2005 ANNUAL REPORT

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SAFETY FIRST: AN INTRODUCTION TO ATRION CORPORATION

Atrion manufactures precision equipment, components and supplies for healthcare professionals and medical products manufacturers worldwide. Another major market for our technology is makers of essential safety products for marine and aviation markets. Our products have a common premise: high quality, reliability, and cost-effective performance in critical applications dedicated to safety and wellbeing of end users and healthcare providers.

Focusing our technological capabilities and business strategies on serving these vigorous and growing niche markets has given Atrion a competitive edge in developing and marketing new and improved products to customers who value and trust our brands.

The result is steady and profitable growth, market leadership in many product categories and a healthy cash flow enabling us to reinvest in people, products and plant facilities. These are the constants that have seen Atrion through turbulent times in the economy and have shaped our vision of the future. We are committed to building lasting value for the Company, its stockholders, and customers through continued growth–as we achieved in 2005 for the seventh consecutive year.

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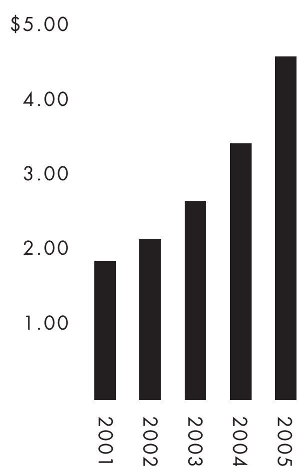
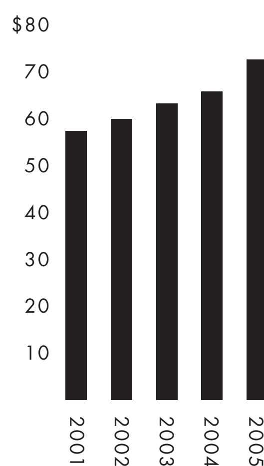
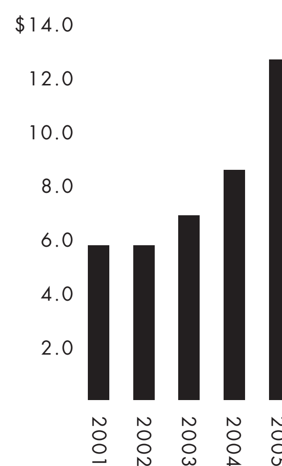
EARNING PER DILUTED SHARE FROM CONTINUING OPERATIONS



REVENUES *IN MILLIONS*



OPERATING INCOME *IN MILLIONS*



FOR THE YEAR ENDED DECEMBER 31,	2005	2004
REVENUES	**$ 72,089,000**	$ 66,081,000
OPERATING INCOME	**12,698,000**	8,596,000
INCOME FROM CONTINUING OPERATIONS	**8,793,000**	6,305,000
EARNINGS PER DILUTED SHARE FROM CONTINUING OPERATIONS	**$ 4.57**	$ 3.41
WEIGHTED AVERAGE DILUTED SHARES OUTSTANDING	**1,924,000**	1,850,000
AS OF DECEMBER 31,	**2005**	**2004**
TOTAL ASSETS	**$ 78,470,000**	$ 67,408,000
WORKING CAPITAL	**19,747,000**	19,206,000
LONG-TERM DEBT	**2,529,000**	2,936,000
STOCKHOLDERS' EQUITY	**$ 61,895,000**	$ 50,603,000

Another Year of Record Earnings

We are pleased to report that Atrion achieved superior growth in revenues and operating income in 2005. For the year that ended December 31, 2005, our Company's net income from continuing operations was $4.57 per diluted share, an increase of 34% over the $3.41 per diluted share for 2004. This is the seventh consecutive year that Atrion has achieved earnings-per-share growth of 15% or greater. Operating income increased to $12.7 million, a 48% gain over the $8.6 million in 2004.

Revenues Grow 9% to $72 Million

Despite the continued leveling off of ophthalmic products sales—one of our four major product categories—revenues for 2005 increased 9% to $72,089,000 from $66,081,000 in 2004. Over several years our steady growth in sales, our diversified mix of established brands and new products, and our continued focus on controlling operating expenses have led to continual increases in operating income and earnings per diluted share.

Atrion Share Price Increases 50%; Dividend Grows

Building and returning value to our stockholders is the guiding principle for our financial and operational strategies. In 2005, the market price for Atrion's (NM/NASDAQ–ATRI) stock grew from $46.13 on January 1, 2005 to $69.43 on December 31, 2005, an increase of 50%. This superb performance compares to a 3% increase in the S&P Composite Index and a 6% decline in the SIC Code Index for the Surgical and Medical Instrument industry in the same period.

Beginning in 2003, we initiated a program of paying quarterly cash dividends to stockholders. During 2005, we increased the quarterly dividend by 21% from 14 cents per share to 17 cents per share.

Increased Inventories

In 2005 and in the first quarter of 2006, we have continued a program initiated in 2004 of buying critical raw materials in larger volumes to take advantage of quantity discounts and to hedge against further price increases. Moreover, in 2005 we began to increase our inventories of finished goods in response to sales forecasts and to ensure uninterrupted deliveries to our customers when we relocate our manufacturing operations in St. Petersburg, Florida, to a new facility in the second half of 2006.

New Plant On Stream in 2006

As previewed in our 2004 Annual Report, we began construction in October 2005 on a 165,000-square-foot manufacturing facility in St. Petersburg, Florida. Located four miles from our existing facility, the new state-of-the-art plant will more than double the manufacturing capacity of

2005 REVENUES BY PRODUCT LINE

our St. Petersburg operations. Presently, operations are housed in a leased 72,000-square-foot facility that was not suited for expansion or upgrading. The cost of our new facility, exclusive of land and site preparation, is estimated at $16 million. This new plant is a demonstration of Atrion's strategy of building stockholder value by reinvesting cash flow in developing new products, improving existing product lines, and upgrading processes and facilities to maintain technological and market-share leadership.

Given the complexity of our manufacturing, assembly, and R&D equipment, this relocation entails not only a physical move but also the installation, testing, and revalidation of equipment to meet our quality and regulatory requirements. We expect the entire process to take place over a ten-week period.

When the new St. Petersburg plant is up and running later in 2006, Atrion will have more than 385,000 square feet of manufacturing and R&D capacity, including the plant at our headquarters in Texas and another in Alabama. In addition to the new plant, in 2005 Atrion invested $6.0 million to upgrade manufacturing technology and processes, as well as $2.4 million in R&D.

Atrion's Diversified Product Mix

One of our Company's fundamental strengths is a diversified mix of products. Most of these products have in common safeguarding their end users, or greater safety in surgical and patient-care procedures. Within these larger market categories are a number of dynamic and growing niche markets in which Atrion brands are established as the leader in market share.

Performance By Product Group

In 2005, sales of our swabable valves—a safe, economical substitute for needle ports in IV applications—and our tubing sets and medical clamps helped boost the *Fluid Delivery* product group's performance by 19%. *Cardiovascular* products sales, driven by our proprietary MPS® Myocardial Protection System and our catheter inflation devices, increased 16%. (The MPS delivers essential fluids and medications to the heart during open-heart surgery and is used in more than 35,000 open-heart surgeries annually.) Sales for the category *Other Products* grew by 7%. This category encompasses a variety of safety devices and components, including pressure relief valves and devices for self-inflating marine and aviation safety products. Although our *Ophthalmology* product sales declined 7%, our Company remains the leading manufacturer of soft contact lens disinfection cases. Our LacriCATH® balloon catheter used

in the treatment of tear duct blockages is an important contributor to revenues in this category.

Atrion also provides contract engineering design, manufacturing, and packaging services for select manufacturers. These services provide an additional source of revenues and earnings.

The Outlook for 2006

Looking at 2006, we hope to again show double-digit growth. Although we are working hard to ensure a smooth transition to the new plant, industrial moves involving precision equipment are always highly complex, and we are mindful of the potential for disruptions. Our results quarter to quarter may show variability in earnings as we incur moving costs and as we continue to reflect the impact of the build-up in inventories before the move and reductions in the months following.

Atrion entered the new fiscal year energized by a number of positive trends and positions: our record sales and earnings levels in 2005, our established product mix and leadership in many niche markets, and the anticipation of increased sales from existing lines as well as from the launch of a variety of new and improved products awaiting FDA approval.

We realize that our continued profitable growth is a finely-tuned balance of steadily increasing sales of our trusted brands, rigorous cost controls, reinvestment of a large portion of cash flow into our operations and product development, the judicious use of our line of credit, and leveraging our technological assets and market leadership for the continuing benefit of our stockholders.

In closing, we wish to thank our loyal customers, employees, suppliers, and the communities in which Atrion operates for their respective roles in achieving the results of this outstanding year and helping drive our Company forward. Our thanks also go to Dick Jacobson who will be retiring from the Board of Directors at the end of his elected term. For the past 14 years, Dick has been a tireless champion of Atrion, devoting time, energy, and expertise to help direct our Company. Dick's advice was never sugarcoated, always incisive, and much appreciated. His advice and counsel will be greatly missed.

Emile A. Battat
Chairman of the Board, President
and Chief Executive Officer

ARTIST'S RENDERING

We began construction in 2005 on a 165,000-square-foot manufacturing facility in St. Petersburg, Florida. Located only four miles from our existing facility, the new state-of-the-art plant will more than double the manufacturing capacity of our St. Petersburg operations.

ASSETS:

AS OF DECEMBER 31, 2005 AND 2004 (IN THOUSANDS)	2005	2004
Current Assets:		
Cash and cash equivalents	**$ 525**	$ 255
Accounts receivable, net of allowance for doubtful accounts of $65 and $118 in 2005 and 2004, respectively	**8,291**	7,588
Inventories	**17,705**	14,013
Prepaid expenses	**832**	1,028
Land deposit	**—**	3,750
Deferred income taxes	**620**	1,039
	27,973	27,673
Property, Plant and Equipment	**63,041**	50,402
Less accumulated depreciation and amortization	**27,787**	25,071
	35,254	25,331
Other Assets and Deferred Charges:		
Patents and licenses, net of accumulated amortization of $8,877 and $7,853 in 2005 and 2004, respectively	**2,331**	1,895
Goodwill	**9,730**	9,730
Other	**3,182**	2,779
	15,243	14,404
	$ 78,470	$ 67,408

The accompanying notes are an integral part of these statements.

LIABILITIES AND STOCKHOLDERS' EQUITY:

AS OF DECEMBER 31, 2005 AND 2004 (IN THOUSANDS)	2005	2004
Current Liabilities:		
Accounts payable	**$ 4,501**	$ 3,788
Accrued liabilities	**2,627**	3,358
Accrued income and other taxes	**1,098**	1,321
	8,226	8,467
Line of Credit	**2,529**	2,936
Other Liabilities and Deferred Credits:		
Deferred income taxes	**4,344**	4,263
Other	**1,476**	1,139
	5,820	5,402
Commitments and Contingencies		
Stockholders' Equity:		
Common stock, par value $.10 per share, authorized 10,000 shares, issued 3,420 shares	**342**	342
Additional paid-in capital	**12,508**	10,013
Retained earnings	**82,318**	74,479
Treasury shares, 1,586 shares in 2005 and 1,701 shares in 2004, at cost	**(33,273)**	(34,231)
	61,895	50,603
	$ 78,470	$ 67,408

The accompanying notes are an integral part of these statements.

FOR THE YEAR ENDED DECEMBER 31, 2005, 2004 AND 2003
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	2005	2004	2003
Revenues	**$ 72,089**	$ 66,081	$ 62,803
Cost of Goods Sold	**43,119**	40,804	40,564
Gross Profit	**28,970**	25,277	22,239
Operating Expenses:			
Selling	**5,637**	5,676	5,594
General and administrative	**8,239**	8,631	7,576
Research and development	**2,396**	2,374	2,146
	16,272	16,681	15,316
Operating Income	**12,698**	8,596	6,923
Interest Income	**37**	45	69
Interest Expense	**(61)**	(93)	(195)
Other Income (Expense), net	**10**	46	(26)
Income from Continuing Operations before Provision for Income Taxes	**12,684**	8,594	6,771
Income Tax Provision	**(3,891)**	(2,289)	(1,879)
Income from Continuing Operations	**8,793**	6,305	4,892
Gain on Disposal of Discontinued Operations, net of tax	**165**	165	165
Net Income	**$ 8,958**	$ 6,470	$ 5,057
Income Per Basic Share:			
Continuing operations	**$ 4.90**	$ 3.68	$ 2.86
Discontinued operations	**.09**	.10	.10
Net Income Per Basic Share	**$ 4.99**	$ 3.78	$ 2.96
Weighted Average Basic Shares Outstanding	**1,794**	1,711	1,711
Income Per Diluted Share:			
Continuing operations	**$ 4.57**	$ 3.41	$ 2.66
Discontinued operations	**.09**	.09	.09
Net Income Per Diluted Share	**$ 4.66**	$ 3.50	$ 2.75
Weighted Average Diluted Shares Outstanding	**1,924**	1,850	1,839

The accompanying notes are an integral part of these statements.

FOR THE YEAR ENDED DECEMBER 31, 2005, 2004 AND 2003 (IN THOUSANDS)	2005	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	**$ 8,958**	$ 6,470	$ 5,057
Adjustments to reconcile net income to net cash provided by operating activities:			
Gain on disposal of discontinued operations	**(165)**	(165)	(165)
Depreciation and amortization	**5,389**	4,830	4,783
Deferred income taxes	**500**	487	1,639
Tax benefit related to stock options	**1,168**	90	515
Other	**10**	20	34
	15,860	11,732	11,863
Changes in operating assets and liabilities:			
Accounts receivable	**(703)**	(1,362)	495
Inventories	**(3,692)**	(2,698)	(1,003)
Prepaid expenses	**196**	866	379
Other non-current assets	**(1,863)**	542	(29)
Accounts payable and accrued liabilities	**(18)**	1,109	1,008
Accrued income and other taxes	**(223)**	670	(208)
Other non-current liabilities	**337**	165	199
Net cash provided by continuing operations	**9,894**	11,024	12,704
Net cash provided by discontinued operations (Note 3)	**165**	165	165
	10,059	11,189	12,869
CASH FLOWS FROM INVESTING ACTIVITIES:			
Property, plant and equipment additions	**(10,569)**	(5,570)	(4,215)
Deposit on land purchase	**—**	(3,750)	—
Property, plant and equipment sales	**21**	—	—
	(10,548)	(9,320)	(4,215)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net change in line of credit	**(407)**	(1,351)	(6,050)
Exercise of stock options	**2,285**	414	2,656
Purchase of treasury stock	**—**	(84)	(4,909)
Dividends paid	**(1,119)**	(891)	(406)
	759	(1,912)	(8,709)
NET CHANGE IN CASH AND CASH EQUIVALENTS	**270**	(43)	(55)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	**255**	298	353
CASH AND CASH EQUIVALENTS, END OF YEAR	**$ 525**	$ 255	$ 298
CASH PAID FOR:			
Interest (net of capitalization)	**$ 62**	$ 96	$ 207
Income taxes	**2,508**	716	554

The accompanying notes are an integral part of these statements.

FOR THE YEAR ENDED DECEMBER 31, 2005, 2004 AND 2003 (IN THOUSANDS)	COMMON STOCK SHARES OUTSTANDING	COMMON STOCK AMOUNT	TREASURY STOCK SHARES	TREASURY STOCK AMOUNT	ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS	TOTAL
Balance, January 1, 2003	1,706	$ 342	1,714	$(31,122)	$ 8,222	$64,249	$41,691
Net income						5,057	5,057
Tax benefit from exercise of stock options					515		515
Exercise of stock options	187		(187)	1,720	936		2,656
Purchase of treasury stock	(193)		193	(4,909)			(4,909)
Dividends						(406)	(406)
Balance, December 31, 2003	1,700	342	1,720	(34,311)	9,673	68,900	44,604
Net income						6,470	6,470
Tax benefit from exercise of stock options					90		90
Exercise of stock options	21		(21)	164	250		414
Purchase of treasury stock	(2)		2	(84)			(84)
Dividends						(891)	(891)
Balance, December 31, 2004	1,719	342	1,701	(34,231)	10,013	74,479	50,603
Net income						8,958	8,958
Tax benefit from exercise of stock options					1,168		1,168
Exercise of stock options	115		(115)	958	1,327		2,285
Dividends						(1,119)	(1,119)
Balance, December 31, 2005	**1,834**	**$ 342**	**1,586**	**$(33,273)**	**$12,508**	**$82,318**	**$61,895**

The accompanying notes are an integral part of this statement.

1 | SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Atrion Corporation ("Atrion") and its subsidiaries (collectively, the "Company") design, develop, manufacture, sell and distribute products primarily for the medical and healthcare industry. The Company markets its products throughout the United States and internationally. The Company's customers include hospitals, distributors, and other manufacturers. The principal subsidiaries of Atrion through which these operations are conducted are Atrion Medical Products, Inc. ("Atrion Medical Products"), Halkey-Roberts Corporation ("Halkey-Roberts") and Quest Medical, Inc. ("Quest Medical").

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of Atrion and its subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation.

FAIR VALUE

The carrying amounts of cash and cash equivalents, accounts receivable and accounts payable approximate fair value due to the short-term nature of these items. The carrying amount of debt approximates fair value as the interest rate is tied to market rates.

ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 dates of the financial statements and the reported amount of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

CASH AND CASH EQUIVALENTS

Cash equivalents are securities with original maturities of 90 days or less.

TRADE RECEIVABLES

Trade accounts receivable are recorded at the original sales price to the customer. The Company maintains an allowance for doubtful accounts to reflect estimated losses resulting from the inability of customers to make required payments. On an ongoing basis, the collectibility of accounts receivable is assessed based upon historical collection trends, current economic factors and the assessment of the collectibility of specific accounts. The Company evaluates the collectibility of specific accounts and determines when to grant credit to its customers using a combination of factors, including the age of the outstanding balances, evaluation of customers' current and past financial condition, recent payment history, current economic environment, and discussions with appropriate Company personnel and with the customers directly. Accounts are written off when it is determined the receivable will not be collected.

INVENTORIES

Inventories are stated at the lower of cost (including materials, direct labor and applicable overhead) or market. Cost is determined by using the first-in, first-out method. The following table details the major components of inventory (in thousands):

	DECEMBER 31, 2005	2004
Raw materials	**$ 6,898**	$ 5,665
Work in process	**4,291**	3,753
Finished goods	**6,516**	4,595
Total inventories	**$ 17,705**	$ 14,013

INCOME TAXES

The Company utilizes the asset and liability approach to financial accounting and reporting for income taxes. Deferred income tax assets and liabilities are computed annually for differences between the financial reporting basis and the tax basis of the Company's other assets and liabilities. These amounts are based on tax laws and rates applicable to the periods in which the differences are expected to affect taxable income.

PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment is stated at cost and depreciated using the straight-line method over the estimated useful lives of the related assets. Expenditures for repairs and maintenance are charged to expense as incurred. The following table represents a summary of property, plant and equipment at original cost (in thousands):

	DECEMBER 31, 2005	DECEMBER 31, 2004	USEFUL LIVES
Land	**$ 5,284**	$ 1,506	—
Buildings	**13,982**	9,147	30-40 yrs
Machinery and equipment	**43,775**	39,749	3-10 yrs
Total property, plant and equipment	**$ 63,041**	$ 50,402	

Depreciation expense of $4,365,005, $4,408,000 and $4,442,000 was recorded for the years ended December 31, 2005, 2004 and 2003, respectively.

Capitalized interest related to the construction of a new facility at Halkey-Roberts in the amount of $26,850 was recorded during 2005.

PATENTS AND LICENSES

Cost for patents and licenses acquired is determined at acquisition date. Patents and licenses are amortized over the useful lives of the individual patents and licenses, which are from 7 to 19 years. Patents and licenses are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable.

GOODWILL

Goodwill represents the excess of cost over the fair value of tangible and identifiable intangible net assets acquired. Annual impairment testing for goodwill is done using a fair value-based test. Goodwill is also reviewed periodically for impairment whenever events or changes in circumstances indicate a change in value may have occurred. The Company has identified three reporting units where goodwill was recorded for purposes of testing goodwill impairment annually: (1) Atrion Medical Products (2) Halkey-Roberts and (3) Quest Medical. The carrying amount for goodwill in each of the three years ended December 31, 2005, 2004 and 2003 was $9,730,000.

CURRENT ACCRUED LIABILITIES

The items comprising current accrued liabilities are as follows (in thousands):

	DECEMBER 31, 2005	DECEMBER 31, 2004
Accrued payroll and related expenses	**$ 1,277**	$ 1,106
Accrued vacation	**261**	517
Accrued professional fees	**427**	1,255
Other accrued liabilities	**662**	480
Total accrued liabilities	**$ 2,627**	$ 3,358

REVENUES

The Company recognizes revenue when its products are shipped to its customers and distributors, provided an arrangement exists, the fee is fixed and determinable and collectibility is reasonably assured. All risks and rewards of ownership pass to the customer upon shipment. Net sales represent gross sales invoiced to customers, less certain related charges, including discounts, returns and other allowances. Returns, discounts and other allowances have been insignificant historically.

SHIPPING AND HANDLING POLICY

Shipping and handling fees charged to customers are reported as revenue and all shipping and handling costs incurred related to products sold are reported as cost of goods sold.

RESEARCH AND DEVELOPMENT COSTS

Research and development costs relating to the development of new products and improvements of existing products are expensed as incurred.

ADVERTISING

Advertising production costs are expensed as incurred. Media for print placement costs are expensed in the period the advertising appears. Total advertising expenses were approximately $219,000, $161,000 and $146,000 for the years ended December 31, 2005, 2004 and 2003, respectively.

STOCK-BASED COMPENSATION

At December 31, 2005, the Company had two stock-based employee compensation plans, which are described more fully in Note 8. The Company accounts for those plans under the recognition and measurement principles of Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations. No stock-based employee compensation cost is reflected in net income, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant.

In December 2004, the Financial Accounting Standards Board ("FASB") issued a revision of FASB Statement No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123R"). SFAS No. 123R supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees" and requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award, and recognize that cost over the vesting period. SFAS No. 123R is effective for the Company's first annual period beginning after June 15, 2005. The Company will begin recognizing option expense starting January 1, 2006. Since most of the Company's outstanding options will have vested prior to January 1, 2006, the amount of expense to be recognized for options starting in the first quarter of 2006 is not expected to be significant.

The following table illustrates the effect on net income and income per share if the Company had applied the fair value recognition provisions of SFAS No. 123R to stock-based employee compensation:

		YEAR ENDED DECEMBER 31,	
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)	2005	2004	2003
Net income, as reported	**$ 8,958**	$ 6,470	$ 5,057
Deduct: Total stock-based employee compensation expense determined under fair value-based methods for all awards, net of tax effects	**(129)**	(658)	(526)
Pro forma net income	**$ 8,829**	$ 5,812	$ 4,531
Income per share:			
Basic — as reported	**$ 4.99**	$ 3.78	$ 2.96
Basic — pro forma	**$ 4.92**	$ 3.40	$ 2.65
Diluted — as reported	**$ 4.66**	$ 3.50	$ 2.75
Diluted — pro forma	**$ 4.59**	$ 3.14	$ 2.46

NEW ACCOUNTING PRONOUNCEMENTS

In addition to SFAS No. 123R more fully discussed above, the FASB issued Statement of Financial Accounting Standards ("SFAS") No. 151, "Inventory Costs," which amends Accounting Research Bulletin 43, Chapter 4, "Inventory Pricing," to clarify that abnormal amounts of idle facility expense, freight, handling costs and spoilage should be recognized as current period expenses. Also, the statement requires fixed overhead costs to be allocated to inventory based on normal production capacity. SFAS No. 151 is effective for inventory costs incurred in fiscal years beginning after June 15, 2005. The Company does not expect the adoption of this pronouncement to have a material impact on its financial statements.

2 PATENTS AND LICENSES

Purchased patents and licenses paid for the use of other entities' patents are amortized over the useful life of the patent or license. Patents and licenses are as follows (dollars in thousands):

DECEMBER 31, 2005		
WEIGHTED AVERAGE ORIGINAL LIFE (YEARS)	GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION
14.74	**$ 11,208**	**$ 8,877**

DECEMBER 31, 2004		
WEIGHTED AVERAGE ORIGINAL LIFE (YEARS)	GROSS CARRYING AMOUNT	ACCUMULATED AMORTIZATION
15.15	$ 9,748	$ 7,853

Aggregate amortization expense for patents and licenses was $1,024,000 for 2005, $422,000 for 2004 and $341,000 for 2003. Estimated future amortization expense for each of the years set forth below ending December 31, is as follows (in thousands):

2006	$ 305
2007	$ 294
2008	$ 277
2009	$ 258
2010	$ 244

3 DISCONTINUED OPERATIONS

During 1997, the Company sold all of its natural gas operations. The consolidated financial statements presented herein reflect the Company's natural gas operations as discontinued operations for all periods presented. The consolidated financial statements reflect a gain on disposal of these discontinued operations of $165,000 in each of 2005, 2004 and 2003. These amounts are net of income tax expense of $85,000 in each of the three years.

In addition to the initial consideration received in 1997 upon the sale of the natural gas operations, certain annual contingent deferred payments of up to $250,000 per year were to be paid to the Company over an eight-year period which began in 1999, with the amount paid each year to be dependent upon revenues received by the purchaser from certain gas transportation contracts. The Company received deferred payments of $250,000 each, before tax, from the purchaser in April 2005, 2004 and 2003 which are reflected in each year as a gain from discontinued operations of $165,000, net of tax.

4 LINE OF CREDIT

The Company has a revolving credit facility ("Credit Facility") with a money center bank. Under the Credit Facility, the Company and certain of its subsidiaries have a line of credit of $25 million which is secured by substantially all inventories, equipment and accounts receivable of the Company. Interest under the Credit Facility is assessed at 30-day, 60-day or 90-day LIBOR, as selected by the Company, plus one percent (5.25 percent at December 31, 2005) and is payable monthly. At December 31, 2005 and 2004, $2.5 million and $2.9 million, respectively, was outstanding under the line of credit. The Credit Facility expires November 12, 2009 and may be extended under certain circumstances. At any time during the term, the Company may convert any or all outstanding amounts under the Credit Facility to a term loan with a maturity of two years. The Company's ability to borrow funds under the Credit Facility from time to time is contingent on meeting certain covenants in the loan agreement, the most restrictive of which is the ratio of total debt to earnings before interest, income tax, depreciation and amortization. At December 31, 2005, the Company was in compliance with all financial covenants.

5 | INCOME TAXES

The items comprising income tax expense for continuing operations are as follows (in thousands):

	YEAR ENDED DECEMBER 31,		
	2005	2004	2003
Current — Federal	**$ 3,189**	$ 1,807	$ 914
— State	**257**	91	32
	3,446	1,898	946
Deferred — Federal	**408**	380	912
— State	**37**	11	21
	445	391	933
Total income tax expense	**$ 3,891**	$ 2,289	$ 1,879

Temporary differences and carryforwards which have given rise to deferred income tax assets and liabilities as of December 31, 2005 and 2004 are as follows (in thousands):

	2005	2004
DEFERRED TAX ASSETS:		
Benefit plans	**$ 471**	$ 517
Inventories	**448**	413
Patents and goodwill	**—**	187
Other	**63**	443
Total deferred tax assets	**$ 982**	$ 1,560
DEFERRED TAX LIABILITIES:		
Property, plant and equipment	**$ 3,930**	$ 4,222
Pensions	**488**	562
Patents and goodwill	**288**	—
Total deferred tax liabilities	**$ 4,706**	$ 4,784
Net deferred tax liability	**$ 3,724**	$ 3,224
BALANCE SHEET CLASSIFICATION:		
Non-current deferred income tax liability	**$ 4,344**	$ 4,263
Current deferred income tax asset	**620**	1,039
Net deferred tax liability	**$ 3,724**	$ 3,224

Total income tax expense for continuing operations differs from the amount that would be provided by applying the statutory federal income tax rate to pretax earnings as illustrated below (in thousands):

	YEAR ENDED DECEMBER 31,		
	2005	2004	2003
Income tax expense at the statutory federal income tax rate	**$ 4,313**	$ 2,922	$ 2,298
Increase (decrease) resulting from:			
State income taxes	**210**	67	34
R&D credit	**(100)**	(75)	(100)
Foreign sales benefit	**(434)**	(441)	(250)
Other, net	**(98)**	(184)	(103)
Total income tax expense	**$ 3,891**	$ 2,289	$ 1,879

6 STOCKHOLDERS' EQUITY

The Board of Directors of the Company has at various times authorized repurchases of Company stock in open-market or negotiated transactions at such times and at such prices as management may from time to time decide. There were no repurchases made in 2005, but the Company has effected a number of open-market or negotiated transactions to purchase its stock during the previous years. These repurchases totaled 1,900 and 20,200 shares during the years 2004 and 2003, respectively, at per share prices ranging from $23.43 to $44.16. As of December 31, 2005, authorization for the repurchase of up to 92,100 additional shares remained. The Company purchased 173,614 shares of its common stock at $23.00 per share in April 2003 pursuant to a tender offer. All shares purchased in the tender offer and in the open-market or negotiated transactions became treasury shares upon repurchase by the Company.

In September 2003, the Company announced that it had adopted a policy for the payment of regular quarterly cash dividends on the Company's common stock. The Company began paying a quarterly cash dividend of $.12 per share starting in September of 2003. The quarterly dividend was increased to $.14 per share in September of 2004 and to $.17 per share in September of 2005.

7 INCOME PER SHARE

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

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)	YEAR ENDED DECEMBER 31, 2005	2004	2003
Income from continuing operations	**$ 8,793**	$ 6,305	$ 4,892
Weighted average basic shares outstanding	**1,794**	1,711	1,711
Add: Effect of dilutive securities (options)	**130**	139	128
Weighted average diluted shares outstanding	**1,924**	1,850	1,839
Income per share from continuing operations:			
Basic	**$ 4.90**	$ 3.68	$ 2.86
Diluted	**$ 4.57**	$ 3.41	$ 2.66

For the years ended December 31, 2004 and 2003, options to purchase approximately 26,000 and 25,250 shares of common stock, respectively, were not included in the computation of diluted income per share because their effect would have been antidilutive.

8 STOCK OPTION PLANS

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

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

Option transactions for the three years in the period ended December 31, 2005 are as follows:

	SHARES	WEIGHTED AVERAGE EXERCISE PRICE
Options outstanding at January 1, 2003	467,350	$ 15.82
Granted in 2003	12,000	$ 29.30
Expired in 2003	(4,550)	$ 20.18
Exercised in 2003	(187,200)	$ 14.19
Options outstanding at December 31, 2003	287,600	$ 17.38
Granted in 2004	62,000	$ 44.39
Exercised in 2004	(21,100)	$ 19.63
Options outstanding at December 31, 2004	328,500	$ 22.33
Granted in 2005	12,500	$ 46.05
Expired in 2005	(1,000)	$ 31.39
Exercised in 2005	(114,900)	$ 19.88
Options outstanding at December 31, 2005	225,100	$ 24.86
Exercisable options at December 31, 2003	217,000	$ 15.41
Exercisable options at December 31, 2004	287,250	$ 22.32
Exercisable options at December 31, 2005	206,350	$ 24.26

As of December 31, 2005, there remained 1,034 shares for which options may be granted in the future under the 1997 Stock Incentive Plan. The following table summarizes information about stock options outstanding at December 31, 2005:

	OPTIONS OUTSTANDING			OPTIONS EXERCISABLE	
RANGE OF EXERCISE PRICES	NUMBER OUTSTANDING	WEIGHTED AVERAGE REMAINING CONTRACTUAL LIFE	WEIGHTED AVERAGE EXERCISE PRICE	NUMBER EXERCISABLE	WEIGHTED AVERAGE EXERCISE PRICE
$6.875-$14.063	106,800	3.2 years	$ 11.17	106,800	$ 11.17
$14.875-$22.50	10,000	4.7 years	$ 20.98	10,000	$ 20.98
$26.13-$31.39	43,900	3.5 years	$ 30.05	25,150	$ 29.05
$43.75-$46.28	64,400	3.9 years	$ 44.62	64,400	$ 44.62
	225,100			206,350	

Pro forma information regarding net income and income per share as required by SFAS No. 123 has been determined as if the Company had accounted for its stock options under the fair value method of that statement. The fair value for these options was estimated at the date of grant using a Black-Scholes option pricing model with the following weighted average assumptions for 2005, 2004 and 2003:

	2005	2004	2003
Risk-free interest rate	**3.4%**	2.1%	3.2%
Dividend yield	**1.3%**	1.1%	0.0%
Volatility factor	**31.3%**	47.7%	39.1%
Expected life	**3 years**	2.8 years	7 years

The resulting estimated weighted average fair values of the options granted in 2005, 2004 and 2003 were $10.51, $13.45 and $13.51, respectively.

The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including expected stock price volatility. The option grants in 2003 occurred prior to the declaration of dividends by the Company.

9 | REVENUES FROM MAJOR CUSTOMERS

The Company had one major customer which represented approximately $7.8 million (10.8 percent), $9.6 million (14.5 percent) and $9.1 million (14.4 percent) of the Company's operating revenues during the years 2005, 2004 and 2003, respectively.

10 | INDUSTRY SEGMENT AND GEOGRAPHIC INFORMATION

The Company operates in one reportable industry segment: designing, developing, manufacturing, selling and distributing products for the medical and healthcare industry and has no foreign operating subsidiaries. The Company has other product lines which include pressure relief valves and inflation systems, which are sold primarily to the aviation and marine industries. Due to the similarities in product technologies and manufacturing processes, these products are managed as part of the medical products segment. The Company recorded incidental revenues from its oxygen pipeline, which totaled approximately $955,000 in each of the years of 2005, 2004 and 2003. Pipeline net assets totaled $2.4 and $2.5 million at December 31, 2005 and 2004, respectively. Company revenues from sales to parties outside the United States totaled approximately 27 percent, 30 percent and 26 percent of the Company's total revenues in 2005, 2004 and 2003, respectively. No Company assets are located outside the United States. A summary of revenues by geographic territory, based on shipping destination, for the three years 2005, 2004 and 2003 is as follows (in thousands):

	YEAR ENDED DECEMBER 31,		
	2005	2004	2003
United States	**$ 52,283**	$ 46,375	$ 46,721
Canada	**8,232**	9,113	8,620
United Kingdom	**1,984**	1,883	1,547
Japan	**1,824**	1,739	902
Other	**7,766**	6,971	5,013
Total	**$ 72,089**	$ 66,081	$ 62,803

11 EMPLOYEE RETIREMENT AND BENEFIT PLANS

A noncontributory cash balance defined benefit retirement plan is maintained for all regular employees of the Company except those of Quest Medical. This plan was amended effective May 1, 2005 to discontinue the addition of newly-hired employees to the plan after that date. The Company's funding policy is to make the annual contributions required by applicable regulations and recommended by its actuary. The Company uses a December 31 measurement date for the plan.

The changes in the plan's projected benefit obligation ("PBO") as of December 31, 2005 and 2004 are as follows (in thousands):

	2005	2004
CHANGE IN BENEFIT OBLIGATION:		
Benefit obligation, January 1	**$ 5,539**	$ 4,878
Service cost	**267**	241
Interest cost	**322**	311
Actuarial (gain)/loss	**(61)**	423
Benefits paid	**(412)**	(314)
Benefit obligation, December 31	**$ 5,655**	$ 5,539

The changes in the fair value of plan assets, funded status of the plan and the status of the prepaid pension benefit recognized, which is included in the Company's balance sheets as of December 31, 2005 and 2004 are as follows (in thousands):

	2005	2004
CHANGE IN PLAN ASSETS:		
Fair value of plan assets, January 1	**$ 5,661**	$ 5,413
Actual return on plan assets	**227**	562
Employer contributions	**200**	—
Benefits paid	**(412)**	(314)
Fair value of plan assets, December 31	**$ 5,676**	$ 5,661
Funded status of plan	**$ 21**	$ 122
Unrecognized actuarial loss	**2,182**	2,122
Unrecognized prior service cost	**(427)**	(465)
Unrecognized net transition obligation	**—**	(44)
Net amount recognized as other assets	**$ 1,776**	$ 1,735

The accumulated benefit obligation for the pension plan was $5,571,000 and $5,447,000 at December 31, 2005 and 2004, respectively. The components of net periodic pension cost for 2005, 2004 and 2003 were as follows (in thousands):

	YEAR ENDED DECEMBER 31,		
	2005	2004	2003
COMPONENTS OF NET PERIODIC PENSION COST:			
Service cost	**$ 267**	$ 241	$ 214
Interest cost	**322**	311	298
Expected return on assets	**(456)**	(423)	(349)
Prior service cost amortization	**(37)**	(37)	(37)
Actuarial loss	**107**	103	128
Transition amount amortization	**(44)**	(44)	(44)
Net periodic pension cost	**$ 159**	$ 151	$ 210

Actuarial assumptions used to determine benefit obligations at December 31 were as follows:

	2005	2004
Discount rate	**6.00%**	6.00%
Rate of compensation increase	**5.00%**	5.00%

Actuarial assumptions used to determine net periodic pension cost were as follows:

	YEAR ENDED DECEMBER 31,		
	2005	2004	2003
Discount rate	**6.00%**	6.50%	7.00%
Expected long-term return on assets	**8.00%**	8.00%	8.00%
Rate of compensation increase	**5.00%**	5.00%	5.00%

The Company's expected long-term rate of return assumption is based upon the plan's actual long-term investment results as well as the long-term outlook for investment returns in the marketplace at the time the assumption is made.

The Company's pension plan assets at December 31, 2005 and 2004 were invested in the following asset categories:

	2005	2004
ASSET CATEGORY:		
Equity securities	**70%**	74%
Debt securities	**29%**	25%
Other	**1%**	1%
Total	**100%**	100%

It is the Company's investment policy to maintain 66 percent to 79 percent of the plan's assets in equity securities and 21 percent to 31 percent of the plan's assets in debt securities with the balance invested in a money market account to meet liquidity requirements for distributions. The asset allocation at December 31, 2005 represents the targeted asset allocation. Based upon the plan's current funded position, the Company expects to make $250,000 in contributions to its pension plan in 2006, and the Company's estimated future benefit payments under the plan are as follows (in thousands):

2006	$ 254
2007	$ 485
2008	$ 279
2009	$ 284
2010	$ 282
2011-2015	$ 1,716

The Company also sponsors a defined contribution plan for all employees. Each participant may contribute certain amounts of eligible compensation. The Company makes a matching contribution to the plan. The Company's contribution under this plan was $223,000, $214,000 and $202,000 in 2005, 2004 and 2003, respectively.

12 | COMMITMENTS AND CONTINGENCIES

The Company is subject to legal proceedings, third-party claims and other contingencies related to patent infringement, product liability, regulatory, employee and other matters that arise in the ordinary course of business. As of December 31, 2005, the Company had accrued $250,000 for legal fees and expenses that it expected to incur in connection with the litigation or arbitration of two such matters.

The Company has arrangements with its executive officers (the "Executives") pursuant to which the termination of their employment under certain circumstances would result in lump sum payments to the Executives. Termination under such circumstances in 2006 could result in payments aggregating $800,000, excluding any excise tax that may be reimbursable by the Company.

In May 1996, Halkey-Roberts began leasing the land, building and building improvements in St. Petersburg, Florida, which serve as Halkey-Roberts' headquarters and manufacturing facility, under a 10-year lease. This lease has been extended until September 30, 2006 at the rent payment in effect on May 1, 2006. The Company has guaranteed Halkey-Roberts' payment and performance obligations under the lease. The lease is being accounted for as an operating lease, and the rental expense for the years ended December 31, 2005, 2004 and 2003 was $422,000, $409,000 and $396,000, respectively. Future minimum rental commitment under this lease is $321,000 in 2006.

During 2004, the Company began planning for the construction of a new facility for its Halkey-Roberts operation to be located approximately four miles from its current facility. In 2004, the Company made a $3.75 million deposit required in connection with a proposed purchase of ten acres of land to be used for the construction of this new facility. During 2005, this property was acquired and construction of the new facility commenced. The Company is planning to complete the construction of this new facility and move the Halkey-Roberts operation into the new facility around mid-year 2006.

13 | QUARTERLY FINANCIAL DATA (UNAUDITED)

The following table shows selected unaudited quarterly financial data for 2005 and 2004:

QUARTER ENDED	OPERATING REVENUE	OPERATING INCOME	NET INCOME	INCOME PER BASIC SHARE	INCOME PER DILUTED SHARE
	(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)				
03/31/05	$ 18,645	$ 3,418	$ 2,294	$ 1.33	$ 1.23
06/30/05	18,102	3,131	2,272	1.27	1.18
09/30/05	18,338	3,111	2,241	1.23	1.15
12/31/05	17,003	3,037	2,149	1.17	1.10
03/31/04	$ 16,789	$ 1,901	$ 1,287	$ .76	$ .70
06/30/04	16,417	2,064	1,608	.94	.87
09/30/04	16,704	2,217	1,756	1.02	.95
12/31/04	16,171	2,414	1,819	1.06	.98

The quarterly information presented above reflects, in the opinion of management, all adjustments necessary for a fair presentation of the results for the interim periods presented.

BOARD OF DIRECTORS AND STOCKHOLDERS OF ATRION CORPORATION

We have audited the accompanying consolidated balance sheets of Atrion Corporation and subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of income, changes in stockholders' equity and cash flows for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements 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 consolidated financial position of Atrion Corporation and subsidiaries as of December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with accounting principles generally accepted in the United States of America.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of Atrion Corporation and subsidiaries' 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 13, 2006 expressed an unqualified opinion on management's assessment that Atrion Corporation and subsidiaries' internal control over financial reporting as of December 31, 2005, was effective based on criteria established in *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organization of the Treadway Commission (COSO) and an unqualified opinion on the effectiveness of Atrion Corporation and subsidiaries' 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 Organization of the Treadway Commission (COSO).

Grant Thornton LLP
Dallas, Texas
March 13, 2006

The Company's management, including the Chief Executive Officer and Chief Financial Officer, is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934, as amended. Our internal control system is 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. All internal control systems, no matter how well designed, have inherent limitations. A system of internal control may become inadequate over time because of changes in conditions or deterioration in the degree of compliance with the policies or procedures. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2005 using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control—Integrated Framework*. Based on this assessment, our management concluded that, as of December 31, 2005, our internal control over financial reporting was effective.

BOARD OF DIRECTORS AND STOCKHOLDERS OF ATRION CORPORATION

We have audited management's assessment, included on page 23 in Management's Report on Internal Control Over Financial Reporting, that Atrion Corporation 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"). Atrion Corporation's management is 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 opinions.

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 Atrion Corporation 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 COSO. Also in our opinion, Atrion Corporation 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 COSO.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Atrion Corporation and subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the three years in the period ended December 31, 2005, and our report dated March 13, 2006, expressed an unqualified opinion on those financial statements.

Grant Thornton LLP
Dallas, Texas
March 13, 2006

OVERVIEW

The Company designs, develops, manufactures, sells and distributes products and components, primarily for the medical and healthcare industry. The Company markets components to other equipment manufacturers for incorporation in their products and sells finished devices to physicians, hospitals, clinics and other treatment centers. The Company's medical products primarily serve the fluid delivery, cardiovascular, and ophthalmology markets. The Company's other medical and non-medical products include obstetrics products, instrumentation and disposables used in dialysis, contract manufacturing and valves and inflation devices used in marine and aviation safety products. In 2005 approximately 27 percent of the Company's sales were outside the United States.

The Company's products are used in a wide variety of applications by numerous customers, the largest of which accounted for approximately 10.8 percent of net sales in 2005. The Company encounters competition in all of its markets and competes primarily on the basis of product quality, price, engineering, customer service and delivery time.

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

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

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

For the year ended December 31, 2005, the Company reported revenues of $72.1 million, income from continuing operations of $8.8 million and net income of $9.0 million, up 9 percent, 39 percent and 38 percent, respectively, from 2004.

RESULTS OF OPERATIONS

The Company's net income was $9.0 million, or $4.99 per basic and $4.66 per diluted share, in 2005, compared to net income of $6.5 million, or $3.78 per basic and $3.50 per diluted share, in 2004 and $5.1 million, or $2.96 per basic and $2.75 per diluted share, in 2003. Revenues were $72.1 million in 2005, compared with $66.1 million in 2004 and $62.8 million in 2003. The 9 percent revenue increase in 2005 over the prior year was primarily attributable to a 19 percent increase in the revenues from the Company's fluid delivery products, a 16 percent increase from the Company's cardiovascular products, and a 7 percent increase from the Company's other medical and non-medical products. These revenue increases were generally attributable to higher sales volumes. These increases were partially offset by a 7 percent decrease from the Company's ophthalmic products. The 5 percent revenue increase in 2004 over the prior year was primarily attributable to a 22 percent increase in the revenues from the Company's cardiovascular products, a 17 percent increase from the Company's fluid delivery products and a 7 percent increase from the Company's other medical and non-medical products. These revenue increases were generally attributable to higher sales volumes and were partially offset by an 18 percent decrease in the revenues from the Company's ophthalmic products following the completion of a contract in 2003.

The Company's cost of goods sold was $43.1 million in 2005, compared with $40.8 million in 2004 and $40.6 million in 2003. The 6 percent increase in cost of goods sold for 2005 over 2004 was primarily related to the revenue increase discussed above, an improved mix of product sales toward products with lower costs and favorable manufacturing efficiencies brought on by increased volumes and continued manufacturing cost improvement projects. The one percent increase in cost of goods sold for 2004 over 2003 was primarily related to the revenue increases discussed above, offset by favorable manufacturing efficiencies brought on by increased volumes and manufacturing productivity improvements. The shift in product mix had a favorable effect on cost of goods sold as the products with increased revenues had lower costs than the products with lower revenues.

Gross profit was $29.0 million in 2005, compared with $25.3 million in 2004 and $22.2 million in 2003. The Company's gross profit in 2005 was 40 percent of revenues compared with 38 percent of revenues in 2004 and 35 percent of revenues in 2003. The increase in gross profit percentage in 2005 from the prior year was primarily due to the favorable shift in product mix mentioned above, productivity improvements and improved manufacturing efficiencies. The increase in gross profit percentage in 2004 from the prior year was primarily due to the above-mentioned improvement in manufacturing variances.

Operating expenses were $16.3 million in 2005, compared with $16.7 million in 2004 and $15.3 million in 2003. The decrease in operating expenses in 2005 from 2004 was primarily related to decreased general and administrative ("G&A") expenses. G&A expenses consist primarily of salaries and other related expenses of administrative, executive and financial personnel and outside professional fees. The decrease in G&A is primarily attributable to reduced legal costs partially offset by increases in compensation and costs related to information technology enhancements. The increase in operating expenses in 2004 from 2003 was primarily attributable to increased G&A and research and development ("R&D") expenses. The increase in G&A expenses in 2004 was primarily attributable to increased legal costs and compensation. R&D expenses consist primarily of salaries and other related expenses of the research and development personnel as well as costs associated with regulatory expenses. The increase in R&D expenses in 2004 was primarily related to increased legal costs related to patents. The Company anticipates that G&A expenses are likely to increase in the foreseeable future but at a rate less than the anticipated rate of increase in revenues. The Company anticipates that R&D expenses will continue at approximately the current level for the foreseeable future. Selling ("Selling") expenses consist primarily of salaries, commissions and other related expenses for sales and marketing personnel, marketing, advertising and promotional expenses. The Company anticipates that Selling expenses are likely to increase in the foreseeable future but at a rate less than the anticipated rate of increase in revenues.

The Company's operating income for 2005 was $12.7 million, compared with $8.6 million in 2004 and $6.9 million in 2003. The previously mentioned increase in gross profit along with the decrease in operating expenses were the major contributors to the operating income improvement in 2005. The previously mentioned increase in gross profit along with cost containment and cost reduction activities were the major contributors to the operating income improvements in 2004.

Interest expense was $61,000 in 2005 compared to $93,000 in 2004 and $195,000 in 2003. The decrease in 2005 was primarily related to lower average borrowings partially offset by increased interest rates during 2005 as compared with 2004. The decrease in 2004 was primarily related to lower average borrowings during 2004 as compared with 2003. The Company's other income for 2004 was primarily related to the sale of non-operational assets.

Income tax expense in 2005 totaled $3.9 million, compared with $2.3 million in 2004 and $1.9 million in 2003. The effective tax rates for 2005, 2004 and 2003 were 30.7 percent, 26.6 percent and 27.8 percent, respectively. Benefits from tax incentives for exports and R&D expenditures totaled $534,000 in 2005, $516,000 in 2004 and $350,000 in 2003. The higher effective tax rate in 2005 is primarily a result of benefits from tax incentives for exports and R&D expenditures being a lesser percentage of taxable income in 2005 than in 2004. The lower effective tax rate in 2004 is primarily a result of benefits from tax incentives for exports and R&D expenditures being a larger percentage of taxable income in 2004 than in 2003.

The Company believes that 2006 revenues will be higher than 2005 revenues and that the cost of goods sold, gross profit, operating income and income from continuing operations will each be higher in 2006 than in 2005. In 2006, the Company further believes that it will have continuing volume growth in most of its product lines, complemented by the introduction of new products, and that it will achieve continued growth in operating income.

DISCONTINUED OPERATIONS

During 1997, the Company sold all of its natural gas operations. The financial statements presented herein reflect the Company's natural gas operations as discontinued operations for all periods presented. The financial statements also reflect an after-tax gain on disposal of these discontinued operations of $0.2 million, or $.09 per basic share in 2005 and $.10 per basic share, in each of 2004 and 2003, and $.09 per diluted share, in each of 2005, 2004 and 2003.

In addition to the initial consideration received in 1997 upon the sale of the natural gas operations, certain annual contingent deferred payments of up to $250,000 per year were to be paid to the Company over an eight-year period which began in 1999, with the amount paid each year to be dependent upon revenues received by the purchaser from certain gas transportation contracts. The Company received deferred payments of $250,000 each, before tax, from the purchaser in April 2005, 2004 and 2003 which are reflected in each year as a gain from discontinued operations of $165,000, net of tax.

LIQUIDITY AND CAPITAL RESOURCES

The Company has a $25.0 million revolving credit facility (the "Credit Facility") with a money center bank to be utilized for the funding of operations and for major capital projects or acquisitions, subject to certain limitations and restrictions (see Note 4 of Notes to Consolidated Financial Statements). Borrowings under the Credit Facility bear interest that is payable monthly at 30-day, 60-day or 90-day LIBOR, as selected by the Company, plus one percent. At December 31, 2005, the Company had $22.5 million available to borrow under the Credit Facility.

At December 31, 2005, the Company had cash and cash equivalents of $525,000 compared with $255,000 at December 31, 2004. The Company had outstanding borrowings of $2.5 million under its Credit Facility at December 31, 2005 and $2.9 million at December 31, 2004. The Credit Facility, which expires November 11, 2009, and may be extended under certain circumstances, contains various restrictive covenants, none of which is expected to impact the Company's liquidity or capital resources. At December 31, 2005, the Company was in compliance with all financial covenants.

Cash flows from continuing operations generated $9.9 million in 2005 as compared to $11.0 million in 2004. The primary contributor to this decrease was an increase in inventories. Cash provided by operating activities consists primarily of net income adjusted for certain non-cash items and changes in working capital items. Non-cash items include depreciation and amortization and deferred income taxes. Working capital items consist primarily of accounts receivable, accounts payable, inventories and other current assets and other current liabilities. The $541,000 increase in working capital during 2005 was

primarily related to increases in inventories partially offset by a decrease in land deposit. The increase in inventories was primarily attributable to a program to purchase critical raw materials in larger volumes to take advantage of quantity discounts and to hedge against future price increases. In addition, the Company began to increase its inventory of finished goods to reflect increasing sales and to assure uninterrupted deliveries to the Company's customers when the Florida facility is relocated to a new facility in St. Petersburg, Florida in mid-year 2006. The decrease in land deposits is related to the completion of the purchase of ten acres of land for the new St. Petersburg facility for which the Company had made a $3.75 million deposit.

Capital expenditures for property, plant and equipment totaled $10.6 million in 2005, compared with $5.6 million in 2004 and $4.2 million in 2003. Of the $10.6 million expended for the addition of property, plant and equipment during 2005, the Company expended $4.6 million toward the construction of its new St. Petersburg facility for its Halkey-Roberts operation. In 2004, the Company expended $3.75 million for the purchase of ten acres of land being used for this construction. The Company anticipates spending an additional $12.0 million in 2006 to complete the construction of the new facility. The Company is planning to complete the construction of this facility and move the Halkey-Roberts operation into the facility around mid-year 2006 (See Note 12).

During 2005 the Company reduced its outstanding borrowings under the Credit Facility by $407,000. During 2004, the Company expended $84,000 for the purchase of the Company's common stock. During 2003, the Company expended $4.9 million for the purchase of the Company's common stock. Included in this amount was $4.1 million used in April 2004 for the completion of a tender offer in which a total of 173,614 shares of common stock were repurchased at a price of $23.00 per share.

In September 2003, the Company announced that its Board of Directors had approved a policy for the payment of regular quarterly cash dividends on the Company's common stock. During 2005 the Company paid dividends totaling $1.1 million to its stockholders and received $2.3 million from the exercise of stock options.

The table below summarizes debt, lease and other contractual obligations outstanding at December 31, 2005:

		PAYMENTS DUE BY PERIOD			
CONTRACTUAL OBLIGATIONS	TOTAL	2006	2007 - 2008	2009 - 2010	2011 AND THEREAFTER
			(IN THOUSANDS)		
Credit Facility	$ 2,529	—	—	$ 212	$ 2,317
Operating Leases	$ 321	$ 321	—	—	—
Purchase Obligations	$ 5,845	$ 5,799	$ 46	—	—
Total	$ 8,695	$ 6,120	$ 46	$ 212	$ 2,317

The payment schedule for the Credit Facility assumes at maturity, November 2009, the Company will convert this outstanding debt to a two-year term note as permitted by the terms of the agreement. The payment schedule for the operating lease assumes the lease expires in September 2006 (see Note 12 of Notes to Consolidated Financial Statements).

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

OFF BALANCE SHEET ARRANGEMENTS

Companies sometimes establish legal entities for a specific business transaction or activity in the form of a Variable Interest Entity ("VIE"). VIEs may be used to facilitate off-balance sheet financing, acquire financial assets, raise cash from owned assets and similar transactions. The Company has no VIEs, no off-balance sheet financing arrangements and no derivative financial instruments.

IMPACT OF INFLATION

The Company experiences the effects of inflation primarily in the prices it pays for labor, materials and services. Over the last three years, the Company has experienced the effects of moderate inflation in these costs. At times, the Company has been able to offset a portion of these increased costs by increasing the sales prices of its products. However, competitive pressures have not allowed for full recovery of these cost increases.

NEW ACCOUNTING PRONOUNCEMENTS

In December 2004, the Financial Accounting Standards Board ("FASB") issued a revision of FASB Statement No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123R"). In addition to SFAS No. 123R the FASB issued Statement of Financial Accounting Standards ("SFAS") No. 151, "Inventory Costs," which amends Accounting Review Bulletin 43, Chapter 4, "Inventory Pricing." The impact to the Company for these items is described in Note 1 of Notes to the Consolidated Financial Statements.

CRITICAL ACCOUNTING POLICIES

The discussion and analysis of the Company's financial condition and results of operations are based on the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. In the preparation of these financial statements, the Company makes estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. The Company believes the following discussion addresses the Company's most critical accounting policies and estimates, which are those that are most important to the portrayal of the Company's financial condition and results and require management's most difficult, subjective and complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Actual results could differ significantly from those estimates under different assumptions and conditions.

During 2005, the Company accrued for legal costs associated with certain litigation. The Company believes these accruals are adequate to cover the legal fees and expenses associated with litigating these matters. However, the time and cost required to litigate these matters as well as the outcomes of the proceedings may vary from what the Company has projected.

The Company assesses the impairment of its long-lived identifiable assets, excluding goodwill which is tested for impairment pursuant to SFAS No. 142 as explained below, whenever events or changes in circumstances indicate that the carrying value may not be recoverable. This review is based upon projections of anticipated future cash flows. While the Company believes that its estimates of future cash flows are reasonable, different assumptions regarding such cash flows or future changes in the Company's business plan could materially affect its evaluations. No such changes are anticipated at this time.

The Company assesses goodwill for impairment pursuant to SFAS No. 142 which requires that goodwill be assessed whenever events or changes in circumstances indicate that the carrying value may not be recoverable, or, at a minimum, on an annual basis by applying a fair value test.

FORWARD-LOOKING STATEMENTS

The statements in this Management’s Discussion and Analysis and elsewhere in this Annual Report that are forward-looking are based upon current expectations, and actual results or future events may differ materially. Therefore, the inclusion of such forward-looking information should not be regarded as a representation by the Company that the objectives or plans of the Company will be achieved. Such statements include, but are not limited to, the Company’s expectations regarding future revenues, cost of goods sold, gross profit, operating income, income from continuing operations, cash flows from operations, growth in product lines, and availability of equity and debt financing. Words such as “anticipates,” “believes,” “intends,” “expects,” “should” and variations of such words and similar expressions are intended to identify such forward-looking statements. Forward-looking statements contained herein involve numerous risks and uncertainties, and there are a number of factors that could cause actual results or future events to differ materially, including, but not limited to, the following: changing economic, market and business conditions; acts of war or terrorism; the effects of governmental regulation; the impact of competition and new technologies; slower-than-anticipated introduction of new products or implementation of marketing strategies; implementation of new manufacturing processes or implementation of new information systems; the Company’s ability to protect its intellectual property; changes in the prices of raw materials; changes in product mix; intellectual property and product liability claims and product recalls; the ability to attract and retain qualified personnel and the loss of any significant customers. In addition, assumptions relating to budgeting, marketing, product development and other management decisions are subjective in many respects and thus susceptible to interpretations and periodic review which may cause the Company to alter its marketing, capital expenditures or other budgets, which in turn may affect the Company’s results of operations and financial condition.

(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)	2005	2004	2003	2002	2001
OPERATING RESULTS FOR THE YEAR ENDED DECEMBER 31,:					
Revenues	**$ 72,089**	$ 66,081	$ 62,803	$ 59,533	$ 57,605
Operating income	**12,698**	8,596	6,923	5,782	5,820
Income from continuing operations	**8,793**	6,305	4,892	4,065	4,262
Net income	**8,958**	6,470	5,057	2,589[b]	9,754[c]
Depreciation and amortization	**5,389**	4,830	4,783	4,418	4,603
PER SHARE DATA:					
Income from continuing operations, per diluted share	**4.57**	3.41	2.66	2.18	1.88
Net income per diluted share	**4.66**	3.50	2.75	1.39[b]	4.30[c]
Cash dividends per common share	**.62**	.52	.24[a]	—	—
Average diluted shares outstanding	**1,924**	1,850	1,839	1,863	2,272
FINANCIAL POSITION AT DECEMBER 31,:					
Total assets	**78,470**	67,408	60,050	60,807	65,555
Long-term debt	**2,529**	2,936	4,287	10,337	17,125

(a) Dividends on outstanding common shares paid in the 3rd and 4th quarters at $.12 per share

(b) Includes a $1.6 million after-tax goodwill impairment charge ($ .88 per diluted share)

(c) Includes a $5.5 million after-tax gain ($ 2.42 per diluted share) from discontinued operations

BOARD OF DIRECTORS

Emile A. Battat
Chairman of the Board, President
and Chief Executive Officer
Atrion Corporation

Richard O. Jacobson
Chairman of the Board
Jacobson Companies
Des Moines, Iowa

Hugh J. Morgan, Jr.
Private Investor, Former Chairman of the Board
National Bank of Commerce of Birmingham
Birmingham, Alabama

Ronald N. Spaulding
President of International Operations
Guidant Corporation
Brussels, Belguim

Roger F. Stebbing
President and Chief Executive Officer
Stebbing and Associates, Inc.
Signal Mountain, Tennessee

John P. Stupp, Jr.
President
Stupp Bros., Inc.
St. Louis, Missouri

EXECUTIVE OFFICERS

Emile A. Battat
Chairman of the Board, President
and Chief Executive Officer

Jeffery Strickland
Vice President and Chief Financial
Officer, Secretary and Treasurer

Richard O. Jacobson will retire from his position on the Atrion Corporation Board of Directors at the end of his term expiring in 2006. We extend our deepest gratitude and appreciation for the extraordinary contribution and insightful direction he has brought to our Company during his years of service.

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www.atrioncorp.com

Registrar and Transfer Agent
American Stock Transfer and Trust Company
59 Maiden Lane
New York, New York 10007

Form 10-K
A copy of the Company's 2005 Annual Report on Form 10-K, as filed with the Securities and Exchange Commission, may be obtained by any stockholder without charge by written request to:

Corporate Secretary
Atrion Corporation
One Allentown Parkway
Allen, Texas 75002

Stock Information
The Company's common stock is traded on The Nasdaq Stock Market (Symbol: ATRI). As of February 7, 2006, there were approximately 1200 stockholders, including beneficial owners holding shares in nominee or "street" name. The table below sets forth the high and low closing prices on The Nasdaq Stock Market and the quarterly dividends per share declared by the Company for each quarter of 2004 and 2005.

2004 Quarter Ended	High	Low	Dividends
March 31	$ 46.82	$ 38.51	$ 0.12
June 30	50.82	40.50	0.12
September 30	48.77	43.51	0.14
December 31	48.20	41.69	0.14

2005 Quarter Ended	High	Low	Dividends
March 31	$ 53.56	$ 45.27	$ 0.14
June 30	74.55	47.52	0.14
September 30	81.28	64.33	0.17
December 31	69.43	61.02	0.17

In the third quarter of 2003 the Company began paying quarterly cash dividends and presently plans to pay quarterly cash dividends in the future.

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