GREATBATCH, INC.
Form 10-Q
November 06, 2012
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U.S. SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 28, 2012

Commission File Number 1-16137

GREATBATCH, INC.

(Exact name of Registrant as specified in its charter)

Delaware

(State of incorporation)

16-1531026

(I.R.S. employer identification no.)

2591 Dallas Parkway

Suite 101

Frisco, TX 75034

(Address of principal executive offices)

(214) 618-5243

(Registrant s telephone number, including area code)

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

Indicate by checkmark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨	Smaller reporting company	¨

Indicate by check mark whether the registrant is a shell company (as defined in Exchange Act Rule 12b-2). Yes ¨ No x

The number of shares outstanding of the Company s common stock, $0.001 par value per share, as of November 6, 2012 was: 23,695,523 shares.

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Greatbatch, Inc.

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PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

GREATBATCH, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS - Unaudited

(in thousands except share and per share data)

	As of	
	September 28, 2012	December 30, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$ 10,843	$ 36,508
Accounts receivable, net of allowance for doubtful accounts of $2.2 million in 2012 and $1.9 million in 2011	124,803	101,946
Inventories	111,163	109,913
Refundable income taxes		1,292
Deferred income taxes	7,261	7,828
Prepaid expenses and other current assets	7,622	7,469
Total current assets	261,692	264,956
Property, plant and equipment, net	156,662	145,806
Amortizing intangible assets, net	91,065	100,258
Indefinite-lived intangible assets	20,828	20,288
Goodwill	347,803	338,653
Deferred income taxes	2,106	2,450
Other assets	11,774	8,936
Total assets	$ 891,930	$ 881,347
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 44,146	$ 40,665
Income taxes payable	2,932	
Deferred income taxes	1,244	845
Accrued expenses	43,992	52,539
Total current liabilities	92,314	94,049
Long-term debt	230,154	235,950
Deferred income taxes	78,290	75,203
Other long-term liabilities	10,506	8,862
Total liabilities	411,264	414,064
Stockholders equity:		
Preferred stock, $0.001 par value, authorized 100,000,000 shares; no shares issued or outstanding in 2012 or 2011		
Common stock, $0.001 par value, authorized 100,000,000 shares; 23,676,453 shares issued and outstanding in 2012 23,466,128 shares issued and 23,406,023 shares outstanding in 2011	24	23
Additional paid-in capital	318,032	307,196
Treasury stock, at cost, no shares in 2012 and 60,105 shares in 2011		(1,387)
Retained earnings	153,279	152,522

Accumulated other comprehensive income	9,331	8,929
Total stockholders equity	480,666	467,283
Total liabilities and stockholders equity	$ 891,930	$ 881,347

The accompanying notes are an integral part of these condensed consolidated financial statements.

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GREATBATCH, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

AND COMPREHENSIVE INCOME (LOSS) Unaudited

(in thousands except per share data)

	Three Months Ended		Nine Months Ended	
	September 28, 2012	September 30, 2011	September 28, 2012	September 30, 2011
Sales	$ 161,340	$ 131,718	$ 486,991	$ 427,076
Cost of sales	110,386	89,811	337,216	291,395
Gross profit	50,954	41,907	149,775	135,681
Operating expenses:				
Selling, general and administrative expenses	20,274	17,760	60,053	53,980
Research, development and engineering costs, net	13,240	11,072	41,325	32,710
Other operating (income) expense, net	15,313	187	23,981	(166)
Total operating expenses	48,827	29,019	125,359	86,524
Operating income	2,127	12,888	24,416	49,157
Interest expense	4,401	4,125	13,176	12,802
Interest income		(1)	(1)	(9)
Gain on cost method investments, net	(350)		(350)	(4,232)
Other (income) expense, net	248	(475)	774	766
Income (loss) before provision for income taxes	(2,172)	9,239	10,817	39,830
Provision for income taxes	5,389	2,250	10,060	12,347
Net income (loss)	$ (7,561)	$ 6,989	$ 757	$ 27,483
Earnings (loss) per share:				
Basic	$ (0.32)	$ 0.30	$ 0.03	$ 1.18
Diluted	$ (0.32)	$ 0.30	$ 0.03	$ 1.16
Weighted average shares outstanding:				
Basic	23,646	23,297	23,559	23,241
Diluted	23,646	23,611	23,924	23,663
Comprehensive income (loss):				
Net income (loss)	$ (7,561)	$ 6,989	$ 757	$ 27,483
Foreign currency translation gain (loss)	1,005	(8,416)	(522)	2,887
Net change in cash flow hedges, net of tax	399	(777)	924	(396)
Comprehensive income (loss)	$ (6,157)	$ (2,204)	$ 1,159	$ 29,974

The accompanying notes are an integral part of these condensed consolidated financial statements.

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GREATBATCH, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS Unaudited

(in thousands)

	Nine Months Ended	
	September 28, 2012	September 30, 2011
Cash flows from operating activities:		
Net income	$ 757	$ 27,483
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	34,070	27,140
Debt related amortization included in interest expense	9,008	8,428
Stock-based compensation	9,007	8,803
Gain on cost method investments, net	(350)	(4,232)
Other non-cash (gains) losses	3,300	(1,180)
Deferred income taxes	3,004	3,274
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	(22,795)	(10,429)
Inventories	(4,765)	(13,594)
Prepaid expenses and other current assets	1,380	316
Accounts payable	3,257	2,212
Accrued expenses	(314)	6,376
Income taxes payable	3,985	3,872
Net cash provided by operating activities	39,544	58,469
Cash flows from investing activities:		
Acquisition of property, plant and equipment	(33,645)	(18,223)
Net proceeds from sale (purchase) of cost and equity method investments	(1,653)	10,315
Acquisitions, net of cash acquired	(17,224)	
Other investing activities	95	(1,910)
Net cash used in investing activities	(52,427)	(9,818)
Cash flows from financing activities:		
Principal payments of long-term debt	(24,000)	(30,000)
Proceeds from issuance of long-term debt	10,000	
Issuance of common stock	1,056	2,253
Payment of debt issuance costs		(2,114)
Other financing activities	(12)	(1,104)
Net cash used in financing activities	(12,956)	(30,965)
Effect of foreign currency exchange rates on cash and cash equivalents	174	1,058
Net increase (decrease) in cash and cash equivalents	(25,665)	18,744
Cash and cash equivalents, beginning of period	36,508	22,883
Cash and cash equivalents, end of period	$ 10,843	$ 41,627

The accompanying notes are an integral part of these condensed consolidated financial statements.

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GREATBATCH, INC.

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY - Unaudited

(in thousands)

	Common Stock		Additional Paid-In	Treasury Stock		Retained	Accumulated Other Comprehensive	Total Stockholders
	Shares	Amount	Capital	Shares	Amount	Earnings	Income	Equity
At December 30, 2011	23,466	$ 23	$ 307,196	(60)	$ (1,387)	$ 152,522	$ 8,929	$ 467,283
Stock-based compensation			6,597					6,597
Net shares issued under stock incentive plans	47		464	21	476			940
Income tax liability from stock options, restricted stock and restricted stock units			(106)					(106)
Shares contributed to 401(k) Plan	163	1	3,881	39	911			4,793
Net income						757		757
Total other comprehensive income							402	402
At September 28, 2012	23,676	$ 24	$ 318,032		$	$ 153,279	$ 9,331	$ 480,666

The accompanying notes are an integral part of these condensed consolidated financial statements.

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GREATBATCH, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Unaudited

1. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information (Accounting Standards Codification (ASC) 270, *Interim Reporting*) and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information necessary for a full presentation of financial position, results of operations, and cash flows in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP). Operating results for interim periods are not necessarily indicative of results that may be expected for the fiscal year as a whole. In the opinion of management, the condensed consolidated financial statements reflect all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of the results of Greatbatch, Inc. and its wholly-owned subsidiary, Greatbatch Ltd. (collectively Greatbatch or the Company), for the periods presented. The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, sales, expenses, and related disclosures at the date of the financial statements and during the reporting period. Actual results could differ materially from these estimates. The December 30, 2011 condensed consolidated balance sheet data was derived from audited consolidated financial statements but does not include all disclosures required by U.S. GAAP. For further information, refer to the consolidated financial statements and notes included in the Company s Annual Report on Form 10-K for the year ended December 30, 2011. The Company utilizes a fifty-two, fifty-three week fiscal year ending on the Friday nearest December 31st. The third quarter and year-to-date periods of 2012 and 2011 each contained 13 weeks and 39 weeks, respectively, and ended on September 28, and September 30, respectively.

2. ACQUISITIONS

NeuroNexus Technologies, Inc.

On February 16, 2012, the Company purchased all of the outstanding common stock of NeuroNexus Technologies, Inc. (NeuroNexus) headquartered in Ann Arbor, MI. NeuroNexus is an active implantable medical device design firm specializing in developing and commercializing neural interface technology, components and systems for neuroscience and clinical markets. NeuroNexus has an extensive intellectual property portfolio, core technologies and capabilities to support the development and manufacturing of neural interface devices across a wide range of applications including neuromodulation, sensing, optical stimulation and targeted drug delivery.

This transaction was accounted for under the acquisition method of accounting. Accordingly, the operating results of NeuroNexus have been included in the Company s Implantable Medical segment from the date of acquisition. For the nine months ended September 28, 2012, NeuroNexus added approximately $1.7 million to the Company s revenue and decreased the Company s net income by $0.1 million. The purchase price of NeuroNexus consisted of cash payments of $11.7 million and potential future payments of up to an additional $2 million. These future payments are contingent upon the achievement of certain financial and development-based milestones and had an estimated fair value of $1.5 million as of the acquisition date.

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The cost of the acquisition was preliminarily allocated to the assets acquired and liabilities assumed from NeuroNexus based on their fair values as of the close of the acquisition, with the amount exceeding the fair value of the net assets acquired being recorded as goodwill. The value assigned to certain assets and liabilities are preliminary and are subject to adjustment as additional information is obtained, including, but not limited to, the finalization of pre-acquisition tax positions. The valuation is expected to be finalized in 2012. When the valuation is finalized, any changes to the preliminary valuation of assets acquired or liabilities assumed may result in material adjustments to the fair value of the intangible assets acquired, as well as goodwill. The following table summarizes the preliminary allocation of the NeuroNexus purchase price to the assets acquired and liabilities assumed as of the acquisition date (in thousands):

Assets acquired	
Current assets	$ 618
Property, plant and equipment	35
Amortizing intangible assets	2,927
Indefinite-lived intangible assets	540
Goodwill	8,875
Other assets	1,576
Total assets acquired	14,571
Liabilities assumed	
Current liabilities	420
Deferred income taxes	940
Total liabilities assumed	1,360
Purchase price	$ 13,211

The preliminary fair values of the assets acquired were determined using one of three valuation approaches: market, income and cost. The selection of a particular method for a given asset depended on the reliability of available data and the nature of the asset, among other considerations.

The market approach estimates the value for a subject asset based on available market pricing for comparable assets. The income approach estimates the value for a subject asset based on the present value of cash flows projected to be generated by the asset. The projected cash flows were discounted at a required rate of return that reflects the relative risk of the asset and the time value of money. The projected cash flows for each asset considered multiple factors from the perspective of a marketplace participant including revenue projections from existing customers, attrition trends, product life-cycle assumptions, marginal tax rates and expected profit margins giving consideration to historical and expected margins. The cost approach estimates the value for a subject asset based on the cost to replace the asset and reflects the estimated reproduction or replacement cost for the asset, less an allowance for loss in value due to depreciation or obsolescence, with specific consideration given to economic obsolescence if indicated. These fair value measurement approaches are based on significant unobservable inputs, including management estimates and assumptions.

Current assets and liabilities - The fair value of current assets and liabilities was assumed to approximate their carrying value as of the acquisition date due to the short-term nature of these assets and liabilities.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Unaudited

Intangible assets - The purchase price was allocated to intangible assets as follows (dollars in thousands):

	Fair Value Assigned	Weighted Average Amortization Period (Years)	Weighted Average Useful Life (Years)	Weighted Average Discount Rate
Amortizing Intangible Assets				
Technology and patents	$ 1,058	6	10	14%
Customer lists	1,869	7	15	13%
	$ 2,927	7	13	13%

	Fair Value Assigned	Weighted Average Amortization Period (Years)	Weighted Average Useful Life (Years)	Weighted Average Discount Rate
Indefinite-Lived Intangible Assets				
In-process research and development	$ 540	N/A	12	26%

The weighted average amortization period is less than the estimated useful life due to the Company using an accelerated amortization method, which approximates the projected cash flows used to determine the fair value of those intangible assets.

Technology and patents Technology and patents consists of technical processes, patented and unpatented technology, manufacturing know-how, trade secrets and the understanding with respect to products or processes that have been developed by NeuroNexus and that will be leveraged in current and future products. The fair value of technology and patents acquired was determined utilizing the relief from royalty method, a form of the income approach, with royalty rates that ranged from 2% to 6%. The estimated useful life of the technology and patents is based upon management s estimate of the product life cycle associated with technology and patents before they will be replaced by new technologies.

Customer lists Customer lists represent the estimated fair value of non-contractual customer relationships NeuroNexus has as of the acquisition date. The primary customers of NeuroNexus include numerous scientists and researchers from various geographic locations around the world. These relationships were valued separately from goodwill at the amount which an independent third party would be willing to pay for these relationships. The fair value of customer lists was determined using the multi-period excess-earnings method, a form of the income approach. The estimated useful life of the existing customer was based upon historical customer attrition as well as management s understanding of the industry and product life cycles.

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GREATBATCH, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Unaudited

In-process research and development (IPR&D) IPR&D represents research projects which are expected to generate cash flows but have not yet reached technological feasibility. The primary basis for determining the technological feasibility of these projects is whether or not regulatory approval has been obtained. The Company classifies IPR&D acquired in a business combination as an indefinite-lived intangible asset until the completion or abandonment of the associated projects. Upon completion, the Company would determine the useful life of the IPR&D and begin amortizing the assets to reflect their use over their remaining lives. Upon permanent abandonment, the remaining carrying amount of the associated IPR&D would be written-off. The Company will test the IPR&D acquired for impairment at least annually, and more frequently if events or changes in circumstances indicate that the assets may be impaired. The impairment test consists of a comparison of the fair value of the intangible assets with their carrying amount. If the carrying amount exceeds its fair value, the Company would record an impairment loss in an amount equal to the excess. The Company used the income approach to determine the fair value of the IPR&D acquired. In arriving at the value of the IPR&D, management considered, among other factors: the projects stage of completion; the complexity of the work to be completed as of the acquisition date; the projected costs to complete the projects; the contribution of other acquired assets; and the estimated useful life of the technology. The Company applied a market-participant risk-adjusted discount rate to arrive at a present value as of the date of acquisition.

The value assigned to IPR&D related to the development of micro-electrodes for deep brain mapping and electrocorticography, and is expected to be commercialized by 2014. For purposes of valuing the IPR&D, the Company estimated total costs to complete the projects to be approximately $1.5 million. If the projects are not successful or completed in a timely manner, the Company may not realize the financial benefits expected for these projects.

Goodwill The excess of the purchase price over the fair value of net tangible and intangible assets acquired and liabilities assumed was allocated to goodwill. Various factors contributed to the establishment of goodwill, including: the value of NeuroNexus s highly trained assembled work force and management team; the incremental value that NeuroNexus s technology will bring to the Company s neuromodulation platform currently in development; and the expected revenue growth over time that is attributable to increased market penetration from future products and customers. The goodwill acquired in connection with the NeuroNexus acquisition was allocated to the Implantable Medical business segment and is not deductible for tax purposes.

Micro Power Electronics, Inc.

On December 15, 2011, the Company purchased all of the outstanding common and preferred stock of Micro Power Electronics, Inc. (Micro Power) headquartered in Beaverton, OR. Micro Power is a leading supplier of custom battery solutions, serving the portable medical, military and handheld automatic identification and data collection markets. The aggregate purchase price of Micro Power was $71.8 million, which was paid in cash. Total assets acquired from Micro Power were $88.2 million. Total liabilities assumed from Micro Power were $16.4 million.

This transaction was accounted for under the acquisition method of accounting. Accordingly, the operating results of Micro Power have been included in the Company s Electrochem Solutions (Electrochem) segment from the date of acquisition and the cost of the acquisition was preliminarily allocated to the assets acquired and liabilities assumed from Micro Power based on their fair values as of the close of the acquisition, with the amount exceeding the fair value of net assets acquired being recorded as goodwill. The value assigned to certain assets and liabilities are preliminary and are subject to adjustment as additional information is obtained, including, but not limited to, the finalization of pre-acquisition tax positions. The valuation will be finalized in 2012. During 2012, the Company has made adjustments to the Micro Power opening balance sheet valuation based upon the receipt of information that was needed in order to complete the valuation of certain assets and liabilities. As a result, the Company reduced the fair value recorded for the Micro Power amortizing intangible assets acquired by $0.4 million and increased the amount of goodwill recorded by $0.4 million. The impact of these adjustments, individually and in the aggregate, was not considered material and therefore has not been reflected as a retrospective adjustment of the historical financial statements.

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GREATBATCH, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Unaudited

Pro Forma Results (Unaudited)

The following unaudited pro forma information presents the consolidated results of operations of the Company, NeuroNexus and Micro Power as if those acquisitions occurred as of the beginning of fiscal years 2011 (NeuroNexus) and 2010 (Micro Power) (in thousands, except per share amounts):

	Three Months Ended		Nine Months Ended	
	September 28, 2012	September 30, 2011	September 28, 2012	September 30, 2011
Sales	$ 161,340	$ 149,991	$ 487,431	$ 478,159
Net income (loss)	(7,561)	7,227	583	26,719
Earnings per share:				
Basic	$ (0.32)	$ 0.31	$ 0.02	$ 1.15
Diluted	$ (0.32)	$ 0.31	$ 0.02	$ 1.13

The unaudited pro forma information presents the combined operating results of Greatbatch, NeuroNexus and Micro Power, with the results prior to the acquisition date adjusted to include the pro forma impact of the amortization of acquired intangible assets based on the purchase price allocations, the adjustment to interest expense reflecting the amount borrowed in connection with the acquisitions at Greatbatch s interest rate, and the impact of income taxes on the pro forma adjustments utilizing the applicable statutory tax rate. The unaudited pro forma consolidated basic and diluted earnings per share calculations are based on the consolidated basic and diluted weighted average shares of Greatbatch.

The unaudited pro forma results are presented for illustrative purposes only and do not reflect the realization of potential cost savings, and any related integration costs. Certain cost savings may result from the acquisition; however, there can be no assurance that these cost savings will be achieved. These pro forma results do not purport to be indicative of the results that would have been obtained, or to be a projection of results that may be obtained in the future.

GREATBATCH, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Unaudited

3. SUPPLEMENTAL CASH FLOW INFORMATION

(in thousands)	Nine Months Ended September 28, 2012	Nine Months Ended September 30, 2011
Noncash investing and financing activities:		
Common stock contributed to 401(k) Plan	$ 4,793	$
Property, plant and equipment purchases included in accounts payable	4,611	1,575
Cash paid during the period for:		
Interest	$ 3,250	$ 3,700
Income taxes	2,923	5,207
Acquisition of noncash assets	$ 14,396	$
Liabilities assumed	1,244	

4. INVENTORIES

Inventories are comprised of the following (in thousands):

	As of September 28, 2012	As of December 30, 2011
Raw materials	$ 56,364	$ 49,773
Work-in-process	36,902	36,603
Finished goods	17,897	23,537
Total	$ 111,163	$ 109,913

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GREATBATCH, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Unaudited

5. INTANGIBLE ASSETS

Amortizing intangible assets are comprised of the following (in thousands):

	Gross Carrying Amount	Accumulated Amortization	Foreign Currency Translation	Net Carrying Amount
At September 28, 2012				
Technology and patents	$ 96,862	$ (59,253)	$ 815	$ 38,424
Customer lists	68,257	(18,455)	1,879	51,681
Other	4,434	(4,169)	695	960
Total amortizing intangible assets	$ 169,553	$ (81,877)	$ 3,389	$ 91,065
At December 30, 2011				
Technology and patents	$ 97,324	$ (54,054)	$ 842	$ 44,112
Customer lists	66,388	(14,009)	1,807	54,186
Other	5,174	(4,019)	805	1,960
Total amortizing intangible assets	$ 168,886	$ (72,082)	$ 3,454	$ 100,258

During the third quarter of 2012, the Company transferred $0.7 million of Electrochem s wireless sensing technology and patents to held-for-sale, which is classified within Prepaid Expenses and Other Current Assets in the Condensed Consolidated Balance Sheet.

Aggregate intangible asset amortization expense is comprised of the following (in thousands):

	Three Months Ended		Nine Months Ended	
	September 28, 2012	September 30, 2011	September 28, 2012	September 30, 2011
Cost of sales	$ 1,863	$ 1,446	$ 5,658	$ 4,595
Selling, general and administrative expenses	1,573	985	4,713	2,912
Research, development and engineering costs, net	136	231	409	231
Total intangible asset amortization expense	$ 3,572	$ 2,662	$ 10,780	$ 7,738

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GREATBATCH, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Unaudited

Estimated future intangible asset amortization expense based on the current carrying value is as follows (in thousands):

	Estimated Amortization Expense
Remainder of 2012	$ 3,474
2013	13,223
2014	13,458
2015	12,407
2016	10,112
Thereafter	38,391
Total estimated amortization expense	$ 91,065

The change in indefinite-lived intangible assets is as follows (in thousands):

	Trademarks and Tradenames	IPR&D	Total
At December 30, 2011	$ 20,288	$	$ 20,288
Indefinite-lived assets acquired		540	540
At September 28, 2012	$ 20,288	$ 540	$ 20,828

The change in goodwill is as follows (in thousands):

	Implantable Medical	Electrochem	Total
At December 30, 2011	$ 297,232	$ 41,421	$ 338,653
Goodwill acquired	8,875	413	9,288
Foreign currency translation	(138)		(138)
At September 28, 2012	$ 305,969	$ 41,834	$ 347,803

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GREATBATCH, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Unaudited

6. DEBT

Long-term debt is comprised of the following (in thousands):

	As of	
	September 28, 2012	December 30, 2011
Revolving line of credit	$ 41,000	$ 55,000
2.25% convertible subordinated notes, due 2013	197,782	197,782
Unamortized discount	(8,628)	(16,832)
Total long-term debt	$ 230,154	$ 235,950

Revolving Line of Credit The Company has a revolving credit facility (the Credit Facility), which provides a $400 million secured revolving credit facility, and can be increased by $200 million upon the Company s request and approval by a majority of the lenders. The Credit Facility also contains a $15 million letter of credit subfacility and a $15 million swingline subfacility. The Credit Facility has a maturity date of June 24, 2016; provided, however, if CSN (defined below) are not repaid in full, modified or refinanced before March 1, 2013, the maturity date of the Credit Facility is March 1, 2013.

The Credit Facility is secured by the Company s non-realty assets including cash, accounts receivable and inventories. Interest rates under the Credit Facility are, at the Company s option either at: (i) the prime rate plus the applicable margin, which ranges between 0.0% and 1.0%, based on the Company s total leverage ratio or (ii) the applicable LIBOR rate plus the applicable margin, which ranges between 1.5% and 3.0%, based on the Company s total leverage ratio. Loans under the swingline subfacility will bear interest at the prime rate plus the applicable margin, which ranges between 0.0% and 1.0%, based on the Company s total leverage ratio. The Company is also required to pay a commitment fee which, varies between 0.175% and 0.25% depending on the Company s total leverage ratio.

The Credit Facility contains limitations on the incurrence of indebtedness, liens and licensing of intellectual property, investments and certain payments. The Credit Facility permits the Company to engage in the following activities up to an aggregate amount of $250 million: 1) engage in permitted acquisitions in the aggregate not to exceed $250 million; 2) make other investments in the aggregate not to exceed $60 million; 3) make stock repurchases not to exceed $60 million in the aggregate; and 4) retire up to $198 million of CSN. At any time that the total leverage ratio of the Company for the two most recently ended fiscal quarters is less than 2.75 to 1.0, the Company may make an election to reset each of the amounts specified above. Additionally, these limitations can be waived upon the Company s request and approval of a majority of the lenders. As of September 28, 2012, the Company had available to it 100% of the above limits as the Company reset these limits in the second quarter of 2012, except for the aggregate limit and other investments limit which are now $248 million and $58 million, respectively.

The Credit Facility requires the Company to maintain a rolling four quarter ratio of adjusted EBITDA to interest expense of at least 3.0 to 1.0, and a total leverage ratio of not greater than 4.0 to 1.0. The calculation of adjusted EBITDA and total leverage ratio excludes non-cash charges, extraordinary, unusual, or non-recurring expenses or losses, non-cash stock-based compensation, and non-recurring expenses or charges incurred in connection with permitted acquisitions. As of September 28, 2012, the Company was in compliance with all covenants.

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The Credit Facility contains customary events of default. Upon the occurrence and during the continuance of an event of default, a majority of the lenders may declare the outstanding advances and all other obligations under the Credit Facility immediately due and payable.

The weighted average interest rate on borrowings under the Credit Facility as of September 28, 2012, was 2.17%. As of September 28, 2012, the Company had $359 million of borrowing capacity available under the Credit Facility. This borrowing capacity may vary from period to period based upon the debt levels of the Company and the level of EBITDA, which impacts the covenant calculations described above.

Interest Rate Swap (Subsequent Event) In October 2012 the Company entered into a three-year $150 million interest rate swap, which amortizes $50 million per year. Under terms of the contract, the Company will receive a floating interest rate indexed to the one-month LIBOR rate and pay a fixed interest rate of 0.573%. The swap will be effective in February 2013. This swap was entered into in order to hedge against potential changes in cash flows on the anticipated outstanding debt on the Credit Facility from the repayment of CSN, which is also expected to be in February 2013 and indexed to the one-month LIBOR rate. The receive variable leg of the interest rate swap and the variable rate paid on the debt is expected to have the same rate of interest, excluding the credit spread, and reset and pay interest on the same dates. This swap will be accounted for as a cash flow hedge.

Convertible Subordinated Notes In March 2007, the Company completed a private placement of $197.8 million of convertible subordinated notes (CSN) at a 5% discount. CSN bear interest at 2.25% per annum, payable semi-annually, and are due on June 15, 2013. The holders may convert CSN into shares of the Company s common stock at a conversion price of $34.70 per share, which is equivalent to a conversion ratio of 28.8219 shares per $1,000 of principal. The conversion price and the conversion ratio will adjust automatically upon certain changes to the Company s capitalization. The fair value of CSN as of September 28, 2012 was approximately $197 million and is based on recent sales prices.

The effective interest rate of CSN, which takes into consideration the amortization of the discount and deferred fees related to the issuance of these notes, is 8.5%. The discount on CSN is being amortized to the maturity date utilizing the effective interest method. As of September 28, 2012, the carrying amount of the discount related to the CSN conversion option value was $7.3 million. As of September 28, 2012, the if-converted value of the CSN does not exceed their principal amount as the Company s closing stock price of $24.33 per share did not exceed the conversion price of CSN.

The contractual interest and discount amortization for CSN were as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 28, 2012	September 30, 2011	September 28, 2012	September 30, 2011
Contractual interest	$ 1,113	$ 1,113	$ 3,338	$ 3,338
Discount amortization	2,781	2,602	8,205	7,676

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CSN are convertible at the option of the holders at such time as: (i) the closing price of the Company s common stock exceeds 150% of the conversion price of the notes for 20 out of 30 consecutive trading days; (ii) the trading price per $1,000 of principal is less than 98% of the product of the closing sale price of common stock for each day during any five consecutive trading day period and the conversion rate per $1,000 of principal; (iii) CSN have been called for redemption; (iv) the Company distributes to all holders of common stock rights or warrants entitling them to purchase additional shares of common stock at less than the average closing price of common stock for the ten trading days immediately preceding the announcement of the distribution; (v) the Company distributes to all holders of common stock any form of dividend which has a per share value exceeding 5% of the price of the common stock on the day prior to such date of distribution; (vi) the Company effects a consolidation, merger, share exchange or sale of assets pursuant to which its common stock is converted to cash or other property; (vii) the occurrence of the period beginning 60 days prior to but excluding June 15, 2013; and (viii) certain fundamental changes, as defined in the indenture governing the notes, occur or are approved by the Board of Directors.

Conversions in connection with corporate transactions that constitute a fundamental change require the Company to pay a premium make-whole amount, based upon a predetermined table as set forth in the indenture, whereby the conversion ratio on the notes may be increased by up to 6.3 shares per $1,000 of principal. The premium make-whole amount will be paid in shares of common stock upon any such conversion, subject to the net share settlement feature of the notes described below.

CSN contains a net share settlement feature that requires the Company to pay cash for each $1,000 of principal to be converted. Any amounts in excess of $1,000 will be settled in shares of the Company s common stock, or at the Company s option, cash. The Company has a one-time irrevocable election to pay the holders in shares of its common stock, which it currently does not plan to exercise.

CSN are redeemable by the Company at any time on or after June 20, 2012, or at the option of a holder upon the occurrence of certain fundamental changes, as defined in the indenture, affecting the Company. CSN are subordinated in right of payment to all of the Company s senior indebtedness and effectively subordinated to all debts and other liabilities of the Company s subsidiaries. The Company currently intends to use availability under the Credit Facility to repay CSN when they mature.

Deferred Financing Fees The change in deferred financing fees is as follows (in thousands):

At December 30, 2011	$ 3,149
Amortization during the period	(802)
At September 28, 2012	$ 2,347

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7. DEFINED BENEFIT PLANS

The Company is required to provide its employees located in Switzerland, Mexico and France certain statutorily mandated defined benefits. Under these plans, benefits accrue to employees based upon years of service, position, age and compensation. The defined benefit plan provided to the Company s employees located in Switzerland is a funded contributory plan while the plans that provide benefits to the Company s employees located in Mexico and France are unfunded and noncontributory. The liability and corresponding expense related to these benefit plans is based on actuarial computations of current and future benefits for employees. As discussed in Note 9 Other Operating (Income) Expense, Net, in the third quarter of 2012, the Company finalized its plan to transfer most major functions currently performed at its facilities in Switzerland into other existing facilities. As a result of this decision, the Company curtailed its defined benefit plan provided to employees at those Swiss facilities during the third quarter of 2012. The Company has estimated that a net curtailment gain will be recognized as a result of this curtailment. In accordance with ASC 715, this gain will be recognized as the related employees are terminated. No curtailment gain was recognized in the third quarter of 2012. Additionally, as nearly all of the Swiss pension liability is expected to be paid off in the next year, the Company moved all Swiss pension plan investments into cash during the third quarter of 2012. Plan assets are expected to be sufficient to cover plan liabilities.

The change in net defined benefit plan liability is as follows (in thousands):

At December 30, 2011	$ 5,569
Net defined benefit cost	914
Benefit payments	(786)
Foreign currency translation	(18)
At September 28, 2012	$ 5,679

Net defined benefit cost is comprised of the following (in thousands):

	Three Months Ended		Nine Months Ended	
	September 28, 2012	September 30, 2011	September 28, 2012	September 30, 2011
Service cost	$ 272	$ 290	$ 835	$ 714
Interest cost	98	124	305	313
Amortization of net loss	30	21	92	16
Expected return on plan assets	(103)	(126)	(318)	(317)
Net defined benefit cost	$ 297	$ 309	$ 914	$ 726

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8. STOCK-BASED COMPENSATION

The components and classification of stock-based compensation expense were as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 28, 2012	September 30, 2011	September 28, 2012	September 30, 2011
Stock options	$ 671	$ 629	$ 2,038	$ 1,792
Restricted stock and units	1,523	1,186	4,559	3,270
401(k) stock contribution	1,280	1,193	2,410	3,741
Total stock-based compensation expense	$ 3,474	$ 3,008	$ 9,007	$ 8,803
Cost of sales	$ 1,119	$ 1,013	$ 2,486	$ 3,094
Selling, general and administrative	2,006	1,675	5,732	4,787
Research, development and engineering	349	320	789	922
Total stock-based compensation expense	$ 3,474	$ 3,008	$ 9,007	$ 8,803

The weighted average fair value and assumptions used to value options granted are as follows:

	Nine Months Ended	
	September 28, 2012	September 30, 2011
Weighted average fair value	$ 8.20	$ 9.42
Risk-free interest rate	0.83%	2.04%
Expected volatility	40%	40%
Expected life (in years)	5	5
Expected dividend yield	0%	0%

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The following table summarizes time-vested stock option activity:

	Number of Time-Vested Stock Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (In Years)	Aggregate Intrinsic Value (In Millions)
Outstanding at December 30, 2011	1,558,771	$ 23.42		
Granted	383,292	22.20		
Exercised	(44,993)	20.86		
Forfeited or expired	(106,092)	24.05		
Outstanding at September 28, 2012	1,790,978	$ 23.19	6.2	$ 3.6
Exercisable at September 28, 2012	1,239,536	$ 23.38	5.1	$ 2.7

The following table summarizes performance-vested stock option activity:

	Number of Performance-Vested Stock Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (In Years)	Aggregate Intrinsic Value (In Millions)
Outstanding at December 30, 2011	478,364	$ 24.44		
Exercised	(5,353)	22.11		
Forfeited or expired	(177,733)	26.49		
Outstanding at September 28, 2012	295,278	$ 23.25	4.6	$ 0.4
Exercisable at September 28, 2012	295,278	$ 23.25	4.6	$ 0.4

The following table summarizes time-vested restricted stock and unit activity:

	Time-Vested Activity	Weighted Average Fair Value
Nonvested at December 30, 2011	69,942	$ 22.69
Granted	87,803	23.48
Vested	(24,228)	21.91
Forfeited	(5,586)	22.30

Nonvested at September 28, 2012	127,931	$ 23.40

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The following table summarizes performance-vested restricted stock and unit activity:

	Performance-Vested Activity	Weighted Average Fair Value
Nonvested at December 30, 2011	529,743	$ 16.68
Granted	332,918	15.30
Vested	(7,500)	24.62
Forfeited	(64,715)	15.72
Nonvested at September 28, 2012	790,446	$ 16.11

9. OTHER OPERATING (INCOME) EXPENSE, NET

Other Operating (Income) Expense, Net is comprised of the following (in thousands):

	Three Months Ended		Nine Months Ended	
	September 28, 2012	September 30, 2011	September 28, 2012	September 30, 2011
Orthopaedic facility optimization[(a)]	$ 12,452	$ 164	$ 14,774	$ 425
Medical device facility optimization[(b)]	388		1,282	
ERP system upgrade[(c)]	1,938		4,745	
Integration costs[(d)]	232		1,287	
Asset dispositions, severance and other[(e)]	303	23	1,893	(591)
	$ 15,313	$ 187	$ 23,981	$ (166)

(a) Orthopaedic facility optimization. In 2010, the Company began updating its Indianapolis, IN facility to streamline operations, consolidate two buildings, increase capacity, further expand capabilities and reduce dependence on outside suppliers. This initiative was completed in 2011.

In 2011, the Company began construction on an orthopaedic manufacturing facility in Fort Wayne, IN, which was completed in the second quarter of 2012. In the third quarter of 2012, the Company completed the transfer of the manufacturing operations being performed at its Columbia City, IN orthopaedic facility into this new facility.

In the third quarter of 2012, the Company finalized plans to transfer most major functions currently performed at its facilities in Orvin and Corgemont, Switzerland into existing facilities in Fort Wayne, IN and Tijuana, Mexico by mid-2013.

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The total capital investment expected for these initiatives is between $25 million and $35 million, of which $21 million has been expended to date. Total expense expected to be incurred for these initiatives is between $30 million and $36 million, of which $15.4 million has been incurred to date. All expenses will be recorded within the Implantable Medical segment and are expected to include the following; other costs include production inefficiencies, moving, revalidation, personnel, training and travel costs associated with these consolidation projects:

Severance and retention: $11 million - $13 million;

Accelerated depreciation and asset write-offs: $10 million - $12 million; and

Other: $9 million - $11 million.

The change in accrued liabilities related to the orthopaedic facility optimization is as follows (in thousands):

	Severance and Retention	Accelerated Depreciation/Asset Write-offs	Other	Total
At December 30, 2011	$	$	$	$
Restructuring charges	4,525	5,246	5,003	14,774
Write-offs		(5,246)		(5,246)
Cash payments	(83)		(5,003)	(5,086)
At September 28, 2012	$ 4,442	$	$	$ 4,442

(b) Medical device facility optimization. Near the end of 2011, the Company initiated plans to upgrade and expand its manufacturing infrastructure in order to support its medical device strategy. This will include the transfer of certain product lines to create additional capacity for the manufacture of medical devices, expansion of two existing facilities, as well as the purchase of equipment to enable the production of medical devices. These initiatives are expected to be completed over the next two to three years. Total capital investment under these initiatives is expected to be between $15 million to $20 million of which approximately $8.5 million has been expended to date. Total expenses expected to be incurred on these projects is between $2.5 million to $3.5 million, of which $1.3 million has been incurred to date. All expenses will be recorded within the Implantable Medical segment and are expected to include the following:

Production inefficiencies, moving and revalidation: $0.5 million - $1.0 million;

Personnel: $1.0 million - $1.5 million; and

Other: $1.0 million.

The change in accrued liabilities related to the medical device facility optimization is as follows (in thousands):

	Production Inefficiencies, Moving and Revalidation	Personnel	Other	Total
At December 30, 2011	$	$	$	$
Restructuring charges	549	531	202	1,282
Cash payments	(549)	(531)	(202)	(1,282)
At September 28, 2012	$	$	$	$

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(c) ERP system upgrade. In 2011, the Company initiated plans to upgrade its existing global ERP system. This initiative is expected to be completed over the next two years. Total capital investment under this initiative is expected to be between $4 million to $5 million of which approximately $2.8 million has been expended to date. Total expenses expected to be incurred on this initiative is between $5 million to $7 million, of which $4.7 million has been incurred to date. Expenses related to this initiative will be recorded within the applicable segment and corporate cost centers that the expenditures relate to and include the following:

Training and consulting costs: $3 million - $4.5 million; and

Accelerated depreciation and asset write-offs: $2 million - $2.5 million.

The change in accrued liabilities related to the ERP system upgrade is as follows (in thousands):

	Training & Consulting Costs	Accelerated Depreciation/ Asset Write-offs	Total
At December 30, 2011	$	$	$
Charges	2,579	2,166	4,745
Write-offs		(2,166)	(2,166)
Cash payments	(1,853)		(1,853)
At September 28, 2012	$ 726	$	$ 726

(d) Integration costs. During 2012, the Company incurred costs related to the integration of Micro Power and NeuroNexus. These expenses were primarily for retention bonuses, travel costs in connection with integration efforts, training and severance, which will not be required or incurred after the integrations are completed.

***(e) Asset dispositions, severance and other*.** During 2012 and 2011, the Company recorded (gains) write-downs in connection with various asset disposals, net of insurance proceeds received, if any. Additionally, during the second quarter of 2012, the Company incurred $1.2 million of costs related to the relocation of its global headquarters to Frisco, Texas.

10. INCOME TAXES

The income tax provision for interim periods is determined using an estimate of the annual effective tax rate, adjusted for discrete items, if any, that are taken into account in the relevant period. Each quarter, the estimate of the annual effective tax rate is updated, and if the estimated effective tax rate changes, a cumulative adjustment is made. There is a potential for volatility of the effective tax rate due to several factors, including changes in the mix of the pre-tax income and the jurisdictions to which it relates, changes in tax laws and foreign tax holidays, business reorganizations, settlements with taxing authorities and foreign currency fluctuations.

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The effective tax rate for the first nine months of 2012 was 93.0% compared to 31.0% for the same period of 2011. This increase was primarily attributable to approximately $5.0 million of tax charges recorded in connection with the Swiss orthopaedic consolidation. These charges related to the loss of the Company s Swiss tax holiday, due to its third quarter 2012 decision to discontinue manufacturing in Switzerland, as well as the establishment of a valuation allowance on a portion of its Swiss deferred tax assets as it is more likely than not that they will not be fully realized. Additionally, the 2012 effective tax rate reflects the impact of losses resulting from the Swiss restructuring, the benefit of which are recorded at a lower Swiss effective tax rate, thus increasing the overall effective tax rate of the Company. The effective tax rate also does not include the benefit of the U.S. R&D tax credit, which expired at the end of 2011. The provision for income taxes for the third quarter of 2012 represents the amount necessary to bring the year-to-date effective tax rate to 93.0% and is based upon the Company s full year expected U.S. GAAP effective tax rate.

During the first nine months of 2012, the balance of unrecognized tax benefits decreased by $0.8 million as a result of the settlement of IRS audits for 2009 and 2010 and as a result of the lapse of certain statute of limitations. Approximately $0.7 million of the balance of unrecognized tax benefits would favorably impact the effective tax rate, net of federal benefit on state issues, if recognized.

11. COMMITMENTS AND CONTINGENCIES

Litigation The Company is a party to various legal actions arising in the normal course of business. While the Company does not believe that the ultimate resolution of any such pending actions will have a material effect on its results of operations, financial position, or cash flows, litigation is subject to inherent uncertainties. If an unfavorable ruling were to occur, there exists the possibility of a material impact in the period in which the ruling occurs.

Product Warranties The Company generally warrants that its products will meet customer specifications and will be free from defects in materials and workmanship. The change in aggregate product warranty liability is as follows (in thousands):

At December 30, 2011	$ 2,013
Additions to warranty reserve	483
Warranty claims paid	(993)
Foreign currency effect	3
At September 28, 2012	$ 1,506

Contractual Obligations Contractual obligations are defined as agreements that are enforceable and legally binding on the Company and that specify all significant terms, including: fixed or minimum obligations; fixed or minimum price provisions; and the approximate timing of the transaction. The Company s contractual obligations are normally fulfilled within short time horizons. The Company also enters into blanket orders with vendors that have preferred pricing and terms, however these orders are normally cancelable by us without penalty. As of September 28, 2012, the total contractual obligations of the Company are approximately $29.7 million and will primarily be funded by existing cash and cash equivalents, cash flow from operations, or the Credit Facility. The Company also enters into contracts for outsourced services; however, the obligations under these contracts were not significant and the contracts generally contain clauses allowing for cancellation without significant penalty.

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Operating Leases The Company is a party to various operating lease agreements for buildings, equipment and software. Estimated future operating lease expense is as follows (in thousands):

Remainder of 2012	$ 1,072
2013	4,156
2014	4,155
2015	3,566
2016	3,092
Thereafter	3,133
Total estimated operating lease expense	$ 19,174

Foreign Currency Contracts The Company enters into forward contracts to purchase Mexican pesos in order to hedge the risk of peso-denominated payments associated with the operations at its Tijuana, Mexico facility. The impact to the Company s results of operations from these forward contracts was as follows (in thousands):

	Three Months Ended		**Nine Months Ended**	
	September 28, 2012	**September 30, 2011**	**September 28, 2012**	**September 30, 2011**
Increase (reduction) in Cost of Sales	$ 11	$ (213)	$ (8)	$ (529)
Ineffective portion of change in fair value				

Instrument	**Type of Hedge**	**Aggregate Notional Amount**	**Start Date**	**End Date**	**$/Peso**	**Fair Value**	**Balance Sheet Location**
FX Contract	Cash flow	$ 1,500	Jan-12	Dec-12	0.0767	$ 11	Current Assets
FX Contract	Cash flow	1,050	Jan-12	Dec-12	0.0713	89	Current Assets
FX Contract	Cash flow	6,000	Jan-13	Dec-13	0.0727	235	Current Assets/ Other Assets
FX Contract	Cash flow	6,000	Jan-13	Dec-13	0.0693	548	Current Assets/ Other Assets

Self-Insured Medical Plan The Company self-funds the medical insurance coverage provided to its U.S. based employees. The risk to the Company is being limited through the use of stop loss insurance, which has an annual maximum aggregate loss of $13.5 million with a maximum benefit of $1.0 million. As of September 28, 2012, the Company has $2.0 million accrued related to the self-insurance of its medical plan, which is recorded in Accrued Expenses in the Condensed Consolidated Balance Sheet, and is primarily based upon claim history.

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12. EARNINGS (LOSS) PER SHARE (EPS)

The following table illustrates the calculation of Basic and Diluted EPS (in thousands, except per share amounts):

	Three Months Ended		Nine Months Ended	
	September 28, 2012	September 30, 2011	September 28, 2012	September 30, 2011
Numerator for basic and diluted EPS:				
Net income (loss)	$ (7,561)	$ 6,989	$ 757	$ 27,483
Denominator for basic EPS:				
Weighted average shares outstanding	23,646	23,297	23,559	23,241
Effect of dilutive securities:				
Stock options, restricted stock and restricted stock units		314	365	422
Denominator for diluted EPS	23,646	23,611	23,924	23,663

Basic EPS