

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549**

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended June 30, 2013

**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**  
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

**08536**  
(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  No

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  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

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

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

The number of shares of the registrant's Common Stock, \$0.01 par value, outstanding as of July 29, 2013 was 37,000,208.

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**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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Total revenue, net	\$ 205,547	\$ 210,170	\$ 402,199	\$ 406,355
Costs and Expenses:				
Cost of goods sold	83,068	78,274	163,336	152,949
Research and development	11,809	13,131	24,525	25,043
Selling, general and administrative	99,619	96,097	199,780	183,508
Intangible asset amortization	3,073	4,647	6,624	9,367
Total costs and expenses	<u>197,569</u>	<u>192,149</u>	<u>394,265</u>	<u>370,867</u>
Operating income	7,978	18,021	7,934	35,488
Interest income	289	415	352	793
Interest expense	(4,965)	(7,103)	(9,765)	(15,032)
Other income (expense), net	(307)	236	(1,281)	(87)
Income (loss) before income taxes	2,995	11,569	(2,760)	21,162
Income tax (benefit) expense	(445)	3,055	(2,150)	5,955
Net income (loss)	<u>\$ 3,440</u>	<u>\$ 8,514</u>	<u>\$ (610)</u>	<u>\$ 15,207</u>
Basic net income per common share	\$ 0.12	\$ 0.30	\$ (0.02)	\$ 0.54
Diluted net income per common share	\$ 0.12	\$ 0.30	\$ (0.02)	\$ 0.53
Weighted average common shares outstanding (See Note 11):				
Basic	27,873	28,419	27,834	28,382
Diluted	28,118	28,609	27,834	28,549
Comprehensive income (loss) (See Note 12)	<u>\$ 5,317</u>	<u>\$ (2,730)</u>	<u>\$ (5,217)</u>	<u>\$ 10,911</u>

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

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

	June 30, 2013	December 31, 2012
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 98,636	\$ 96,938
Trade accounts receivable, net of allowances of \$9,637 and \$7,221	114,749	114,916
Inventories, net	195,457	171,806
Deferred tax assets	38,120	39,100
Prepaid expenses and other current assets	30,774	30,291
Total current assets	477,736	453,051
Property, plant and equipment, net	184,537	177,898
Intangible assets, net	206,884	212,267
Goodwill	292,881	294,067
Deferred tax assets	14,988	15,957
Other assets	10,475	10,359
Total assets	\$ 1,187,501	\$ 1,163,599
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current Liabilities:		
Accounts payable, trade	\$ 44,767	\$ 36,742
Deferred revenue	3,748	3,505
Accrued compensation	27,822	34,914
Accrued expenses and other current liabilities	33,002	31,768
Total current liabilities	109,339	106,929
Long-term borrowings under senior credit facility	341,875	321,875
Long-term convertible securities	201,375	197,672
Deferred tax liabilities	5,396	5,393
Other liabilities	12,927	13,955
Total liabilities	\$ 670,912	\$ 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; 36,969 and 36,852 issued at June 30, 2013 and December 31, 2012, respectively	370	369
Additional paid-in capital	591,331	587,301
Treasury stock, at cost; 8,903 shares at June 30, 2013 and December 31, 2012	(367,121)	(367,121)
Accumulated other comprehensive (loss)	(9,404)	(4,797)
Retained earnings	301,413	302,023
Total stockholders' equity	\$ 516,589	\$ 517,775
Total liabilities and stockholders' equity	\$ 1,187,501	\$ 1,163,599

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

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

	<b>Six Months Ended June 30,</b>	
	<b>2013</b>	<b>2012</b>
<b>OPERATING ACTIVITIES:</b>		
Net income (loss)	\$ (610)	\$ 15,207
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	24,025	25,808
Deferred income tax (benefit) provision	(400)	(2,554)
Amortization of debt issuance costs	1,094	1,480
Non-cash interest expense	3,232	6,496
Payment of accreted interest	—	(30,617)
Loss on disposal of property and equipment	1,831	431
Share-based compensation	4,764	4,355
Excess tax benefits from stock-based compensation arrangements	(102)	(418)
Changes in assets and liabilities, net of business acquisitions:		
Accounts receivable	(745)	2,252
Inventories	(23,966)	(2,155)
Prepaid expenses and other current assets	(624)	7,664
Other non-current assets	(368)	(876)
Accounts payable, accrued expenses and other current liabilities	2,893	7,378
Deferred revenue	278	(289)
Other non-current liabilities	(538)	432
Net cash provided by operating activities	<u>\$ 10,764</u>	<u>\$ 34,594</u>
<b>INVESTING ACTIVITIES:</b>		
Purchases of property and equipment	(24,475)	(24,642)
Sales of property and equipment	530	—
Cash used in business acquisition, net of cash acquired	(2,830)	(2,867)
Purchases of short-term investments	—	(67,907)
Maturities of short-term investments	—	26,058
Net cash used in investing activities	<u>\$ (26,775)</u>	<u>\$ (69,358)</u>
<b>FINANCING ACTIVITIES:</b>		
Borrowings under senior credit facility	20,000	155,000
Repayments under senior credit facility	—	(12,812)
Payment of liability component of convertible notes	—	(134,383)
Payment of debt issuance costs	(1,013)	—
Proceeds from exercised stock options	234	250
Excess tax benefits from stock-based compensation arrangements	102	418
Net cash provided by (used in) financing activities	<u>\$ 19,323</u>	<u>\$ 8,473</u>
Effect of exchange rate changes on cash and cash equivalents	(1,614)	953
Net change in cash and cash equivalents	1,698	(25,338)
Cash and cash equivalents at beginning of period	96,938	100,808
Cash and cash equivalents at end of period	<u>\$ 98,636</u>	<u>\$ 75,470</u>

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

**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 June 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 six-month periods ended June 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

There have been no recently issued accounting standards that have an impact on the Company’s financial statements.

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

**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:

	<b>Final Purchase Price Allocation</b>		
	<b>(Dollars in thousands)</b>		
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		<u>6,928</u>	
Accounts payable and other liabilities		111	
Deferred tax liability		2,152	
Net assets acquired	\$	<u>4,665</u>	

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 remeasured to fair value at each reporting date until the contingency is resolved. Changes in fair value of 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 June 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.

### 3. INVENTORIES

Inventories, net consisted of the following:

	June 30, 2013	December 31, 2012
(In thousands)		
Finished goods	\$ 118,464	\$ 102,401
Work-in process	44,771	39,944
Raw materials	32,222	29,461
	<u>\$ 195,457</u>	<u>\$ 171,806</u>

The finished goods inventory includes \$4.6 million of capitalized medical device excise tax at June 30, 2013.

### 4. GOODWILL AND OTHER INTANGIBLE ASSETS

The excess of the cost over the fair value of net assets of acquired businesses is recorded as goodwill. Goodwill is not subject to amortization, but is reviewed for impairment at the reporting unit level annually, or more frequently if impairment indicators arise. The Company's assessment of the recoverability of goodwill is based upon a comparison of the carrying value of goodwill with its estimated fair value. This assessment is performed annually during the third quarter and was performed most recently on July 31, 2012 resulting in no impairment. However, if future results do not meet or exceed the Company's forecasts, or if unfavorable changes occur in the weighted-average cost of capital, growth assumptions for future revenue, terminal value growth rate and/or forecasted cash flows utilized in the discounted cash flow analysis, the Company may record an impairment of this goodwill at a future date.

The Company has experienced a decline in sales relative to the previous forecasts, partially with respect to its U.S. Spine and Private Label reporting units which has recorded goodwill of \$46.8 million and \$8.9 million, respectively. This decline is in part attributable to the recall, as well as lower sales to customers. The Company currently believes this impact is temporary. However, in the event that sales and operating results of the U.S. Spine and Private Label reporting units in the second half of the year continue to deteriorate, or in the event that management revises its forecasts, an impairment of goodwill may be recognized.

Changes in the carrying amount of goodwill for the six months ended June 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			116			116
Foreign currency translation	(417)	(255)	(267)	(249)	(114)	(1,302)
Balance at June 30, 2013	<u>\$ 93,895</u>	<u>\$ 57,259</u>	<u>\$ 60,202</u>	<u>\$ 55,970</u>	<u>\$ 25,555</u>	<u>\$ 292,881</u>

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

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

	Weighted Average Life	June 30, 2013			Weighted Average Life	December 31, 2012		
		Cost	Accumulated Amortization	Net		Cost	Accumulated Amortization	Net
(Dollars in thousands)								
Completed technology	12 years	\$ 80,456	\$ (41,496)	\$ 38,960	12 years	\$ 75,692	\$ (38,402)	\$ 37,290
Customer relationships	12 years	146,333	(74,633)	71,700	12 years	147,690	(70,005)	77,685
Trademarks/brand names	31 years	33,578	(15,164)	18,414	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	(8,561)	26,160	27 years	34,721	(7,817)	26,904
All other <sup>(1)</sup>	4 years	4,830	(1,664)	3,166	4 years	4,519	(1,388)	3,131
		<u>\$ 348,402</u>	<u>\$ (141,518)</u>	<u>\$ 206,884</u>		<u>\$ 344,913</u>	<u>\$ (132,646)</u>	<u>\$ 212,267</u>

<sup>(1)</sup> At June 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.

## 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

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

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 \$1.0 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 June 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 June 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 2.0% and 1.8%, respectively. At June 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 June 30, 2013 was approximately \$335.9 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 June 30, 2013, the carrying amount of the liability component was \$201.4 million, the remaining unamortized discount was \$28.6 million, and the principal amount outstanding was \$230.0 million. The fair value of the 2016 Notes at June 30, 2013 was approximately \$230.1 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 June 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.

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

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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
(In thousands)				
<b>2016 Notes:</b>				
Amortization of the discount on the liability component	\$ 1,622	\$ 1,763	\$ 3,232	\$ 3,502
Cash interest related to the contractual interest coupon	813	934	1,631	1,869
Total	\$ 2,435	\$ 2,697	\$ 4,863	\$ 5,371
<b>2012 Notes:</b>				
Amortization of the discount on the liability component	\$ —	\$ 1,206	\$ —	\$ 2,995
Cash interest related to the contractual interest coupon	—	653	—	1,633
Total	\$ —	\$ 1,859	\$ —	\$ 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 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.

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

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 June 30, 2013 and December 31, 2012:

<u>Location on Balance Sheet <sup>(1)</sup>:</u>	<u>Fair Value as of</u>		<u>Notional Amount as of</u>	
	<u>June 30, 2013</u>	<u>December 31, 2012</u>	<u>June 30, 2013</u>	<u>December 31, 2012</u>
	(In thousands)			
<b>Derivatives designated as hedges — Assets:</b>				
Foreign currency forward contracts — Other current assets	\$ (27)	—	\$ 1,392	
<b>Derivatives designated as hedges — Liabilities:</b>				
Interest rate swap — Accrued expenses and other current liabilities <sup>(2)</sup>	1,748	1,888		
Interest rate swap — Other liabilities <sup>(2)</sup>	1,282	2,238		
<b>Total Derivatives designated as hedges — Liabilities</b>	<b>\$ 3,030</b>	<b>\$ 4,126</b>		

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

<sup>(2)</sup> At June 30, 2013 and December 31, 2012, the notional amount related to the Company's sole interest rate swap was \$120.0 million and \$127.5 million, respectively. In the next twelve months, the Company expects to reduce the notional amount by \$15.0 million.

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

The following presents the effect of derivative instruments designated as cash flow hedges on the accompanying consolidated statements of operations during the three and six months ended June 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)					
<b>Three Months Ended June 30, 2013</b>					
Forward currency forward contracts	\$ —	\$ 162	\$ —	\$ 162	Costs of goods sold
Interest rate swap	(3,644)	108	(506)	(3,030)	Interest (expense)
	<u>\$ (3,644)</u>	<u>\$ 270</u>	<u>\$ (506)</u>	<u>\$ (2,868)</u>	
<b>Three Months Ended June 30, 2012</b>					
Forward currency forward contracts	\$ (9)	\$ (338)	\$ (171)	\$ (176)	Costs of goods sold
Interest rate swap	(4,092)	(759)	(477)	(4,374)	Interest (expense)
	<u>\$ (4,101)</u>	<u>\$ (1,097)</u>	<u>\$ (648)</u>	<u>\$ (4,550)</u>	
(In thousands)					
	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
<b>Six Months Ended June 30, 2013</b>					
Forward currency forward contracts	\$ (34)	\$ 162	\$ (34)	\$ 162	Cost of goods sold
Interest rate swap	(4,125)	99	(996)	(3,030)	Interest (expense)
	<u>\$ (4,159)</u>	<u>\$ 261</u>	<u>\$ (1,030)</u>	<u>\$ (2,868)</u>	
<b>Six Months Ended June 30, 2012</b>					
Forward currency forward contracts	\$ (216)	\$ (131)	\$ (171)	\$ (176)	Cost of goods sold
Interest rate swap	(4,092)	(1,208)	(926)	(4,374)	Interest (expense)
	<u>\$ (4,308)</u>	<u>\$ (1,339)</u>	<u>\$ (1,097)</u>	<u>\$ (4,550)</u>	

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

**7. STOCK-BASED COMPENSATION**

As of June 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. Performance stock vesting, issued under the Plans, is subject to service and performance conditions.

Stock Options

There were 32,468 stock options granted during the six months ended June 30, 2013. As of June 30, 2013, there were approximately \$1.8 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.

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

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 174,000 restricted stock awards/stock units and 55,000 performance shares during the six months ended June 30, 2013. As of June 30, 2013, there were approximately \$16.2 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 six month periods ended June 30, 2013 and 2012.

As of June 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 June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(In thousands)			
Service cost	\$ —	\$ 6	\$ —	\$ 12
Interest cost	136	161	273	321
Return on plan assets	(100)	(145)	(200)	(289)
Net period benefit cost	\$ 36	\$ 22	\$ 73	\$ 44

The Company made \$0.4 million of contributions to its defined benefit pension plans during the six months ended June 30, 2013 and 2012.

**10. INCOME TAXES**

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

	Three Months Ended June 30,	
	2013	2012
Reported tax rate	(14.9)%	26.4%
	Six Months Ended June 30,	
	2013	2012
Reported tax rate	77.9%	28.1%

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

The Company's effective income tax rates for the three months ended June 30, 2013 and 2012 were (14.9)% and 26.4%, respectively. For the three months ended June 30, 2013, the reduction in the income tax rate compared to the same period in 2012 was primarily the result of a change in the jurisdictional mix of year-to-date worldwide pretax income and the establishment of the Irish research and development credit. During the quarter, the Company was granted an Irish research and development credit for 2011 and 2012, which resulted in a benefit of \$0.5 million. The Company also recorded a benefit of \$0.8 million for the release of uncertain tax positions due to the expiration of the statute of limitation in certain state jurisdictions, which is offset by an expense of \$0.3 million due to additional non-U.S. tax contingency reserves.

The Company's effective income tax rates for the six months ended June 30, 2013 and 2012 were 77.9% and 28.1%, respectively. For the six months ended June 30, 2013, the increase in the income tax rate compared to the same period in 2012 primarily resulted from a change in the jurisdictional mix of year-to-date worldwide pretax income, a reinstatement of the Federal research and development credit of, which resulted in a benefit \$0.9 million and the establishment of the Irish research and development credit.

The Company expects its effective income tax rate for the full year to be approximately 4.5% resulting in part from foreign earnings taxed at lower tax rates, the expected release of tax contingency reserves, and the benefit from the Federal research credit. This estimate could be revised in the future as additional information is presented to the Company.

**11. NET INCOME PER SHARE**

Basic and diluted net income per share was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
(In thousands, except per share amounts)				
Basic net income per share:				
Net income (loss)	\$ 3,440	\$ 8,514	\$ (610)	\$ 15,207
Weighted average common shares outstanding	27,873	28,419	27,834	28,382
Basic net income per common share	\$ 0.12	\$ 0.30	\$ (0.02)	\$ 0.54
Diluted net income per share:				
Net income (loss)	\$ 3,440	\$ 8,514	\$ (610)	\$ 15,207
Weighted average common shares outstanding — Basic	27,873	28,419	27,834	28,382
Effect of dilutive securities:				
Stock options and restricted stock	245	190	—	167
Weighted average common shares for diluted earnings per share	28,118	28,609	27,834	28,549
Diluted net income per common share	\$ 0.12	\$ 0.30	\$ (0.02)	\$ 0.53

At June 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 June 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 months ended June 30, 2013 and 2012, 1.0 million and 1.2 million of anti-dilutive stock options, respectively, were excluded from the diluted earnings per share calculation. As the strike price of the warrants exceeded the Company's average stock price for the period, the warrants are anti-dilutive and the entire number of warrants was also excluded from the diluted earnings per share calculation. For the six months ended June 30, 2013, all stock options, restricted stock and warrants are excluded in the diluted earnings per share calculation using the treasury stock method because of their anti-dilutive effect.

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

**12. COMPREHENSIVE (LOSS) INCOME**

Comprehensive (loss) income was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(In thousands)			
Net (loss) income	\$ 3,440	\$ 8,514	\$ (610)	\$ 15,207
Foreign currency translation adjustment	1,357	(11,005)	(5,423)	(4,158)
Change in unrealized gain on derivatives, net of tax	451	(241)	747	(136)
Pension liability adjustment, net of tax	69	2	69	(2)
Comprehensive (loss) income	<u>\$ 5,317</u>	<u>\$ (2,730)</u>	<u>\$ (5,217)</u>	<u>\$ 10,911</u>

Changes in Accumulated Other Comprehensive Income by component between December 31, 2012 and June 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	160	69	(5,423)	(5,194)
Amounts reclassified from accumulated other comprehensive income	(587)	—	—	(587)
Net current-period other comprehensive income (loss)	747	69	(5,423)	(4,607)
Ending balance	<u>\$ (1,626)</u>	<u>\$ (1,085)</u>	<u>\$ (6,693)</u>	<u>\$ (9,404)</u>

The reclassification adjustments out of Accumulated Other Comprehensive (Loss) Income during the three and six months ended June 30, 2013 were as follows:

Details about Accumulated Other Comprehensive Income Components	Three Months Ended June 30, 2013		Affected Line Item in the Statement where Net Income (loss) is Presented
	Amount Reclassified from Accumulated Other Comprehensive Income		
	(In thousands)		
Gains and losses on cash flow hedges			
Interest rate swap	\$	(506)	Interest (expense)
Foreign currency forwards		—	Cost of goods sold
		(506)	Total before tax
		218	Tax (expense) or benefit
	<u>\$</u>	<u>(288)</u>	Net of tax

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

Details about Accumulated Other Comprehensive Income Components	Six Months Ended June 30, 2013 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	\$ (996)	Interest (expense)
Foreign currency forwards	(34)	Cost of goods sold
	(1,030)	Total before tax
	443	Tax (expense) or benefit
	<u>\$ (587)</u>	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.

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

Net sales and profit by reportable segment for the three and six months ended June 30, 2013 and 2012 and three months ended March 31, 2013 and 2012 are as follows:

	Three Months Ended March 31,		Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012	2013	2012
(In thousands)						
<b>Segment Net Sales</b>						
U.S. Neurosurgery	\$ 38,996	\$ 40,183	\$ 41,767	\$ 42,324	\$ 80,763	\$ 82,507
U.S. Instruments	36,948	37,994	39,991	41,269	76,939	79,263
U.S. Extremities	31,361	26,587	33,538	32,048	64,899	58,635
U.S. Spine and Other	43,548	44,810	42,962	48,823	86,510	93,633
International	45,799	46,611	47,289	45,706	93,088	92,317
Total revenues	\$ 196,652	\$ 196,185	\$ 205,547	\$ 210,170	\$ 402,199	\$ 406,355
<b>Segment Profit</b>						
U.S. Neurosurgery	\$ 16,904	\$ 21,156	\$ 19,786	\$ 21,890	\$ 36,690	\$ 43,046
U.S. Instruments	9,312	10,067	11,206	11,982	20,518	22,049
U.S. Extremities	10,734	9,183	13,225	13,305	23,959	22,488
U.S. Spine and Other	13,183	13,533	12,284	13,862	25,467	27,395
International	12,654	17,465	14,350	13,441	27,004	30,906
Segment profit	62,787	71,404	70,851	74,480	133,638	145,884
Amortization	(3,551)	(4,720)	(3,073)	(4,647)	(6,624)	(9,367)
Corporate and other	(59,280)	(49,217)	(59,800)	(51,812)	(119,080)	(101,029)
Operating (loss) income	\$ (44)	\$ 17,467	\$ 7,978	\$ 18,021	\$ 7,934	\$ 35,488

The segment profits for the U.S. Instruments and U.S. Extremities segments, and Corporate and Other for the three and six months ended June 30, 2012 have been revised. The segment profits for the U.S. Instruments and U.S. Extremities segments for the three months ended March 31, 2013 and 2012 have been also revised.

Revenue by major product category consisted of the following:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
(In thousands)				
Orthopedics	\$ 91,434	\$ 95,695	\$ 181,694	\$ 181,847
Neurosurgery	68,459	67,775	131,644	133,832
Instruments	45,654	46,700	88,861	90,676
Total Revenues	\$ 205,547	\$ 210,170	\$ 402,199	\$ 406,355

The Company attributes revenues to geographic areas based on the location of the customer. There are certain revenues that the various U.S. segments manage that are generated from non-U.S. customers and therefore are included in Europe and the Rest of World revenues below. Total revenue by major geographic area consisted of the following:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
(In thousands)				
United States	\$ 157,166	\$ 163,483	\$ 307,185	\$ 312,157
Europe	23,776	22,884	47,393	46,552
Rest of World	24,605	23,803	47,621	47,646
Total Revenues	\$ 205,547	\$ 210,170	\$ 402,199	\$ 406,355

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

**14. COMMITMENTS AND CONTINGENCIES**

In consideration for certain technology, manufacturing, distribution, and selling rights and licenses granted to the Company, the Company has agreed to pay royalties on sales of certain products that we sell. The royalty payments that the Company made under these agreements were not significant for any of the periods presented.

The Company is subject to various claims, lawsuits and proceedings in the ordinary course of the Company's business, including claims by current or former employees, distributors and competitors and with respect to its products and product liability claims, lawsuits and proceedings, some of which have been settled by the Company. In the opinion of management, such claims are either adequately covered by insurance or otherwise indemnified, or are not expected, individually or in the aggregate, to result in a material adverse effect on our financial condition. However, it is possible that the Company's results of operations, financial position and cash flows in a particular period could be materially affected by these contingencies.

On June 6, 2012, the Company was contacted by the United States Attorney's Office for the District of New Jersey regarding the activities of sales representatives in a single region within our Extremities Reconstruction division. The U.S. Attorney's Office is investigating the activities of three sales representatives, one of whom was a supervisor until terminated by the Company for failure to cooperate with this investigation. The activities at issue pertain to alleged improper billing of products for extremities indications. The Company is cooperating with the United States Attorney's Office on a voluntary basis and is not a subject or target of an investigation at this time.

The Company accrues for loss contingencies when it is deemed probable that a loss has been incurred and that loss is estimable. The amounts accrued are based on the full amount of the estimated loss before considering insurance proceeds, and do not include an estimate for legal fees expected to be incurred in connection with the loss contingency. The Company consistently accrues legal fees expected to be incurred in connection with loss contingencies as those fees are incurred by outside counsel as a period cost.

**15. SUBSEQUENT EVENTS**

On July 1, 2013, the Company entered into a Lease Agreement with 109 Morgan Lane, LLC (the "Landlord") (the "Lease"). The Lease terminates and replaces the prior lease between the Company and the Landlord dated May 15, 2008, as amended. The Company is leasing approximately 58,011 square feet located at 109 Morgan Lane, Plainsboro, New Jersey (the "Premises") for general office, labs (research & development and/or product development), manufacturing and warehouse purposes. The term of the Lease is 20 years from July 1, 2013 to June 30, 2033 with a 5 year renewal option. The rent for the Premises is \$585.9 thousand per year, with monthly rent payments of \$48.8 thousand. Additional payments are also required to be made by the Company to the Landlord consisting of \$290.1 thousand per year, with monthly payments of \$24.2 thousand for taxes and operating expenses as well as other charges. In addition, pursuant to the Lease, the Landlord agreed to pay the Company (i) \$40.0 thousand of the total cost to replace the existing roof on the building and (ii) \$100.0 thousand of the total cost to replace all of the existing windows in the building.

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and the related notes thereto appearing elsewhere in this report and our consolidated financial statements for the year ended December 31, 2012 included in our Annual Report on Form 10-K.

We have made statements in this report which constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 (the "Exchange Act"). These forward-looking statements are subject to a number of risks, uncertainties and assumptions about the Company. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of many factors, including but not limited to those set forth above under the heading "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2012 and under the heading "Risk Factors" in this Report. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

You can identify these forward-looking statements by forward-looking words such as "believe," "may," "could," "will," "estimate," "continue," "anticipate," "intend," "seek," "plan," "expect," "should," "would" and similar expressions in this report.

**GENERAL**

Integra is a world leader in medical devices focused on limiting uncertainty for surgeons so they can concentrate on providing the best patient care. Integra provides customers with clinically relevant, innovative and cost-effective products that improve

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the quality of life for patients. We focus on cranial and spinal procedures, small bone and joint injuries, the repair and reconstruction of soft tissue, and instruments for surgery.

We manage our business through a combination of product groups and geography, and accordingly, we report our financial results under five reportable segments - U.S. Instruments, U.S. Neurosurgery, U.S. Extremities, U.S. Spine and Other (which consists of our U.S. Spine and Private Label businesses) and International.

We present revenues in the following three product categories: Orthopedics, Neurosurgery and Instruments. Our orthopedics product group includes specialty metal implants for surgery of the extremities, shoulder and spine, orthobiologics products for repair and grafting of bone, dermal regeneration products and tissue-engineered wound dressings and nerve and tendon repair products. Our neurosurgery product group includes, among other things, dural grafts that are indicated for the repair of the dura mater, ultrasonic surgery systems for tissue ablation, cranial stabilization and brain retraction systems, systems for measurement of various brain parameters and devices used to gain access to the cranial cavity and to drain excess cerebrospinal fluid from the ventricles of the brain. Our instruments product group includes a wide range of specialty and general surgical and dental instruments and surgical lighting for sale to hospitals, outpatient surgery centers, and physician, veterinarian and dental practices.

We manufacture many of our products in plants located in the United States, Puerto Rico, France, Germany, Ireland, the United Kingdom and Mexico. We also source most of our handheld surgical instruments and specialty metal and pyrocarbon implants through specialized third-party vendors.

In the United States, we have several sales channels. We sell orthopedics products through a large direct sales organization and through specialty distributors focused on their respective surgical specialties. Neurosurgery products are sold through directly employed sales representatives. Instruments products are sold through two sales channels, both directly and through distributors and wholesalers, depending on the customer call point. We sell in the international markets through a combination of a direct sales organization and distributors.

We also market certain products through strategic partners in the United States.

Our objective is to become a multi-billion dollar diversified global medical technology company that (i) helps patients by limiting uncertainty for medical professionals and (ii) is a high-quality investment for shareholders. We will achieve these goals by delivering on our Brand Promises to our customers worldwide and by becoming a top player in all markets in which we compete. Our strategy includes the following key elements: geographic expansion, disciplined focus and execution, global quality assurance and acquiring or in-licensing products that fit existing sales channels, margin expansion and leveraging platform synergies.

We aim to achieve growth in our revenues while maintaining strong financial results. While we pay attention to any meaningful trend in our financial results, we pay particular attention to measurements that are indicative of long-term profitable growth. These measurements include (1) revenue growth (including internal growth and by acquisitions), (2) gross margins on total revenues, (3) operating margins (which we aim to expand as we leverage our existing infrastructure and improve our quality systems), (4) earnings before interest, taxes, depreciation, and amortization, and (5) earnings per diluted share of common stock.

We believe that we are particularly effective in the following aspects of our business:

- *Regenerative Medicine Platform.* We have developed numerous product lines through our proprietary collagen matrix and demineralized bone matrix technologies that are sold through every one of our sales channels.
- *Diversification and Platform Synergies.* Each of our three selling platforms contributes a different strength to our core business. Orthopedics enables us to grow our top line and increase gross margins. Neurosurgery provides stable growth as a market with few elective procedures. The Instruments business has a strong capacity to generate cash flows. We have unique synergies among these platforms, such as our regenerative medicine technology, instrument sourcing capabilities, and Group Purchasing Organization (“GPO”) contract management.
- *Unique Sales Footprint.* Our sales footprint provides us with a unique set of customer call-points and synergies. Each of our sales channels can benefit from the GPO and Integrated Delivery Network (“IDN”) relationships that our Instruments group manages. We have market-leading products for neurosurgeons, many of whom also perform spine surgeries, and we have yet to fully leverage those relationships to sell our spine products. We also have clinical expertise across all of our channels in the United States, and have an opportunity to expand and leverage this expertise in markets worldwide.

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- *Ability to Change and Adapt.* Our corporate culture is truly what enables us to adapt and reinvent ourselves. We have demonstrated that we can quickly and profitably integrate new products and businesses. This core strength has made it possible for us to grow over the years, and is key to our ability to grow into a multi-billion dollar company.

**ACQUISITIONS**

We did not complete any acquisitions during the second quarter of 2013.

**RESULTS OF OPERATIONS**

**Executive Summary**

Net income for the three months ended June 30, 2013, was \$3.4 million, or \$0.12 per diluted share as compared with net income of \$8.5 million or \$0.30 per diluted share for the three months ended June 30, 2012.

Net loss for the six months ended June 30, 2013 was \$0.6 million, or \$0.02 per diluted share as compared with net income of \$15.2 million or \$0.53 per diluted share for the six months ended June 30, 2012.

The results of operations for the three and six months ended June 30, 2013 were adversely affected by a voluntary recall of certain collagen-based products manufactured in our Añasco, Puerto Rico facility. Increases in the sales returns reserve and product shortages caused by the recall led to revenue and margin reductions. We also incurred incremental expenses related to the recall, including scrap of finished good products that were not released to customers and work in process, legal and consulting costs, and expenses for remediation of our quality systems. Additionally, our expenses were impacted by higher selling, general and administration headcount, increased consulting fees and expenses incurred in connection with the implementation of our global ERP system.

The effects of the recall noted above were offset by a decrease in our interest expense as a result of the June 2012 repayment of our 2012 Notes and capitalization of a portion of our interest expense into the cost of our capital projects.

Income before taxes includes the following special charges:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(In thousands)		(In thousands)	
Global ERP implementation charges	\$ 7,616	\$ 3,607	\$ 13,765	\$ 7,276
Facility optimization charges	2,262	2,984	5,670	4,620
Manufacturing facility remediation costs	2,963	1,770	5,088	3,405
Certain expenses associated with product recalls	165	—	1,444	—
Certain employee termination charges	—	—	—	501
Discontinued product lines charges	—	—	—	835
Acquisition-related charges	286	1,019	674	1,721
Impairment charges	—	—	—	141
Convertible debt non-cash interest	1,622	2,969	3,232	6,497
Total	\$ 14,914	\$ 12,349	\$ 29,873	\$ 24,996

The items reported above are reflected in the condensed consolidated statements of operations as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(In thousands)		(In thousands)	
Cost of goods sold	\$ 4,371	\$ 3,685	\$ 8,872	\$ 8,229
Selling, general and administrative	8,921	5,695	17,769	10,270
Interest expense	1,622	2,969	3,232	6,497
Total	\$ 14,914	\$ 12,349	\$ 29,873	\$ 24,996

We typically define special charges as items for which the amounts and/or timing of such expenses may vary significantly from period to period, depending upon our acquisition, integration and restructuring activities, and for which the amounts are non-

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cash in nature, or for which the amounts are not expected to recur at the same magnitude as we implement certain tax planning strategies. We believe that given our ongoing strategy of seeking acquisitions, our continuing focus on rationalizing our existing manufacturing and distribution infrastructure and our continuing review of various product lines in relation to our current business strategy, certain of the special charges discussed above could recur with similar materiality in the future. In 2010 we began investing significant resources in the global implementation of a single enterprise resource planning system. We began capitalizing certain costs for the project starting in 2011.

We believe that the separate identification of these special charges provides important supplemental information to investors regarding financial and business trends relating to our financial condition and results of operations. Investors may find this information useful in assessing comparability of our operating performance from period to period, the business model objectives that management has established, and other companies in our industry. We provide this information to investors so that they can analyze our operating results in the same way that management does and to use this information in their assessment of our core business and valuation of Integra.

### **Update on Remediation Activities**

Remediation activities in our regenerative medicine facility in Plainsboro, New Jersey affected revenues and gross margin in the first and second quarters of 2013. We received a warning letter from the FDA in December 2011, related to quality systems and compliance issues at that plant. The letter resulted from an inspection held at that facility in August 2011, and did not identify any new observations that were not provided in the Form 483 that followed the inspection. The warning letter did not restrict our ability to manufacture or ship products, nor did it require the recall of any product. In June and July 2012, the FDA again inspected the regenerative medicine facility. The second inspection closed out on July 30, 2012 and a FDA Form 483 Inspectional Observations was issued. We have been addressing the Form 483 observations, warning letter citations and communicating with the FDA on a monthly basis. Our efforts with respect to closing out the warning letter are well along. On July 16, 2013, the FDA began an inspection of the Plainsboro facility. At this point, the inspection remains in progress.

The FDA inspected our neurosurgery manufacturing facility in Andover, England in June 2012. Subsequently, on November 5, 2012, we received a warning letter from the FDA dated November 1, 2012 related to quality systems issues at the Andover manufacturing facility. The warning letter identified violations related to corrective and preventative actions, process validations, internal quality audits, and internal review of the suitability and effectiveness of the quality system at defined intervals. We filed the FDA warning letter as an exhibit to a Current Report on Form 8-K on November 13, 2012. Since the conclusion of the FDA inspection in June 2012, we have undertaken significant efforts to remediate the observations that the FDA has made and continue to do so. We are providing the FDA with monthly status reports and working cooperatively with the FDA to resolve any outstanding issues.

On February 14, 2013, we received a warning letter from the FDA relating to quality systems issues at our manufacturing facility located in Añasco, Puerto Rico. The letter resulted from an inspection conducted at that facility during October and November 2012. On February 15, 2013 we stopped distribution of our collagen products manufactured in the Añasco facility in order to confirm that we had successfully validated all such products and engaged a third-party consultant having appropriate quality system regulations expertise to confirm such validations. On February 22, 2013 the third-party consultant certified the completeness of such validations and we resumed distribution of collagen products from the Añasco facility.

On April 10, 2013, we initiated a voluntary recall of certain products manufactured in our Añasco facility between December 2010 and May 2011 and between November 2012 and March 2013. Specific lots of these products, as described below, have been recalled because we identified that there may have been deviations from required processes in their production. We identified through an internal quality assurance review that we may have deviated from a production process during the manufacture of specific lots of collagen products during the periods described. The product lots in question passed all product finished goods testing including endotoxin testing, are sterile, and were tested and accepted for release. However, due to the process deviation, they may have been released with higher levels of endotoxins than permitted by the product specifications. Higher levels of endotoxins may result in a fever in the immediate postoperative period. There have been no reports of patient injuries or other adverse events attributable to the products subject to the recall. We continue to manufacture all such products in our Añasco facility.

We believe that most of the recalled product lots manufactured between December 2010 and May 2011 have already been consumed, and that therefore, the recall of those lots will not have a material financial impact. However, the return of products, manufactured between November 2012 and March 2013, which were substantially sold in the first three months ended March 31, 2013, directly reduced revenues in the six months ended June 30, 2013 by \$3.1 million. As we anticipated, we were not able to produce all the affected products quickly enough to meet the demand from customers in the three months ended June 30, 2013. Such supply shortages resulted in lower revenues in the first six months of 2013 and will result in lower revenues for

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the third quarter of 2013 than previously forecasted. As expected, the recall and supply shortages had a significant impact on the U.S. Neurosurgery, U.S. Spine and Other, and International segments during the first six months of 2013.

The recall applies to limited and specific lots of DuraGen® Dural Graft Matrix, DuraGen® Plus Dural Regeneration Matrix, DuraGen® Suturable Dural Regeneration Matrix, DuraGen XS™ Dural Regeneration Matrix, Layershield® Adhesion Barrier Matrix, NeuraWrap™ Nerve Protector, NeuraGen® Nerve Guide, BioMend® Absorbable Collagen Membrane, OraMem® Absorbable Collagen Membrane, BioMend® Extend Absorbable Collagen Membrane, CollaCote® Absorbable Collagen Wound Dressing for Dental Surgery, CollaTape® Absorbable Collagen Wound Dressing for Dental Surgery, CollaPlug® Absorbable Collagen Wound Dressing for Dental Surgery, HeliTape® Absorbable Collagen Wound Dressing for Dental Surgery, HeliPlug® Absorbable Collagen Wound Dressing for Dental Surgery, OraTape® Absorbable Collagen Wound Dressing for Dental Surgery, OraPlug® Absorbable Collagen Wound Dressing for Dental Surgery, Instat® Microfibrillar Collagen Hemostat, Helistat® Absorbable Collagen Hemostatic Sponge (ACS/Helistat), and Helitene® Absorbable Collagen Hemostatic Agent. The Absorbable Collagen Sponge (ACS) is not a final product, but a component of a product assembled by another company.

We met with the Office of Compliance at the Center for Devices and Radiological Health on March 26, 2013. We presented our plans for both immediate remediation and our corporate plan for the development and implementation of a single Quality System for the entire Company. We have engaged former FDA professionals as third party consultants to work with us on our remediation plans. We also met with the Office of Compliance at the FDA San Juan, Puerto Rico office to discuss the remediation plans at the Añasco facility. We have prioritized senior level quality and regulatory staff to address the quality system improvement plans at all of our facilities.

We have undertaken significant efforts to remediate the observations that the FDA has made and have been working on improving and revising our quality systems. During the three and six months ended June 30, 2013, we incurred \$3.0 million and \$5.1 million in remediation activities expenses, respectively, consisting of consulting expenses and other work activities required to complete our remediation activities. For the full year 2013, we expect to spend approximately \$7.0 million on our quality systems and expect to have these activities completed in the second half of 2013. We will provide periodic status reports to the FDA and work cooperatively with the agency to resolve any outstanding issues.

**Revenues and Gross Margin on Product Revenues**

Our revenues and gross margin on product revenues were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
<i>Segment Net Sales</i>	(In thousands)		(In thousands)	
U.S. Neurosurgery	\$ 41,767	\$ 42,324	\$ 80,763	\$ 82,507
U.S. Instruments	39,991	41,269	76,939	79,263
U.S. Extremities	33,538	32,048	64,899	58,635
U.S. Spine and Other	42,962	48,823	86,510	93,633
International *	47,289	45,706	93,088	92,317
Total revenue	205,547	210,170	402,199	406,355
Cost of goods sold	83,068	78,274	163,336	152,949
Gross margin on total revenues	\$ 122,479	\$ 131,896	\$ 238,863	\$ 253,406
Gross margin as a percentage of total revenues	59.6%	62.8%	59.4%	62.4%

\* The Company attributes revenue to geographic areas based on the location of the customer. There are certain revenues managed by the various U.S. segments above that are generated from non-U.S. customers and therefore included in Europe and the Rest of World revenues.

**Three Months Ended June 30, 2013 as Compared to Three Months Ended June 30, 2012**

**Revenues and Gross Margin**

For the three months ended June 30, 2013, total revenues decreased by \$4.7 million to \$205.5 million from \$210.2 million for the same period in 2012.

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Our total revenues were negatively affected by our voluntary recall of certain products manufactured in our Añasco, Puerto Rico facility, including DuraGen® Dural Graft Matrix products. Although we continue to manufacture all the affected products in, and distribute from, our Añasco facility, the recall caused significant supply disruptions resulting in a decrease in our worldwide revenue and a larger than usual total backorder at the end of the current quarter. The Company expects to resolve most of these disruptions by the end of 2013, but there can be no assurance the Company will not lose some customers or that backorder levels will return to normal by the end of the year.

U.S. Neurosurgery revenues were \$41.8 million, a decrease of 1% from the prior-year period. The decrease continues to be directly related to our collagen product shortages caused by the recall. Tissue ablation sales also decreased on a strong comparison from the prior year period, but strong growth in neuro critical care, cranial stabilization and sterotaxy partly offset these decreases. Overall sales of neuro capital products were relatively flat.

U.S. Instruments revenues were \$40.0 million, a decrease of 3% from the prior-year period. In the quarter, we saw mid-single digit growth in our acute care sales channel as a result of several large orders for hospital starts. We continued to experience sustained growth in sales of our LED surgical headlamp, which was offset by lower sales of our legacy xenon lighting products. In addition, we experienced softness in our alternate site sales resulting from pricing pressures and discontinuation of some of our lower margin products.

U.S. Extremities revenues were \$33.5 million, an increase of 5% from the prior-year period. This increase resulted primarily from mid-single digit growth in sales of our regenerative products compared to the prior year period when sales of such products were unusually high following the elimination of a significant backorder. We also saw low single digit growth in both our upper and lower extremities businesses, driven by new product introductions, including pyrocarbon implants.

U.S. Spine and Other revenues, which include our spine hardware, orthobiologics and private label products, were \$43.0 million, a 12% decrease from the prior-year period. In addition to general market softness and pricing pressure, our spine hardware product sales declined more than the market because of poor execution in the business and some distributor turnover. We have identified the issues impacting our performance and have plans in place to return to market performance by the end of the year. Orthobiologics sales were flat because of backorders in collagen ceramic bone void fillers. Sales growth in the rest of the portfolio offset much of this decrease, and demand for the overall orthobiologics line remains strong. Sales of our private label products were down significantly from the prior-year period due to the recall-related supply shortage and declining sales of absorbable collagen sponges to our important customers.

International segment revenues were \$47.3 million, an increase of 4% from the prior-year period. Our sales around the world were affected by the recall of our collagen products and backorders on these recalled products. We saw double digit growth in our spine implants and mid-single digit growth in neurosurgery products. Foreign currency had a negligible impact on our sales in the current quarter.

Gross margin decreased 7% to \$122.5 million for the three-month period ended June 30, 2013 from \$131.9 million for the same period last year. Gross margin as a percentage of total revenue decreased to 59.6% for the second quarter of 2013 from 62.8% for the same period last year. The decrease in gross margin percentage resulted primarily from product mix, increased validation and remediation costs related to improving quality systems at our manufacturing facilities and the impact of the 2.3% manufacturer's excise tax that we capitalize in our inventory and subsequently record in cost of goods sold as these products are sold to third-party customers.

We expect our consolidated gross margin percentage for the full year 2013 to be between 60% and 61%, down compared to 2012. Costs related to the expansion of our regenerative medicine activities, continued downward pressure on our private-label and spine hardware product sales volumes, and the inclusion of the medical device tax will negatively affect our consolidated gross margin.

### **Operating Expenses**

The following is a summary of operating expenses as a percent of total revenues:

	Three Months Ended June 30,	
	2013	2012
Research and development	5.7%	6.2%
Selling, general and administrative	48.5%	45.7%
Intangible asset amortization	1.5%	2.2%
Total operating expenses	55.7%	54.1%

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Total operating expenses, which consist of research and development expenses, selling, general and administrative expenses, and amortization expense, increased \$0.6 million, or 1%, to \$114.5 million in the three months ended June 30, 2013, compared to \$113.9 million in the same period last year.

Research and development expenses in the second quarter of 2013 decreased \$1.3 million compared to the same period last year due to lower product development spending. We target full-year 2013 spending on research and development to be approximately 6.0% of total revenues.

Selling, general and administrative expenses in the second quarter of 2013 increased by \$3.5 million to \$99.6 million compared to \$96.1 million in the same period last year. Selling and marketing expenses increased by \$1.3 million, primarily resulting from a higher headcount of our sales force in Europe and marketing and logistic groups in the United States. General and administrative costs were up \$2.2 million, primarily because of higher expenses incurred in connection with the implementation of our global ERP system and consulting costs to support various strategic projects. Our prior year general and administrative expenses included \$1.1 million of expenses to terminate an exclusive product distribution agreement with a former distributor in China.

Amortization expense in the second quarter of 2013 was \$3.1 million compared to \$4.6 million in the same period last year. The decrease is primarily due to certain intangible assets becoming fully amortized in 2013.

### Non-Operating Income and Expenses

The following is a summary of non-operating income and expenses:

	Three Months Ended June 30,	
	2013	2012
	(In thousands)	
Interest income	\$ 289	\$ 415
Interest expense	(4,965)	(7,103)
Other income (expense)	(307)	236

### Interest Income and Interest Expense

Interest income decreased in the three months ended June 30, 2013, because the Company no longer holds any short-term investments in time deposit accounts held outside the United States as it did in the prior-year period.

Interest expense in the three months ended June 30, 2013 decreased by \$2.1 million primarily as a result of the June 2012 repayment of our 2012 Senior Convertible Notes, which decreased our interest expense by \$1.9 million. In addition, we also capitalized \$0.7 million of interest expense on our qualified construction in progress balances. This amount was offset by an additional \$0.5 million of higher interest because of increased borrowing on our revolving line of credit. Our reported interest expense for the three-month periods ended June 30, 2013 and 2012 includes non-cash interest related to the accounting for convertible securities of \$1.6 million and \$3.0 million, respectively.

### Other Income (Expense)

Other expense for the second quarter of 2013 was primarily attributable to foreign exchange losses on intercompany balances.

### Income Taxes

	Three Months Ended June 30,	
	2013	2012
	(In thousands)	
Income before income taxes	\$ 2,995	\$ 11,569
Income tax (benefit) expense	(445)	3,055
Effective tax rate	(14.9)%	26.4%

Our effective income tax rates for the three months ended June 30, 2013 and 2012 were (14.9)% and 26.4%, respectively. For the three months ended June 30, 2013, the reduction in the income tax rate compared to the same period in 2012 was primarily

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the result of a change in the jurisdictional mix of worldwide pretax income and the establishment of the Irish research and development credit. During the quarter, we were granted an Irish research and development credit for 2011 and 2012 that resulted in a benefit of \$0.5 million. Also, in the current quarter, we recorded a benefit of \$0.8 million for the release of uncertain tax positions due to the expiration of the statute of limitations in certain state jurisdictions, which is offset by an expense of \$0.3 million for the establishment of additional non-U.S. tax contingency reserves.

We expect our effective income tax rate for the full year to be approximately 4.5% due, in part, to foreign earnings taxed at lower tax rates, the release of a tax contingency reserve, and the benefit from the Federal research credit. This estimate could be revised in the future as additional information is presented to us.

The effective tax rate may vary from period to period depending on, among other factors, the geographic and business mix of taxable earnings and losses, tax planning and settlements with the various taxing authorities. We consider these factors and others, including our history of generating taxable earnings, in assessing our ability to realize deferred tax assets on a quarterly basis.

While it is often difficult to predict the final outcome or the timing of resolution of any particular matter with the various Federal, state and foreign tax authorities, we believe that our reserves reflect the most probable outcome of known tax contingencies. Settlement of any particular issue would usually require the use of cash. Favorable resolution would be recognized as a reduction to our annual effective tax rate in the year of resolution. The tax reserves are presented in the balance sheet within other liabilities, except for amounts relating to items we expect to pay in the coming year which are classified as current income taxes payable.

### **Six Months Ended June 30, 2013 as Compared to Six Months Ended June 30, 2012**

#### **Revenues and Gross Margin**

For the six-month period ended June 30, 2013, total revenues decreased by \$4.2 million or 1%, to \$402.2 million from \$406.4 million during the prior-year period.

Our total revenues for the six-month period ended June 30, 2013, were negatively affected by our voluntary recall of certain products manufactured in our Añasco, Puerto Rico facility, including DuraGen® Dural Graft Matrix products.

U.S. Neurosurgery revenues were \$80.8 million, a decrease of 2% from the prior year. The decrease was directly related to our collagen product shortages caused by the recall. Capital sales were up mid to high single digits as we saw growth in our critical care, cranial stabilization and stereotaxy lines. This growth was partly offset by a decrease in tissue ablation sales on a strong comparison from the prior period. Our disposable product sales grew to mid-single digits.

U.S. Instruments revenues were \$76.9 million, a decrease of 3% from the prior year. We saw lower sales of our legacy lighting products due to some product discontinuation and conversion of the legacy xenon lighting products to LED lighting. We saw growth in our acute care sales channel as a result of several large orders for hospital starts. These increases were offset by softness in our alternate sites sales due to pricing pressures and product discontinuation of some of our lower margin products.

U.S. Extremities revenues were \$64.9 million, an increase of 11% from the prior year. This low-double digit growth resulted primarily from significant increases in sales of our dermal and wound care products. We also saw low-double digit growth in both our upper and lower extremities businesses, driven by new product introductions, including pyrocarbon implants.

U.S. Spine and Other revenues, which include our spine hardware, orthobiologics and private label products, were \$86.5 million, a decrease of 8% from the prior year. In addition to general market softness and pricing pressure, our spine hardware product sales declined more than the market because of poor execution in the business and some distributor turnover. We have identified the issues impacting our performance and have plans in place to return to market performance by the end of the year. Orthobiologics sales were flat because of backorders in collagen ceramic bone void fillers. We expect supply to return to normal levels by the end of the third quarter. Sales growth in the rest of the portfolio offset much of this decrease, and demand for the overall orthobiologics line remains strong. Sales of our private label products were down significantly from the prior-year period due to the recall-related supply shortage.

International segment revenues were \$93.1 million, an increase of 1% from prior year. Our sales around the world were affected by the recall of our collagen products and backorders on these recalled products. We saw growth in our spine implants and dermal and wound businesses with several new product introductions and increasing product coverage in direct and indirect channels. We experienced growth in Asia-Pacific and Latin America markets for our duraplasty products not affected by the recall. Foreign currency unfavorably impacted our sales by \$0.4 million.

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Gross margin decreased 6% to \$238.9 million for the six-month period ended June 30, 2013 from \$253.4 million for the same period last year. Gross margin as a percentage of total revenue decreased to 59.4% for the first six months of 2013 from 62.4% for the same period last year. The decrease in gross margin percentage resulted primarily from increases in reserves related to inventory associated with the recall and increased spending and remediation costs related to improving quality systems and validation processes at our manufacturing facilities. Finally, in January, we began paying the manufacturer's excise tax imposed on the first sale of certain medical devices in the United States. We elected to capitalize the excise tax in inventory and subsequently record in cost of goods sold as these products are sold to third-party customers, which had the impact of decreasing our gross margin by 0.5%.

**Operating Expenses**

The following is a summary of operating expenses as a percent of total revenues:

	Six Months Ended June 30,	
	2013	2012
Research and development	6.1%	6.2%
Selling, general and administrative	49.7%	45.2%
Intangible asset amortization	1.6%	2.3%
Total operating expenses	57.4%	53.7%

Total operating expenses, which consist of research and development expenses, selling, general and administrative expenses and amortization expense, increased \$13.0 million, or 6%, to \$230.9 million in the six months of 2013, compared to \$217.9 million in the same period last year.

Research and development expenses in the six months of 2013 decreased slightly compared to the same period last year due to lower spending on product development.

Selling, general and administrative expenses in the six months of 2013 increased by \$16.3 million to \$199.8 million compared to \$183.5 million in the same period last year. Selling and marketing expenses increased by \$8.4 million primarily resulting from higher headcount. Additionally, U.S. Extremities' commission costs were higher as a result of increases in revenue. General and administrative costs were up \$7.9 million primarily because of higher headcount, increased expenses incurred in connection with the implementation of our global ERP system, and consulting costs to support various strategic projects.

Amortization expense in the first six months of 2013 decreased by \$2.8 million to \$6.6 million, compared to \$9.4 million in the same period last year. The decrease is primarily due to certain intangible assets becoming fully amortized in the first half of 2013.

**Non-Operating Income and Expenses**

The following is a summary of non-operating income and expenses:

	Six Months Ended June 30,	
	2013	2012
	(In thousands)	
Interest income	\$ 352	\$ 793
Interest expense	(9,765)	(15,032)
Other income (expense)	(1,281)	(87)

**Interest Income and Interest Expense**

Interest income decreased in the six-month period ended June 30, 2013, because the Company no longer holds any short-term investments in time deposit accounts held outside the United States as it did in the prior year period.

Interest expense in the six-month period ended June 30, 2013 decreased by \$5.3 million primarily as a result of the June 2012 repayment of our 2012 Senior Convertible Notes, which decreased our interest expense by \$4.9 million. In addition, we capitalized \$1.4 million of interest expense on our qualified construction in progress balances. This amount was offset by an

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additional \$1.0 million of higher interest because of increased borrowing on our revolving line of credit. Furthermore, the amount of our 2016 Notes discount amortization increased by \$0.2 million as expected when using the effective interest method for its amortization in the six month period ended June 30, 2012. Our reported interest expense for the six-month periods ended June 30, 2013 and 2012 includes non-cash interest related to the accounting for convertible securities of \$3.2 million and \$6.5 million, respectively.

**Other Income (Expense)**

Other expenses of \$1.3 million in 2013 were primarily attributable to a write off of \$1.5 million for a capital expenditure project not placed into service and by foreign exchange losses on intercompany balances.

**Income Taxes**

	Six Months Ended June 30,	
	2013	2012
	(In thousands)	
(Loss) income before income taxes	\$ (2,760)	\$ 21,162
Income tax (benefit) expense	(2,150)	5,955
Effective tax rate	77.9%	28.1%

The Company's effective income tax rates for the six months ended June 30, 2013 and 2012 were 77.9% and 28.1%, respectively. The change in year-to-date effective tax rates is attributable to the change in the mix in year-to-date worldwide pretax income, as well as a reduction in the estimated domestic manufacturing deduction caused by a change in U.S. taxable income for 2013. The year-to-date tax increase is offset by a benefit of \$1.2 million for the release of tax contingency reserves and a benefit of \$0.9 million for the extension of the Federal research credit and the establishment of the Irish research and development credit.

The effective tax rate may vary from period to period depending on, among other factors, the geographic and business mix of taxable earnings and losses, tax planning and settlements with the various taxing authorities. We consider these factors and others, including our history of generating taxable earnings, in assessing our ability to realize deferred tax assets on a quarterly basis.

While it is often difficult to predict the final outcome or the timing of resolution of any particular matter with the various Federal, state and foreign tax authorities, we believe that our reserves reflect the most probable outcome of known tax contingencies. Settlement of any particular issue would usually require the use of cash. Favorable resolution would be recognized as a reduction to our annual effective tax rate in the year of resolution. The tax reserves are presented in the balance sheet within other liabilities, except for amounts relating to items it expects to pay in the coming year which are classified as current income taxes payable.

We expect our effective income tax rate for the full year to be approximately 4.5%.

## GEOGRAPHIC PRODUCT REVENUES AND OPERATIONS

We attribute revenues to geographic areas based on the location of the customer. There are certain revenues that the various U.S. segments manage that are generated from non-U.S. customers and therefore included in Europe and the Rest of World revenues below – these revenues are not significant. Total revenue by major geographic area consisted of the following:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
	(In thousands)		(In thousands)	
United States	\$ 157,166	\$ 163,483	\$ 307,185	\$ 312,157
Europe	23,776	22,884	47,393	46,552
Rest of World	24,605	23,803	47,621	47,646
Total Revenues	<u>\$ 205,547</u>	<u>\$ 210,170</u>	<u>\$ 402,199</u>	<u>\$ 406,355</u>

Domestic revenues decreased 4% to \$157.2 million, or 76% of total revenues, for the three months ended June 30, 2013 from \$163.5 million, or 78% of total revenues, for the three months ended June 30, 2012. International revenues increased to \$48.4 million from \$46.7 million in the prior-year period, an increase of 4%. Foreign exchange rate fluctuations accounted for a \$0.1 million decrease in revenues during the second quarter of 2013 as compared to the same period last year.

Domestic revenues decreased by 2% to \$307.2 million, and were 76% of the total revenues, for the six months ended June 30, 2013 from \$312.2 million, or 77% of total revenues, for the six months ended 2012. International revenues increased by 1% to \$95.0 million. Foreign exchange rate fluctuations accounted for a \$0.4 million decrease in revenues during the six-month period ended June 30, 2013 as compared to the same period last year.

We generate significant revenues outside the United States, a portion of which are U.S. dollar-denominated transactions conducted with customers who generate revenue in currencies other than the U.S. dollar. As a result, currency fluctuations between the U.S. dollar and the currencies in which those customers do business could have an impact on the demand for our products in foreign countries.

Local economic conditions, regulatory compliance or political considerations, the effectiveness of our sales representatives and distributors, local competition and changes in local medical practice all may combine to affect our sales into markets outside the United States.

## LIQUIDITY AND CAPITAL RESOURCES

### Cash and Marketable Securities

We had cash and cash equivalents totaling approximately \$98.6 million and \$96.9 million at June 30, 2013 and December 31, 2012, respectively. At June 30, 2013, our non-U.S. subsidiaries held approximately \$82.4 million of cash and cash equivalents that are available for use by our operations outside of the United States. If these funds were repatriated to the United States, or used for United States operations, certain amounts could be subject to tax in the United States for the incremental amount in excess of the foreign tax paid.

### Cash Flows

	Six Months Ended June 30,	
	2013	2012
	(In thousands)	
Net cash provided by operating activities	\$ 10,764	\$ 34,594
Net cash used in investing activities	(26,775)	(69,358)
Net cash provided by (used in) financing activities	19,323	8,473
Effect of exchange rate fluctuations on cash	(1,614)	953
Net increase (decrease) in cash and cash equivalents	<u>\$ 1,698</u>	<u>\$ (25,338)</u>

In 2013, we anticipate that our principal uses of cash will include payments of the new medical device excise tax in a range of \$9 - \$12 million. We also plan to spend between \$55.0 million and \$65.0 million on capital expenditures primarily for our

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continued expansion of regenerative medicine manufacturing capacity, support maintenance in our existing plants, our enterprise resource planning system implementation, and additions to our instrument kits used in sales of orthopedic products.

### **Cash Flows Provided by Operating Activities**

We generated operating cash flows of \$10.8 million and \$34.6 million for the six months ended June 30, 2013 and 2012, respectively.

Operating cash flow was lower than the same period in 2012 largely because net income decreased by \$15.8 million for the six months ended June 30, 2013. Changes in working capital decreased cash flows by approximately \$22.2 million. Among the changes in working capital, accounts receivable used \$0.7 million of cash, inventory used \$24.0 million of cash, prepaid expenses and other current assets used \$0.6 million of cash, and accounts payable, accrued expenses and other current liabilities provided \$2.9 million of cash.

Net income for the six months ended June 30, 2012 plus non-cash items included in those earnings amounted to approximately \$50.8 million. The operating cash flows were largely impacted by the repayment of our convertible 2012 Notes of \$165 million, of which \$31.0 million was classified as an operating use of cash for the repayment of accreted interest.

### **Cash Flows Used in Investing Activities**

During the six months ended June 30, 2013, we paid \$24.5 million in cash for capital expenditures, most of which was directed to the expansion of our regenerative medicine production capacity and global enterprise system implementation. We also paid \$2.8 million for the acquisition of Tarsus Medical, Inc.

During the six months ended June 30, 2012, we paid \$24.6 million in cash for capital expenditures, most of which was directed to the expansion of our regenerative medicine production capacity and global enterprise system implementation. We had net purchases of \$41.8 million in short-term time deposit accounts, which are held outside of the United States.

### **Cash Flows Provided by Financing Activities**

Our principal sources of cash for financing activities in the six months ended June 30, 2013 were \$20.0 million of borrowings under our Senior Credit Facility offset by amendment costs of \$1.0 million.

Our principal uses of cash for financing activities in the six months ended June 30, 2012 were \$155.0 million of borrowings under our Senior Credit Facility offset by the repayment of the liability component of our convertible 2012 Notes of \$134.4 million and \$12.8 million of repayments under our Senior Credit Facility.

### **Working Capital**

At June 30, 2013 and December 31, 2012, working capital was \$368.4 million and \$346.1 million, respectively.

### **Amended and Restated Senior Credit Agreement**

On August 10, 2010, the Company entered into an amended and restated credit agreement (the "Senior Credit Facility") with a syndicate of lending banks and further amended the Senior Credit Facility on June 8, 2011 (the "2011 Amendment"). The 2011 Amendment increased the revolving credit component from \$450.0 million to \$600.0 million and eliminated the \$150.0 million term loan component that previously existed under the Senior Credit Facility, allows the Company to further increase the size of the revolving credit component by an aggregate of \$200.0 million with additional commitments, provides the Company with decreased borrowing rates and annual commitment fees, and provides more favorable financial covenants. The 2011 Amendment extended the Senior Credit Facility's maturity date from August 10, 2015 to June 8, 2016.

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 June 30, 2013, the Company was in compliance with all such covenants.

On May 11, 2012, the Company entered into another amendment to the Senior Credit Facility. The amendment modified certain financial and negative covenants as disclosed in Note 5 to the Financial Statements, the effect of which was to increase the Company's capacity to borrow.

On June 21, 2013, the Company entered into a second amendment to the Senior Credit Facility. The amendment provides for an increase to the Company's Maximum Consolidated Total Leverage Ratio and permits the addition of certain costs and expenses in the calculation of the consolidated EBIDTA as disclosed in Note 5 to the Financial Statements. There were no other changes as a result of the second amendment. In connection with the June 21, 2013 amendment, the Company capitalized \$1.0 million in incremental financing costs.

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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 ("net debt") to (b) consolidated EBITDA) at the time of the applicable borrowing. The Company will also pay 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.

We plan to utilize the Senior Credit Facility for working capital, capital expenditures, share repurchases, acquisitions, debt repayments and other general corporate purposes. At June 30, 2013 and December 31, 2012, there was \$341.9 million and \$321.9 million, respectively, outstanding under the Senior Credit Facility at a weighted average interest rate of 2.0% and 1.8%, respectively. 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.

At June 30, 2013, there was approximately \$258.1 million available, subject to certain limitations, for borrowing under the Senior Credit Facility.

### **Convertible Debt and Related Hedging Activities**

We pay interest each June 15 and December 15 on our \$230.0 million senior convertible notes due December 2016 ("2016 Notes") at an annual interest rate of 1.625%.

The 2016 Notes are senior, unsecured obligations of Integra, and are convertible into cash and, if applicable, shares of our 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). We expect to satisfy any conversion of the 2016 Notes with cash up to the principal amount pursuant to the net share settlement mechanism set forth in the respective indenture and, with respect to any excess conversion value, with shares of our common stock. The 2016 Notes are convertible only in the following circumstances: (1) if the closing sale price of our common stock exceeds 150% of the conversion price during a period as defined in the applicable 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 applicable 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 amounts, which is also the amount holders are entitled to receive at maturity if the 2016 Notes are not converted. None of these conditions existed with respect to the 2016 Notes; therefore the 2016 Notes are classified as long-term.

In connection with the issuance of the 2016 Notes, we entered into call transactions and warrant transactions, primarily with affiliates of the initial purchasers of the 2016 Notes (the "hedge participants"). The cost of the call transactions to us was approximately \$42.9 million for the 2016 Notes. We received approximately \$28.5 million of proceeds from the warrant transactions for the 2016 Notes. The call transactions involved our purchasing call options from the hedge participants, and the warrant transactions involved us selling call options to the hedge participants with a higher strike price than the purchased call options. The initial strike price of the call transactions is approximately \$57.44 for the 2016 Notes, subject to anti-dilution adjustments. The initial strike price of the warrant transactions is approximately \$70.05 for the 2016 Notes, in each case subject to customary anti-dilution adjustments.

We may from time to time seek to retire or purchase a portion of our outstanding 2016 Notes through cash purchases and/or exchanges for equity securities, in open market purchases, privately negotiated transactions or otherwise. Such repurchases or exchanges, if any, will depend on prevailing market conditions, our liquidity requirements, contractual restrictions and other factors. Under certain circumstances, the call options associated with any repurchased 2016 Notes may terminate early, but only with respect to the number of 2016 Notes that cease to be outstanding. The amounts involved may be material.

### **Share Repurchase Plan**

On October 23, 2012, our Board of Directors authorized a repurchase of up to \$75.0 million of outstanding common stock through December 2014. Shares may be repurchased either in the open market or in privately negotiated transactions. We repurchased no shares under this program during the first six months of 2013 and \$75.0 million remains available under the authorization.

### **Dividend Policy**

We have not paid any cash dividends on our common stock since our formation. Our Senior Credit Facility limits the amount of dividends that we may pay. Any future determinations to pay cash dividends on our common stock will be at the discretion of our Board of Directors and will depend upon our financial condition, results of operations, cash flows and other factors deemed relevant by the Board of Directors.

### **Capital Resources**

We believe that our cash and available borrowings under the Senior Credit Facility are sufficient to finance our operations and capital expenditures. The Company considers all such outstanding amounts to be long-term in nature based on its current intent and ability to repay the borrowings outside of the next twelve month period.

### **Off-Balance Sheet Arrangements**

There were no off-balance sheet arrangements during the six months ended June 30, 2013 that have or are reasonably likely to have, a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to our interests.

## **OTHER MATTERS**

### **Critical Accounting Estimates**

The critical accounting estimates included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012 have not materially changed.

### **Recently Issued Accounting Standards**

There have been no recently issued accounting standards that have an impact on our financial statements.

## **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

We are exposed to various market risks, including changes in foreign currency exchange rates and interest rates that could adversely affect our results of operations and financial condition. To manage the volatility relating to these typical business exposures, we may enter into various derivative transactions when appropriate. We do not hold or issue derivative instruments for trading or other speculative purposes.

### **Foreign Currency Exchange and Other Rate Risks**

We operate on a global basis and are exposed to the risk that changes in foreign currency exchange rates could adversely affect our financial condition, results of operations and cash flows. We are primarily exposed to foreign currency exchange rate risk with respect to transactions and net assets denominated in euros, Swiss francs, British pounds, Canadian dollars, Australian dollars and Japanese yen. We manage the foreign currency exposure centrally, on a combined basis, which allows us to net exposures and to take advantage of any natural offsets. To mitigate the impact of currency fluctuations on transactions denominated in nonfunctional currencies, we periodically enter into derivative financial instruments in the form of foreign currency exchange forward contracts with major financial institutions. We temporarily record realized and unrealized gains and losses on these contracts that qualify as cash flow hedges in other comprehensive income, and then recognize them in other income or expense when the hedged item affects net earnings.

From time to time, we enter into foreign currency forward exchange contracts with terms of up to 12 months to manage currency exposures for transactions denominated in a currency other than an entity's functional currency. As a result, the impact of foreign currency gains/losses recognized in earnings are partially offset by gains/losses on the related foreign currency forward exchange contracts in the same reporting period.

We maintain written policies and procedures governing our risk management activities. With respect to cash flow hedges, changes in cash flows attributable to hedged transactions are generally expected to be completely offset by changes in the fair value of hedge instruments. Consequently, foreign currency exchange contracts would not subject us to material risk due to exchange rate movements, because gains and losses on these contracts offset gains and losses on the assets, liabilities or transactions being hedged.

The results of operations discussed herein have not been materially affected by inflation.

## **Interest Rate Risk**

*Cash and Cash Equivalents* - We are exposed to the risk of interest rate fluctuations on the interest income earned on our cash and cash equivalents. A hypothetical 100 basis point movement in interest rates applicable to our cash and cash equivalents outstanding at June 30, 2013 would increase interest income by approximately \$1.0 million on an annual basis. No significant decrease in interest income would be expected as our cash balances are earning interest at rates close to zero. We are subject to foreign currency exchange risk with respect to cash balances maintained in foreign currencies.

*Senior Credit Facility* - Our interest rate risk relates primarily to U.S. dollar LIBOR-indexed borrowings. We have used an interest rate derivative instrument to manage our earnings and cash flow exposure to changes in interest rates by utilizing a forward-starting interest rate swap that began to offset a portion of our interest payments in the first quarter of 2011. This interest rate derivative instrument fixed the interest rate on a portion of our expected LIBOR-indexed floating-rate borrowings beginning on December 31, 2010. The interest rate swap had a notional amount of \$120.0 million outstanding as of June 30, 2013. We recognized \$0.5 million of additional interest expense related to this derivative during the three months ended June 30, 2013. The fair value of our interest rate derivative instrument was a net liability of \$3.0 million at June 30, 2013.

Based on our outstanding borrowings at June 30, 2013, a one-percentage point change in interest rates would have impacted interest expense on the unhedged portion of the debt by \$2.2 million on an annualized basis.

## **ITEM 4. CONTROLS AND PROCEDURES**

### **Evaluation of Disclosure Controls and Procedures**

We maintain disclosure controls and procedures that are designed to provide reasonable assurance that information required to be disclosed in our Exchange Act report is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate, to allow timely decisions regarding required disclosure. Disclosure controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Management has designed our disclosure controls and procedures to provide reasonable assurance of achieving the desired control objectives.

As required by Exchange Act Rule 13a-15(b), we have carried out an evaluation, under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of June 30, 2013. Based upon this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective as of June 30, 2013 to provide such reasonable assurance.

As previously disclosed, the Company is in the process of a multi-year implementation of a global enterprise resource planning ("ERP") system. In the second quarter of 2013, the Company began deploying its first ERP module within certain U.S. operations. In addition, in response to business integration activities, the Company has and will continue to further align and streamline the design and operation of the financial control environment to be responsive to the changing business model.

### **Changes in Internal Control Over Financial Reporting**

There were no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that occurred during the quarter ended June 30, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **ITEM 1. LEGAL PROCEEDINGS**

Various lawsuits, claims and proceedings are pending or have been settled by us; the most significant of which are described below.

The Company is subject to various claims, lawsuits and proceedings in the ordinary course of the Company's business, including claims by current or former employees, distributors and competitors and with respect to its products and product liability claims, lawsuits and proceedings, some of which have been settled by the Company. In the opinion of management, such claims are either adequately covered by insurance or otherwise indemnified, or are not expected, individually or in the aggregate, to result in a material adverse effect on our financial condition. However, it is possible that the Company's results of operations, financial position and cash flows in a particular period could be materially affected by these contingencies.

On June 6, 2012, the Company was contacted by the United States Attorney's Office for the District of New Jersey regarding the activities of sales representatives in a single region within our Extremities Reconstruction division. The U.S. Attorney's Office is investigating the activities of three sales representatives, one of whom was a supervisor until terminated by the Company for failure to cooperate with this investigation. The activities at issue pertain to alleged improper billing of products for extremities indications. The Company is cooperating with the United States Attorney's Office on a voluntary basis and is not a subject or target of an investigation at this time.

The Company accrues for loss contingencies when it is deemed probable that a loss has been incurred and that loss is estimable. The amounts accrued are based on the full amount of the estimated loss before considering insurance proceeds, and do not include an estimate for legal fees expected to be incurred in connection with the loss contingency. The Company consistently accrues legal fees expected to be incurred in connection with loss contingencies as those fees are incurred by outside counsel as a period cost.

### **ITEM 1A. RISK FACTORS**

The Risk Factors included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012, as modified by the subsequent Quarterly Report on Form 10-Q for the period ended March 31, 2013, have not materially changed other than the modifications to the risk factors as set forth below.

#### **Risks Related to Our Business**

##### *Our operating results may fluctuate.*

Our operating results, including components of operating results such as gross margin and cost of product sales, may fluctuate from time to time, and such fluctuations could affect our stock price. Our operating results have fluctuated in the past and can be expected to fluctuate from time to time in the future. Some of the factors that may cause these fluctuations include:

- economic conditions in the United States or abroad, especially in Europe, which could affect the ability of hospitals and other customers to purchase our products and could result in a reduction in elective and non-reimbursed operative procedures;
- the impact of acquisitions;
- the impact of our restructuring activities;
- the timing of significant customer orders, which tend to increase in the fourth quarter to coincide with the end of budget cycles for many hospitals;
- market acceptance of our existing products, as well as products in development;
- the timing of regulatory approvals;
- changes in the rates of exchange between the U.S. dollar and other currencies of foreign countries in which we do business, such as the euro, the British pound and the Japanese yen;
- expenses incurred and business lost in connection with product field correction actions or recalls;
- potential backorders and lost sales resulting from stoppages in production relating to product recalls or field corrective actions;
- changes in the cost or decreases in the supply of raw materials, including energy and steel;
- our ability to manufacture and ship our products efficiently or in sufficient quantities to meet sales demands;
- the timing of our research and development expenditures;
- reimbursement for our products by third-party payors such as Medicare, Medicaid, private and public health insurers and foreign governmental health systems;
- inspections of our manufacturing facilities for compliance with Quality System Regulations (Good Manufacturing Practices) which could result in Form 483 observations, warning letters, injunctions or other adverse findings from the FDA or from equivalent regulatory bodies, and corrective actions, procedural changes and other actions

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- that we determine are necessary or appropriate to address the results of those inspections, any of which may affect production and our ability to supply our customers with our products; and
- the increased regulatory scrutiny of certain of our products, including products which we manufacture for others, could result in their being removed from the market.

### ***The industry and market segments in which we operate are highly competitive, and we may be unable to compete effectively with other companies.***

In general, there is intense competition among medical device companies. We compete with established medical technology companies in many of our product areas. Competition also comes from early-stage companies that have alternative technological solutions for our primary clinical targets, as well as universities, research institutions and other non-profit entities. Many of our competitors have access to greater financial, technical, research and development, marketing, manufacturing, sales, distribution, administrative, consulting and other resources than we do. Our competitors may be more effective at developing commercial products. Our competitors may be able to gain market share by offering lower-cost products or by offering products that enjoy better reimbursement methodologies from third-party payors, such as Medicare, Medicaid, private and public health insurers and foreign governmental health systems.

Our competitive position will depend on our ability to achieve market acceptance for our products, develop new products, implement production and marketing plans, secure regulatory approval for products under development, obtain and maintain reimbursement coverage under Medicare, Medicaid and private healthcare insurance, obtain patent protection and to produce products consistently in sufficient quantities to meet demand. We may need to develop new applications for our products to remain competitive. Technological advances by one or more of our current or future competitors or their achievement of superior reimbursement from Medicare, Medicaid and private healthcare insurance could render our present or future products obsolete or uneconomical. Our future success will depend upon our ability to compete effectively against current technology as well as to respond effectively to technological advances. Competitive pressures could adversely affect our profitability. Additionally, purchasing decisions of our customers may be based on clinical evidence or comparative effectiveness studies and, because of our vast array of products, we might not be able to fund the studies necessary or provide the required information to compete effectively. Other companies may have more resources available to fund such studies. For example, competitors have launched and have been developing products to compete with our duraplasty products, extremity reconstruction implants, neuro critical care monitors and ultrasonic tissue ablation devices, among others.

Our largest competitors in the neurosurgery markets are Medtronic, Inc., Johnson & Johnson and Stryker Corporation. In addition, many of our neurosurgery product lines compete with smaller specialized companies or larger companies that do not otherwise focus on neurosurgery. Our competitors in extremity reconstruction include Johnson & Johnson, Synthes, Inc. and Stryker Corporation, as well as other major orthopedic companies that carry a full line of reconstructive products. We also compete with Wright Medical Group, Inc., Small Bone Innovations, Inc., Tornier, Inc. and other companies in the extremity reconstruction market category. Our competitors in the spinal implant and orthobiologics markets include Medtronic, Inc., Johnson & Johnson, Synthes, Inc., Stryker Corporation, Zimmer, Inc., NuVasive, Inc., Globus Medical, Inc., Alphatec Spine, Inc., Orthofix and several smaller, biologically focused companies. In surgical instruments, we compete with V. Mueller, as well as the Aesculap division of B. Braun Medical, Inc. In addition, we compete with Symmetry Medical Inc. and many smaller instrument companies in the reusable and disposable specialty instruments markets. Our private-label products face diverse and broad competition, depending on the market addressed by the product. Finally, in certain cases our products compete primarily against medical practices that treat a condition without using a device or any particular product, such as the medical practices that use autograft tissue instead of our dermal regeneration products, duraplasty products and nerve repair products.

### ***To market our products under development we will first need to obtain regulatory approval. Further, if we fail to comply with the extensive governmental regulations that affect our business, we could be subject to penalties and could be precluded from marketing our products.***

As a manufacturer and marketer of medical devices, we are subject to extensive regulation by the FDA and the Center for Medicare Services of the U.S. Department of Health and Human Services and other federal governmental agencies and, in some jurisdictions, by state and foreign governmental authorities. These regulations govern the introduction of new medical devices, the observance of certain standards with respect to the design, manufacture, testing, labeling, promotion and sales of the devices, the maintenance of certain records, the ability to track devices, the reporting of potential product defects, the import and export of devices and other matters. We are facing an increasing amount of scrutiny and compliance costs as more states are implementing regulations governing medical devices, pharmaceuticals and/or biologics which affect many of our products. As a result, we have been implementing additional procedures, controls and tracking and reporting processes, as well as paying additional permit and license fees, where required.

Our products under development are subject to FDA approval or clearance prior to marketing for commercial use. The process of obtaining necessary FDA approvals or clearances can take years and is expensive and uncertain. The FDA has issued Guidance

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Documents regarding the approval and review of medical devices such as the Refuse to Accept Policy for 510(k)s, Acceptance and Filing Reviews for Premarket Approval Process (PMA) as well as other guidance documents. We must be in substantial compliance with these FDA Regulations and Guidance Documents for the FDA to review our submissions.

Our inability to obtain required regulatory approval on a timely or acceptable basis could harm our business. Further, approval or clearance may place substantial restrictions on the indications for use for which the product may be marketed or to whom it may be marketed, warnings that may be required to accompany the product or additional restrictions placed on the sale and/or use of the product. Further studies, including clinical trials and FDA approvals, may be required to gain approval for the use of a product for clinical indications other than those for which the product was initially approved or cleared or for significant changes to the product. These studies could take years to complete and could be expensive, and there is no guarantee that the results will convince the FDA to approve or clear the additional indication. Any negative outcome in our clinical trials as a result of any interim analysis which we may do with respect to our clinical trials from time to time, could adversely affect our ability to launch new products, which could affect our sales and our ability to achieve reimbursement for new or existing products. In addition, for products with an approved PMA, the FDA requires annual reports and may require post-approval surveillance programs and/or studies to monitor the products' safety and effectiveness. Results of post-approval programs may limit or expand the further marketing of the product. We are also seeing third-party payors require clinical trial data for products cleared through the 510(k) process in order to continue reimbursement coverage. There is also no guarantee that the payors will agree to continue reimbursement or provide additional coverage based upon these clinical trials. These clinical trials could take years to complete and be expensive, and there is no guarantee that the FDA will approve the additional indications for use. If the FDA does not approve the additional indications for use, our ability to obtain reimbursement for these products and our ability to compete against alternative products or technologies could suffer and, consequently, affect our sales.

Another risk of application to the FDA relates to the regulatory classification of new products or proposed new uses for existing products. In the filing of each application, we make a judgment about the appropriate form and content of the application. If the FDA disagrees with our judgment in any particular case and, for example, requires us to file a Premarket Approval (PMA) application rather than allowing us to market for approved uses while we seek broader approvals or requires extensive additional clinical data, the time and expense required to obtain the required approval might be significantly increased or approval might not be granted. Furthermore, the timing of approvals in the U.S. and Europe is dependent on the class of product. Any of our Class III devices (those categorized as supporting or sustaining human life, are of substantial importance in preventing impairment of human health, or which present a potential, unreasonable risk of illness or injury) and products of animal origin take an extensive amount of time to obtain approval in the European Union, and all require Clinical Evaluation Reports or clinical trial data which can be costly.

The FDA Safety and Innovation Act (FDASIA), which includes the Medical Device User Fee Amendments of 2012 (MDUFA III), as well as other medical device provisions, went into effect October 1, 2012. This includes performance goals and user fees paid to the FDA by medical device companies when they register and list with the FDA and when they submit an application to market a device in the U.S. This will affect the fees paid to the FDA over the five-year period that FDASIA is in effect. As part of FDASIA, there are also new requirements regarding FDA Establishment Registration and Listing of Medical Devices. All foreign manufacturers must register and list medical devices for sale in the U.S. All of our facilities comply with these requirements. However, we also source products from foreign contract manufacturers. From this business practice, it is possible that some of our foreign contract manufacturers will not comply with the new requirements and choose not to register with the FDA. In such an event, we will need to determine if there are alternative foreign contract manufacturers who comply with the FDA Establishment Registration requirements. If such a foreign contract manufacturer is a sole supplier of one of our products, there is a risk that we may not be able to source another supplier.

Our manufacturing facilities must be in compliance with FDA Quality System Regulations (current Good Manufacturing Practices). In addition, approved products are subject to continuing FDA requirements relating to quality control and quality assurance, maintenance of records, reporting of adverse events and product recalls, documentation, and labeling and promotion of medical devices. For example, some of our orthobiologics products are subject to FDA and certain state regulations regarding human cells, tissues, and cellular or tissue-based products, which include requirements for Establishment Registration and listing, donor eligibility, current good tissue practices, labeling, adverse-event reporting, and inspection and enforcement. Some states have their own tissue banking regulation. We are licensed or have permits as a tissue bank in California, Florida, New York and Maryland. In addition, tissue banks may undergo voluntary accreditation by the AATB. The AATB has issued operating standards for tissue banking. Compliance with these standards is a requirement in order to become a licensed tissue bank. The FDA issued new regulations regarding "Current Good Manufacturing Practice Requirements for Combination Products" on January 22, 2013. While we have not had any products approved or cleared through the FDA as Combination Products, these new regulations may apply to some of our product lines that were approved or cleared previously. There could be additional costs associated with compliance with these new Good Manufacturing Practice Requirements regulations for Combination Products.

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The FDA and foreign regulatory authorities require that our products be manufactured according to rigorous standards. These and future regulatory requirements could significantly increase our production or purchasing costs and could even prevent us from making or obtaining our products in amounts sufficient to meet market demand. If we or a third-party manufacturer change our approved manufacturing process, the FDA may require a new approval before that process may be used. Failure to develop our manufacturing capability could mean that, even if we were to develop promising new products, we might not be able to produce them profitably, as a result of delays and additional capital investment costs.

All of our manufacturing facilities, both international and domestic, are also subject to inspections by or under the authority of the FDA and other regulatory agencies. Failure to comply with applicable regulatory requirements could subject us to issuance of FDA Form 483 Inspectional Observations, warning letters or enforcement action by the FDA or other agencies, including product seizures, recalls, withdrawal of clearances or approvals, restrictions on or injunctions against marketing our product or products based on our technology, denials of requests for exportation certificates to foreign governments, cessation of operations and civil and criminal penalties, any of which could materially affect our business.

We have received warning letters at our Plainsboro, New Jersey, Andover, England, and Añasco, Puerto Rico facilities. We have incurred, and will incur, expenses to remediate issues identified in those warning letters and other observations issued in connection with other inspections at other facilities, and to prepare our manufacturing facilities for anticipated FDA inspections. The FDA has notified us that it will not grant requests for exportation certificates to foreign governments until the violations identified in the warning letters have been corrected. If such remediation cannot be completed in a timely manner, we may not be able to produce certain products for a period of time or may not be able to sell such products in certain markets. There can be no assurance that such remediation and preparation activities will address all such observations to the FDA's satisfaction, or that the FDA will not impose additional regulatory sanctions with respect to such observations.

We manufacture medical devices that are subject to various electrical safety standards. Many countries have adopted the recommendations of the International Electrotechnical Commission ("IEC") for the safety and effectiveness of medical electrical equipment. The IEC is a non-profit, non-governmental international standards organization that prepares and publishes International Standards for all electrical, electronic and related technologies. Their updated standards are being implemented in some markets starting in July 2012 and will continue to be adopted over the following years worldwide. If we cannot comply with these standards, we may not be able to sell some of our products in the affected markets. Most of our affected products have already been modified to meet the new standards and are substantially in compliance with these standards. Except in limited circumstances, we do not anticipate any delays in selling our products in the markets that have adopted the IEC updated standards.

We are also subject to other regulatory requirements of countries outside the United States where we do business. For example, under the European Union Medical Device Directive (MDD), all medical devices must meet the Medical Device Directive standards in order to obtain CE Mark Certification prior to marketing in the EU. CE Mark Certification requires a comprehensive Quality System program, comprehensive technical and clinical documentation and data on the product, which a Notified Body in the EU reviews. In addition, we must be certified to the ISO 13485:2003 Quality System standards and maintain this certification in order to market our products in the EU, Canada, Japan, Latin America, countries in the Asia-Pacific region and most other countries outside the United States. The EU has revised the Medical Device Directive (93/42/EC as amended by 2007/47/EC).

Compliance with these regulations requires extensive documentation, Clinical Evaluation Reports for all products sold in the EU and other requirements. Requirements to meet these regulations can be costly and are mandatory to market our products in the EU. Many other countries have instituted new medical device regulations and/or revised current medical device regulations. These regulations often require extensive documentation, including clinical data and could require audits of our manufacturing facilities in order to gain approval to sell our products in that country. There are also associated fees with these new regulations. These regulations are required for all new products and re-registration of our medical devices, and could involve lengthy and expensive reviews.

Our products that contain human derived tissue, including those containing demineralized bone matrices, are not medical devices in the EU as defined in the Medical Device Directive (93/42/EC). They are also not medicinal products as defined in Directive 2001/83/EC. Today, regulations, if applicable, differ from one EU member state to the next. Because of the absence of a harmonized regulatory framework, the approval process for human-derived cell or tissue based medical products may be extensive, lengthy, expensive, and unpredictable. Among others, some of our orthobiologics products are subject to EU member states' regulations that govern the donation, procurement, testing, coding, traceability, processing, preservation, storage, and distribution of human tissues and cells and cellular or tissue-based products. These EU member states' regulations include requirements for registration, listing, labeling, adverse-event reporting, and inspection and enforcement. Some EU member states have their own tissue banking regulations. In addition, some EU member states have instituted new requirements for additional testing of donors that may prevent our obtaining approval of certain products in those member states.

***Certain of our products contain materials derived from animal sources and may become subject to additional regulation.***

Certain of our products, including our dermal regeneration products, duraplasty products, biomaterial products for the spine, nerve and tendon repair products and certain other products, contain material derived from bovine tissue. In 2012 approximately 24% of our products contained material derived from bovine tissue. Products that contain materials derived from animal sources, including food, pharmaceuticals and medical devices, are subject to scrutiny in the media and by regulatory authorities. Regulatory authorities are concerned about the potential for the transmission of disease from animals to humans via those materials. This public scrutiny has been particularly acute in Japan and Western Europe with respect to products derived from animal sources, because of concern that materials infected with the agent that causes bovine spongiform encephalopathy, otherwise known as BSE or mad cow disease, may, if ingested or implanted, cause a variant of the human Creutzfeldt-Jakob Disease, an ultimately fatal disease with no known cure. Cases of BSE in cattle discovered in Canada and the United States have increased awareness of the issue in North America. In 2013, the World Organization for Animal Health (OIE) recommended that the United States risk classification for BSE be upgraded from controlled risk to negligible risk.

We take care to provide that our products are safe and free of agents that can cause disease. In particular, we have qualified a source of collagen from a country outside the United States that is considered BSE-free. The World Health Organization classifies different types of cattle tissue for relative risk of BSE transmission. Deep flexor tendon is in the lowest-risk categories for BSE transmission (the same category as milk, for example), and is therefore considered to have a negligible risk of containing the agent that causes BSE (an improperly folded protein known as a prion). Nevertheless, products that contain materials derived from animals, including our products, could become subject to additional regulation, or even be banned in certain countries, because of concern over the potential for the transmission of prions. Significant new regulation, or a ban of our products, could have a material adverse effect on our current business or our ability to expand our business.

Certain countries, such as Japan, China, Taiwan and Argentina, have issued regulations that require our collagen products be processed from bovine tendon sourced from countries where no cases of BSE have occurred, and the EU has requested that our dural replacement products and other products that are used in neurological tissue be sourced from bovine tendon sourced from a country where no cases of BSE have occurred. Currently, we purchase our tendon from the United States and New Zealand. We received approval in the EU, Japan, Taiwan, China and Argentina for the use of New Zealand-sourced tendon in the manufacturing of our products. If we cannot continue to use or qualify a source of tendon from New Zealand or another country that has never had a case of BSE, we will not be permitted to sell our collagen products in certain countries.

***Lack of market acceptance for our products or market preference for technologies that compete with our products could reduce our revenues and profitability.***

We cannot be certain that our current products or any other products that we develop or market will achieve or maintain market acceptance. Certain of the medical indications that our devices can treat can also be treated by other medical devices or by medical practices that do not include a device. The medical community widely accepts many alternative treatments, and certain of these other treatments have a long history of use. For example, the use of autograft tissue is a well-established means for repairing the dermis, and it competes for acceptance in the market with our collagen-based wound care products.

We cannot be certain that our devices and procedures will be able to replace those established treatments or that physicians, the medical community or third-party payors, including Medicare, Medicaid, private and public health insurers and foreign governmental health systems, will accept and utilize our devices or any other medical products that we may develop. For example, market acceptance of our bone graft substitutes will depend on our ability to demonstrate that our bone graft substitutes and technologies are an attractive alternative to existing treatment options. Additionally, if there are negative events in the industry, whether real or perceived, there could be a negative impact on the industry as a whole. For example, we believe that some in the medical community have lingering concerns over the risk of disease transmission through the use of natural bone graft substitutes.

In addition, our future success depends, in part, on our ability to develop additional products. Even if we determine that a product candidate has medical benefits, the cost of commercializing that product candidate could be too high to justify development. Competitors could develop products that are more effective, achieve or maintain more favorable reimbursement status from third-party payors both domestically and internationally, including Medicare, Medicaid, private and public health insurers, and foreign governmental health systems, cost less or are ready for commercial introduction before our products. If we are unable to develop additional commercially viable products, our future prospects could be adversely affected.

Market acceptance of our products depends on many factors, including our ability to convince prospective collaborators and customers that our technology is an attractive alternative to other technologies, to manufacture products in sufficient quantities and at acceptable costs, and to supply and service sufficient quantities of our products directly or through our distribution alliances. In addition, unfavorable reimbursement methodologies, or adverse determinations of third-party payors, including Medicare, Medicaid, private and public health insurers, and foreign governmental health systems, against our products or third-party determinations that favor a competitor's product over ours, could harm acceptance or continued use of our products. The industry is subject to rapid and continuous change arising from, among other things, consolidation, technological improvements, the pressure on governments, third-party payors and providers to reduce healthcare costs, and healthcare reform legislation and initiatives

domestically and internationally. One or more of these factors may vary unpredictably, and such variations could have a material adverse effect on our competitive position. We may not be able to adjust our contemplated plan of development to meet changing market demands.

***Changes in the healthcare industry may require us to decrease the selling price for our products, may reduce the size of the market for our products, or may eliminate a market, any of which could have a negative impact on our financial performance.***

Trends toward managed care, healthcare cost containment and other changes in government and private sector initiatives in the United States and other countries in which we do business are placing increased emphasis on the delivery of more cost-effective medical therapies that could adversely affect the sale and/or the prices of our products. For example:

- as mentioned above, new legislation, which is intended to expand access to health insurance coverage over time, will result in major changes in the United States healthcare system that could have an adverse effect on our business, including a 2.3% excise tax on U.S. sales of most medical devices, implemented in 2013, which will adversely affect our earnings;
- third-party payors of hospital services and hospital outpatient services, including Medicare, Medicaid, private and public health insurers and foreign governmental health systems, annually revise their payment methodologies, which can result in stricter standards for reimbursement of hospital charges for certain medical procedures or the elimination of reimbursement;
- foreign governmental health systems have revised, and continue to consider whether to revise, their payment methodologies, which have resulted and could continue to result in stricter standards for reimbursement of hospital charges for certain medical procedures leading to less government reimbursement, thereby putting downward pricing pressure on our products or rendering some uneconomical;
- Medicare, Medicaid, private and public health insurer and foreign governmental cutbacks could create downward price pressure on our products;
- in the United States, local Medicare coverage as well as commercial carrier coverage determinations will eliminate reimbursement or coverage for certain of our matrix wound dressing products as well as other collagen products in most regions, negatively affecting our market for these products, and future determinations could eliminate reimbursement or coverage for these products in other regions and could eliminate reimbursement or coverage for other products;
- there has been a consolidation among healthcare facilities and purchasers of medical devices in the United States some of whom prefer to limit the number of suppliers from whom they purchase medical products, and these entities may decide to stop purchasing our products or demand discounts on our prices;
- in the United States, we are party to contracts with group purchasing organizations, which negotiate pricing for many member hospitals, that require us to discount our prices for certain of our products and limit our ability to raise prices for certain of our products, particularly surgical instruments;
- there is economic pressure to contain healthcare costs in domestic and international markets, and, regardless of the consolidation discussed above, providers generally are exploring ways to cut costs by eliminating purchases or driving reductions in the prices that they pay for medical devices;
- there are proposed and existing laws, regulations and industry policies in domestic and international markets regulating the sales and marketing practices and the pricing and profitability of companies in the healthcare industry;
- proposed laws or regulations will permit hospitals to provide financial incentives to doctors for reducing hospital costs (known as gainsharing), will award physician efficiency (known as physician profiling), and will encourage partnerships with healthcare service and goods providers to reduce prices;
- the growing prevalence of physician-owned distributorships catering to the spinal surgery market has reduced and may continue to reduce our ability to compete effectively for business from surgeons who own such distributorships; and
- there have been initiatives by third-party payors and foreign governmental health systems to challenge the prices charged for medical products that could affect our ability to sell products on a competitive basis.

Any and all of the above factors could materially and adversely affect our levels of revenue and our profitability.

***Oversight of the medical device industry might affect the manner in which we may sell medical devices and compete in the marketplace.***

There are laws and regulations that govern the means by which companies in the healthcare industry may market their products to healthcare professionals and may compete by discounting the prices of their products, including for example, the federal Anti-Kickback Statute, the federal False Claims Act, the federal Health Insurance Portability and Accountability Act of 1996, state law equivalents to these federal laws that are meant to protect against fraud and abuse and analogous laws in foreign countries. Violations

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of these laws are punishable by criminal and civil sanctions, including, but not limited to, in some instances civil and criminal penalties, damages, fines, exclusion from participation in federal and state healthcare programs, including Medicare and Medicaid. Although we exercise care in structuring our sales and marketing practices and customer discount arrangements to comply with those laws and regulations, we cannot assure that:

- government officials charged with responsibility for enforcing those laws will not assert that our sales and marketing practices or customer discount arrangements are in violation of those laws or regulations; or
- government regulators or courts will interpret those laws or regulations in a manner consistent with our interpretation.

Correspondingly, federal and state laws are also sometimes open to interpretation, and from time to time we may find ourselves at a competitive disadvantage if our interpretation differs from that of our competitors. AdvaMed (U.S.), EucoMed (Europe), MEDEC (Canada), and MTAA (Australia), the principal trade associations for the medical device industry, promulgate model codes of ethics that set forth standards by which its members should (and non-member companies may) abide in the promotion of their products; AdvaMed is undergoing initiatives in Latin America and Asia Pacific to develop regional codes of ethics there as well. We have in place policies and procedures for compliance that we believe are at least as stringent as those set forth in the revised AdvaMed Code, and we provide routine training to our sales and marketing personnel on our policies regarding sales and marketing practices. Pursuant to the revised AdvaMed Code, we have certified our adoption of the revised AdvaMed Code. Nevertheless, the sales and marketing practices of our industry have been the subject of increased scrutiny from federal and state government agencies, and we believe that this trend will continue. For example, recent federal legislation, state legislation and foreign legislation requires detailed disclosure of gifts and other remuneration made to healthcare professionals. In addition, prosecutorial scrutiny and governmental oversight, on the state and federal levels, over some major device companies regarding the retention of healthcare professionals as consultants has limited the manner in which medical device companies may retain healthcare professionals as consultants. Various hospital organizations, medical societies and trade associations are establishing their own practices that may require detailed disclosures of relationships between healthcare professionals and medical device companies or ban or restrict certain marketing and sales practices such as gifts and business meals.

## **ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

On October 23, 2012, our Board of Directors authorized a repurchase of up to \$75.0 million of outstanding common stock through December 2014. Shares may be repurchased either in the open market or in privately negotiated transactions.

There were no repurchases of our common stock during the three months ended June 30, 2013 under this program.

## **ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

## **ITEM 5. OTHER INFORMATION**

On July 1, 2013, the Company entered into a Lease Agreement with 109 Morgan Lane, LLC (the "Landlord") (the "Lease"). The Lease terminates and replaces the prior lease between the Company and the Landlord dated May 15, 2008, as amended. The Company is leasing approximately 58,011 square feet located at 109 Morgan Lane, Plainsboro, New Jersey (the "Premises") for general office, labs (research & development and/or product development), manufacturing and warehouse purposes. The term of the Lease is for twenty years from July 1, 2013 to June 30, 2033 with a five year renewal option. The rent for the Premises is \$585,911 per year, with monthly rent payments of \$48,826. Additional payments are also required to be made by the Company to the Landlord consisting of \$290,055 per year, with monthly payments of \$24,171 for taxes and operating expenses as well as other charges. In addition, pursuant to the Lease, the Landlord agreed to pay the Company (i) \$40,000 of the total cost to replace the existing roof on the building and (ii) \$100,000 of the total cost to replace all of the existing windows in the building.

The foregoing description of the Lease is qualified in its entirety by reference to a copy of such Lease which is attached as Exhibit 10.1 to the Current Report on Form 8-K filed July 1, 2013 and is incorporated by reference herein.

**ITEM 6. EXHIBITS**

4.1 Second Amendment, dated as of June 21, 2013, to Second Amended and Restated Credit Agreement dated as of June 8, 2011, among Integra LifeSciences Holdings Corporation, the lenders party thereto, Bank of America, N.A., as Administrative Agent, Swing Line Lender and L/C Issuer, JPMorgan Chase Bank, N.A., as Syndication Agent, and HSBC Bank USA, National Association, Royal Bank of Canada, Wells Fargo Bank, National Association, Fifth Third Bank, DNB Bank ASA and TD Bank, N.A., as Co-Documentation Agents (Incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed on June 24, 2013)

10.1 Lease Agreement dated as of July 1, 2013, between 109 Morgan Lane, LLC and Integra LifeSciences Corporation (Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on July 1, 2013)

\*31.1 Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

\*31.2 Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

\*32.1 Certification of Principal Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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\*†101.INS XBRL Instance Document

\*†101.SCH XBRL Taxonomy Extension Schema Document

\*†101.CAL XBRL Taxonomy Extension Calculation Linkbase Document

\*†101.DEF XBRL Definition Linkbase Document

\*†101.LAB XBRL Taxonomy Extension Labels Linkbase Document

\*†101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

\* Filed herewith

† The financial information of Integra LifeSciences Holdings Corporation Quarterly Report on Form 10-Q for the quarter ended June 30, 2013 filed on August 1, 2013 formatted in XBRL (Extensible Business Reporting Language): (i) the Condensed Consolidated Statements of Operations and Comprehensive Income, (ii) the Condensed Consolidated Balance Sheets, (iii) Parenthetical Data to the Condensed Consolidated Balance Sheets, (iv) the Condensed Consolidated Statements of Cash Flows, and (v) Notes to Condensed Consolidated Financial Statements, is furnished electronically herewith.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

**INTEGRA LIFESCIENCES HOLDINGS CORPORATION**

Date: August 1, 2013

/s/ Peter J. Arduini

Peter J. Arduini  
President and Chief Executive Officer

Date: August 1, 2013

/s/ John B. Henneman, III

John B. Henneman, III  
Corporate Vice President, Finance and Administration,  
and Chief Financial Officer

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**Certification of Principal Executive Officer  
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, Peter J. Arduini, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Integra LifeSciences Holdings Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
  - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 1, 2013

/s/ Peter J. Arduini

Peter J. Arduini

*President and Chief Executive Officer*

**Certification of Principal Financial Officer  
Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002**

I, John B. Henneman, III, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Integra LifeSciences Holdings Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and we have:
  - (a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 1, 2013

/s/ John B. Henneman, III

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John B. Henneman, III

*Corporate Vice President, Finance and Administration,  
and Chief Financial Officer*

**Certification of Principal Executive Officer  
Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

I, Peter J. Arduini, President and Chief Executive Officer of Integra LifeSciences Holdings Corporation (the "Company"), hereby certify that, to my knowledge:

1. The Quarterly Report on Form 10-Q of the Company for the quarter ended June 30, 2013 (the "Report") fully complies with the requirement of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 1, 2013

/s/ Peter J. Arduini

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Peter J. Arduini

*President and Chief Executive Officer*

**Certification of Principal Financial Officer  
Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002**

I, John B. Henneman, III, Corporate Vice President Finance and Administration, and Chief Financial Officer of Integra LifeSciences Holdings Corporation (the "Company"), hereby certify that, to my knowledge:

1. The Quarterly Report on Form 10-Q of the Company for the quarter ended June 30, 2013 (the "Report") fully complies with the requirement of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: August 1, 2013

/s/ John B. Henneman, III

John B. Henneman, III

*Corporate Vice President, Finance and Administration,  
and Chief Financial Officer*

