

2005 Annual Report

OPPORTUNITY
CHALLENGE

Young Innovations, Inc.

FINANCIAL HIGHLIGHTS

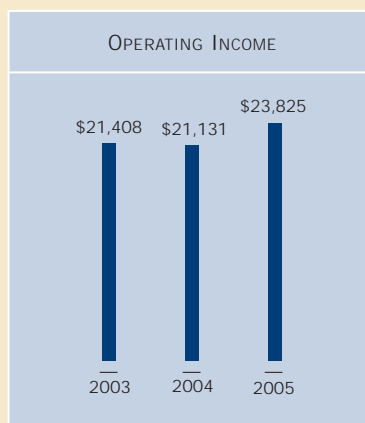
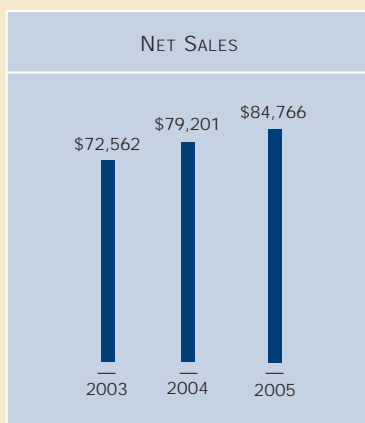
OPERATING RESULTS (In thousands except for per share data)	2005	2004	2003	% Change 2004-2005
Net Sales	\$84,766	\$79,201	\$72,562	7.0%
Operating Income	23,825	21,131	21,408	12.8%
Net Income from Continuing Operations	15,338	13,137	13,286	16.8%
Net Income	15,338	13,934	13,201	10.0%
Diluted Earnings Per Share from Continuing Operations	\$ 1.65	\$ 1.40	\$ 1.41	17.9%
Diluted Earnings Per Share	1.65	1.48	1.40	11.5%
Weighted Average Fully Diluted Shares Outstanding	9,312	9,409	9,431	1.0%
Net Cash Flows from Operating Activities	\$17,843	\$12,531	\$16,441	42.4%

FINANCIAL POSITION

Working Capital	\$28,186	\$19,428	\$12,676
Cash & Equivalents	10,227	2,552	938
Stockholders' Equity	103,564	95,137	82,963

FINANCIAL RATIOS

Operating Income to Net Sales	28.1%	26.7%	29.5%
Net Income to Net Sales	18.1%	17.6%	18.2%



LETTER TO SHAREHOLDERS

In 2005, Young Innovations achieved record financial results, posting sales and diluted earnings per share of \$85 million and \$1.65, respectively. This performance reflects sales growth of 7% and earnings per share growth of 12%. While we are pleased with these results, it is important to note that driving growth has never been without its challenges, and 2005 was no exception. Throughout the year we managed through changing markets for our products, consolidation activities and a difficult acquisition environment. These challenges presented opportunities for the Company to grow and improve.

In 2005, we encountered shifts in the market dynamics of a number of our core product lines. In particular, we experienced an unexpected decline in sales of our panoramic X-ray systems late in the fourth quarter. This caused us to refocus on the critical needs of our customers. We worked to identify new financing, service and system options to strengthen our market position. Additionally, we acquired D & N Microproducts, Inc., the supplier of key components and assembly services for our panoramic X-ray systems. This purchase gives us the flexibility to address future customer demands more quickly and effectively. We remain positive about our competitive position in the panoramic X-ray market, and we believe the steps we have taken will further strengthen this franchise.

Competitive stresses in our endodontic product line increased when two competitors entered our segment of the market for obturation systems. We believe we will benefit from increased awareness in the product category resulting from the additional marketing activity of these new competitors. Having recently introduced our next generation obturation system, the Obtura III, we continued to work on a number of new product initiatives to upgrade and strengthen our product offering. With a refreshed product line and solid base of existing users we believe we are well-positioned to continue to take part in the growth of the endodontic category.



L to R:
Arthur L. Herbst, Jr.
Alfred E. Brennan
George E. Richmond

OPPORTUNITY CHALLENGE

With respect to our consolidation activities, we completed the move of our Louisville, Colorado manufacturing operations into our Earth City, Missouri facility. This move was the final step in consolidating our chemical operations, reducing the number of facilities from three to one, in order to support the growth of this product line. During the final stages of this process, we identified weaknesses in the production of our fluoride products. Confirming our commitment to quality, we elected to voluntarily recall certain fluoride products. In addition, we redesigned and upgraded certain fluoride manufacturing processes and quality systems. We believe that as a result of this experience we are stronger and better able to manage the future growth of our chemical product line.

We did not complete a significant acquisition in 2005 due to the difficult transaction environment, characterized by higher prices and limited availability of quality targets. Low interest rates, aggressive lending practices, and increased interest in the category from private equity funds put upward pressure on the prices for acquisitions. While this caused us to reexamine our acquisition criteria, we ultimately decided to maintain our transaction discipline. We remain active in the acquisition market, and we continue to challenge ourselves to consider creative ways to source and structure transactions. We believe that our financial and organizational structure allows us to competitively approach a wide range of businesses.

In addition, given the challenging acquisition environment, we worked to develop an operating company less dependent on acquisitions for future growth. We have restructured our sales organizations and formed product management functions to enable a more focused approach to building market share in our core product categories. We also added capacity to our management team in a number of key areas across the organization. We will need to continue to attract and retain qualified individuals to facilitate our goal of increasing internal growth rates over the next three years.

After eight years as a public company, we remain committed to our three-pronged growth strategy focused on evolutionary product development, increasing operating efficiencies, and completing strategic acquisitions. Our Company is flexible, values continuous learning, and has a proven ability to execute on this strategy. This has enabled us to deliver solid financial results for our shareholders over time.

We would like to extend our sincere appreciation to our Board of Directors, who helped us achieve record results despite a difficult operating environment. We appreciate their counsel, guidance and support.

We are grateful to our employees and proud of the manner in which they responded to the challenges they faced throughout the year. We believe that in aggressively confronting these challenges, they were able to turn them into opportunities. It is their hard work and enthusiasm that make us optimistic about the future growth potential of the Company.



GEORGE E. RICHMOND
CHAIRMAN OF THE BOARD



ALFRED E. BRENNAN
VICE CHAIRMAN OF THE BOARD
& CHIEF EXECUTIVE OFFICER



ARTHUR L. HERBST, JR.
PRESIDENT

An unexpected decline in sales of our panoramic
X-ray systems at the end of the fourth quarter.

CHALLENGE OPPORTUNITY

To refocus our organization on the critical needs of our
customers to strengthen our leading position in this market.

- We worked to identify new financing,
service and system options that will strengthen
our market position
- We restructured our sales organization

The need to continue to evolve and improve
our prophy product offering.

CHALLENGE OPPORTUNITY

To acquire and/or develop new technologies that will improve and enhance our prophy product offering, in order to maintain and grow our strong leading position in the product category.

- We established a product management function to oversee this critical product line
- We acquired intellectual property relating to prophy cup designs from Brahler Technologies, Inc.

In completing the consolidation of our Louisville, Colorado operations into our Earth City, Missouri facility, we identified weaknesses in the production of our fluoride products.

CHALLENGE OPPORTUNITY

To reinforce our commitment to high quality standards, and build the quality infrastructure for continued growth in our fluoride product line.

- We voluntarily recalled some of our fluoride products
- We redesigned and upgraded our manufacturing processes and quality systems associated with our fluoride products
- We restructured the management of our fluoride operations

A difficult acquisition environment, characterized by increased prices and limited availability of quality targets.

CHALLENGE OPPORTUNITY

To reexamine our acquisition criteria and improve our processes for acquiring strategic businesses.

- We evaluated the propriety of our historical acquisition criteria, and decided to reaffirm our transaction discipline
- We identified creative ways for sourcing and structuring acquisitions

A difficult acquisition environment, characterized by increased prices and limited availability of quality targets.

CHALLENGE OPPORTUNITY

To build an operating organization less dependant on acquisitions for growth that may achieve internal growth in excess of historical rates.

- We restructured our sales organizations and formed product management functions to enable a more focused approach to building market share in our core product categories
- We added managerial strength in a variety of key operating functions throughout the Company
- We anticipate further investments in human capital to achieve our growth objectives for the long-term

FINANCIAL
REVIEW

SELECTED FINANCIAL DATA

The following table presents selected financial data of the Company. This historical data should be read in conjunction with the Consolidated Financial Statements and the related notes thereto and "Management's Discussion and Analysis of Financial Condition and Results of Operations." All amounts except per share data are expressed in thousands.

<i>Year ended December 31</i>	2005	2004	2003 ⁽¹⁾	2002 ⁽²⁾	2001 ⁽³⁾
Income Statement Data					
Net sales	\$84,766	\$79,201	\$72,562	\$67,147	\$58,824
Cost of goods sold	<u>38,851</u>	<u>35,851</u>	<u>32,129</u>	<u>30,025</u>	<u>26,397</u>
Gross profit	45,915	43,350	40,433	37,122	32,427
Selling, general and administrative expenses	<u>22,090</u>	<u>22,219</u>	<u>19,025</u>	<u>18,562</u>	<u>16,943</u>
Income from operations	23,825	21,131	21,408	18,560	15,484
Interest (income) expense and other, net	<u>(485)</u>	<u>(144)</u>	<u>(109)</u>	<u>286</u>	<u>225</u>
Income from operations before provision for income taxes	24,310	21,275	21,517	18,274	15,259
Provision for income taxes	<u>8,972</u>	<u>8,138</u>	<u>8,231</u>	<u>7,127</u>	<u>5,875</u>
Income from continuing operations	15,338	13,137	13,286	11,147	9,384
Income (loss) from discontinued operations	<u>0</u>	<u>797</u>	<u>(85)</u>	<u>264</u>	<u>161</u>
Net income	<u>15,338</u>	<u>\$13,934</u>	<u>\$13,201</u>	<u>\$11,411</u>	<u>\$9,545</u>
Basic earnings per share ⁽⁴⁾	\$1.71	\$1.54	\$1.46	\$1.29	\$0.99
Basic earnings per share from continuing operations	\$1.71	\$1.45	\$1.47	\$1.26	\$0.97
Basic earnings per share from discontinued operations	\$0.00	\$0.09	\$(0.01)	\$0.03	\$0.02
Basic weighted average common shares outstanding ⁽⁴⁾	8,957	9,040	9,017	8,876	9,662
Diluted earnings per share ⁽⁴⁾	\$1.65	\$1.48	\$1.40	\$1.22	\$0.96
Diluted earning per share from continuing operations	\$1.65	\$1.40	\$1.41	\$1.19	\$0.95
Diluted earning (loss) per share from discontinued operations	\$0.00	\$0.08	\$(0.01)	\$0.03	\$0.01
Diluted weighted average common shares outstanding ⁽⁴⁾	9,312	9,409	9,431	9,331	9,904
Cash dividends declared per common share	\$0.16	\$0.16	\$0.06	n/a	n/a

<i>As of December 31</i>	2005	2004	2003 ⁽¹⁾	2002 ⁽²⁾	2001 ⁽³⁾
Balance Sheet Data					
Working capital	\$28,186	\$19,428	\$12,676	\$12,645	\$12,439
Total assets	118,089	109,829	101,484	84,988	83,605
Total debt (including current maturities)	0	0	2,852	4,304	16,984
Stockholders' equity	<u>103,564</u>	<u>95,137</u>	<u>82,963</u>	<u>67,670</u>	<u>55,885</u>

⁽¹⁾ On December 1, 2003 the Company acquired substantially all of the assets of Obtura Corporation and Earth City Technologies (collectively "Obtura Spartan"). The income statement data for the year ended December 31, 2003 include results of operations for Obtura Spartan from December 1, 2003 through December 31, 2003. The balance sheet data as of December 31, 2003 include the Obtura Spartan acquisition.

⁽²⁾ Weighted average common shares outstanding decreased from 2001 to 2002 primarily as a result of the Company's buyback of 1,050 shares from George E. Richmond, its Chairman of the Board and then Chief Executive Officer, in November 2001.

⁽³⁾ On June 12, 2001 the Company acquired substantially all of the assets of the Biotrol and Challenge subsidiaries of Pro-Dex, Inc. (collectively "Biotrol"). The income statement data for the year ended December 31, 2001 include results of operations for Biotrol from June 12, 2001 through December 31, 2001. The balance sheet data as of December 31, 2001 include the Biotrol acquisition.

⁽⁴⁾ Earnings per share data and shares outstanding retroactively reflect the impact of the three-for-two stock split of the Company's Common Stock in the form of a stock dividend payable on March 28, 2002 to stockholders of record as of the close of business on March 22, 2002. All share and per share numbers give effect to such stock split.

Market for Registrant's Common Equity and Related Stockholder Matters

Market Prices and Dividends

The Company's Common Stock trades on the Nasdaq National Market under the symbol "YDNT."

The following table sets forth the high and low prices of the Company's Common Stock as reported by the Nasdaq National Market during the last eight quarters.

On January 31, 2006, there were approximately 141 holders of record of the Company's Common Stock.

The Company has paid quarterly dividends on its Common Stock since the third quarter of 2003.

Payment of future cash dividends will be at the discretion of the Company's Board of Directors and will be dependent upon the earnings and financial condition of the Company and any other factors deemed relevant by the Board of Directors, and will be subject to any applicable restrictions contained in the Company's then existing credit arrangements.

2004	Quarter	Market Price		Cash Dividends Declared
		High	Low	
	First	\$38.86	\$33.27	\$0.04
	Second	\$36.53	\$25.25	\$0.04
	Third	\$33.10	\$23.96	\$0.04
	Fourth	\$36.10	\$29.77	\$0.04
<hr/>				
2005				
	First	\$36.72	\$32.00	\$0.04
	Second	\$41.94	\$35.44	\$0.04
	Third	\$37.95	\$32.08	\$0.04
	Fourth	\$39.00	\$31.45	\$0.04

Forward-Looking Statements

This Annual Report includes "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). All statements other than statements of historical facts included herein are "forward-looking statements." Although the Company believes that the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations will prove to be correct. Forward-looking statements include statements which are predictive in nature, which depend upon or refer to future events or conditions and which include words such as "expects," "anticipates," "intends," "plans," "believes," "estimates," or similar expressions. These statements are not guaranties of future performance, and the Company makes no commitment to update or disclose any revisions to forward-looking statements, or any facts, events or circumstances after the date hereof that may bear upon forward-looking statements. Because such statements involve risks and uncertainties,

actual actions and strategies and the timing and expected results thereof may differ materially from those expressed or implied by such forward-looking statements. These risks and uncertainties include, but are not limited to, those disclosed in this Annual Report and Form 10-K and other reports filed with the Securities and Exchange Commission for the year ended December 31, 2005.

The Company makes no commitment to update these factors or to revise any forward-looking statements for events or circumstances occurring after the statement is issued.

At any time when the Company makes forward-looking statements, it desires to take advantage of the "safe harbor" which is afforded such statements under the Private Securities Litigation Reform Act of 1995.

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

All numbers in thousands, except per share data

General

Young Innovations, Inc. and subsidiaries ("the Company") develop, manufacture, and market supplies and equipment used to facilitate the practice of dentistry and to promote oral health. The Company's product offerings include disposable and metal prophylaxis ("prophy") angles, prophy cups and brushes, prophy pastes, panoramic X-ray machines, dental handpieces (drills) and related components, home care kits, orthodontic and children's toothbrushes, flavored examination gloves, infection control products, ultrasonic cleaning systems, ultrasonic scaling and endodontic systems, and obturation systems used in endodontic surgery (root canal procedures). These products are primarily marketed to dental professionals, principally dentists, endodontists, orthodontists, dental hygienists and dental assistants. The Company's manufacturing and distribution facilities are located in Missouri, California, Indiana, Tennessee, Texas and Canada.

The Company operates in one reporting segment, which is the development and manufacture of a broad line of products marketed to dental professionals. The Company markets its products primarily in the U.S. The Company also markets its products in several international markets, including Canada, Europe, South America, Central America, and the Pacific Rim. International sales represented less than 10% of the Company's total net sales in 2005, 2004 and 2003.

In December 2004, the Company completed the sale of the retail division of its Plak Smacker subsidiary. The retail division, which was previously reported as a distinct reporting segment, sold toothbrushes, children's toothpastes and dental accessories to mass merchandisers under the Plak Smacker brand name. As a result of the disposition, we have reclassified our financial statements to reflect the retail segment as discontinued operations.

Critical Accounting Policies

In December 2001, the SEC requested that all registrants include in their MD&A a description of their most critical accounting policies, the judgments and uncertainties affecting the application of those policies, and the likelihood that materially different amounts would be reported under different conditions using different assumptions. The SEC indicated that a "critical accounting policy" is one which is both important to the portrayal of the company's financial condition and results and requires management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. We believe that the following accounting policies fit this definition:

Allowance for doubtful accounts – The Company has 38% of its December 31, 2005 accounts receivable balance with two large customers (see footnote 6 of the notes to consolidated financial statements) with the remaining balance comprised of amounts due from numerous customers, some of which are international. Accounts receivable balances are subject to credit risk. Management has reserved for expected credit losses, sales returns and allowances, and discounts based upon past experience, as well as knowledge of current customer information. We believe that our reserves are adequate. It is possible, however, that the accuracy of our estimation process could be impacted by unforeseen circumstances. We continuously review our reserve balance and refine the estimates to reflect any changes in circumstances.

Inventory – The Company values inventory at the lower of cost or market on a first-in, first-out (FIFO) basis. Inventory values are based upon standard costs, which approximate historical costs. Management regularly reviews inventory quantities on hand and records a provision for excess or obsolete inventory based primarily on estimated product demand and other information related to the inventory including planned introduction of new products and changes in technology. If demand for the Company's products is significantly different than management's expectations, the

reserve could be materially impacted. Charges to the reserves are included in cost of goods sold.

Goodwill and other intangible assets – The Company adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Intangible Assets," effective January 1, 2002. Goodwill and other intangible assets with indefinite useful lives are reviewed by management for impairment at least annually, or whenever events or changes in circumstances indicate the carrying amount may not be recoverable. If indicators of impairment are present, the determination of the amount of impairment would be based on management's judgment as to the future operating cash flows to be generated from the assets. SFAS No. 142 also requires that intangible assets with estimable useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets."

Contingencies – The Company and its subsidiaries from time to time are subject to various contingencies, including legal proceedings arising in the normal course of business. Management, with the assistance of external legal counsel, performs an analysis of current litigation, and will record liabilities if a loss is probable and can be reasonably estimated. The Company believes the reserve is adequate; however, it cannot guarantee that costs will not be incurred in excess of current estimates.

Assets and liabilities acquired in business combinations – The Company periodically acquires businesses. All business acquisitions completed subsequent to 2002 were accounted for under the provisions of SFAS No. 141, "Business Combinations," which requires the use of the purchase method. All business acquisitions completed in years prior to 2002 were accounted for under the purchase method as set forth in APB No. 16, "Business Combinations." The purchase method requires the Company to allocate the cost of an acquired business to the assets acquired

and liabilities assumed based on their estimated fair values at the date of acquisition. The allocation of acquisition cost to assets acquired includes the consideration of identifiable intangible assets. The excess of the cost of an acquired business over the fair value of the assets acquired and liabilities assumed is recognized as goodwill. The Company's measurement of fair values and certain preacquisition contingencies may impact the Company's cost allocation to assets acquired and liabilities assumed for a period of up to one year following the date of an acquisition. The

Company utilizes a variety of information sources to determine the value of acquired assets and liabilities. For larger acquisitions, third-party appraisers are utilized to assist the Company in determining the fair value and useful lives of identifiable intangibles, including the determination of intangible assets that have an indefinite life. The valuation of the acquired assets and liabilities and the useful lives assigned by the Company will impact the determination of future operating performance of the Company.

Results of Operations

The following table sets forth, for the periods indicated, certain items from the Company's statements of income expressed as a percentage of net sales.

<i>Year ended December 31</i>	2005	2004	2003
Net sales	100.0%	100.0%	100.0%
Cost of goods sold	45.8	45.3	44.3
Gross profit	54.2	54.7	55.7
Selling, general and administrative expenses	26.1	28.1	26.2
Income from continuing operations	28.1	26.6	29.5
Interest expense (income) and other, net	(.6)	(.2)	(.2)
Income from continuing operations before provision for income taxes	28.7	26.8	29.7
Provision for income taxes	10.6	10.2	11.4
Net income from continuing operations	18.1	16.6	18.3
Net income from discontinued operations	0	1.0	(.1)
Net income	18.1%	17.6%	18.2%

Year Ended December 31, 2005 Compared to Year Ended December 31, 2004

Net Sales – Net sales from continuing operations for the year ended December 31, 2005 were \$84,766, up 7.0% or \$5,565 from \$79,201 in the prior year. The sales increase was largely a result of favorable comparisons due to a significant decrease in sales experienced in the second quarter of 2004 as a result of a restructuring of certain sales incentive programs to dealers in May 2004. Strong dealer response to targeted marketing initiatives in 2005 and solid end-user demand for a majority of the Company's products also contributed to the increase. These increases were partially offset by the suspension, in the third quarter, of manufacturing and sales of certain chemical products, which represented approximately \$2,400 of annual sales. The Company also experienced a decline in sales in the diagnostic product line in the last month of the year.

The sales incentive programs that were restructured by the Company in 2004 principally consisted of off-invoice pricing discounts (i.e., a discount reflected directly on the billing and requiring no performance obligation on the part of the customer). For accounting purposes, these discounts were recorded in the net sales account at the time of sale. During the second quarter of 2004, the Company eliminated certain of these promotional pricing incentives, which reduced customer orders and sales in that quarter. The reason for this second quarter change was to transition to product-line-based pricing promotions from the brand based promotions that had been run in previous periods. These changes were made to facilitate certain new product introductions and facilities consolidation efforts, while providing for improved service levels to the Company's distributors.

Gross Profit – Gross profit increased \$2,565, or 5.9%, from \$43,350 in 2004 to \$45,915 in 2005. The additional gross profit was primarily a result of the increased net sales. Gross margin decreased slightly from 54.7% in 2004 to 54.2% in 2005. The increase in sales volume as well as changes in product mix had a positive impact on the gross profit margin. These margin improvements were offset by the effects of temporary production inefficiencies related to facility consolidation activity and the impact of the voluntary recall of certain chemical products in the third quarter of 2005.

Selling, General and Administrative Expenses ("SG&A") – SG&A expenses remained relatively consistent, decreasing by \$129, or 0.6%, to \$22,090 in 2005 from \$22,219 in 2004. The decrease in SG&A is primarily attributable to headcount reductions related to facility consolidations, reduced management incentive compensation consistent with our results and solid expense control. These decreases were partially offset by increased costs related to the growth in infrastructure of the business, such as regulatory and facilities costs. As a percentage of net sales, SG&A expenses decreased to 26.1% in 2005 from 28.1% in 2004 as a result of the factors explained above.

Income from Operations – Income from operations in 2005 was \$23,825 compared to \$21,131 in 2004, an increase of 12.8%. The increase is a result of the factors described above.

Interest (income) expense and other, net – Other income, net increased to \$485 versus \$144 in 2004. This increase was primarily attributable to lower interest expense in the current year, as no borrowings were outstanding on the Company's credit facility during 2005.

Provision for Income Taxes – During the year ended 2005, the Company's provision for income taxes increased to \$8,972 versus \$8,138 in 2004 as a result of higher pre-tax income partially offset by a decrease in the effective tax rate. The effective tax rate in 2005 was approximately 37.0% compared to 38.25% in 2004. The lower effective tax rate in 2005 is primarily attributable to recognition of a tax benefit associated with a non-recurring capital loss, which created a \$.03 per share benefit in the Company's

third quarter results. The 2005 rate also reflected the estimated impact of the IRC Section 199 manufacturing deduction.

Discontinued Operations – The results of operations and gain from the sale of our retail segment, which was sold in December 2004, were reflected as discontinued operations in the results of that year. The 2004 results include sales of \$3,086 and related operating income of \$1,292, including a pre-tax gain on the sale of \$1,156, net of certain transaction costs.

Year Ended December 31, 2004 Compared to Year Ended December 31, 2003

Net Sales – Net sales from continuing operations increased \$6,639, or 9.1%, to \$79,201 in 2004 from \$72,562 in 2003. The increase was the result of incremental sales from acquired businesses and growth in end-user demand for our products. Approximately \$8,000 of this growth is the result of the acquisition of Obtura Spartan on December 1, 2003. The increase was offset by a reduction in second quarter sales resulting from the restructuring of sales incentive programs to dealers.

Gross Profit – Gross profit increased \$2,917, or 7.2%, to \$43,350 in 2004 from \$40,433 in 2003. Gross margin decreased from 55.7% in 2003 to 54.7% in 2004. The decrease in gross margin was primarily the result of changes in product mix.

Selling, General and Administrative Expenses ("SG&A") – SG&A expenses increased \$3,194, or 16.8%, to \$22,219 in 2004 from \$19,025 in 2003. The increase in SG&A costs in 2004 is primarily attributable to incremental SG&A expenses from acquired businesses. Additionally, increased personnel and related costs necessary to comply with the new Sarbanes-Oxley legislation con-

tributed to the increase in 2004. These increases were partially offset by a reduction in performance-based compensation expense and personnel costs resulting from consolidation activities. As a percentage of net sales, SG&A expenses increased to 28.1% in 2004 from 26.2% in 2003 as a result of the factors explained above.

Income from Operations – Income from operations decreased \$277, or 1.3%, to \$21,131 in 2004 from \$21,408 in 2003 as a result of the factors explained above.

Provision for Income Taxes – Provision for income taxes decreased to \$8,138 in 2004 from \$8,231 in 2003 primarily as a result of lower pre-tax income. The effective tax rate was 38.25% in 2004 and 2003.

Discontinued Operations – The results of operations and gain from the sale of our retail segment, which was sold in December 2004, are reflected as discontinued operations. The 2004 results include sales of \$3,086 and related operating income of \$1,292. This includes a pre-tax gain on the sale of \$1,156, net of certain transaction costs.

Liquidity and Capital Resources

Sources of Cash

Historically, the Company has financed its operations primarily through cash flow from operating activities and, to a lesser extent, through borrowings under its credit facility. Net cash flow from operating activities was \$17,843, \$12,531, and \$16,441, for 2005, 2004 and 2003, respectively. The increase in operating cash flow in 2005 is primarily attributable to increased net income. The Company also benefited from stable inventory levels year over year and a less significant reduction in accounts payable and accrued liabilities as compared to 2004. These increases in operating cash flow were offset by an increase in notes receivable due to increased participation in an equipment financing program.

The Company maintains a credit agreement with a borrowing capacity of \$50,000, which expires in September 2007. Borrowings under the agreement bear interest at rates ranging from LIBOR + 1% to LIBOR + 2.25%, or Prime to Prime + .5%, depending on the Company's level of indebtedness. Commitment fees for this agreement range from .15% to .20% of the unused balance. The agreement is unsecured and contains various financial and other covenants. As of December 31, 2005, the Company was in compliance with all of these covenants.

At December 31, 2005, there were no outstanding borrowings under this agreement. Management believes through its operating cash flows as well as borrowing capabilities, the Company has adequate liquidity and capital resources to meet its needs on a short- and long-term basis.

Uses of Cash

Consistent with historical spending, the Company's uses of cash primarily relate to acquisition activity, capital expenditures, dividend distributions to shareholders, and stock repurchases. Specific significant uses of cash over the three years are as follows:

2005

Capital expenditures for property, plant and equipment were \$1,807 in 2005. Significant capital expenditures included new equipment purchases and facility improvements. During the third quarter of 2005, the Company acquired the assets of a product line for \$986 that primarily consisted of patents. The Company also repurchased 179 shares of its Common Stock from various stockholders for \$6,514, including 100 shares from a trust controlled by George E. Richmond, its Chairman and principal stockholder, for an aggregate purchase price of \$3,725. Quarterly dividends of \$0.04 per share were paid March 15, June 15, September 15, and December 15, 2005, for a total payment of \$1,455.

2004

Capital expenditures for property, plant and equipment were \$5,577 in 2004. Significant capital expenditures included the purchase of a new distribution facility in California, office and meeting space in Illinois, and new tooling and equipment for our manufacturing facilities. In February 2004, YI Ventures LLC (a wholly owned subsidiary) acquired a small ultrasonic cleaning systems product line. In the fourth quarter of 2004, the Company repurchased 77 shares of its Common Stock from various stock-

holders for \$2,522. Quarterly dividends of \$0.04 per share were paid March 15, June 15, September 15, and December 15, 2004, for a total payment of \$1,476.

2003

Capital expenditures for property, plant and equipment were \$2,122 in 2003. Significant capital expenditures related to building improvements and new tooling for product enhancements. In September 2003, YI Ventures LLC (a wholly owned subsidiary) acquired

a company which provides dental services. On December 1, 2003, the Company acquired substantially all of the assets of Obtura Corporation and Earth City Technologies, Inc., collectively known as Obtura Spartan. The Company originally paid \$12,572 in cash, with money set aside in escrow pending the settlement of any indemnification claims. Upon final settlement in 2004, the purchase price was \$12,347. Quarterly dividends of \$0.03 per share were paid September 15 and December 15, 2003, for a total payment of \$547.

<i>Contractual Obligations (Payments due by period)</i>	Total	Less than 1 Year	1-3 years	4-5 years	Beyond 5 years
Operating Leases (including buildings)	\$ 1,425	\$ 755	\$ 670	\$ —	—
Total	\$ 1,425	\$ 755	\$ 670	\$ —	—

As of December 31, 2005 and 2004, management was aware of no relationships with any other unconsolidated entities, financial partnerships, structured finance entities, or special purpose enti-

ties that were established for the purpose of facilitating off-balance-sheet arrangements or for other contractually narrow or limited purposes.

Recent Financial Accounting Standards Board Statements

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123(Revised), "Share-Based Payment." This statement replaces SFAS No. 123, "Accounting for Stock-Based Compensation," and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees." SFAS No. 123(R) requires companies to apply a fair-value-based measurement method in accounting for share-based payment transactions with employees and to record compensation cost for all stock awards granted, modified, repurchased, or cancelled after the required effective date. In addition, the Company is required to record compensation expense (as previous awards continue to vest) for the unvested portion of previously granted awards that remain outstanding at the date of adoption. SFAS No. 123(R) is effective for quarterly periods beginning after December 15, 2005, which is the Company's first quarter ending March 31, 2006. The Company will adopt SFAS No. 123(R) in the first quarter of fiscal 2006 using the modified prospective method of transition. The Company's existing outstanding options will be equity classified. The compensation expense in future periods specific to unvested options outstanding as of December 31, 2005 is not material.

In May 2005, the FASB issued Statement 154, "Accounting Changes and Error Corrections," which will be effective in the first quarter of 2007. This statement addresses the retrospective application of certain accounting changes and corrections, and will be followed if and when necessary.

In June 2005, the FASB ratified the consensus reached by the Emerging Issues Task Force (EITF) on Issue 05-6, "Determining the Amortization Period for Leasehold Improvements." This consensus, which will be effective in the first quarter of 2006, states that leasehold improvements acquired after the inception of a lease should be amortized over the shorter of the useful life of the assets or a term that includes renewals that are reasonably assured at the date of acquisition of the leasehold improvements. The Company has evaluated this consensus and concluded that it is already following this procedure.

In October 2005, FASB issued Staff Position 13-1, "Accounting for Rental Costs Incurred During a Construction Period." This pronouncement states that rental costs associated with ground or building operating leases that are incurred during a construction period should be recognized as rental expense. The Company is already in conformity with this new pronouncement; therefore, the implementation will not impact the financial statements.

In November 2005, the FASB issued FSP No. 123(R)-3, "Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards." This pronouncement provides an alternative method of calculating the excess tax benefits available to absorb any tax deficiencies recognized subsequent to the adoption of SFAS No. 123(R). The Company has until November 2006 to make a one-time election to adopt the transition method. The Company is currently evaluating FSP No. 123(R)-3. The Company does not expect that this one-time election will affect operating income or net earnings.

Quantitative and Qualitative Disclosures About Market Risk

Market risks relating to the Company's operations result primarily from changes in interest rates and changes in foreign exchange rates. From time to time, the Company finances acquisitions, capital expenditures and its working capital needs with borrowings under a revolving credit facility. Due to the variable interest rate feature on the debt, the Company is exposed to interest rate risk. Based on the Company's average debt balance, a theoretical 100-basis-point increase in interest rates would have resulted in approximately \$0, \$31, and \$26 of additional interest expense in the years ended December 31, 2005, 2004 and 2003, respectively.

Sales of the Company's products in a given foreign country can be affected by fluctuations in the exchange rate. However, the Company sells less than 10% of its products outside the United States. Of these foreign sales, more than 80% are denominated in U.S. dollars, with the remaining amount denominated in Canadian dollars. As a result, the Company does not feel that foreign currency movements have a material impact on its financial statements.

The Company does not use derivatives to manage its interest rate or foreign exchange rate risks.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors and Stockholders
Young Innovations, Inc.:

We have audited the accompanying consolidated balance sheets of Young Innovations, Inc. and subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of income, stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 2005. In connection with our audits of the consolidated financial statements, we also have audited the financial statement schedule. These consolidated financial statements and the financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and the financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Young Innovations, Inc. and subsidiaries as of December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles. Also in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Young Innovations, Inc.'s internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 3, 2006, expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

/s/ KPMG LLP
Chicago, IL
March 3, 2006

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of Young Innovations, Inc. is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. Internal control over financial reporting includes policies and procedures that:

- pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America;
- provide reasonable assurance that receipts and expenditures of the Company are being made in accordance with authorization of management and directors of the Company; and
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of assets that could have a material effect on the consolidated financial statements.

Internal control over financial reporting includes the controls themselves, monitoring and testing, and actions taken to correct deficiencies as identified.

All internal control systems, no matter how well designed, have inherent limitations, including the possibility that controls can be circumvented or overridden, and misstatements due to error or fraud may occur and not be detected. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Further, conditions in our business change over time, and, therefore, internal control effectiveness may vary over time.

The Company's management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2005. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control-Integrated Framework. Management's assessment included an evaluation of the design of the Company's internal control over financial reporting and testing of the operational effectiveness of its internal control over financial reporting. Based on this assessment, management believes that, as of December 31, 2005, the Company's internal control over financial reporting is effective based on those criteria.

The Company's independent registered public accounting firm, KPMG LLP, have issued an attestation report on our assessment of the Company's internal control over financial reporting. This report appears on the following page.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Board of Directors
Young Innovations, Inc.:

We have audited management's assessment, included in the accompanying Management's Report on Internal Control over Financial Report, that Young Innovations, Inc. and subsidiaries maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Young Innovations, Inc. and subsidiaries' management are responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed 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. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the

company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Young Innovations, Inc. and subsidiaries maintained effective internal control over financial reporting as of December 31, 2005, is fairly stated, in all material respects, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Also, in our opinion, Young Innovations, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Young Innovations, Inc. and subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of income, stockholders' equity and cash flows for each of the years in the three-year period ended December 31, 2005, and our report dated March 3, 2006 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG LLP
Chicago, IL
March 3, 2006

CONSOLIDATED BALANCE SHEETS

(In thousands, except per share data)

<i>December 31</i>	2005	2004
Assets		
Current assets:		
Cash and cash equivalents	\$ 10,227	\$ 2,552
Trade accounts receivable, net of allowance for doubtful accounts of \$435 and \$451, in 2005 and 2004, respectively	9,538	9,976
Inventories	10,796	10,942
Other current assets	3,796	3,640
Total current assets	34,357	27,110
Property, plant and equipment, net	21,567	22,137
Goodwill	52,690	52,617
Other intangible assets	7,074	6,105
Other assets	2,401	1,860
Total assets	\$118,089	\$109,829
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	6,171	7,639
Net liabilities for discontinued operations	—	43
Total current liabilities	6,171	7,682
Deferred income taxes	8,354	7,010
Stockholders' equity:		
Common stock, voting, \$.01 par value, 25,000 shares authorized, 8,917 and 9,038 shares issued and outstanding, net of treasury stock, in 2005 and 2004, respectively	\$ 90	\$ 90
Additional paid-in capital	29,184	29,033
Deferred stock compensation	(262)	(598)
Retained earnings	97,767	83,884
Common stock in treasury, at cost, 1,292 and 1,146 shares in 2005 and 2004, respectively	(23,215)	(17,272)
Total stockholders' equity	103,564	95,137
Total liabilities and stockholders' equity	\$118,089	\$109,829

The accompanying notes are an integral part of these statements.

CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share data)

<i>Years ended December 31</i>	2005	2004	2003
Net sales	\$84,766	\$79,201	\$72,562
Cost of goods sold	38,851	35,851	32,129
Gross profit	45,915	43,350	40,433
Selling, general and administrative expenses	22,090	22,219	19,025
Income from operations	23,825	21,131	21,408
Interest (income) expense, net	(195)	18	17
Other income	(290)	(162)	(126)
Income before provision for income taxes	24,310	21,275	21,517
Provision for income taxes	8,972	8,138	8,231
Income from continuing operations	15,338	13,137	13,286
Income (loss) from discontinued operations	—	797	(85)
Net income	\$15,338	\$13,934	\$13,201
Basic earnings per share	\$ 1.71	\$ 1.54	\$ 1.46
Basic earnings per share from continuing operations	\$ 1.71	\$ 1.45	\$ 1.47
Basic earnings per share from discontinued operations	—	\$ 0.09	\$ (0.01)
Diluted earnings per share	\$ 1.65	\$ 1.48	\$ 1.40
Diluted earnings per share from continuing operations	\$ 1.65	\$ 1.40	\$ 1.41
Diluted earnings per share from discontinued operations	—	\$ 0.08	\$ (0.01)
Basic weighted average shares outstanding	8,957	9,040	9,017
Diluted weighted average shares outstanding	9,312	9,409	9,431

The accompanying notes are an integral part of these statements.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(In thousands)

	Common Stock	Additional Paid-In Capital	Retained Earnings	Common Stock in Treasury	Deferred Stock Compensation	Total	Comprehensive Income
Balance, December 31, 2002	\$89	\$28,050	\$58,772	\$(17,970)	\$(1,271)	\$67,670	
Net income	—	—	13,201	—	—	13,201	\$13,201
Common stock purchased	1	—	—	(66)	—	(65)	
Stock options exercised	—	317	—	2,051	—	2,368	
Amortization of deferred stock compensation	—	—	—	—	336	336	
Cash dividends, (\$0.06 per share)	—	—	(547)	—	—	(547)	
Comprehensive income							<u>\$13,201</u>
Balance, December 31, 2003	\$90	\$28,367	\$71,426	\$(15,985)	\$(935)	\$82,963	
Net income	—	—	13,934	—	—	13,934	\$13,934
Common stock purchased	—	—	—	(1,924)	—	(1,924)	
Stock options exercised	—	666	—	637	—	1,303	
Amortization of deferred stock compensation	—	—	—	—	337	337	
Cash dividends, (\$0.16 per share)	—	—	(1,476)	—	—	(1,476)	
Comprehensive income							<u>13,934</u>
Balance, December 31, 2004	\$90	\$29,033	\$83,884	\$(17,272)	\$(598)	\$95,137	
Net income	—	—	15,338	—	—	15,338	\$15,338
Common stock purchased	—	—	—	(6,039)	—	(6,039)	
Stock options exercised	—	151	—	96	—	247	
Amortization of deferred stock compensation	—	—	—	—	336	336	
Cash dividends, (\$0.16 per share)	—	—	(1,455)	—	—	(1,455)	
Comprehensive income							<u>\$15,338</u>
Balance, December 31, 2005	\$90	\$29,184	\$97,767	\$(23,215)	\$(262)	\$103,564	

The accompanying notes are an integral part of these statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

<i>Years ended December 31</i>	2005	2004	2003
Cash flows from operating activities:			
Net income	\$15,338	\$13,934	\$13,201
Adjustments to reconcile net income to net cash flows from operating activities:			
Gain from sale of discontinued operations, net of tax	—	(714)	—
Depreciation and amortization	3,110	3,166	2,625
Deferred income taxes	1,344	383	1,723
Loss on disposal of property, plant and equipment	—	113	35
Changes in assets and liabilities, net of effects of acquisitions and divestitures			
Trade accounts receivable	418	1,388	(319)
Inventories	(28)	(2,024)	322
Other current assets	(156)	(180)	(720)
Other assets	(873)	(1,340)	(367)
Accounts payable and accrued liabilities	(1,310)	(2,195)	(59)
Total adjustments	2,505	(1,403)	3,240
NET CASH FLOWS FROM OPERATING ACTIVITIES	17,843	12,531	16,441
Cash flows from investing activities:			
Payouts for acquisitions of businesses and intangibles, net of cash acquired	(986)	(1,254)	(13,178)
Proceeds from sale of discontinued operations	—	1,800	—
Purchases of property, plant and equipment	(1,807)	(5,577)	(2,122)
Proceeds from sale of IAI	200	—	—
NET CASH FLOWS FROM INVESTING ACTIVITIES	(2,593)	(5,031)	(15,300)
Cash flows from financing activities:			
Payments on long-term debt	—	(12,420)	(4,304)
Borrowings on long-term debt	—	9,568	2,852
Proceeds from stock options exercised	394	953	2,088
Purchases of treasury stock	(6,514)	(2,511)	(846)
Payment of cash dividends	(1,455)	(1,476)	(547)
NET CASH FLOWS FROM FINANCING ACTIVITIES	(7,575)	(5,886)	(757)
Net increase in cash and cash equivalents	7,675	1,614	384
Cash and cash equivalents, beginning of period	2,552	938	554
Cash and cash equivalents, end of period	\$10,227	\$ 2,552	\$ 938

The accompanying notes are an integral part of these statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except per share data)

*December 31, 2005***1. Organization**

Young Innovations, Inc. and its subsidiaries ("the Company") develop, manufacture, and market supplies and equipment used to facilitate the practice of dentistry and to promote oral health. The Company's product offerings include disposable and metal prophylaxis ("prophy") angles, prophy cups and brushes, prophy pastes, panoramic X-ray machines, dental handpieces (drills) and related components, home care kits, orthodontic and children's

toothbrushes, flavored examination gloves, infection control products, ultrasonic cleaning systems, ultrasonic scaling and endodontic systems, and obturation systems used in endodontic surgery (root canal procedures). The Company's manufacturing and distribution facilities are located in Missouri, California, Indiana, Tennessee, Texas and Canada. Export sales were less than 10% of total net sales for 2005, 2004 and 2003.

2. Summary of Significant Accounting Policies***Principles of Consolidation***

The consolidated financial statements include the accounts of Young Innovations, Inc. and its direct and indirect wholly owned subsidiaries. All significant intercompany accounts and transactions are eliminated in consolidation.

Use of Estimates

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosures of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expenses during the reported period. Actual results could differ from those estimates.

Cash and Cash Equivalents

Cash and cash equivalents include all highly liquid investments with an initial maturity of three months or less.

Inventories

Inventories are stated at the lower of cost (which includes material, labor and manufacturing overhead) or net realizable value. Inventory values are based upon standard costs which approximate historical costs, determined by the first-in, first-out (FIFO) method.

Property, Plant and Equipment

Property, plant and equipment are stated at cost. Expenditures for repairs and maintenance are charged to expense as incurred, and additions and improvements that significantly extend the lives of assets are capitalized. Upon disposition, cost and accumulated depreciation are eliminated from the related accounts, and any gain or loss is reflected in the statements of income. The Company provides depreciation using the straight-line method over the estimated useful lives of respective classes of assets as follows:

Buildings and improvements	3 to 40 years
Machinery and equipment	3 to 10 years
Equipment rented to others	4 to 15 years

Goodwill and Other Intangible Assets

Goodwill represents the excess of costs over fair value of assets of businesses acquired. The Company adopted the provisions of Financial Accounting Standards Board (FASB) Statement No. 142, Goodwill and Other Intangible Assets, as of January 1, 2002. Pursuant to Statement 142, goodwill and indefinite life intangi-

ble assets acquired in a purchase business combination are not amortized, but are instead tested for impairment at least annually in accordance with the provisions of Statement 142. Statement 142 also requires that intangible assets with estimable useful lives be amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with FASB Statement No. 144, Accounting for Impairment or Disposal of Long-Lived Assets. Intangible assets primarily consist of trademarks, license agreements, core technology, patents and patent applications, product formulas, and supplier and customer relationships. Trademarks have been determined to have indefinite useful lives, and therefore the carrying value is reviewed at least annually for recoverability in accordance with the requirements of SFAS No. 142. Other intangible assets are amortized on a straight-line basis over the estimated useful lives of the assets, generally between 5 and 40 years, and tested for impairment whenever conditions indicate that an asset may be impaired.

Impairment of Long-Lived Assets

The Company assesses and measures any impairments of long-lived assets in accordance with the provisions of Statement of Financial Accounting Standards (SFAS) No. 144. If facts and circumstances suggest that a long-lived asset may be impaired, the carrying value is reviewed. If this review indicates that the carrying value of the asset will not be recovered, as determined based on projected undiscounted cash flows related to the asset over its remaining life, the carrying value of the asset is reduced to its estimated fair value. The Company has not incurred any material impairments of long-lived assets during the years ended 2005, 2004 and 2003.

Fair Value of Financial Instruments

Financial instruments consist principally of cash, accounts receivable, notes receivable, accounts payable and debt. The estimated fair value of these instruments approximates their carrying value. Due to the short-term nature of the notes receivable, book value approximates fair value.

Revenue Recognition

Revenue from the sale of products is recorded at the time title passes, generally when the products are shipped, as the Company's shipping terms are customarily FOB shipping point. Revenue from the rental of equipment to others is recognized on a month-to-month basis as the revenue is earned. The Company

generally warrants its products against defects, and its most generous policy provides a two-year parts and labor warranty on X-ray machines. The policy with respect to sales returns generally provides that a customer may not return inventory except at the Company's option, with the exception of X-ray machines, which have a 90-day return policy. The Company owns X-ray equipment rented on a month-to-month basis to customers. A liability for the removal costs of the rented X-ray machines is capitalized and amortized over four years. A liability for the removal costs of the purchased X-ray machines expected to be returned to the Company is included in accounts payable and accrued liabilities at December 31, 2005 and 2004.

Advertising Costs

Advertising costs are expensed when incurred. Advertising costs were approximately \$2,159, \$2,347, and \$1,950 for 2005, 2004 and 2003, respectively.

Research and Development Costs

Research and development costs are expensed when incurred and totaled \$752, \$715, and \$511 for 2005, 2004 and 2003, respectively.

Interest (Income) Expense, Net

Interest (income) expense, net includes interest paid related to borrowings on the Company's credit facility, as well as interest income earned on various investments and notes receivable. In 2005, 2004 and 2003, interest income totaled \$326, \$76, and \$62, respectively.

Other Income

Other income includes rental income from leased space and other miscellaneous income, all of which are not directly related to the Company's primary business.

Income Taxes

The Company has accounted for income taxes under SFAS No. 109, which requires an asset-and-liability approach to accounting and reporting for income taxes. Deferred income taxes are provided for temporary differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities using rates which are expected to apply in the period the differences are estimated to reverse.

Stock-Based Compensation

The Company adopted the 1997 Stock Option Plan ("the Plan") effective in November 1997, and amended the Plan in 1999 and 2001. In accordance with SFAS No. 123, "Accounting for Stock-Based Compensation," the Company has elected to apply APB Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations in accounting for the Plan. Accordingly, because all options granted under the Plan have an exercise price equal to the fair value of the underlying stock on the grant date, no compensation cost has been recognized for the Plan. Had compensation costs for the Plan been determined based upon the fair value of the options at the grant date consistent with the methodology prescribed under SFAS No. 123, the Company's net income and earnings per share would approximate the pro forma amounts below:

	Year Ended December 31, 2005		Year Ended December 31, 2004		Year Ended December 31, 2003	
	As Reported	Pro Forma	As Reported	Pro Forma	As Reported	Pro Forma
Net income	\$15,338	\$11,424	\$13,934	\$13,267	\$13,201	\$11,919
Net income from continuing operations	15,338	11,424	13,137	12,470	13,286	12,004
Net income (loss) from discontinued operations	—	—	797	797	(85)	(85)
Earnings per share:						
Basic	\$1.71	\$1.28	\$1.54	\$1.47	\$1.46	\$1.32
Basic earnings per share from continuing operations	\$1.71	\$1.28	\$1.45	\$1.38	\$1.47	\$1.33
Basic earnings per share from discontinued operations	—	—	\$0.09	\$0.09	\$(0.01)	\$(0.01)
Diluted	\$1.65	\$1.23	\$1.48	\$1.41	\$1.40	\$1.26
Diluted earnings per share from continuing operations	\$1.65	\$1.23	\$1.40	\$1.33	\$1.41	\$1.27
Diluted earnings per share from discontinued operations	—	—	\$0.08	\$0.08	\$(0.01)	\$(0.01)

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	2005	2003	2001
Dividend yield	0.49%	0.37%	0.0%
Expected volatility	38.8%	32.3%	43.7%
Risk-free interest rate	4.5%	4.5%	4.8%
Expected life	8.0	8.0	8.0

The weighted average fair value of the options at the grant date was \$18.52 for 2005 and \$14.22 for 2003. No options were granted in 2004.

On March 1, 2005, the Company granted 320 options to employees and nonemployee directors. All options were vested immediately. As of December 31, 2005, a total of 1,848 options had been granted. Net of forfeitures, 1,596 options have been granted.

Supplemental Cash Flow Information

Cash flows from operating activities include \$7,525, \$6,545, and \$5,782 for the payment of federal and state income taxes, and

\$75, \$81, and \$83 for the payment of interest related to borrowings on the Company's credit facility during 2005, 2004 and 2003, respectively.

3. Acquisitions

During the first quarter of 2004, YI Ventures LLC (a wholly owned subsidiary) acquired substantially all the assets of Healthsonics Corporation for \$1,500. Healthsonics manufactures ultrasonic cleaning systems. The acquisition resulted in the recognition of approximately \$1,400 of goodwill. The results of operations for Healthsonics are included in the consolidated financial statements since February 2004.

On December 1, 2003, the Company acquired substantially all of the assets and assumed a portion of the liabilities of Obtura Corporation and Earth City Technologies (collectively "Obtura Spartan"). The Company paid \$12,572 in cash, including transaction costs. Of the purchase price, \$1,000 was set aside in an escrow account pending the settlement of any indemnification claims. Upon final settlement, the purchase price was \$12,347.

The settlement included the acquisition of the seller's Obtura Spartan Canada operations in November 2004 for approximately \$500. Upon the finalization of the settlement and purchase accounting during the fourth quarter of 2004, the purchase price allocation was completed and goodwill was determined to be \$8,166, including the Canadian operations. During 2005, certain adjustments were made to finalize the purchase price allocation for the Canadian operations, resulting in final goodwill of \$8,267. There are no potential contingent payments outstanding with respect to the transaction. The following table summarizes the adjustments made to the preliminary purchase price allocation. Some management and administrative terminations were completed and all accrued severance liabilities were paid prior to December 31, 2004.

	Preliminary Allocation	Total Adjustments	Final Allocation
Purchase Price	\$ 12,572	\$ (225)	\$ 12,347
Current assets	2,470	239	2,709
Property, plant and equipment	394	27	421
Intangible assets	3,588	250	3,838
Goodwill	8,089	178	8,267
Current liabilities assumed	(1,769)	(519)	(2,288)
Accrued severance liabilities	(200)	(400)	(600)
Net assets acquired	\$ 12,572	\$ (225)	\$ 12,347

Of the \$3,838 allocated to intangible assets, \$1,200 was assigned to license arrangements and \$591 was assigned to core technology, both with 20-year useful lives. In addition, \$250 was assigned to customer relationships with a five-year useful life. The remaining \$1,797 was assigned to trademarks that are not subject to amortization. The results of operations for Obtura

Spartan are included in the consolidated financial statements since December 1, 2003. George E. Richmond, the Company's Chairman, owned 20% of Earth City Technologies at the time of the acquisition. The transaction was unanimously approved by the independent directors of the Company.

4. Discontinued Operations

In December 2004, the Company completed the sale of the retail division of its Plak Smacker subsidiary. The retail division, which has previously been reported as a separate segment, sold toothbrushes, children's toothpaste and dental accessories to mass merchandisers under the Plak Smacker brand name. The retail

operations were accounted for as discontinued operations and accordingly, operating results and net assets were segregated in the accompanying Consolidated Statements of Income and Consolidated Balance Sheets. Results for discontinued operations are as follows (in thousands):

<i>Years ended December 31</i>	2004	2003
Net sales	\$ 3,086	\$ 3,594
Income (loss) before income taxes	1,292	(139)
Provision for income taxes	495	(54)
Net income (loss)	797	(85)

5. Discontinued Equity Investment

On May 17, 1999, the Company acquired a one-third interest in International Assembly, Inc., a Texas corporation (IAI). The investment was accounted for under the equity method of accounting and included in other assets on the Consolidated Balance Sheets. Equity income (loss) was recorded using a three-month lag. The Company's losses attributed to IAI were included in other expense, net and totaled \$0, \$10 and \$1 for 2005, 2004 and

2003, respectively. The Company purchased certain services from IAI at amounts less than would be paid to unrelated parties. The amounts paid for these services totaled \$112, \$244 and \$198 in 2005, 2004 and 2003, respectively. During the second quarter of 2005, the Company sold its interest in IAI for \$200, which approximated the book value of the asset.

6. Major Customers and Credit Concentration

The Company generates trade accounts receivable in the normal course of business. The Company grants credit to distributors and customers throughout the world and generally does not require

collateral to secure the accounts receivable. The Company's credit risk is concentrated among two distributors accounting for 38% of accounts receivable at December 31, 2005 and 2004.

The percentage of net sales made to major distributors of the Company's continuing operations were as follows:

<i>Years ended December 31</i>	2005	2004	2003
Distributor			
Henry Schein, Inc.	14.2%	16.2%	22.0%
Patterson Companies, Inc.	13.5%	13.7%	18.9%

7. Notes Receivable

The Company offers various financing options to its equipment customers, including notes payable to the Company and financing through third parties. The equipment is used to secure the notes. Total revenue from sales of equipment financed by the Company was \$4,770, \$4,215 and \$1,234 during 2005, 2004 and 2003,

respectively. These transactions are recorded as a sale upon the transfer of title to the purchaser, which generally occurs at the time of shipment, at an amount equal to the sales price of non-financed sales. Interest on these notes is accrued as earned and recorded as interest income.

Notes receivable consist of the following:

<i>December 31</i>	2005	2004
Notes receivable, short-term	\$2,160	\$1,764
Notes receivable, long-term	<u>2,328</u>	<u>1,496</u>
Total notes receivable	<u>\$4,488</u>	<u>\$3,260</u>

Notes receivable are included in other current assets and other assets in the accompanying Consolidated Balance Sheets.

The Company expanded the financing program during 2005, which lead to an increased notes receivable balance compared to

December 31, 2004. Notes bear interest at rates ranging from 0% to 12%, and have a weighted average maturity of 28 months. Interest income related to the notes is included in the consolidated income statement caption "interest (income) expense, net."

8. Inventories

Inventories consist of the following:

<i>December 31</i>	2005	2004
Finished products	\$6,742	\$6,489
Work in process	1,808	1,957
Raw materials and supplies	<u>2,246</u>	<u>2,496</u>
Total inventories	<u>\$10,796</u>	<u>\$10,942</u>

9. Property, Plant and Equipment

Property, plant and equipment consist of the following:

<i>December 31</i>	2005	2004
Land	\$ 1,611	\$ 1,611
Buildings and improvements	11,479	11,149
Machinery and equipment	19,256	18,786
Equipment rented to others	6,158	5,952
Construction in progress	<u>991</u>	<u>997</u>
	<u>\$ 39,495</u>	<u>\$ 38,495</u>
Less – Accumulated depreciation	<u>(17,928)</u>	<u>(16,358)</u>
Total property, plant and equipment, net	<u>\$ 21,567</u>	<u>\$ 22,137</u>

The Company has no machinery and equipment under capital lease. Depreciation expense was \$2,427, \$2,603, and \$2,288 for 2005, 2004 and 2003, respectively.

10. Other Assets

Other assets consist of the following:

<i>December 31</i>	2005	2004
Investment in IAI	—	\$280
Notes receivable, long-term	2,328	1,496
Other	73	84
Total other assets	\$2,401	\$1,860

11. Goodwill and Other Intangible Assets

Goodwill consists of the following:

Goodwill at December 31, 2003	\$55,801
Acquisition Healthsonics	1,467
Adjustments to allocation of purchase price	147
Goodwill at December 31, 2004	\$57,415
Adjustments to allocation of purchase price	73
Goodwill at December 31, 2005	\$57,488
Less – Accumulated amortization	(4,798)
Total goodwill, net	\$52,690

During the first quarter of 2004, YI Ventures LLC (a wholly owned subsidiary) acquired substantially all the assets of Healthsonics Corporation for \$1,500. The acquisition resulted in recognition of \$1,467 of goodwill. The remaining increase in goodwill was the result of adjustments to the fair value estimates of the assets and liabilities of Obtura Spartan, which was acquired on December 1, 2003, and Midwest Laboratories, which was acquired on September 16, 2003.

Goodwill increased \$73 during 2005. The final Healthsonics allocation of the purchase price resulted in various adjustments to the goodwill balance in the first quarter of 2005, including a \$220 increase in goodwill, which was primarily related to changes in estimates related to severance liabilities and costs incurred to consolidate the operations of the business into a

pre-existing facility. In addition, the Company allocated \$248 of the purchase price to trademarks, with an indefinite useful life, thereby reducing goodwill. The remaining \$101 increase in goodwill during the year related to adjustments to the purchase price allocation for the Canadian operations of Obtura Spartan, which were acquired in November of 2004. There have been no changes in goodwill related to impairment losses or write-offs due to sales of businesses during the years ended December 31, 2005 and 2004.

During the third quarter of 2005, the Company acquired the assets of a preventative dental product line, which primarily consisted of \$846 in patents, \$90 of customer relationships and \$50 in fixed assets.

Other intangibles consist of the following:

<i>As of December 31, 2005</i>	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Amortized intangible assets			
License agreements	\$1,200	\$125	\$1,075
Core technology	591	62	529
Patents	1,343	339	1,004
Product formulas	430	48	382
Customer relationships	339	59	280
Non-compete agreements	391	161	230
Supplier relationships	130	111	19
Total	\$4,424	\$905	\$3,519
Intangible assets not subject to amortization			
Trademarks	\$3,555		\$3,555
Total intangible assets	\$7,979	\$905	\$7,074

<i>As of December 31, 2004</i>	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Amortized intangible assets			
License agreements	\$1,200	\$65	\$1,135
Core technology	591	32	559
Patents	499	263	236
Product formulas	430	37	393
Customer relationships	250	0	250
Non-compete agreements	252	75	177
Supplier relationships	130	86	44
Total	\$3,352	\$558	\$2,794
Intangible assets not subject to amortization			
Trademarks	\$3,311		\$3,311
Total intangible assets	\$6,663	\$558	\$6,105

The costs of other intangible assets with finite lives are amortized over their expected useful lives using the straight-line method. The amortization lives are as follows: 10 to 20 years for patents, license agreements and core technology; 40 years for product formulations; and 5 years for supplier and customer relationships. Non-compete agreements are amortized over the length of the signed agreement. The weighted average life for amortizable intangible assets is 19 years. Aggregate amortization expense for

the years ended December 31, 2005, 2004 and 2003 was \$347, \$226, and \$73, respectively. Estimated amortization expense for each of the next five years is as follows:

For the year ended 12/31/06	\$ 436
For the year ended 12/31/07	309
For the year ended 12/31/08	309
For the year ended 12/31/09	309
For the year ended 12/31/10	250

12. Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities consist of the following:

<i>December 31</i>	2005	2004
Accounts payable	\$2,617	\$3,380
Accrued salaries and bonuses	698	875
Accrued taxes	676	1,004
Accrued rebate payments	438	398
Accrued expenses and other	1,742	1,982
Total accounts payable and accrued liabilities	\$6,171	\$7,639

13. Credit Arrangements and Notes Payable

The Company has a credit arrangement that provides for an unsecured revolving credit facility with an aggregate commitment of \$50,000. Borrowings under the arrangement bear interest at rates ranging from LIBOR +1% to LIBOR +2.25%, or Prime to Prime +.5%, depending on the Company's level of indebtedness. Commitment fees for this arrangement range from .15% to .20% of the unused balance. The agreement is unsecured and contains various financial and other covenants. As of December 31, 2005 and 2004, there were no borrowings on the Company's credit arrangement.

In certain circumstances, the Company provides recourse for loans for equipment purchases by customers. Certain banks require the Company to provide recourse to finance equipment for

new dentists and other customers with credit histories which are not consistent with the banks' lending criteria. In the event that a bank requires recourse on a given loan, the Company would assume the bank's security interest in the equipment securing the loan. As of December 31, 2005 and 2004, respectively, approximately \$98 and \$205 of the equipment financed with various lenders was subject to such recourse. Recourse on a given loan is generally eliminated by the bank after one year, provided the bank has received timely payments on that loan. Based on the Company's past experience with respect to these arrangements, it is the opinion of management that the fair value of the recourse provided is minimal and not material to the results of operations or financial position of the Company.

14. Common Stock

During 2005, the Company repurchased 166 shares of its Common Stock from various stockholders for \$6,039, including 100 shares of its Common Stock from a trust controlled by George E. Richmond, its Chairman and principal stockholder, for an aggregate purchase price of \$3,725. The purchases were financed through cash generated from operations. The Company also reissued 34 shares of its Common Stock in conjunction with stock option exercises for \$394. In addition, the restrictions on 24 previously issued shares of Common Stock lapsed during 2005 and 13 were repurchased by the Company for \$475 (see footnote 15).

During 2004, the Company repurchased 60 shares of its Common Stock from various stockholders for \$1,924. The purchases were financed through cash generated from operations.

The Company also reissued 87 shares of its Common Stock in conjunction with stock option exercises for \$953. In addition, the restrictions on 24 previously issued shares of Common Stock lapsed during 2004 and 17 were repurchased by the Company for \$587 (see footnote 15).

During 2003, the Company repurchased 3 shares of its Common Stock from various stockholders for \$66. The purchases were financed through cash generated from operations. The Company also reissued 210 shares of its Common Stock in conjunction with stock option exercises for \$2,088. In addition, the restrictions on 24 previously issued shares of Common Stock lapsed during 2003 and 24 were repurchased by the Company for \$780 (see footnote 15).

15. Stock Awards

Stock Options – The Company adopted the 1997 Stock Option Plan (“the Plan”) effective in November 1997, and amended the Plan in 1999 and 2001. A total of 1,725 shares of Common Stock are reserved for issuance under this plan, which is administered by the compensation committee of the Board of Directors (“Compensation Committee”). Participants in the Plan will be

those employees whom the Compensation Committee may select from time to time and those nonemployee directors as the Company’s Board of Directors may select from time to time. As of December 31, 2005, 1,848 options had been granted. Net of forfeits, 1,589 options have been granted.

A summary of the options outstanding and exercisable is as follows:

	Shares	Range of Exercise Prices	Weighted Average Exercise Price
Outstanding, January 1, 2003	896	\$8.00 - \$14.02	\$11.77
Granted	107	\$32.74	\$32.74
Exercised	209	\$8.00 - \$14.02	\$9.92
Forfeited	—	—	—
Outstanding, December 31, 2003	794	\$8.00 - \$32.74	\$15.08
Exercisable at December 31, 2003	509	\$8.00 - \$32.74	\$13.51
Outstanding, January 1, 2004	794	\$8.00 - \$32.74	\$15.08
Granted	—	—	—
Exercised	87	\$8.00 - \$14.02	\$11.61
Forfeited	58	\$14.02 - \$32.74	\$19.48
Outstanding, December 31, 2004	649	\$8.00 - \$32.74	\$15.15
Exercisable at December 31, 2004	558	\$8.00 - \$14.02	\$15.03
Outstanding, January 1, 2005	649	\$8.00 - \$32.74	\$15.15
Granted	320	\$35.38	\$35.38
Exercised	34	\$8.00 - \$14.02	\$11.83
Forfeited	7	\$14.02	\$14.02
Outstanding, December 31, 2005	928	\$8.00 - \$35.38	\$22.42
Exercisable at December 31, 2005	908	\$8.00 - \$35.38	\$22.24

The weighted average remaining contractual life of the options outstanding at December 31, 2005 is 7.1 years. On January 1, 2006 the remaining 20 shares vested, therefore as of January 1, 2006, 928 shares were exercisable with a range of exercise prices from \$8.00 to \$35.38 with a weighted average price of \$22.42.

The Compensation Committee of the Board of Directors establishes vesting schedules for each option issued under the Plan. Outstanding options generally vest over a period up to four years. The exercise price has historically been equal to the fair value of the Common Stock at the date of grant. All options expire 10 years from the grant date.

Restricted Stock – Under the above Plan, restricted stock may be awarded or sold to participants under terms and conditions established by the Compensation Committee. For restricted stock grants, compensation expense is based upon the grant date market price, and is recorded over the vesting period. In October 2001, the Company granted 120 shares of restricted stock to certain executive officers of the Company. No monetary consider-

ation was paid by the officers who received the restricted stock. These shares vest 20% each year for five years beginning in October 2002. For the years ended December 31, 2005, 2004, and 2003, the Company recorded \$336, \$337, and \$336, respectively, of compensation expense related to the restricted stock grants.

16. Income Taxes

The components of the provision for income taxes are as follows:

<i>Years ended December 31</i>	2005	2004	2003
Current	\$7,810	\$7,384	\$7,047
Deferred	1,162	1,249	1,130
Total provision for income taxes	\$8,972	\$8,633	\$8,177

The income tax provisions are different from the amount computed by applying the U.S. federal income tax rates to income before provision for income taxes. The reasons for these differences are as follows:

<i>Years ended December 31</i>	2005	2004	2003
Income from continuing operations before provision for income taxes	\$24,310	\$21,275	\$21,517
U.S. federal income tax rate	35%	35%	35%
Computed income taxes	8,509	7,446	7,531
Sale of investment in International Assembly, Inc. (IAI)	(235)		
Deduction for Domestic Production Activities	(123)		
Other	(73)	73	82
Provision for federal income taxes on continuing operations	8,078	7,519	7,613
State income taxes from continuing operations, net of federal tax benefit	894	619	618
Provision for income taxes on continuing operations	\$ 8,972	\$ 8,138	\$ 8,231
Effective tax rate on continuing operations	36.90%	38.25%	38.25%
Provision for income taxes on discontinued operations	—	495	(54)
Total provision for income taxes	\$ 8,972	\$ 8,633	\$ 8,177

Temporary differences that gave rise to deferred income tax assets and liabilities are as follows:

<i>December 31</i>	2005	2004
Deferred income tax assets:		
Trade accounts receivable	\$ 175	\$ 171
Inventories	323	297
Accrued liabilities	319	171
Other	163	159
Total deferred income tax assets	980	798
Deferred income tax liabilities:		
Property, plant and equipment	(2,723)	(2,641)
Intangibles	(5,637)	(4,369)
Other	6	—
Total deferred income tax liabilities	(8,354)	(7,010)
Net deferred income tax liability	\$(7,374)	\$(6,212)

Current deferred income tax assets of \$980 and \$798 are included in other current assets as of December 31, 2005 and 2004, respectively.

17. Sales of Equipment Rented to Others

Periodically, customers who rent X-ray equipment from the Company elect to purchase the equipment. The Company recognizes revenue for the proceeds of such sales and records as cost of goods sold the net book value of the equipment. Net sales of

equipment consistent with this practice were \$1,623, \$1,679 and \$1,560 for 2005, 2004 and 2003, respectively, and gross profit from these sales was \$806, \$783, and \$775 for 2005, 2004 and 2003, respectively.

18. Employee Benefits

The Company has defined contribution 401(k) plans covering substantially all full-time employees meeting service and age requirements. Contributions to the Plan can be made by an employee through deferred compensation and through a discre-

tionary employer contribution. Compensation expense related to this plan was \$224, \$255, and \$317 for 2005, 2004 and 2003, respectively. The Company also offers certain healthcare insurance benefits for substantially all employees.

19. Related-Party Transactions

In May 2005, the Company purchased 100 shares of its common stock from a trust controlled by George E. Richmond, its Chairman and principal stockholder, for an aggregate purchase price of \$3,725.

During 2005 and 2004, the Company paid consulting fees of \$54 and \$54, respectively, to a corporation which is wholly owned by George E. Richmond, the Company's Chairman.

During 2005 and 2004, the Company paid fees of \$123 and \$88, respectively, to a corporation which is wholly owned by George E. Richmond, the Company's Chairman, for corporate use of an aircraft owned by that corporation.

20. Earnings Per Share

Basic earnings per share (Basic EPS) is computed by dividing net income by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share (Diluted EPS) includes the dilutive effect of stock options and

restricted stock, if any, using the treasury stock method. The following table sets forth the computation of basic and diluted earnings per share:

<i>Years ended December 31</i>	2005	2004	2003
Net income	\$15,338	\$13,934	\$13,201
Net income from continuing operations	15,338	13,137	13,286
Net income from discontinued operations	—	797	(85)
Weighted average shares outstanding for basic earnings per share	8,957	9,040	9,017
Dilutive effect of stock options and restricted stock	355	369	414
Weighted average shares outstanding for diluted earnings per share	9,312	9,409	9,431
Basic earnings per share	\$1.71	\$1.54	\$1.46
Basic earnings per share from continuing operations	\$1.71	\$1.45	\$1.47
Basic earnings per share from discontinued operations	—	\$0.09	\$(0.01)
Diluted earnings per share	\$1.65	\$1.48	\$1.40
Diluted earnings per share from continuing operations	\$1.65	\$1.40	\$1.41
Diluted earnings per share from discontinued operations	—	\$0.08	\$(0.01)

21. Quarterly Financial Data (Unaudited)

2005	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	Year
Net sales	\$20,634	\$20,906	\$21,616	\$21,610	\$84,766
Gross profit	10,884	11,538	11,805	11,688	45,915
Income from continuing operations	3,470	3,560	4,168	4,140	15,338
Net income	3,470	3,560	4,168	4,140	15,338
Basic earnings per share	\$.38	\$.40	\$.47	\$.46	\$1.71
Basic earnings per share from continuing operations	\$.38	\$.40	\$.47	\$.46	\$1.71
Diluted earnings per share	\$.37	\$.38	\$.45	\$.45	\$1.65
Diluted earnings per share from continuing operations	\$.37	\$.38	\$.45	\$.45	\$1.65

2004	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	Year
Net sales	\$19,494	\$16,738	\$20,891	\$22,078	\$79,201
Gross profit	10,888	8,649	11,706	12,107	43,350
Income from continuing operations	3,281	1,998	3,745	4,113	13,137
Income from discontinued operations	16	35	48	698	797
Net income	3,297	2,033	3,793	4,811	13,934
Basic earnings per share	\$.37	\$.22	\$.42	\$.53	\$1.54
Basic earnings per share from continuing operations	\$.37	\$.22	\$.41	\$.45	\$1.45
Basic earnings per share from discontinued operations	\$.00	\$.00	\$.01	\$.08	\$.09
Diluted earnings per share	\$.35	\$.22	\$.40	\$.51	\$1.48
Diluted earnings per share from continuing operations	\$.35	\$.22	\$.39	\$.44	\$1.40
Diluted earnings per share from discontinued operations	\$.00	\$.00	\$.01	\$.07	\$.08

22. Commitments and Contingencies

The Company leases certain office and warehouse space, manufacturing facilities, automobiles, and equipment under non-cancelable operating leases. The total rental expense for all operating leases was \$887, \$1,001, and \$876 for 2005, 2004 and 2003, respectively. Rental commitments amount to: \$755 for 2006, \$445 for 2007 and \$225 for 2008.

The Company and its subsidiaries from time to time are parties to various legal proceedings arising in the normal course of busi-

ness. Management believes that none of these proceedings, if determined adversely, would have a material adverse effect on the Company's financial position, results of operations or liquidity.

The Company generally warrants its products against defects, and its most generous policy provides a two-year parts and labor warranty on X-ray machines. The accrual for warranty costs was \$285 and \$280 at December 31, 2005 and 2004, respectively. There were no significant warranty costs during the year ended December 31, 2005.

23. Subsequent Events

In January 2006, the Company acquired D&N Microproducts. D&N Microproducts had been the Company's contract manufacturer for X-ray equipment and provided labor, purchased components and performed administrative and logistical functions associated with the production of the machines. The purchase price was approximately \$3 million.

On January 30, 2006, the Board of Directors declared a quarterly dividend of \$0.04 per share, payable March 15, 2006 to shareholders of record on February 15, 2006.

In February 2006, the Board of Directors approved up to a \$3 million investment in a private equity fund.

24. New Accounting Standards

In December 2004, the Financial Accounting Standards Board ("FASB") issued a revised Statement of Financial Accounting Standards ("SFAS") No. 123, "Share-Based Payment" ("SFAS 123R"). Among its provisions, SFAS No. 123R will require the Company to measure the value of employee services in exchange for an award of equity instruments based on the grant-date fair value of the award and to recognize the cost over the requisite service period. SFAS No. 123(R) is effective for quarterly periods beginning after December 15, 2005, which is the Company's first quarter ending March 31, 2006. The Company will adopt FAS No. 123(R) in the first quarter of fiscal 2006 using the modified prospective method of transition. The Company's existing outstanding options will be equity classified. The compensation expense in future periods specific to unvested options outstanding as of December 31, 2005 is not material.

In May 2005, the FASB issued Statement 154, "Accounting Changes and Error Corrections," which will be effective in the first quarter of 2007. This statement addresses the retrospective application of accounting changes and corrections and will be followed if and when necessary.

In June 2005, the FASB ratified the consensus reached by the Emerging Issues Task Force (EITF) on Issue 05-6, "Determining the Amortization Period for Leasehold Improvements." This consensus, which will be effective in the first quarter of 2006, states

that leasehold improvements acquired after the inception of a lease should be amortized over the shorter of the useful life of the assets or a term that includes renewals that are reasonably assured at the date of acquisition of the leasehold improvements. The Company has evaluated this consensus and concluded that it is already following this procedure.

In October 2005, the FASB issued Staff Position 13-1, "Accounting for Rental Costs Incurred During a Construction Period." This pronouncement states that rental costs associated with ground or building operating leases that are incurred during a construction period should be recognized as rental expense. The Company is already in conformity with this new pronouncement; therefore, the implementation will not impact the financial statements.

In November 2005, the FASB issued FSP No. 123(R)-3, "Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards." This pronouncement provides an alternative method of calculating the excess tax benefits available to absorb any tax deficiencies recognized subsequent to the adoption of SFAS No. 123(R). The Company has until November 2006 to make a one-time election to adopt the transition method. The Company is currently evaluating FSP No. 123(R)-3. The Company does not expect that this one-time election will affect operating income or net earnings.

DIRECTORS AND OFFICERS

George E. Richmond
Chairman of the Board

Alfred E. Brennan
Vice Chairman of the Board
& Chief Executive Officer

Brian F. Bremer^{1, 2, 3}
Partner – CroBern Management
Partnership II LP

Marc R. Sarni^{1, 2, 3}
Principal – Cornerstore Investment LLC

Dr. Patrick J. Ferrillo^{1, 2, 3}
Vice Provost & Dean – University of
Nevada – Las Vegas
School of Dental Medicine

¹ Audit Committee

² Compensation Committee

³ Nominating Committee

George E. Richmond
Chairman of the Board

Alfred E. Brennan
Vice Chairman of the Board
& Chief Executive Officer

Arthur L. Herbst, Jr.
President

Christine R. Boehning
Secretary, Vice President &
Chief Financial Officer

Daniel J. Tarullo
Vice President

Stephen T. Yaggy
Vice President

CORPORATE INFORMATION

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Earth City, Missouri 63045
314-344-0010
Investor Relations: Ext. 3133

Stock Listing
Nasdaq/AMEX
Symbol: YDNT

Independent Certified Public Accountants
KPMG LLP
Chicago, Illinois

Transfer Agent
UMB Bank
P.O. Box 410064
Kansas City, Missouri 64141
816-860-7445

ANNUAL MEETING

The Annual Meeting for Shareholders
of Young Innovations will be held on
Tuesday, May 9, 2006, starting at
4:00 p.m. at:

The University Club of Chicago
75 East Monroe Street
Chicago, Illinois

OPPORTUNITY CHALLENGE

Young Innovations develops, manufactures and markets supplies and equipment used by dentists and dental hygienists.

Young Innovations, Inc.

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