INTEGRA LIFESCIENCES HOLDINGS CORP
Form 10-Q
October 30, 2013
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2013

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

For the transition period from to
COMMISSION FILE NO. 0-26224

INTEGRA LIFESCIENCES HOLDINGS CORPORATION
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE (STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	51-0317849 (I.R.S. EMPLOYER IDENTIFICATION NO.)
311 ENTERPRISE DRIVE PLAINSBORO, NEW JERSEY	08536
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)	(ZIP CODE)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (609) 275-0500

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 o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, 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 o

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 x	Accelerated filer o
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

The number of shares of the registrant's Common Stock, $0.01 par value, outstanding as of October 28, 2013 was 28,113,418.

Table of Contents

INTEGRA LIFESCIENCES HOLDINGS CORPORATION
INDEX

Exhibit 99.1
EX-101 INSTANCE DOCUMENT
EX-101 SCHEMA DOCUMENT
EX-101 CALCULATION LINKBASE DOCUMENT
EX-101 DEFINITION LINKBASE DOCUMENT
EX-101 LABELS LINKBASE DOCUMENT
EX-101 PRESENTATION LINKBASE DOCUMENT

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

INTEGRA LIFESCIENCES HOLDINGS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
AND COMPREHENSIVE INCOME
(UNAUDITED)
(In thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Total revenue, net	$213,246	$210,084	$615,445	$616,439
Costs and Expenses:				
Cost of goods sold	84,101	79,548	247,437	232,497
Research and development	13,052	13,105	37,577	38,148
Selling, general and administrative	95,933	93,077	295,713	276,585
Intangible asset amortization	3,036	4,618	9,660	13,985
Goodwill impairment charge	46,738	—	46,738	—
Total costs and expenses	242,860	190,348	637,125	561,215
Operating income	(29,614)	19,736	(21,680)	55,224
Interest income	38	100	390	893
Interest expense	(5,316)	(5,549)	(15,081)	(20,581)
Other income (expense), net	(263)	(31)	(1,544)	(118)
Income (loss) before income taxes	(35,155)	14,256	(37,915)	35,418
Income tax (benefit) expense	(6,605)	1,045	(8,755)	7,000
Net income (loss)	$(28,550)	$13,211	$(29,160)	$28,418
Basic net income per common share	$(1.02)	$0.46	$(1.05)	$1.00
Diluted net income per common share	$(1.02)	$0.46	$(1.05)	$0.99
Weighted average common shares outstanding (See Note 11):				
Basic	27,896	28,446	27,855	28,403
Diluted	27,896	28,777	27,855	28,629
Comprehensive income (loss) (See Note 12)	$(19,860)	$17,106	$(25,076)	$28,016

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

Table of Contents

INTEGRA LIFESCIENCES HOLDINGS CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)
(In thousands)

	September 30, 2013	December 31, 2012
ASSETS		
Current Assets:		
Cash and cash equivalents	$118,868	$96,938
Trade accounts receivable, net of allowances of $8,159 and $7,221	113,538	114,916
Inventories, net	207,389	171,806
Deferred tax assets	40,049	39,100
Prepaid expenses and other current assets	30,739	30,291
Total current assets	510,583	453,051
Property, plant and equipment, net	192,724	177,898
Intangible assets, net	202,410	212,267
Goodwill	248,824	294,067
Deferred tax assets	19,545	15,957
Other assets	9,986	10,359
Total assets	$1,184,072	$1,163,599
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable, trade	$54,466	$36,742
Deferred revenue	4,474	3,505
Accrued compensation	28,520	34,914
Accrued expenses and other current liabilities	34,818	31,768
Total current liabilities	122,278	106,929
Long-term borrowings under senior credit facility	341,875	321,875
Long-term convertible securities	203,265	197,672
Deferred tax liabilities	5,154	5,393
Other liabilities	12,023	13,955
Total liabilities	$684,595	$645,824
Commitments and contingencies		
Stockholders' Equity:		
Preferred Stock; no par value; 15,000 authorized shares; none outstanding		
Common stock; $0.01 par value; 60,000 authorized shares; 36,972 and 36,852 issued at September 30, 2013 and December 31, 2012, respectively	370	369
Additional paid-in capital	594,078	587,301
Treasury stock, at cost; 8,903 shares at September 30, 2013 and December 31, 2012	(367,121)	(367,121)
Accumulated other comprehensive (loss)	(713)	(4,797)
Retained earnings	272,863	302,023
Total stockholders' equity	$499,477	$517,775
Total liabilities and stockholders' equity	$1,184,072	$1,163,599

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

Table of Contents

INTEGRA LIFESCIENCES HOLDINGS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
(In thousands)

	Nine Months Ended September 30, 2013	2012
OPERATING ACTIVITIES:		
Net income (loss)	$(29,160)	$28,418
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	35,695	39,122
Non-cash impairment charges	46,738	—
Deferred income tax (benefit) provision	(7,238)	(3,184)
Amortization of debt issuance costs	1,707	2,103
Non-cash interest expense	4,865	8,284
Payment of accreted interest	—	(30,617)
Loss on disposal of property and equipment	1,816	807
Share-based compensation	7,594	6,632
Excess tax benefits from stock-based compensation arrangements	(140)	(432)
Changes in assets and liabilities, net of business acquisitions:		
Accounts receivable	1,440	(1,333)
Inventories	(34,855)	1,080
Prepaid expenses and other current assets	(282)	8,148
Other non-current assets	(515)	(877)
Accounts payable, accrued expenses and other current liabilities	14,185	6,528
Deferred revenue	986	(913)
Other non-current liabilities	(1,264)	(1,263)
Net cash provided by operating activities	$41,572	$62,503
INVESTING ACTIVITIES:		
Purchases of property and equipment	(37,722)	(44,359)
Sales of property and equipment	533	—
Cash used in business acquisition, net of cash acquired	(2,980)	(2,177)
Purchases of short-term investments	—	(67,907)
Maturities of short-term investments	—	64,940
Net cash used in investing activities	$(40,169)	$(49,503)
FINANCING ACTIVITIES:		
Borrowings under senior credit facility	30,000	155,000
Repayments under senior credit facility	(10,000)	(12,812)
Payment of liability component of convertible notes	—	(134,383)
Payment of debt issuance costs	(1,053)	—
Proceeds from exercised stock options	420	696
Excess tax benefits from stock-based compensation arrangements	140	432
Net cash provided by (used in) financing activities	$19,507	$8,933
Effect of exchange rate changes on cash and cash equivalents	1,020	2,977
Net change in cash and cash equivalents	21,930	24,910
Cash and cash equivalents at beginning of period	96,938	100,808
Cash and cash equivalents at end of period	$118,868	$125,718

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

Table of Contents

INTEGRA LIFESCIENCES HOLDINGS CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION
General
The terms “we,” “our,” “us,” “Company” and “Integra” refer to Integra LifeSciences Holdings Corporation, a Delaware corporation, and its subsidiaries unless the context suggests otherwise.
In the opinion of management, the September 30, 2013 unaudited condensed consolidated financial statements contain all adjustments (consisting only of normal recurring adjustments) necessary for a fair statement of the financial position, results of operations and cash flows of the Company. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted in accordance with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. These unaudited condensed consolidated financial statements should be read in conjunction with the Company’s consolidated financial statements for the year ended December 31, 2012 included in the Company’s Annual Report on Form 10-K. The December 31, 2012 consolidated balance sheet was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States. Operating results for the three and nine-month periods ended September 30, 2013 are not necessarily indicative of the results to be expected for the entire year.
The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, the disclosure of contingent liabilities, and the reported amounts of revenues and expenses. Significant estimates affecting amounts reported or disclosed in the consolidated financial statements include allowances for doubtful accounts receivable and sales returns and allowances, net realizable value of inventories, valuation of intangible assets including in-process research and development, amortization periods for acquired intangible assets, discount rates and estimated projected cash flows used to value and test impairments of long-lived assets and goodwill, estimates of projected cash flows and depreciation and amortization periods for long-lived assets, computation of taxes, valuation allowances recorded against deferred tax assets, the valuation of stock-based compensation, valuation of pension assets and liabilities, valuation of derivative instruments, valuation of the equity component of convertible debt instruments, valuation of contingent liabilities, the fair value of debt instruments and loss contingencies. These estimates are based on historical experience and on various other assumptions that are believed to be reasonable under the current circumstances. Actual results could differ from these estimates.
Certain amounts from the prior year’s financial statements have been reclassified in order to conform to the current year’s presentation.
Recently Issued Accounting Standards
On July 17, 2013, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2013-10, Inclusion of the Fed Funds Effective Swap Rate (or Overnight Index Swap Rate) as a Benchmark Interest Rate for Hedge Accounting Purposes. The revised standard allows entities to now use the Federal Funds Effective Swap Rate (which is the Overnight Index Swap Rate, or OIS rate, in the U.S.) as a benchmark interest rate for hedge accounting purposes under U.S. Generally Accepted Accounting Principles (GAAP). Previously, only U.S. Treasury and London Interbank Offered Rate (LIBOR) rates could be used as benchmark interest rates in hedge accounting. In issuing the new guidance, which became effective July 17, 2013, the FASB responded to an increase in demand for hedging exposures to the OIS rate, driven partly by regulations that require collateralization and central clearing of over-the-counter derivatives. The guidance allows entities to develop new hedging strategies but does not resolve ineffectiveness issues that arise in existing LIBOR hedges when the OIS rate is used to discount future cash flows. The standard adoption did not have a material impact on the Company's financial statements.
On July 18, 2013, the FASB issued Accounting Standards Update No. 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. This updated guidance requires an unrecognized tax benefit to be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, similar tax loss, or a tax credit carryforward. To the extent the

tax benefit is not available at the reporting date under the governing tax law or if the entity does not intend to use the deferred tax asset for such purpose, the unrecognized tax benefit should be presented as a liability and not combined with deferred tax assets. The ASU 2013-11 is effective for fiscal years and interim periods within those years beginning after December 15, 2013 for public entities. Early adoption is permitted. The amendments are to be applied to all unrecognized tax benefits that exist as of the effective date and

6

INTEGRA LIFESCIENCES HOLDINGS CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

may be applied retrospectively to each prior reporting period presented. The Company is in the process of evaluating the impact of this standard, but does not believe its adoption will have a material impact on the Company's financial statements.

2. BUSINESS ACQUISITIONS

Tarsus Medical, Inc.

On January 24, 2013, the Company acquired all outstanding preferred and common stock of Tarsus Medical, Inc. for a total of $4.7 million consisting of $2.8 million in cash (less cash acquired) and contingent consideration with an estimated acquisition date fair value of approximately $1.6 million. The potential maximum undiscounted contingent consideration consists of the first milestone payment of up to $1.5 million and the second payment of up to $11.5 million. These payments are based on reaching certain sales of acquired products. Tarsus Medical, Inc. is a podiatry device company addressing clinical needs associated with diseases and injuries of the foot and ankle.

The following summarizes the final allocation of the purchase price based on fair value of the assets acquired and liabilities assumed:

	Final Purchase Price Allocation (Dollars in thousands)	
Cash	$85	
Prepaid expenses	13	
Intangible assets		Wtd. Avg. Life:
Technology	5,040	10 - 14 years
In-process research and development	340	Indefinite
Deferred tax asset - long term	1,334	
Goodwill	116	
Total assets acquired	6,928	
Accounts payable and other liabilities	111	
Deferred tax liability	2,152	
Net assets acquired	$4,665	

Management determined the preliminary fair value of net assets acquired during the first quarter of 2013 and finalized the working capital adjustment in the second quarter of 2013. The Company accounts for the contingent consideration by recording its fair value as a liability on the date of the acquisition. The contingent consideration is re-measured to fair value at each reporting date until the contingency is resolved. Changes in fair value of the contingent consideration are recognized in earnings. Accordingly, on January 24, 2013 the Company recorded $1.6 million representing the initial fair value estimate of the contingent consideration that will be earned through December 31, 2015. At September 30, 2013 there was no change in the fair value of the contingent consideration. The fair value of this liability is based on future sales projections of the Tarsus Medical product under various potential scenarios and weighting the probability of these outcomes for the period ended December 31, 2015. At the date of the acquisition, the first milestone cash flow projection was discounted using a rate of 4.3% based on an estimated after tax cost of debt; the second milestone cash flow projection was discounted using a weighted average cost of capital of 16.5%. These fair value measurements were based on significant inputs not observed in the market and thus represented a Level 3 measurement.

The goodwill recorded in connection with this acquisition is based on (i) expected cost savings, operating synergies and other benefits expected to result from the combined operations, (ii) the value of the going-concern element of Tarsus’ existing business (that is, the higher rate of return on the assembled net assets versus if the Company had acquired all of the net assets separately), and (iii) intangible assets that do not qualify for separate recognition such as Tarsus’ assembled workforce. The goodwill acquired will not be deductible for tax purposes.

The impact of the Tarsus acquisition is not material to the consolidated operating results of the Company; therefore, the pro-forma impact of the acquisition has not been presented.

INTEGRA LIFESCIENCES HOLDINGS CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

3. INVENTORIES

Inventories, net consisted of the following:

	September 30, 2013	December 31, 2012
	(In thousands)	
Finished goods	$126,891	$102,401
Work-in process	47,059	39,944
Raw materials	33,439	29,461
	$207,389	$171,806

The finished goods inventory includes $6.1 million of capitalized medical device excise tax at September 30, 2013.

4. GOODWILL AND OTHER INTANGIBLE ASSETS

The Company reviews goodwill for impairment annually during its third quarter and whenever events or changes in circumstances indicate the carrying value of goodwill may not be recoverable. The Company performed its most recent annual assessment on July 31, 2013 which resulted in a non-cash goodwill impairment charge of $46.7 million for its U.S. Spine reporting unit, which is a part of the U.S. Spine and Other reportable segment.

As previously disclosed, the Company has monitored its U.S. Spine business and disclosed that it was at risk for impairment. In the third quarter, during the course of the annual strategic planning process, the Company determined that both the actual and expected income and cash flows for the U.S. Spine reporting unit are projected to be substantially lower than forecasts, and the U.S. spine market recovery may take longer than originally forecasted, including the current expectation of future significant negative pricing pressures. Factors that contributed to the impairment of the U.S. Spine reporting unit include broader market issues as well as company-specific issues. Company-specific issues have included turnover of some distributors, significant delays in new product introductions and other operational issues that negatively impacted and decreased projected revenues by a material amount. As a result, the Company lowered its expectations of recovery in the U.S. market and its related impact on the U.S. Spine reporting unit. This revised outlook resulted in a reduction of the U.S. Spine forecasts of the sales, operating income and cash flows expected in 2014 and beyond and consequently, resulted in an impairment charge.

To derive the fair value of the reporting units, as required in step one of the impairment test, the Company used the income approach, specifically the discounted cash flow ("DCF") method, which incorporates significant estimates and assumptions made by management which, by their nature, are characterized by uncertainty. Inputs used to fair value the Company's reporting units are considered Level 3 inputs of the fair value hierarchy. For Level 3 measurements, significant increases or decreases in long-term growth rates or discount rates in isolation or in combination could result in a significantly lower or higher fair value measurement. The key assumptions impacting the valuation included:

- The Company's financial projections for its reporting units, which are based on management's assessment of regional and macroeconomic variables, industry trends and market opportunities, and the Company's strategic objectives and future growth plans.
- The projected terminal value for each reporting unit, which represents the present value of projected cash flows beyond the last period in the discounted cash flow analysis. The terminal value reflects the Company's assumptions related to long-term growth rates and profitability, which are based on several factors, including local and macroeconomic variables, market opportunities, and future growth plans.

- The discount rate used to measure the present value of the projected future cash flows is set using a weighted-average cost of capital method that considers market and industry data as well as the Company's specific risk factors that are likely to be considered by a market participant. The weighted-average cost of capital is the Company's estimate of the overall after-tax rate of return required by equity and debt holders of a business enterprise.

Based on the results of step one of the impairment test, the Company determined that the carrying value of the U.S. Spine reporting unit exceeded its respective fair value, and accordingly, the Company proceeded to step two of the impairment test.

In the second step, the Company assigned the reporting unit's fair value to all of its assets and liabilities, including any unrecognized intangible assets, in a hypothetical analysis that calculates the implied fair value of goodwill in the same manner as if the reporting unit were being acquired in a business combination. If the implied fair value of the reporting unit's goodwill

INTEGRA LIFESCIENCES HOLDINGS CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

is less than the carrying value, the difference is recorded as an impairment charge. This allocation process was performed only for the purposes of measuring the goodwill impairment and not to adjust the carrying values of the recognized tangible assets and liabilities. Step two of the impairment was initiated, but due to the time necessary to complete the analysis, has not been completed. The Company recorded its estimate of the goodwill impairment charge of $46.7 million, which represents the remaining goodwill balance in the U.S. Spine reporting unit. The Company expects to finalize the step two analysis in the fourth quarter of 2013. Any adjustment, which the Company does not expect to be material to the impairment charge, would be recorded in the Condensed Consolidated Statement of Operations and Comprehensive Income in that period. Only $5.5 million of the goodwill impairment charge was deductible for tax purposes.

Changes in the carrying amount of goodwill for the nine months ended September 30, 2013 were as follows:

	U.S. Neurosurgery	U.S. Instruments	U.S. Extremities	U.S. Spine and Other	International	Total
	(In thousands)					
Goodwill, gross	$94,312	$57,514	$60,353	$56,219	$25,669	$294,067
Accumulated impairment losses						
Goodwill at December 31, 2012	94,312	57,514	60,353	56,219	25,669	294,067
Tarsus Medical, Inc. acquisition			180			180
Goodwill impairment charge	—	—	—	(46,738)	—	(46,738)
Foreign currency translation	494	300	316	70	135	1,315
Balance at September 30, 2013	$94,806	$57,814	$60,849	$9,551	$25,804	$248,824

Prior to performing the annual goodwill impairment tests for the U.S. Spine reporting unit, the Company tested long-lived assets to be held and used by this reporting unit for impairment on an undiscounted cash flow basis. Based on the results of this testing, there was no impairment of the Company's long-lived assets to be held and used.

The components of the Company’s identifiable intangible assets were as follows:

	Weighted Average Life	September 30, 2013 Cost	Accumulated Amortization	Net	Weighted Average Life	December 31, 2012 Cost	Accumulated Amortization	Net
	(Dollars in thousands)							
Completed technology	12 years	$80,835	$ (43,512)	$37,323	12 years	$75,692	$ (38,402)	$37,290
Customer relationships	12 years	146,914	(77,361)	69,553	12 years	147,690	(70,005)	77,685
Trademarks/brand names	31 years	33,750	(15,516)	18,234	31 years	33,807	(15,034)	18,773
Trademarks/brand names	Indefinite	48,484	—	48,484	Indefinite	48,484	—	48,484
Supplier relationships	27 years	34,721	(8,933)	25,788	27 years	34,721	(7,817)	26,904
All other [1]	4 years	4,830	(1,802)	3,028	4 years	4,519	(1,388)	3,131
		$349,534	$ (147,124)	$202,410		$344,913	$ (132,646)	$212,267

(1) At September 30, 2013 and December 31, 2012, all other included in-process research and development of $2.1 million and $1.7 million, respectively, which was indefinite-lived.

Based on quarter-end exchange rates, annual amortization expense is expected to approximate $19.4 million in 2013, $18.4 million in 2014, $16.6 million in 2015, $14.3 million in 2016 and $12.5 million in 2017. Identifiable intangible assets are initially recorded at fair market value at the time of acquisition using an income or cost approach.

INTEGRA LIFESCIENCES HOLDINGS CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

5. DEBT

Amended and Restated Senior Credit Agreement

On August 10, 2010, the Company entered into an amended and restated credit agreement with a syndicate of lending banks (the “Senior Credit Facility”). The Company amended the Senior Credit Facility on June 8, 2011, and further amended it on May 11, 2012 and June 21, 2013.

The June 8, 2011 amendment:

i. increased the revolving credit component from $450 million to $600 million and eliminated the $150 million term loan component that existed under the original amended and restated credit agreement;

ii. allows the Company to further increase the size of the revolving credit component by an aggregate of $200 million with additional commitments;

iii. provides the Company with decreased borrowing rates and annual commitment fees, and provides more favorable financial covenants; and

iv. extended the maturity date from August 10, 2015 to June 8, 2016.

On May 11, 2012, the Company entered into another amendment to the Senior Credit Facility (the “2012 Amendment”). The 2012 Amendment modified certain financial and negative covenants. The 2012 Amendment provides that the Company’s Maximum Consolidated Total Leverage Ratio (a measure of net debt to consolidated EBITDA, in each case as defined in the Senior Credit Facility, as amended) during any consecutive four quarter period should not be greater than 3.75 to 1.00 during any such period ending on December 31, 2013 (instead of March 31, 2012). In addition, when calculating consolidated EBITDA for any period, the 2012 Amendment permits the addition of certain costs and expenses in the calculation of consolidated net income for such period, to the extent deducted in the calculation of consolidated net income.

On June 21, 2013, the Company entered into a second amendment to the Senior Credit Facility (the “2013 Amendment”). The 2013 Amendment modified certain financial and negative covenants and increased the Company’s Maximum Consolidated Total Leverage Ratio (a measure of net debt to consolidated EBITDA, in each case as defined in the Senior Credit Facility, as amended) to 4.25 through June 30, 2014, with a step-down to 4.00 through March 31, 2015, and then with another step-down to 3.75 thereafter. In addition, when calculating consolidated EBITDA for any period, the 2013 Amendment permits the addition of certain costs and expenses in the calculation of consolidated net income for such period, to the extent deducted in the calculation of consolidated net income. The effect of the 2013 Amendment is to increase the ability of the Company to borrow under the Senior Credit Facility during the affected periods. The Company capitalized $1.1 million of incremental financing costs in connection with the 2013 Amendment, which will be amortized through the maturity date of the Senior Credit Facility.

The Senior Credit Facility is collateralized by substantially all of the assets of the Company’s U.S. subsidiaries, excluding intangible assets. The Senior Credit Facility is subject to various financial and negative covenants and at September 30, 2013, the Company was in compliance with all such covenants.

Borrowings under the Senior Credit Facility currently bear interest, at the Company’s option, at a rate equal to (i) the Eurodollar Rate (as defined in the Senior Credit Facility, which definition has not changed) in effect from time to time plus the applicable rate (ranging from 1.00% to 1.75%) or (ii) the highest of (x) the weighted average overnight Federal funds rate, as published by the Federal Reserve Bank of New York, plus 0.5%, (y) the prime lending rate of Bank of America, N.A. or (z) the one-month Eurodollar Rate plus 1.0%. The applicable rates are based on the Company’s consolidated total leverage ratio (defined as the ratio of (a) consolidated funded indebtedness less cash in excess of $40 million that is not subject to any restriction of the use or investment thereof to (b) consolidated EBITDA) at the time of the applicable borrowing.

The Company also pays an annual commitment fee (ranging from 0.15% to 0.30%, based on the Company’s consolidated total leverage ratio) on the daily amount by which the revolving credit facility exceeds the outstanding loans and letters of credit under the credit facility.

At September 30, 2013 and December 31, 2012, there was $341.9 million and $321.9 million outstanding under the Senior Credit Facility at a weighted average interest rate of 1.9% and 1.8%, respectively. At September 30, 2013, there was approximately $258.1 million available for borrowing under the Senior Credit Facility. The fair value of outstanding borrowings under the Senior Credit Facility at September 30, 2013 was approximately $337.0 million. The fair value of the Senior Credit Facility was determined by using a discounted cash flow model based on current market interest rates available to the Company. These inputs are corroborated by observable market data for similar liabilities and therefore classified within Level 2 of the fair value hierarchy. Level 2 inputs represent inputs that are observable for the asset or liability, either directly or indirectly and are other than active market observable inputs that reflect unadjusted quoted prices for identical assets or liabilities. The Company considers the balance to be long-term in nature based on its current intent and ability to repay the borrowing outside of the next twelve-month period.

2016 Convertible Senior Notes

On June 15, 2011, the Company issued $230.0 million aggregate principal amount of its 1.625% Convertible Senior Notes due in 2016 (the “2016 Notes”). The 2016 Notes mature on December 15, 2016, and bear interest at a rate of 1.625% per annum payable semi-annually in arrears on December 15 and June 15 of each year. The portion of the debt proceeds that was classified as equity at the time of the offering was $43.2 million, an equivalent of that amount is being amortized to interest expense using the effective interest method through December 2016. The effective interest rate implicit in the liability component is 5.6%.

At September 30, 2013, the carrying amount of the liability component was $203.3 million, the remaining unamortized discount was $26.7 million, and the principal amount outstanding was $230.0 million. The fair value of the 2016 Notes at September 30, 2013 was approximately $237.6 million. At December 31, 2012, the carrying amount of the liability component was $197.7 million, the remaining unamortized discount was $32.3 million and the principal amount outstanding was $230.0 million. The fair value of the liability of the 2016 Notes was determined using a discounted cash flow model based on current market interest rates available to the Company. These inputs are corroborated by observable market data for similar liabilities and therefore classified within Level 2.

The 2016 Notes are senior, unsecured obligations of the Company, and are convertible into cash and, if applicable, shares of its common stock based on an initial conversion rate, subject to adjustment of 17.4092 shares per $1,000 principal amount of 2016 Notes (which represents an initial conversion price of approximately $57.44 per share). The Company will satisfy any conversion of the 2016 Notes with cash up to the principal amount of the 2016 Notes pursuant to the net share settlement mechanism set forth in the indenture and, with respect to any excess conversion value, with shares of the Company’s common stock. The 2016 Notes are convertible only in the following circumstances: (1) if the closing sale price of the Company’s common stock exceeds 150% of the conversion price during a period as defined in the indenture; (2) if the average trading price per $1,000 principal amount of the 2016 Notes is less than or equal to 98% of the average conversion value of the 2016 Notes during a period as defined in the indenture; (3) at any time on or after June 15, 2016; or (4) if specified corporate transactions occur. The issue price of the 2016 Notes was equal to their face amount, which is also the amount holders are entitled to receive at maturity if the 2016 Notes are not converted. As of September 30, 2013, none of these conditions existed with respect to the 2016 Notes and as a result, the 2016 Notes are classified as long term.

In connection with the issuance of the 2016 Notes, the Company entered into call transactions and warrant transactions, primarily with affiliates of the initial purchasers of such notes (the “hedge participants”). The initial strike price of the call transaction is approximately $57.44 per share, subject to customary anti-dilution adjustments. The initial strike price of the warrant transaction is approximately $70.05 per share, subject to customary anti-dilution adjustments.

Convertible Note Interest

The interest expense components of the Company’s convertible notes are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(In thousands)			
2016 Notes:				
Amortization of the discount on the liability component	$1,633	$1,788	$4,865	$5,289
Cash interest related to the contractual interest coupon	807	934	2,438	2,803
Total	$2,440	$2,722	$7,303	$8,092
2012 Notes:				

Amortization of the discount on the liability component	$—	$—	$—	$2,995
Cash interest related to the contractual interest coupon	—	—	—	1,633
Total	$—	$—	$—	$4,628

6. DERIVATIVE INSTRUMENTS

Interest Rate Hedging

The Company's interest rate risk relates to U.S. dollar denominated variable LIBOR interest rate borrowings. The Company uses an interest rate swap derivative instrument entered into on August 10, 2010 with an effective date of December 31, 2010 to

INTEGRA LIFESCIENCES HOLDINGS CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

manage its earnings and cash flow exposure to changes in interest rates by converting a portion of its floating-rate debt into fixed-rate debt beginning on December 31, 2010. This interest rate swap expires on August 10, 2015.

The Company designates this derivative instrument as a cash flow hedge. The Company records the effective portion of any change in the fair value of a derivative instrument designated as a cash flow hedge as unrealized gains or losses in accumulated other comprehensive income ("AOCI"), net of tax, until the hedged item affects earnings, at which point the effective portion of any gain or loss will be reclassified to earnings. If the hedged cash flow does not occur, or if it becomes probable that it will not occur, the Company will reclassify the amount of any gain or loss on the related cash flow hedge to interest expense at that time.

The Company expects that approximately $1.7 million of pre-tax losses recorded as net in AOCI related to the interest rate hedge could be reclassified to earnings within the next twelve months.

Foreign Currency Hedging

From time to time the Company enters into foreign currency hedge contracts intended to protect the U.S. dollar value of certain forecasted foreign currency denominated transactions. The Company records the effective portion of any change in the fair value of foreign currency cash flow hedges in AOCI, net of tax, until the hedged item affects earnings. Once the related hedged item affects earnings, the Company reclassifies the effective portion of any related unrealized gain or loss on the foreign currency cash flow hedge to earnings. If the hedged forecasted transaction does not occur, or if it becomes probable that it will not occur, the Company will reclassify the amount of any gain or loss on the related cash flow hedge to earnings at that time.

The success of the Company's hedging program depends, in part, on forecasts of certain activity denominated in euros. The Company may experience unanticipated currency exchange gains or losses to the extent that there are differences between forecasted and actual activity during periods of currency volatility. In addition, changes in currency exchange rates related to any unhedged transactions may affect its earnings and cash flows.

Counterparty Credit Risk

The Company manages its concentration of counterparty credit risk on its derivative instruments by limiting acceptable counterparties to a group of major financial institutions with investment grade credit ratings, and by actively monitoring their credit ratings and outstanding positions on an ongoing basis. Therefore, the Company considers the credit risk of the counterparties to be low. Furthermore, none of the Company's derivative transactions are subject to collateral or other security arrangements, and none contain provisions that depend upon the Company's credit ratings from any credit rating agency.

Fair Value of Derivative Instruments

The Company has classified all of its derivative instruments within Level 2 of the fair value hierarchy because observable inputs are available for substantially the full term of the derivative instruments. The fair value of the foreign currency forward exchange contracts related to inventory purchases is determined by comparing the forward rate as of the period end and the settlement rate specified in each contract. The fair value of the interest rate swaps was developed using a market approach based on publicly available market yield curves and the terms of the related swap. The Company performs ongoing assessments of counterparty credit risk.

The following table summarizes the fair value and presentation in the condensed consolidated balance sheets for derivatives designated as hedging instruments as of September 30, 2013 and December 31, 2012:

Location on Balance Sheet (1):	Fair Value as of September 30, 2013	Fair Value as of December 31, 2012	Notional Amount as of September 30, 2013	Notional Amount as of December 31, 2012
	(In thousands)			
Derivatives designated as hedges — Liabilities:				
Interest rate swap — Accrued expenses and other current liabilities (2)	1,731	1,888		

Interest rate swap — Other liabilities[2]	1,075	2,238
Total Derivatives designated as hedges — Liabilities	$2,806	$4,126

(1) The Company classifies derivative assets and liabilities as current based on the cash flows expected to be incurred within the following 12 months.

INTEGRA LIFESCIENCES HOLDINGS CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

(2) At September 30, 2013 and December 31, 2012, the notional amount related to the Company's sole interest rate swap was $116.3 million and $127.5 million, respectively. In the next twelve months, the Company expects to reduce the notional amount by $15.0 million.

The following presents the effect of derivative instruments designated as cash flow hedges on the accompanying consolidated statements of operations during the three and nine months ended September 30, 2013 and 2012:

	Balance in AOCI Beginning of Quarter	Amount of Gain (Loss) Recognized in AOCI- Effective Portion	Amount of Gain (Loss) Reclassified from AOCI into Earnings-Effective Portion	Balance in AOCI End of Quarter	Location in Statements of Operations
	(In thousands)				
Three Months Ended September 30, 2013					
Forward currency forward contracts	$162	$(19)	$ 110	$ 33	Costs of goods sold
Interest rate swap	(3,030)	(258)	(483)	(2,805)	Interest (expense)
	$(2,868)	$(277)	$ (373)	$ (2,772)	
Three Months Ended September 30, 2012					
Forward currency forward contracts	$(176)	$(9)	$ (6)	$ (179)	Costs of goods sold
Interest rate swap	(4,374)	(744)	(476)	(4,642)	Interest (expense)
	$(4,550)	$(753)	$ (482)	$ (4,821)	

	Balance in AOCI Beginning of Year	Amount of Gain (Loss) Recognized in AOCI- Effective Portion	Amount of Gain (Loss) Reclassified from AOCI into Earnings-Effective Portion	Balance in AOCI End of Quarter	Location in Statements of Operations
	(In thousands)				
Nine Months Ended September 30, 2013					
Forward currency forward contracts	$(34)	$142	$ 75	$ 33	Cost of goods sold
Interest rate swap	(4,125)	(159)	(1,479)	(2,805)	Interest (expense)
	$(4,159)	$(17)	$ (1,404)	$ (2,772)	
Nine Months Ended September 30, 2012					
Forward currency forward contracts	$(216)	$(140)	$ (177)	$ (179)	Cost of goods sold
Interest rate swap	(4,092)	(1,952)	(1,402)	(4,642)	Interest (expense)
	$(4,308)	$(2,092)	$ (1,579)	$ (4,821)	

The Company recognized no gains or losses resulting from ineffectiveness of cash flow hedges during the three and nine months ended September 30, 2013 and 2012.

7. STOCK-BASED COMPENSATION

As of September 30, 2013, the Company had stock options, restricted stock awards, performance stock awards, contract stock awards and restricted stock unit awards outstanding under three plans, the 2000 Equity Incentive Plan (the “2000 Plan”), the 2001 Equity Incentive Plan (the “2001 Plan”), and the 2003 Equity Incentive Plan (the “2003 Plan,” and collectively, the “Plans”).

Stock options issued under the Plans become exercisable over specified periods, generally within four years from the date of grant for officers and directors, and generally expire from six to ten years for directors and certain executive officers. Restricted stock issued under the Plans vests over specified periods, generally three years after the date of grant. The vesting of performance stock, issued under the Plans, is subject to service and performance conditions.

INTEGRA LIFESCIENCES HOLDINGS CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Stock Options
There were 32,468 stock options granted during the nine months ended September 30, 2013. As of September 30, 2013, there were approximately $1.5 million of total unrecognized compensation costs related to unvested stock options. These costs are expected to be recognized over a weighted-average period of approximately one year, six months.
Awards of Restricted Stock, Performance Stock and Contract Stock
Performance stock, restricted stock and contract stock awards generally have requisite service periods of three years. Performance stock awards are subject to graded vesting conditions and the Company expenses their fair value over the requisite service period. The Company expenses the fair value of restricted stock and contract stock awards on a straight-line basis over the vesting period or requisite service period, whichever is shorter. The Company granted approximately 181,000 restricted stock awards/stock units and 55,000 performance shares during the nine months ended September 30, 2013. As of September 30, 2013, there were approximately $13.8 million of total unrecognized compensation costs related to these unvested awards. The Company expects to recognize these costs over a weighted-average period of approximately two years.
The Company has no formal policy related to the repurchase of shares for the purpose of satisfying stock-based compensation obligations.
The Company also maintains an Employee Stock Purchase Plan (the “ESPP”), which provides eligible employees with the opportunity to acquire shares of common stock at periodic intervals by means of accumulated payroll deductions. The ESPP is a non-compensatory plan based on its terms.

8. TREASURY STOCK

On October 23, 2012, the Company's Board of Directors authorized a repurchase of up to $75.0 million of its outstanding common stock through December 2014. The Company has not repurchased any of its outstanding shares of common stock during the three and nine month periods ended September 30, 2013 and 2012.
As of September 30, 2013, there remained $75.0 million available for repurchases under this authorization.

9. RETIREMENT BENEFIT PLANS
The Company maintains defined benefit pension plans that cover employees in its manufacturing plants located in Andover, United Kingdom (the “UK Plan”) and Tuttlingen, Germany (the “Germany Plan”). The Company closed the Tuttlingen, Germany plant in December 2005. The Company did not terminate the Germany Plan, and the Company remains obligated for the accrued pension benefits related to this plan. Effective March 31, 2011, the Company froze the benefits due to the participants of the UK Plan in their entirety; this curtailment resulted in a $0.3 million reduction in the projected benefit obligations which the Company recorded on that date. The plans cover certain current and former employees.
Net periodic benefit costs for the Company’s defined benefit pension plans included the following amounts:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(In thousands)			
Service cost	$—	$6	$—	$19
Interest cost	137	157	410	478
Return on plan assets	(100)	(142)	(300)	(432)
Net period benefit cost	$37	$21	$110	$65

The Company made $0.7 million and $0.6 million of contributions to its defined benefit pension plans during the nine months ended September 30, 2013 and 2012, respectively.

INTEGRA LIFESCIENCES HOLDINGS CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

10. INCOME TAXES

The following table provides a summary of the Company’s effective tax rate:

	Three Months Ended September 30,	
	2013	2012
Reported tax rate	18.8 %	7.3 %
	Nine Months Ended September 30,	
	2013	2012
Reported tax rate	23.1 %	19.8 %

The Company’s effective income tax rates for the three months ended September 30, 2013 and 2012 were 18.8% and 7.3%, respectively. For the three months ended September 30, 2013, the increase in the income tax rate compared to the same period in 2012 was primarily the goodwill impairment charge as only a portion of the impairment charge was deductible for tax and lower income within the U.S.-based operations relative to foreign operations, which created a favorable effect on the effective tax rate. The Company also recorded a benefit of $2.3 million for the release of uncertain tax positions and related interest due to the expiration of the statute of limitations, which is offset by an expense of $0.2 million due to additional U.S. tax contingency reserves.

The Company's effective income tax rates for the nine months ended September 30, 2013 and 2012 were 23.1% and 19.8%, respectively. For the nine months ended September 30, 2013, the increase in the income tax rate compared to the same period in 2012 primarily resulted from the tax impact of the goodwill impairment and the release of uncertain tax positions.

The Company expects its effective income tax rate for the full year to be approximately 36.3% resulting largely from the income tax impact associated with the goodwill impairment, offset with foreign earnings taxed at lower tax rates, as well as the expected release of tax contingency reserves. This estimate could be revised in the future as additional information is presented to the Company.

11. NET INCOME (LOSS) PER SHARE

Basic and diluted net income per share was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(In thousands, except per share amounts)			
Basic net income per share:				
Net income (loss)	$(28,550)	$13,211	$(29,160)	$28,418
Weighted average common shares outstanding	27,896	28,446	27,855	28,403
Basic net income per common share	$(1.02)	$0.46	$(1.05)	$1.00
Diluted net income per share:				
Net income (loss)	$(28,550)	$13,211	$(29,160)	$28,418
Weighted average common shares outstanding — Basic	27,896	28,446	27,855	28,403
Effect of dilutive securities:				
Stock options and restricted stock	—	331	—	226
	27,896	28,777	27,855	28,629

Weighted average common shares for diluted earnings per share				
Diluted net income per common share	$(1.02)	$0.46	$(1.05)	$0.99

At September 30, 2013 and 2012, the Company had 1.7 million of outstanding stock options. The Company also has warrants outstanding relating to its 2016 Notes at September 30, 2013 and 2012. Stock options, restricted stock and warrants are included in the diluted earnings per share calculation using the treasury stock method, unless the effect of including the stock options would be anti-dilutive. For the three and nine months ended September 30, 2013 all stock options, restricted stock and warrants were excluded in the diluted earnings per share calculation using the treasury stock method because of their anti-

INTEGRA LIFESCIENCES HOLDINGS CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

dilutive effect. For the three and nine months ended September 30, 2012, 1.0 million and 1.2 million of anti-dilutive stock options, respectively, were excluded from the diluted earnings per share calculation.

12. COMPREHENSIVE (LOSS) INCOME
Comprehensive (loss) income was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
	(In thousands)			
Net (loss) income	$(28,550)	$13,211	$(29,160)	$28,418
Foreign currency translation adjustment	8,711	4,051	3,288	(106)
Change in unrealized gain on derivatives, net of tax	47	(154)	794	(290)
Pension liability adjustment, net of tax	(68)	(2)	2	(6)
Comprehensive (loss) income	$(19,860)	$17,106	$(25,076)	$28,016

Changes in Accumulated Other Comprehensive (Loss) Income by component between December 31, 2012 and September 30, 2013 are presented in the table below, net of tax:

	Gains and Losses on Cash Flow Hedges	Defined Benefit Pension Items	Foreign Currency Items	Total
	(In thousands)			
Beginning balance	$(2,373)	$(1,154)	$(1,270)	$(4,797)
Other comprehensive income before reclassifications	(6)	70	3,288	3,352
Amounts reclassified from accumulated other comprehensive income	(800)	68		(732)
Net current-period other comprehensive income (loss)	794	2	3,288	4,084
Ending balance	$(1,579)	$(1,152)	$2,018	$(713)

The reclassification adjustments out of Accumulated Other Comprehensive (Loss) Income during the three and nine months ended September 30, 2013 were as follows:
Three Months Ended September 30, 2013

Details about Accumulated Other Comprehensive Income Components	Amount Reclassified from Accumulated Other Comprehensive Income	Affected Line Item in the Statement where Net Income (loss) is Presented
	(In thousands)	
Gains and losses on cash flow hedges		
Interest rate swap	$(483)	Interest (expense)
Foreign currency forwards	110	Cost of goods sold
	(373)	Total before tax
	160	Tax (expense) or benefit
	$(213)	Net of tax

16

INTEGRA LIFESCIENCES HOLDINGS CORPORATION
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

Nine Months Ended September 30, 2013

Details about Accumulated Other Comprehensive Income Components	Amount Reclassified from Accumulated Other Comprehensive Income (In thousands)	Affected Line Item in the Statement where Net Income (loss) is Presented
Gains and losses on cash flow hedges		
Interest rate swap	$(1,479)	Interest (expense)
Foreign currency forwards	75	Cost of goods sold
	(1,404)	Total before tax
	604	Tax (expense) or benefit
	$(800)	Net of tax

13. SEGMENT AND GEOGRAPHIC INFORMATION

The Company internally manages and reports the results of its businesses to its chief operating decision maker through five reportable segments. The five reportable segments are U.S. Neurosurgery, U.S. Instruments, U.S. Extremities, U.S. Spine and Other, and International. The U.S. Neurosurgery segment sells a full line of products specifically for neurosurgery and critical care such as tissue ablation equipment, dural repair products, cerebral spinal fluid management devices, intracranial monitoring equipment, and cranial stabilization equipment. The U.S. Instruments business sells more than 60,000 instrument patterns and surgical and lighting products to hospitals, surgery centers, and dental, podiatry, and veterinary offices. The U.S. Extremities segment includes the U.S. Extremity reconstruction business, which includes such offerings as skin and wound repair, bone and joint fixation, implants in the upper and lower extremities, bone grafts and nerve and tendon repair. The U.S. Spine and Other segment includes (i) the U.S. Spine business, which focuses on spinal fusion, spinal implants, and deformity correction, together with bone graft substitutes and other related medical devices that are used to enhance the repair and regeneration of bone in various types of orthopedic surgical procedures, and (ii) the Private Label business, which sells the Company’s regenerative medicine and other products to strategic partners. The International segment sells similar products to those discussed above, but are managed through the following geographies: (i) Europe, Middle East and Africa, and (ii) Central/South America, Asia-Pacific and Canada. The Corporate and other category includes (i) various legal, finance, executive, and human resource functions, (ii) brand management, (iii) share-based compensation costs, and (iv) costs related to procurement, manufacturing operations and logistics for the Company’s entire organization.

The operating results of the various reportable segments as presented are not comparable to one another because (i) certain operating segments are more dependent than others on corporate functions for unallocated general and administrative and/or operational manufacturing functions, and (ii) the Company does not allocate certain manufacturing costs and general and administrative costs to the operating segment results.