marketing and sales capabilities, the resources required for any additional expansion of the Company's corporate headquarters, the extent to which the Company's products generate market acceptance and demand, the outcome of any litigation,

competition from other companies, the continued acceptance of the Company's products and other risk factors detailed in the Company's Securities and Exchange Commission filings, including the Company's Form 10-K for the year ended December 31, 2001.

Item 3. Quantitative and Qualitative Disclosures About Market Risk.

The Company's interest income and expense are most sensitive to changes in the general level of U.S. interest rates. In this regard, changes in U.S. interest rates affect the interest earned on the Company's cash and cash equivalents of \$6.6 million and short-term investments in municipal obligations of \$17.7 million as of March 31, 2002, as well as interest paid on its debt. A 10% adverse change in interest rates affecting the Company's cash equivalents and short-term investments would not have a material impact on the Company's interest income for 2002.

The Company manages interest rate risk through the use of fixed debt and an interest rate swap agreement. At March 31, 2002 approximately \$3 million of the Company's \$7 million in debt charged interest at a fixed rate. This fixed rate debt includes a portion of the Company's outstanding term loan balance that has been effectively converted to fixed rate debt through an interest rate swap agreement. A 10% increase in interest rates affecting the Company's variable rate debt, net of the effect of the interest rate swap agreement, would not have a material increase in the Company's interest expense for 2002.

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Part II - OTHER INFORMATION

Item 1. Legal Proceedings.

For a discussion of certain legal proceedings, see Part I Item 3 in the Company's Form 10-K for the year ended December 31, 2001.

Item 2. Changes in Securities.

None

Item 3. Defaults Upon Senior Securities.

Not Applicable

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

None

Item 5. Other information.

None.

Item 6. Exhibits and Reports on Form 8-K

(a) The exhibit index can be found below.

Exhibit

Number Description

3.1 Restated Certificate of Incorporation of the Company, as amended. (Incorporated by reference to Exhibit 3.1 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2000.)

3.2 ByLaws of the Company, as amended. (Incorporated by reference to Exhibit 3.2 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 1995.)

3.3 Articles of Amendment to the Articles of Incorporation of the Company. (Incorporated by reference to Exhibit 3.3 to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 31, 2000.)

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).)

(b) No Reports on Form 8-K were filed during the quarter.

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)

May 15, 2002

/s/ DAVID ASHLEY LEE

DATE

DAVID ASHLEY LEE
Vice President and Chief Financial
Officer
(Principal Financial and
Accounting Officer)