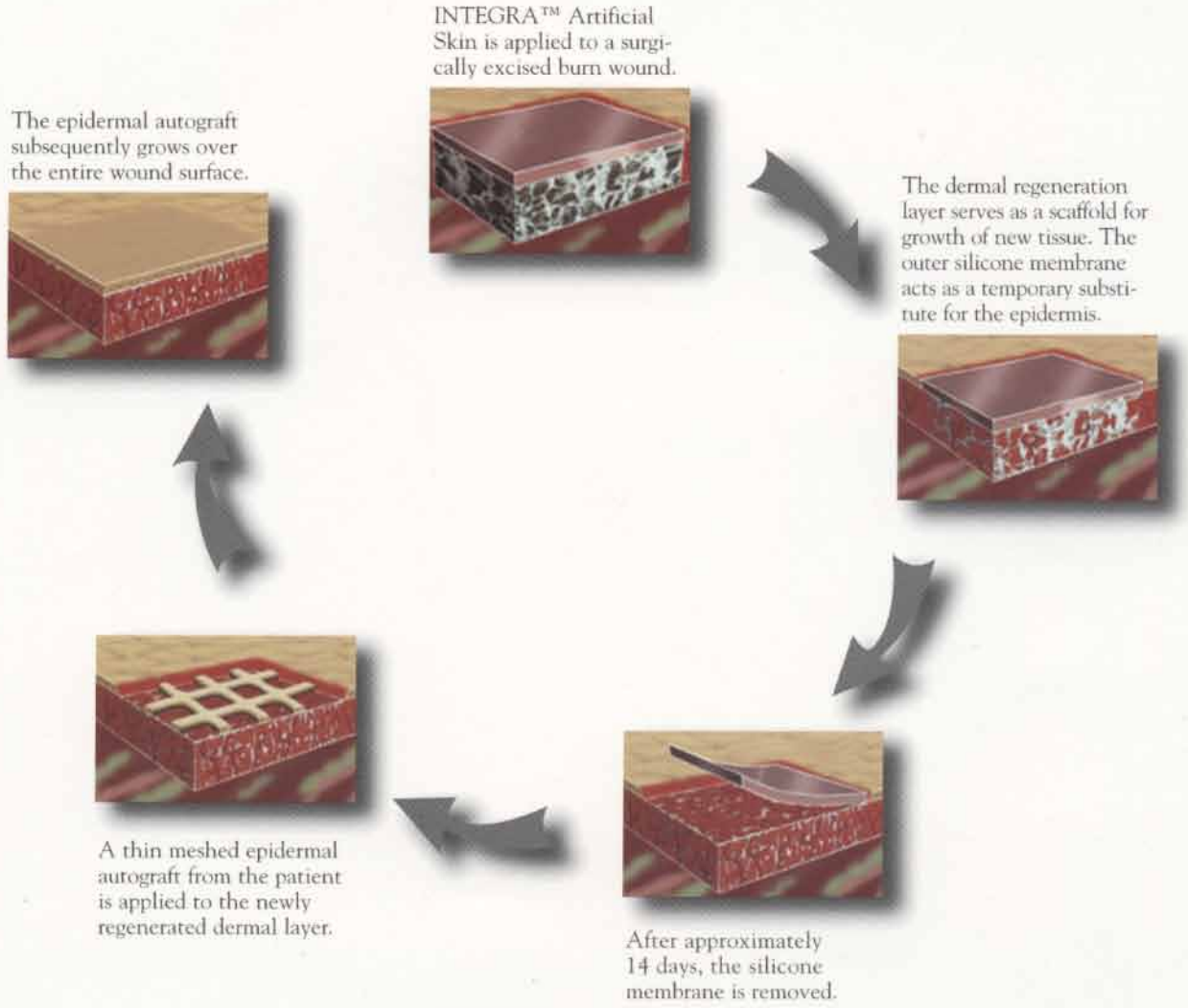
Integra LifeSciences Corporation

Developing and manufacturing a new class of medical products for the future of medicine where the human body will be enabled to regenerate its own functioning tissues and organs.

1995 Annual Report

Integra™
Artificial Skin

Dermal Regeneration Template™ Device. Human skin consists of two layers; the thin, outer layer called the epidermis; and the much thicker, inner layer called the dermis. The Company is not aware of any clinically proven method for regenerating a functional dermis other than INTEGRA™ Artificial Skin. INTEGRA™ Artificial Skin, which has been in development and testing for over 25 years, is specifically designed to restore functional dermal tissue that accepts a thin epidermal autograft, thereby reducing the need to harvest conventional autografts. On March 1, 1996, the Company received notification from the U.S. Food and Drug Administration that its Premarket Approval Application seeking permission to market INTEGRA™ Artificial Skin, Dermal Regeneration Template™ Device was approved.



"It saved my life. I didn't have enough natural skin to be grafted, so the Artificial Skin was a life-saver."

Mark Walsh
Massachusetts

Company Profile

Integra LifeSciences Corporation is a leader in the development of proprietary technologies that enable the human body to regenerate tissue that has been irreversibly lost to disease, accident or surgery. The Company intends to use its proprietary technologies and biomaterials expertise to lead in the commercialization of the relatively new, rapidly evolving field that it calls *regenerative medicine*. INTEGRA™ Artificial Skin, Dermal Regeneration Template™ Device is the Company's first PMA approved by the FDA for a product which is specifically designed to enable the human body to replace a functional tissue that will not otherwise regenerate.

The tissues of humans and animals are comprised of cells imbedded in an infrastructure of proteins and other molecules, known as the *extracellular matrix*. The extracellular matrix provides cells with structural support and biological signals. Regenerative medicine technologies owned or licensed by the Company are used to fabricate tissue specific Regeneration Template™ Devices, which are manufactured by the Company from collagen and other components of the extracellular matrix, using proprietary processes. Once surgically implanted, they serve as temporary extracellular matrix like structures that are intended to support regeneration of functional tissues, while simultaneously being absorbed by the body. The Company also has technologies for products that are intended to interact with the body's own extracellular matrix to control the behavior of cells.

To Our Shareholders:

Your Company, Integra LifeSciences Corporation, was founded in 1989 with a vision that medical practice was about to change; that the human body would be enabled to regenerate many of its own damaged or diseased tissues and organs. Further, that this change would occur not from one technology but from scientific developments in several diverse fields including biological science, chemical engineering and materials science. At Integra, we set out to bring together the technologies and develop what was necessary to lead in the supply of products for this new developing medical practice. We also knew that to be a successful leader, we needed to practice both sound business and excellent science. Your Company has been growing rapidly, principally by combining existing businesses, acquiring synergistic technologies, and forming strategic business and technological alliances. We became a publicly-traded company on August 16, 1995 as a result of our acquisition of Telios Pharmaceuticals, Inc. In January 1996, your Company completed a public offering of its common stock and raised in excess of $35 million to strengthen its financial position and to further develop its business and technologies. We believe that both our business and technological development strategies have been and will continue to be successful.

This success is unfolding as a result of the efforts of the many fine associates at Integra. We are indeed fortunate to have the finest, dedicated people in the medical industry serving your Company. Our substantial accomplishments are a direct result of their expertise, professionalism, hard work and selfless efforts. Integra believes its associates are its most important asset.

We are pleased to report that on March 1, 1996, Integra LifeSciences received notification from the U.S. Food and Drug Administration (FDA) that its Premarket Approval Application (PMA) to market the Company's core and first regenerative product — INTEGRA™ Artificial Skin, Dermal Regeneration Template™ Device — is approved. The technology on which this product is based was invented jointly by Dr. John Burke of Harvard Medical School and Massachusetts General Hospital and Ioannas Yannas, Ph.D. of the Massachusetts Institute of Technology. This product has been in development for over 20 years and before the FDA for over five years. It is the first of a class of regenerative medical products your Company is developing that allows the body to regenerate its own damaged or diseased tissues and, to the Company's knowledge, the first PMA approved by the FDA for a product specifically designed to regenerate a functional body tissue that will not otherwise replace itself. We are now introducing INTEGRA™ Artificial Skin into the United States commercial market to treat life threatening burns.

A serious burn is one of the most horrific injuries the human body can suffer. Severe burn patients have to endure pain and heavy scarring from traditional medical application. This treatment for serious burns, which involves transplanting undamaged skin from the patient's own body, is difficult and gruelling and the results are usually unsatisfactory. Oftentimes, death occurs for lack of skin or a suitable substitute. While no one can prevent or change the seriousness and life-threatening tragedy of the human insult resulting from serious burns, we can change the treatment and thus impressively alter the final result.

INTEGRA™ Artificial Skin is an extracellular matrix-based product that enables the body of severely burned patients to create functional dermal tissue to replace that which has been destroyed. This tissue accepts a thin epidermal autograft, thereby reducing the need to harvest conventional autografts. Prior to the development of regenerative medical products, the

Your Company was founded with a vision that medical practice was about to change; that the human body would be enabled to regenerate many of its own damaged or diseased tissues and organs.

human body was incapable of replacing many of its own damaged or diseased tissues and organs. The need for replacement tissues and organs, already in short supply from traditional sources, is accelerated by the increase in life expectancy.

Life expectancy has increased dramatically in this century. In 1900, four percent of the population was over 65 years of age. In 1995, the percentage doubled and continues to rise. By the year 2030, it is estimated that twenty-two percent of the population will be older than 65 years.

This increase in life expectancy creates a special problem for medical practice. As this trend continues, it becomes more likely that one or more of an individual's body tissues and organs will wear out or become damaged and need to be replaced. Currently, medical treatment is limited to transplants and synthetic prostheses; in each case rejection is a constant possibility. Xenotransplantation, a developing technology which involves using organs from animals, is a future method that, if successful, could provide an "inventory" of spare replacement tissues and organs for humans. Xenotransplantation has many problems to solve including potential disease transmission. Instead, the Company's "regenerative medicine" focus for replacement tissues and organs is one of enabling the body and its own biological system to regenerate damaged or diseased tissues by directing cell behavior toward a new growth of undamaged or healed tissue.

Enabling the conceptualization and the development of this rapidly emerging new major medical practice of regenerative medicine are the simultaneous scientific developments in extracellular matrix chemistry, cell receptor and growth factor biochemistry, cell biology, non-invasive surgery, immunology, organ transplantation, biomaterials science (including natural materials and polymers), and genetic engineering. Much of the technology required to create additional medical products already exists. In large part, your Company has defined its role as one of identifying and developing these technologies for successful commercial applications.

Future successful product and Company development in regenerative medicine requires simultaneously meeting multiple, complex and demanding requirements for device safety (immunological, sterility, biocompatibility, biodegration, etc.), effectiveness (cell matrix, interactions, cell growth/viability/differentiation, angiogenesis, etc.), manufacturability (cost, sterility, storage, packaging, shipping, etc.), surgical and clinical practicability (meeting Clinical requirements, surgical technique, resistance to rejection and infection, etc.), and longevity and long-term performance. Simultaneously meeting these requirements while complying with regulatory standards requires not only sophisticated science and engineering, but extensive testing and development. We are currently well-positioned from both a business and technological perspective to be a leader in the development and manufacture of regenerative products.

Your management believes that efficient and (relatively) low-risk development of products that realize the promise of regenerative medicine will require industry-wide cooperation to combine or consolidate the most promising technologies, to create a regenerative medical products industry, to foster productive relationships between product developers and clinicians, and to create a consistent and scientifically sound approach to regulatory approval of these breakthrough products. In order for this to occur, business history dictates that companies and technologies will consolidate for both financial and technological reasons. Out of this, companies who will become the industry leaders will emerge and lead the way. We believe Integra can serve the simultaneous role of leadership in both technological development and business consolidation, thus emerging as a global leader in regenerative medical technologies as well as the development and manufacture of advanced products that control the behavior of human cells.

Richard E. Caruso, Ph.D.
Chairman, President and
Chief Executive Officer

March 19, 1996

Research and Development

Integra LifeSciences Corporation is a leader in the development of proprietary technologies that enable the human body to regenerate tissue that has been irreversibly lost to disease, accident or surgery.

The Company's strategy is to seek out technology opportunities in its areas of focus which have already demonstrated proof of principle and are available through licensing or purchase. The Company identifies, integrates and develops these complementary technologies focused on biomaterials, cell culture, integrin specific peptides and growth and differentiation factors.

The Company continues the development of these technologies utilizing a combination of its in-house development staff and collaborative relationships with centers of excellence in the applied technologies. These centers include some of the leading hospitals, universities and research foundations in the world.

The Company's lead regenerative medicine product, INTEGRA™ Artificial Skin, has progressed to market in several countries around the world. A dedicated team of people completed the manufacturing scale-up and validation of INTEGRA™ Artificial Skin. Our regulatory associates obtained approval to market in five international markets and recently received the FDA approval letter to market in the United States. They also prepared and published an FDA approved training manual which is now being utilized by Sales & Marketing in physician training programs around the world.

The Company has also progressed in its other regenerative product efforts. The peripheral nerve regeneration effort moved closer to clinical trial with Institutional Review Board approval to conduct a clinical trial at University Hospital, Copenhagen, Denmark, and regulatory approval to import the nerve product into Denmark for the clinical trial. The physicians are beginning recruitment of patients and the first surgery has taken place in the first quarter of 1996. In the interim, the non-human primate studies continue to demonstrate encouraging results in gaps of up to 5 centimeters (2 inches).

The articular cartilage regeneration program continues to progress through pre-clinical trials conducted in compliance with Good Laboratory Practice in anticipation of filing for Institutional Review Board approval and an Investigational Device Exemption in the second half of 1996. With these approvals, the Company expects to initiate clinical trials with this promising procedure which in pre-clinical trial has demonstrated the ability to regenerate normal cartilage tissue.

The acquisition of Telios Pharmaceuticals, Inc. has allowed the Company to work on improvements to our existing regenerative medicine efforts through the addition of integrin specific peptides to our extracellular matrices to enhance and control cellular response. The Company is currently seeking development partners and licensees for some of the technology acquired with Telios that is not targeted to our regenerative focus, further enhancing the value of this acquisition.

Beyond the regenerative medicine effort, the Company's Research and Development associates continue to support the Company's existing medical products with manufacturing technical services, new product development and line extensions. Products under development include: a second generation Collagen Corneal Shield with improved dissolution characteristics; an injectable collagen for tissue bulking; Tyrosine-based polycarbonates for orthopedic implants; and drug delivery technologies focused in reproductive health including fertility control and sexually-transmitted disease prevention.

In the coming year, the Company will continue to expedite the focused development of products which address market needs and capitalize on the Company's intellectual property and core capabilities.

Status and Target Indications of the Company's Regenerative Medicine Technologies

Technology	Target Clinical Applications	Status
INTEGRA™ Artificial Skin	Postexcisional treatment of life-threatening full-thickness or deep partial-thickness thermal injury where sufficient autograft is not available at the time of excision or not desirable due to the physiological condition of the patient	PMA Application submitted to the FDA in May 1990; Approval Letter issued by the FDA in March 1996 Foreign clearance to import with FDA permission to export: (Hong Kong, Singapore, Switzerland, Denmark, Ireland and Canada)
Cartilage Regeneration	Restoration of functional articular cartilage in knee and other joints	Preclinical study in progress; Phase I clinical trials targeted for fourth quarter 1996
Peripheral Nerve Regeneration	Regeneration of severed peripheral nerves	Completed preclinical study establishing effectiveness of technique; Phase I clinical trials began first quarter 1996 in Denmark
BioMend™ Absorbable Collagen Membrane	Guided tissue regeneration in periodontal surgery	510(k) clearance to market received August 1995

Manufacturing/Operations

Integra manufactures the majority of its medical products at a 35,000 square foot FDA-registered and inspected facility in Plainsboro, New Jersey, which also serves as the Company's executive offices. In 1995, the Company completed a 10,000 square foot addition including a commercial-scale manufacturing facility for INTEGRA™ Artificial Skin. The Company recently completed production testing and validation of the INTEGRA™ Artificial Skin facility in accordance with Good Manufacturing Practices requirements, and is currently manufacturing the INTEGRA™ Artificial Skin product at this facility.

The Company also leases a 25,000 square foot site in West Chester, Pennsylvania. This facility has been renovated to provide additional and backup capacity for growth in the Company's product lines. The Company has commenced manufacturing commercial medical products at this facility.

The basic manufacturing process for most of the Company's products involves a four-step procedure; (i) raw material — principally purified collagen prepared from bovine tendon — is processed with various enzymes and solvents to purify and render it non-immunogenic; (ii) the purified material is dispersed into suspensions appropriate for the manufacture of the different forms of collagen material and then dried using freeze-drying techniques; (iii) the fibrous material yielded from the drying step is "cross-linked" through chemical bonding of overlying fibers, with different types of cross-linking being used for different products; and (iv) the bonded material is sized and packaged.

INTEGRA™ Artificial Skin contains additional extracellular matrix components and undergoes additional processing steps, including the application of a silicone membrane to one side of the bonded material, and processes that precisely control the thickness and porosity of the product. The Company's manufacturing processes are proprietary and each Integra associate is required to sign a confidentiality agreement as a condition of employment. The manufacture

The Company has substantial manufacturing experience with FDA-regulated absorbable medical products that serve a broad range of applications, including drug delivery, surgical hemostasis (to control bleeding), infection control, ophthalmic surgery, dental surgery and wound care.

of the Company's nerve regeneration conduit involves forming the collagen material into a tube before cross-linking. The cartilage regeneration technology under development by the Company requires implanting cells from the patient into a bilayer collagen device and culturing the growth of the cells using cell culturing techniques. The Company is planning to establish or obtain use of laboratory facilities for cell culturing to support the development of the cartilage replacement technology.

The Company believes that its existing and renovated manufacturing facilities are adequate for the foreseeable future and, depending on product mix and pricing, can support the manufacturing for significant product sales.

Sales & Marketing

INTEGRA™ Artificial Skin, Dermal Regeneration Template is designed to restore functional dermal tissue in patients with severe burns and is expected to be the Company's most significant near-term commercial product.

The sales efforts of Integra LifeSciences Corporation are divided between distribution relationships with major medical companies in the field of Medical Products, direct distribution in both Medical and Regenerative products and international distributor sales in both areas.

In 1995, the Company's core product, INTEGRA™ Artificial Skin, was introduced in several overseas markets, including Denmark, Hong Kong, Singapore and Switzerland, and was approved in Ireland and portions of Germany.

The Company's medical products showed significant growth in 1995. These products include:

- *Hemostasis and Surgical products*
- *Infection Control products*
- *Dental products*
- *Ophthalmic products*
- *Wound Care products*

In 1996, the Company plans to continue its strong support of its marketing partners, while concentrating extensive efforts on the introduction of INTEGRA™ Artificial Skin in the United States and in other major world markets.

In the domestic market, the Company will distribute INTEGRA™ Artificial Skin through a direct, highly-trained group of technical representatives, and will offer extensive training and introductory programs to enable burn surgeons and their staff to become completely familiar with all aspects of this revolutionary and life-saving new product. Internationally, a select group of national distributors has been identified and trained to provide an equal level of technical support to their respective surgical practitioners. The domestic programs are being launched following receipt of the final FDA PMA approval for INTEGRA™ Artificial Skin.

Selected Financial Data

The statement of operations data for the Company for the years ended December 31, 1995, 1994 and 1993 and the balance sheet data as of December 31, 1995 and 1994 are derived from, and are qualified by reference to, the Company's consolidated financial statements included elsewhere in this report. The statement of operations data for the Company for the nine months ended December 31, 1992, the three months ended March 31, 1992 and the year ended December 31, 1991 and the balance sheet data as of March 31, 1992, and December 31, 1993, 1992 and 1991 are derived from the Company's financial statements not included herein. The data set forth below are qualified by reference to, and should be read in conjunction with, the Company's consolidated financial statements and notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations appearing elsewhere herein. Predecessor basis and successor basis periods reflect the March 31, 1992 purchase of all of the common stock of the Company by an affiliate of Dr. Richard E. Caruso, the controlling stockholder of the Company.

	Successor basis				Predecessor basis	
	Years Ended December 31,			Nine Months Ended Dec. 31,	Three Months Ended March 31,	Year Ended Dec. 31,
(In thousands, except per share data)	1995	1994	1993	1992	1992	1991
Statement of Operations Data (1)						
Product sales	$ 8,356	$ 6,958	$ 3,950	$1,352	$ 464	$ 1,056
Research grants	1,064	912	300	90	29	335
Product license fees	520	200	300	—	250	—
Royalties	239	174	125	4	—	—
Contract product development	50	417	101	31	—	—
Total revenue	10,229	8,661	4,776	1,477	743	1,391
Cost of product sales	4,850	4,402	2,535	940	323	686
Research and development	5,191	3,085	2,170	282	105	507
Selling, general and administrative	6,097	3,505	2,576	992	422	1,094
Acquired in-process research and development (2)	19,593	(275)	20,642	—	—	—
Total costs and expenses	35,731	10,717	27,923	2,214	850	2,287
Operating loss	(25,502)	(2,056)	(23,147)	(737)	(107)	(896)
Interest income	283	221	12	39	35	160
Interest expense	(188)	(64)	(218)	(135)	—	—
Other income (expense)	5	(1)	19	15	—	(76)
Net loss	$(25,402)	$ (1,900)	$(23,334)	$ (818)	$ (72)	$ (812)
Net loss per share	$(1.21)	$(.10)	$(1.41)	$(.06)	$(.01)	$(.06)
Cash dividends per share	$ —	$ —	$ —	$ —	$ .20	$ —
Weighted average number of common shares outstanding	21,073	19,035	16,583	14,450	14,450	14,450

	Successor basis				Predecessor basis	
	December 31,				March 31,	Dec. 31,
(In thousands)	1995	1994	1993	1992	1992	1991
Balance Sheet Data (1)						
Cash, cash equivalents and short-term investments	$ 5,710	$ 3,331	$ 5,066	$1,213	$ 136	$ 3,207
Working capital	7,476	3,610	3,488	1,340	833	3,827
Total assets	19,378	13,703	10,043	2,442	1,337	4,327
Long-term debt	—	1,754	3,224	1,635	—	—
Accumulated deficit (2)	(51,454)	(26,052)	(24,152)	(818)	(4,447)	(1,474)
Total stockholders' equity	17,427	9,275	3,559	92	1,124	4,067

(1) As a result of the Company's acquisitions of ABS LifeSciences, Inc. in November 1990, Colla-Tec, Inc. in June 1991, Vitaphore Corporation in April 1993, Biomat Corporation in June 1993, another company's 50% interest in a joint venture with Vitaphore Corporation in December 1993 and Telios Pharmaceuticals, Inc. in August 1995, the consolidated financial results from these periods are not directly comparable. See Notes 1 and 12 of the Company's consolidated financial statements included elsewhere in this report.

(2) As a result of the required use of purchase accounting, the 1993 loss included $20.6 million of acquired in-process research and development which was charged to expense at the date of the Company's acquisitions in 1993, and the 1995 loss included $19.6 million of acquired in-process research and development which was charged to expense at the date of the Company's acquisition of Telios Pharmaceuticals, Inc.

Management's Discussion

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with the Company's consolidated financial statements, the notes thereto and the other financial information included elsewhere in this report.

General

The Company has developed principally by combining existing businesses, acquiring synergistic technologies and forming strategic business and technological alliances. The Company acquired ABS LifeSciences, Inc. in November 1990, Colla-Tec, Inc. in June 1991, Vitaphore Corporation in April 1993, Biomat Corporation in June 1993, another company's interest in a joint venture with Vitaphore in December 1993 and Telios Pharmaceuticals, Inc. in August 1995. As a result of the required use of purchase accounting, the Company's 1995 loss included approximately $19.6 million of acquired in-process research and development that was charged to expense at the date of the Company's acquisition of Telios, and the Company's 1993 loss included approximately $20.6 million of acquired in-process research and development that was charged to expense at the date of the Company's acquisitions in 1993. As a result of the Company's acquisitions, the consolidated financial results from the periods presented below are not directly comparable. See Notes 1 and 12 of the Company's consolidated financial statements included elsewhere in this report.

Results of Operations

1995 Compared to 1994

Total revenues increased from $8.7 million in 1994 to $10.2 million in 1995 primarily as a result of an increase in product sales of $1.4 million. Product sales increased from $7 million in 1994 to $8.4 million in 1995 with increases in the Company's surgical and hemostasis, dental and ophthalmic product lines. The increases in surgical and hemostasis product sales were largely the result of increases in unit volume associated with the Company's direct marketing efforts and one of the Company's marketing and distribution agreements. Dental product sales increased as a result of initial stocking orders for the Company's BioMend product, which received Food and Drug Administration marketing clearance in August 1995. The Company's ophthalmic product also showed an increase in unit volume sold to the Company's marketing partner. The Company commenced foreign sales of INTEGRA™ Artificial Skin in the third quarter of 1995 and has had limited sales in connection with the product's introduction at foreign training conferences. The Company's total export foreign sales increased from $926,000 in 1994 to $945,000 in 1995 with a significant shift in revenues from supplying a raw material component to a marketing partner (76% of foreign sales in 1994) to direct marketing of the Company's end user surgical and hemostasis product line (56% of foreign sales in 1995).

Research grant revenue increased from $912,000 in 1994 to $1.1 million in 1995. The Company's largest grant is from the National Institute of Science and Technology (NIST), which increased from $431,000 in 1994 to $660,000 in 1995. The Company received several new grants in 1995, which were offset by decreases in two Small Business Innovation Research (SBIR) grants that provided funding in 1994. A substantial portion of licensing revenue in 1994 and 1995 was related to the Company's BioMend product, which is exclusively marketed through the Calcitek Division of Sulzermedica. Contract product development funding declined by $367,000 from 1994 to 1995 as a result of the expiration of funding for development efforts on the Company's ophthalmic product line. The Company continues to seek research grants, licensing and development funding for several of its technologies. The timing and amount of this funding, if any, can not be predicted.

Cost of product sales increased from $4.4 million (63% of product sales) in 1994 to $4.9 million (58% of product sales) in 1995. The decrease in cost of product sales as a percentage of sales was due primarily to costs incurred during 1994 related to the transfer of manufacturing equipment and related materials from the Company's Menlo Park, California facility to its Plainsboro, New Jersey facility and increases in unit volume output in 1995. The decrease was partially offset by an increase in costs in the fourth quarter of 1995 related to production capacity for the INTEGRA™ Artificial Skin product at the Company's Plainsboro, New Jersey facility as well as increased capacity at the Company's West Chester, Pennsylvania facility. The Company's ability to utilize its current capacity to produce INTEGRA™ Artificial Skin and its other medical device products will continue to affect its gross margin on product sales.

Research and development expense increased from $3.1 million in 1994 to $5.2 million in 1995, due in part to $1.2 million of research and development expense incurred by Telios since the Company's acquisition of Telios in August 1995. The remaining $900,000 increase was due to costs associated with the addition of full-time research and development staff, increased expenditures for outside contract research, additional lab supplies and equipment, and consultants for research and product development activities related to the Company's regenerative medicine technologies. The majority of these expenditures were associated with the validation of manufacturing and quality assurance processes for INTEGRA™ Artificial Skin and expenditures funded under research grants. In the fourth quarter of 1995, the INTEGRA™ Artificial Skin manufacturing facility was completed and validated, and has undergone a facility inspection by the FDA in connection with the Company's PMA application. The Company expects the level of research and development expenditures in 1996 to be higher than in 1995 due to the inclusion of Telios for a full year, expenditures related to a planned post approval study of INTEGRA™ Artificial Skin and clinical trials of the Company's other regenerative and matrix medicine technologies. The amount of resources and the allocation of those resources to fund research and development will vary depending upon a number of factors, including the progress of development of the Company's technologies, changing competitive conditions and determinations with respect to the commercial potential of the Company's technologies.

Selling, general and administrative expense increased from $3.5 million in 1994 to $6.1 million in 1995 with $700,000 of the increase resulting from administrative expenses incurred by Telios during the post-acquisition period. The remaining $1.9 million was largely attributable to $1.1 million of additional sales and marketing expenses resulting from the introduction of selected medical product lines in international markets, the development of marketing and training materials for INTEGRA™ Artificial Skin and the establishment in the third quarter of 1994 of a direct surgical sales force to market certain medical product lines domestically. The Company is anticipating additional increases in sales and marketing expenses with the introduction of INTEGRA™ Artificial Skin, including the establishment and implementation of a clinical training program for surgeons and medical institutions. Additional administrative expenditures in 1995 included $300,000 for legal and accounting fees and governmental filing fees incurred in connection with the registration of the Company's common stock under the Securities Exchange Act and the Company's listing on the Nasdaq National Market. The remaining $500,000 of increases during 1995 consisted of additional administrative costs, primarily related to the operation of the Company's West Chester, Pennsylvania facility for a full year compared to a six-month period in 1994, and the hiring of additional regulatory and administrative support personnel at the Company's Plainsboro, New Jersey facility.

Interest income increased by $62,000 from 1994 to 1995 due to higher cash balances following the Telios acquisition. Interest expense increased by approximately $124,000 from 1994 to 1995 as a result of higher outstanding balances under the Company's revolving line of credit (the "Revolving Credit") from an affiliate of Dr. Richard E. Caruso, the controlling stockholder of the Company, through September 1995.

1994 Compared to 1993

Total revenues increased from $4.8 million in 1993 to $8.7 million in 1994 primarily as a result of increases in medical product sales ($3.0 million), research grant revenue ($612,000) and contract product development revenue ($316,000). The increase in medical product sales was primarily due to increases in hemostasis, ophthalmic, dental and wound care product sales. The increase in grant revenue was due to an increase in SBIR grants on nerve and cartilage regenerative medicine projects from $300,000 in 1993 to $477,000 in 1994, as well as $432,000 from the NIST grant for development of certain polymer-based biomaterials, which commenced on January 1, 1994. Increases in contract product development revenue were attributable to initiation of third-party funded product development efforts for the Company's ophthalmic product line.

Cost of product sales increased from $2.5 million (64% of product sales) in 1993 to $4.4 million (63% of product sales) in 1994, primarily as a result of increased product sales and costs incurred during 1994 related to the transfer of manufacturing equipment and related materials from the Company's Menlo Park, California facility to its Plainsboro, New Jersey facility.

Research and development expense increased from $2.2 million in 1993 to $3.1 million in 1994. This increase was due to increased salaries, benefits and administrative costs associated with the addition of full-time research and development staff and increased expenditures for outside contract research, lab supplies, lab equipment and consultants in support of research and development. The majority of these increased expenditures were associated with INTEGRA™ Artificial Skin, including completion of two amendments to its PMA application, the construction and pending validation of manufacturing and quality assurance processes and consultation with inventors and clinicians.

Selling, general and administrative expense increased from $2.6 million in 1993 to $3.5 million in 1994. This increase was partially attributable to increased selling and administrative expenses resulting from the Company's establishment in the third quarter of 1994 of a direct product sales force to market certain medical product lines domestically. The increase was also due to additional expenses associated with maintenance of the Company's patent portfolio, as well as regulatory, environmental, health and safety and general administrative costs related to the Company's broader product lines.

Interest income increased from $12,000 in 1993 to $221,000 in 1994 as a result of the investment of private placement proceeds raised in late 1993 and 1994. Interest expense decreased from $218,000 in 1993 to $64,000 in 1994 due to reduced borrowings under the Revolving Credit.

Liquidity and Capital Resources

The Company has funded its operations through December 31, 1995 primarily through private placements of its common stock to strategic corporate partners and others, revenues from sales of existing products, research grants from government agencies, development agreements with major industrial companies, borrowings under the Revolving Credit and cash acquired in connection with the Telios acquisition.

At December 31, 1995, the Company had cash, cash equivalents and short-term investments of $5.7 million, representing a $2.4 million increase from December 31, 1994. The Company's principal sources of liquidity in 1995 were cash acquired in the Telios acquisition of $10.2 million after payment of bankruptcy claims and acquisition costs, $1.9 million in borrowings under the Revolving Credit and $1.0 million from a private placement of common stock. The principal uses of funds in 1995 were $5.6 million for operations, $2.9 million for plant and equipment and $2.2 million for repayments on the Revolving Credit. As of December 31, 1995, the Company had completed major leasehold improvements to its Plainsboro, New Jersey facility and had completed a substantial portion of its planned leasehold improvements to its West Chester, Pennsylvania facility.

On February 1, 1996, the Company completed a public offering of 4,671,250 shares of its common stock, which resulted in approximately $35.6 million in net proceeds to the Company. As a result of the offering, the outstanding balance of $10,000 on the Revolving Credit was paid and the Revolving Credit terminated in accordance with its terms. The anticipated uses of the offering proceeds, in addition to the expected expenditures described above, include the funding of growth in receivables and inventory in conjunction with the INTEGRA™ Artificial Skin product and general corporate purposes.

The Company anticipates it will continue to use its liquid assets to fund operations until sufficient revenues can be generated through product sales and collaborative arrangements. There can be no assurance that the Company will be able to generate sufficient revenues to obtain profitability.

Other Matters

The Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of" ("SFAS 121"), in March 1995. SFAS 121 requires companies to review their long-lived assets and certain identifiable intangibles (collectively, "Long-Lived Assets") for impairment whenever events or changes in circumstances indicate that the carrying value of a Long-Lived Asset may not be recoverable. Impairment is measured using the lower of a Long-Lived Asset's book value or its fair market value. Based upon management's current estimate, the adoption of SFAS 121 will not have a material impact on the Company's financial position or results of operations.

The Financial Accounting Standards Board issued SFAS 123, "Accounting for Stock-Based Compensation." SFAS 123 encourages, but does not require, companies to recognize compensation expense for grants of stock, stock options and other equity instruments to employees based on fair value accounting rules. SFAS 123 does require companies that choose not to adopt the fair value accounting rules to disclose pro forma net income (loss) and earnings (loss) per share data under the new method. The new disclosure requirements are generally effective for financial statements for years beginning after December 15, 1995. The Company expects to adopt the disclosure-only provisions of SFAS 123 in 1996.

Auditors' Report

To the Board of Directors and Stockholders of
Integra LifeSciences Corporation and Subsidiaries:

We have audited the accompanying consolidated balance sheets of Integra LifeSciences Corporation and Subsidiaries as of December 31, 1995 and 1994, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 1995. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Integra LifeSciences Corporation and Subsidiaries as of December 31, 1995 and 1994, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 1995, in conformity with generally accepted accounting principles.

Coopers & Lybrand L.L.P.

Princeton, New Jersey
February 20, 1996

Consolidated Balance Sheets

December 31,	1995	1994
ASSETS		
Current assets:		
Cash and cash equivalents	$ 4,512,434	$ 3,331,445
Short-term investments	1,197,812	—
Accounts receivable, net of allowance for doubtful accounts of $253,843 and $79,292 as of December 31, 1995 and 1994, respectively	1,768,099	1,517,770
Inventories	1,372,313	949,001
Prepaid expenses and other current assets	468,547	384,121
Total current assets	9,319,205	6,182,337
Property and equipment, net	9,605,796	7,149,363
Intangibles and other assets	452,719	371,507
Total assets	$ 19,377,720	$ 13,703,207
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable, trade	$ 321,304	$ 262,733
Accrued expenses	1,261,771	979,293
Deferred revenue	10,650	360,650
Short-term debt — related party	10,314	—
Other current liabilities	148,173	685,538
Accrual for plant closing	90,914	284,440
Total current liabilities	1,843,126	2,572,654
Other liabilities	107,908	101,828
Long-term debt — related parties	—	1,754,000
Total liabilities	1,951,034	4,428,482
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $.01 par value (15,000,000 authorized shares; no shares issued or outstanding)	—	—
Common stock, $.01 par value (60,000,000 authorized shares; 23,493,916 and 19,413,955 issued and outstanding at December 31, 1995 and 1994, respectively)	234,939	194,140
Additional paid-in capital	68,730,310	35,217,564
Notes receivable — related parties	(84,875)	(84,875)
Accumulated deficit	(51,453,688)	(26,052,104)
Total stockholders' equity	17,426,686	9,274,725
Total liabilities and stockholders' equity	$ 19,377,720	$ 13,703,207

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

Consolidated Statements of Operations

Years Ended December 31,	1995	1994	1993
REVENUE			
Product sales	$ 8,355,961	$ 6,958,491	$ 3,949,720
Research grants	1,063,476	911,626	300,000
Product license fees	520,000	200,000	300,000
Royalties	239,389	174,142	125,017
Contract product development	50,300	416,982	101,174
Total revenue	10,229,126	8,661,241	4,775,911
COSTS AND EXPENSES			
Cost of product sales	4,850,366	4,402,341	2,534,614
Research and development	5,190,495	3,085,368	2,170,297
Selling, general and administrative	6,097,376	3,504,989	2,576,305
Acquired in-process research and development	19,592,567	(275,630)	20,642,069
Total costs and expenses	35,730,804	10,717,068	27,923,285
Operating loss	(25,501,678)	(2,055,827)	(23,147,374)
Interest income	282,604	220,799	11,818
Interest expense — related party	(187,897)	(63,704)	(217,917)
Other income (expense)	5,387	(969)	19,544
Net loss	$(25,401,584)	$(1,899,701)	$(23,333,929)
Net loss per share	$(1.21)	$(0.10)	$(1.41)
Weighted average number of common and common equivalent shares outstanding	21,073,214	19,035,147	16,582,741

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

Consolidated Statements of Cash Flows

Years Ended December 31,	1995	1994	1993
OPERATING ACTIVITIES:			
Net loss	$(25,401,584)	$(1,899,701)	$(23,333,929)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	1,394,422	709,232	558,718
(Gain) loss on sale of assets	(5,387)	969	—
Amortization of discount on investment	(20,968)	—	—
Acquired in-process research and development	19,592,567	(275,630)	20,642,069
Common stock and warrants issued for services rendered	70,000	82,900	109,200
Deferred revenue	(350,000)	(150,000)	160,650
Changes in operating assets and liabilities:			
Accounts receivable	(175,450)	(739,870)	167,169
Inventories	(423,312)	(219,329)	30,735
Prepaids and other current assets	252,201	(215,110)	5,401
Non-current assets	9,825	(16,119)	34,920
Accounts payable, accrued expenses and other liabilities	(584,796)	(383,569)	(101,125)
Net cash used in operating activities	(5,642,482)	(3,106,227)	(1,726,192)
INVESTING ACTIVITIES:			
Cash acquired in business acquisitions	13,116,670	—	33,902
Payments of acquired bankruptcy claims and acquisition costs	(2,940,763)	—	—
Proceeds from sale of assets	12,628	10,330	45,165
Purchases of property and equipment	(2,924,720)	(3,739,956)	(1,120,613)
Purchases of held-to-maturity investments	(1,176,844)	—	—
Net cash provided by (used in) investing activities	6,086,971	(3,729,626)	(1,041,546)
FINANCING ACTIVITIES:			
Notes receivable — related parties	—	32,890	(22,890)
Principal payments on notes payable	—	—	(10,500)
Payments of capital lease obligations	—	—	(101,220)
Payments of long-term debt	(2,181,578)	(4,245,220)	—
Proceeds from long-term debt	1,937,897	1,813,704	967,917
Proceeds from exercised stock options	70,662	—	—
Other financing activities	(90,482)	—	—
Proceeds from sales of common stock and warrants	1,000,001	7,500,000	5,787,636
Net cash provided by financing activities	736,500	5,101,374	6,620,943
Net increase (decrease) in cash and cash equivalents	1,180,989	(1,734,479)	3,853,205
Cash and cash equivalents at beginning of period	3,331,445	5,065,924	1,212,719
Cash and cash equivalents at end of period	$ 4,512,434	$ 3,331,445	$ 5,065,924

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

Consolidated Statements of Stockholders' Equity

	Common Stock Shares	Common Stock Amount	Additional Paid-In Capital	Notes Receivable — Related Parties	Accumulated Deficit	Total Stockholders' Equity
Balance, December 31, 1992	14,450,000	$144,500	$ 855,500	$ (90,000)	$ (818,474)	$ 91,526
Increase in notes receivable	25,000	250	34,625	(27,765)	—	7,110
Business acquisitions	3,195,152	31,952	20,865,141	—	—	20,897,093
Sale of common stock — Boston Scientific Corporation	695,894	6,959	4,993,039	—	—	4,999,998
Sale of common stock — Union Carbide Chemicals and Plastics Company	85,409	854	612,810	—	—	613,664
Issuance of common stock for services rendered	15,000	150	97,800	—	—	97,950
Sale of common stock warrants	—	—	173,974	—	—	173,974
Issuance of common stock warrants	—	—	11,250	—	—	11,250
Net loss	—	—	—	—	(23,333,929)	(23,333,929)
Balance, December 31, 1993	18,466,455	184,665	27,644,139	(117,765)	(24,152,403)	3,558,636
Sale of common stock — Alcon Laboratories, Inc.	375,000	3,750	2,996,250	—	—	3,000,000
Sale of common stock — Genetics Institute, Inc.	375,000	3,750	2,996,250	—	—	3,000,000
Sales of common stock — Other	187,500	1,875	1,498,125	—	—	1,500,000
Issuance of common stock for services rendered	10,000	100	82,800	—	—	82,900
Decrease in notes receivable	—	—	—	32,890	—	32,890
Net loss	—	—	—	—	(1,899,701)	(1,899,701)
Balance, December 31, 1994	19,413,955	194,140	35,217,564	(84,875)	(26,052,104)	9,274,725
Sale of common stock — Manor Care, Inc.	115,607	1,156	998,845	—	—	1,000,001
Issuance of common stock for services rendered	8,000	80	69,920	—	—	70,000
Conversion of Revolving Credit	173,411	1,734	1,498,271	—	—	1,500,005
Business acquisition	3,573,743	35,737	30,877,140	—	—	30,912,877
Issuance of common stock under stock option plans	209,200	2,092	68,570	—	—	70,662
Net loss	—	—	—	—	(25,401,584)	(25,401,584)
Balance, December 31, 1995	23,493,916	$234,939	$68,730,310	$ (84,875)	$(51,453,688)	$ 17,426,686

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

Notes to Consolidated Financial Statements

1. BUSINESS

Integra LifeSciences Corporation and Subsidiaries (collectively, the "Company") intends to commercialize products in the emerging new extracellular matrix and biomaterials-based science of regenerative medicine, an enabling science that encourages the directed regeneration of new physiological body tissues and organs. The science makes use of the Company's proprietary specialized extracellular matrices which it calls Regeneration Template™ Devices. These are a form of biomaterial-based scaffolding, which enables the growth and regeneration of natural functioning substitute tissues and organs. With few exceptions, the human body will not ordinarily regenerate a substitute for its own diseased or damaged tissue or organs. The Company also has extracellular matrix based technologies which may allow for the therapeutic treatment of a wide range of cell based diseases.

In addition to its efforts to commercialize its biomaterials and extracellular matrix technologies, the Company utilizes its same base of medical biomaterials, proprietary technologies and expertise to manufacture and sell directly or through distribution arrangements over a dozen medical products which serve diverse medical markets including surgical hemostasis, ophthalmic, wound care, dental and infection control.

The Company has developed principally by combining existing businesses, acquiring synergistic technologies and forming strategic business and technological alliances. It acquired ABS LifeSciences Inc. (formerly Applied Biomedical Sciences, Inc.) and its wholly-owned subsidiary Medimatrix, Inc. in November 1990; Colla-Tec, Inc. (formerly a subsidiary of Marion Merrell Dow, Inc.) in June 1991; and certain technologies obtained from the Wound Care Division of Marion Merrell Dow, Inc. incorporated as Integra (Artificial Skin) Corp. in August 1991. The Company acquired Vitaphore Corporation (formerly a subsidiary of Union Carbide Chemical and Plastics Company, Inc.) as of April 30, 1993; substantially all of the assets and liabilities of Biomat Corporation incorporated as Biomaterials Corporation as of June 30, 1993; and Smith & Nephew Medical Limited's 50% interest in a joint venture with Vitaphore Corporation as of December 31, 1993. In August 1995, the Company acquired Telios Pharmaceuticals, Inc. (see Note 12).

There are certain risks and uncertainties inherent in the Company's business. The Company has incurred net operating losses since inception and expects to continue to incur such losses unless and until product sales and collaborative arrangements generate sufficient revenue to fund continuing operations. There can be no assurance that the Company's research and development efforts will result in commercially successful products or that the Company will be granted regulatory approvals for its products. In addition, the Company is subject to various other risks and uncertainties common within its industry which could have a material adverse effect on its business.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries, all of which are wholly-owned. All inter-company accounts and transactions are eliminated in consolidation.

Cash and Cash Equivalents

The Company considers all highly liquid investments purchased with original maturities of three months or less to be cash equivalents. Cash and cash equivalents is primarily composed of money market mutual funds, repurchase agreements and U.S. Government securities. The carrying values of these instruments reflect their approximate fair values.

Investments

On January 1, 1994, the Company adopted the provisions of Statement of Financial Accounting Standards ("SFAS") No. 115, "Accounting for Certain Investments in Debt and Equity Securities." There was no effect on income from the adoption of this Standard. Included in short-term investments at December 31, 1995 is one U.S. Government agency security that is classified as held-to-maturity with a market value of $1,192,320.

Liquidity

The Company completed a public offering in February 1996, resulting in net proceeds of $35.6 million (see Note 8). The Company believes that current cash balances and funds available from existing revenue sources will be sufficient to finance the Company's anticipated operations for at least the next twelve months. The Company may in the future seek to issue equity securities or enter into other financing arrangements with strategic partners to raise funds in excess of its anticipated liquidity and capital requirements.

Inventories

Inventories, consisting of purchased materials, direct labor and manufacturing overhead, are stated at the lower of cost (determined on the first-in, first-out method) or market.

Property and Equipment

Purchases of property and equipment are stated at cost. The Company provides for depreciation using the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized using the straight-line method over the minimum lease term or the life of the asset, whichever is shorter. The cost of major additions and improvements is capitalized. Maintenance and repair costs which do not improve or extend the lives of the respective assets are charged to operations as incurred. When depreciable assets are retired or sold, the cost and related accumulated depreciation are removed from the accounts and any resulting gain or loss is reflected in operations.

Intangible Assets

Acquired intangible assets are stated at cost and are amortized using the straight-line method over their estimated useful lives. The Company acquired an intangible asset in December 1993 which is being amortized over three years. For the years ended December 31, 1994 and 1995, the Company's amortization expense was $99,804.

Income Taxes

Effective January 1, 1993, the Company follows the provisions of SFAS 109, "Accounting for Income Taxes." Under the asset and liability method required by SFAS 109, deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the statement of operations in the period that includes the enactment date.

Research and Development

Research and development costs are expensed in the period in which they are incurred.

Revenue Recognition

The Company's product revenue is recognized at the time that products are shipped. Research grant revenue and contract product development revenue are recognized when the related expenses are incurred. Under the terms of current research grants, the Company is reimbursed for allowable direct and indirect research expenses. Product licensing fees are recognized when earned, which is generally when all related commitments have been satisfied. Royalty revenue is recognized when the Company's marketing and distribution partners sell royalty products.

Concentration of Credit Risk

Financial instruments which potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents and short-term investments which are held at major financial institutions and trade receivables. The Company's products are sold on an uncollateralized basis and on credit terms based upon a credit risk assessment of each customer. The Company's principal customers are generally well established and in some cases are industry leaders, or are affiliated with industry leaders, in the sales and marketing of medical devices. The Company's provision for doubtful accounts receivable for the years ended December 31, 1995, 1994 and 1993 were $185,316, $70,524 and $56,968, respectively. Amounts written off for the years ended December 31, 1995, 1994 and 1993 were $10,765, $39,000 and $10,200, respectively.

Loss per Share

Net loss per share is based on the weighted average number of common and common equivalent shares outstanding during the periods. Options and warrants have been excluded in the calculation of common and common equivalent shares as they are antidilutive.

New Accounting Pronouncements

In March 1995, the Financial Accounting Standards Board issued SFAS 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of," which requires companies to review their long-lived assets and certain identifiable intangibles (collectively, "Long-Lived Assets") for impairment whenever events or changes in circumstances indicate that the carrying value of a Long-Lived Asset may not be recoverable. The Company believes that the adoption of SFAS 121 will not have a material impact on its financial position or results of operations.

In October 1995, the Financial Accounting Standards Board issued SFAS 123, "Accounting for Stock-Based Compensation." SFAS 123 encourages, but does not require, companies to recognize compensation expense for grants of stock, stock options and other equity instruments to employees based on fair value accounting rules. SFAS 123 does require companies that choose not to adopt the fair value accounting rules to disclose pro forma net income (loss) and earnings (loss) per share data under the new method. The new disclosure requirements are generally effective for financial statements for years beginning after December 15, 1995. The Company expects to adopt the disclosure-only provisions of SFAS 123 in 1996.

Preparation of Financial Statements

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, including disclosures of contingent assets and liabilities, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Reclassifications

Certain 1993 and 1994 amounts have been reclassified to conform to the 1995 presentation.

3. ACQUISITION OF THE COMPANY

Pursuant to a stock sale agreement dated as of March 31, 1992, an officer/director of the prior owner and now an officer/director of the Company acquired 100% of the outstanding common stock of the Company in trust for himself and other family members ("Majority Shareholder").

4. INVENTORIES

Inventories consist of the following:

December 31,	1995	1994
Finished goods	$ 480,343	$385,043
Work-in-process	516,840	261,486
Raw materials	375,130	302,472
	$1,372,313	$949,001

5. PROPERTY AND EQUIPMENT

Property and equipment, net, consists of the following:

December 31,	1995	1994
Machinery and equipment	$ 4,546,880	$ 2,889,289
Furniture and fixtures	232,969	185,436
Leasehold improvements	6,865,841	4,770,838
Construction in progress	295,882	344,958
	11,941,572	8,190,521
Less: Accumulated depreciation and amortization	(2,335,776)	(1,041,158)
	$ 9,605,796	$ 7,149,363

Depreciation and amortization expense for the years ended December 31, 1995, 1994 and 1993 was $1,294,618, $609,428 and $558,718, respectively.

6. CURRENT LIABILITIES

Accrued expenses consist of the following:

December 31,	1995	1994
Legal fees	$ 315,514	$ 48,091
Contract research	188,423	263,952
Vacation	174,689	135,785
Other	583,145	531,465
	$1,261,771	$979,293

Accrued legal fees as of December 31, 1995 include costs related to the Company's patent portfolio, a public offering (see Note 8) and general and administrative activities.

Accrued plant closing costs represent the Company's estimate of costs to be incurred for the on-going costs of a California facility (see Notes 10 and 12). During the fourth quarter of 1994, the Company reduced the accrual for plant closing by $275,630 to reflect a reduction in anticipated costs associated with closing such facility. The change in accounting estimate is reflected as a reduction in acquired in-process research and development.

Other current liabilities as of December 31, 1995 include $97,355 related to fixed assets purchases. Included in other current liabilities as of December 31, 1994 was $581,000 related to the expansion of the Company's leased New Jersey facility, of which $229,764 was due to an engineering firm which became a stockholder of the Company in 1994 (see Notes 7, 8 and 10).

Deferred revenue as of December 31, 1994 relates principally to a $350,000 license fee for marketing and distribution rights for certain products granted by the Company, with such fee contingently refundable to the licensee. In August 1995, the contingency involving the fee was satisfied.

7. LONG-TERM DEBT

Related Party

At December 31, 1995, the Company had available a $3,500,000 revolving credit facility, as amended (the "Revolving Credit"), from a related party (the "Lender") to be used for general corporate purposes. The Lender is a corporation whose shareholders are trusts whose beneficiaries include beneficiaries of the Majority Shareholder. The Revolving Credit was collateralized by certain tangible and intangible assets of the Company and all of the capital stock of the Company's subsidiaries. Total amounts outstanding under the Revolving Credit, including accrued interest as of December 31, 1995 and 1994 amounted to $10,314 and $1,750,000, respectively.

In April 1995, the Company borrowed an additional $1,750,000 in principal under the Revolving Credit. In June 1995, $1,500,005 of the outstanding principal balance was converted into common stock of the Company at a price of $8.65 per share and the amount committed under the Revolving Credit was reduced from $5,000,000 to $3,500,000.

Interest on the outstanding principal amount of the Revolving Credit is computed at twelve percent (12%) per annum. During the term of the Revolving Credit, amounts may be borrowed, repaid and reborrowed. Outstanding principal and interest are to be paid to the Lender and the Revolving Credit is to expire the earlier of (a) August 15, 1996, (b) the closing of an initial public offering of equity securities by the Company or (c) the Company's private placement or placements of equity securities which nets to the Company an aggregate of $20,000,000. The Revolving Credit terminated in accordance with its terms on February 1, 1996 upon the closing of the public offering of the Company's common stock (see Note 8).

Integra Project Credit Line

The Company has completed its expansion of its leased facility in Plainsboro, New Jersey to house the INTEGRA™ Artificial Skin manufacturing operations, add additional administrative and support facilities and accommodate the move of the Vitaphore operations (see Notes 10 and 12). In December 1992, the Company entered into an agreement with an engineering firm (the "Contractor") to serve as construction manager for the renovation and the moving and installation of the INTEGRA™ Artificial Skin manufacturing equipment (the "Integra Project"). The Contractor agreed to finance a portion of the Integra Project by making available to the Company up to $1,500,000 of credit (the "Credit Line"). All disbursements made by the Contractor against the Credit Line accrued interest at the annual rate of three quarters percent (3/4%) over the prime rate of a local bank from the date of disbursement.

During 1994, the Company satisfied the Contractor's line of credit in full, by retiring $1,578,599 which included $78,599 of accrued interest. The line of credit was canceled upon final payment.

8. STOCKHOLDERS' EQUITY

Common Stock Transactions

In April 1994, in private placement transactions, the Company sold a total of 750,000 shares of its common stock, 375,000 shares each to Alcon Laboratories, Inc. ("Alcon") and Genetics Institute, Inc. ("GI") at a per share price of $8.00 for an aggregate value of $6,000,000.

In June 1994, in private placement transactions, the Company sold a total of 187,500 shares of common stock, 125,000 shares for $1,000,000 to the Contractor and its affiliates (see Notes 6 and 7) and 62,500 shares for $500,000 to a director of the Company.

In December 1994, the Company issued to Rutgers University ("Rutgers") 10,000 shares of its common stock in connection with the licensing of certain technologies from Rutgers. Such amount was expensed in 1994 (see Notes 14 and 18).

In April 1995, in a private placement transaction, the Company sold 115,607 shares of its common stock to Manor Care, Inc. at a price of $8.65 per share for an aggregate value of $1,000,001.

On February 1, 1996, the Company completed the issuance of 4,671,250 shares of its common stock through a public offering, resulting in net proceeds of approximately $35.6 million.

Contingent Shares

As contingent consideration for its acquisition of Vitaphore Corporation (see Note 12), the Company agreed to issue to Union Carbide Chemicals and Plastics Company, Inc. ("UCCP") on April 30, 1996 additional shares of its common stock up to a maximum of 2,197,675 shares, unless the Company enters into certain equity transactions before that date.

As a result of proceeds received from equity transactions through April 30, 1995, the obligation to issue additional shares of common stock to UCCP was eliminated.

Warrants

Boston Scientific Warrant

In conjunction with a 1993 private placement of 695,894 shares of the Company's common stock to Boston Scientific Corporation ("BSC"), the Company sold for additional consideration and issued to BSC a warrant (the "BSC Warrant") to purchase 695,894 shares of the Company's common stock at an exercise price of $7.185 per share. The BSC Warrant is exercisable through the earlier of December 29, 2003 or on the fourth anniversary of the closing date of a public offering of the Company's common stock.

Massachusetts Institute of Technology Warrant

As partial consideration for a technology license entered into with Massachusetts Institute of Technology ("MIT") (see Note 14), the Company granted to MIT a warrant (the "MIT Warrant") to purchase 45,000 shares of the Company's common stock at an exercise price of $7.50 per share. The exercise price increased by $1.00 per share on May 1, 1994 and an additional $1.00 per share on May 1, 1995. The MIT Warrant expires December 31, 1996 and is exercisable prior to such date either by payment of the exercise price or in exchange for a pro rata share of the Company's publicly traded common stock following a public offering.

Stockholders' Rights

As stockholders of the Company, UCCP, BSC, Alcon and GI are entitled to registration rights.

Notes Receivable — Related Parties

Notes receivable — related parties are recourse notes due from two officers of the Company and a former officer of the Company with specified maturity dates through August 1996. The notes are collateralized by shares of the Company or rights to acquire shares of the Company.

9. STOCK OPTIONS

As of December 31, 1995, the Company has in effect two stock option plans, the 1992 Stock Option Plan (the "1992 Plan") and the 1993 Incentive Stock Option and Non-qualified Stock Option Plan (the "1993 Plan").

The Company has reserved 2,550,000 shares of common stock for issuance under the 1992 Plan. The 1992 Plan permits the Company to grant both incentive and non-qualified stock options to designated directors, officers, employees and associates of the Company. Options become exercisable over specified periods, generally 2% or less per month one year after date of grant, and generally expire five years from the date of grant. The Company has reserved 1,500,000 shares of common stock for issuance under the 1993 Plan. The 1993 Plan permits the Company to grant both incentive and non-qualified stock options to designated directors, officers, employees and associates of the Company. Options issued under the 1993 Plan become exercisable over specified periods, generally within five years from the date of grant.

All options granted under both plans were at the common stock's fair market value or greater at the dates of grant. For the three years ended December 31, 1995, option activity for each plan was as follows:

	Option Price Per Share	Outstanding
1992 Plan:		
December 31, 1992, Outstanding	$0.265	2,550,000
December 31, 1993, Outstanding	0.265	2,550,000
Canceled	0.265	(705,500)
December 31, 1994, Outstanding	0.265	1,844,500
Granted	8.650	510,000
Exercised	0.265	(207,000)
December 31, 1995, Outstanding	0.265 - 8.650	2,147,500
December 31, 1995, Exercisable	0.265 - 8.650	1,333,226
December 31, 1995, Available for Grant		195,500
1993 Plan:		
Granted	$6.530	619,750
December 31, 1993, Outstanding	6.530	619,750
Granted	7.185 - 8.000	422,000
Canceled	6.530 - 7.185	(122,720)
December 31, 1994, Outstanding	6.530 - 8.000	919,030
Granted	8.000 - 8.650	466,750
Exercised	7.185	(2,200)
Canceled	6.530 - 8.650	(188,610)
December 31, 1995, Outstanding	6.530 - 8.650	1,194,970
December 31, 1995, Exercisable	6.530 - 8.650	412,458
December 31, 1995, Available for Grant		302,830

10. LEASES

The Company leases all of its facilities through noncancelable operating lease agreements. In November 1992, a corporation whose shareholders are trusts whose beneficiaries include beneficiaries of the Majority Shareholder acquired from independent third parties a 50% interest in the general partnership from which the Company leases its approximately 35,000 square foot administrative, manufacturing, research and principal warehouse facility in Plainsboro, New Jersey.

The lease provides for rent escalations of 13.3%, 10.1% and 8.5% in the years 1997, 2002 and 2007, respectively. The total amount of the minimum lease payments related to the New Jersey facility is being charged to expense on the straight-line method over the term of the lease. In 1995, the Company completed constructing, as a leasehold improvement, a 10,000 square foot addition to the building.

In 1994, the Company leased and otherwise obtained the use of a four building, approximately 25,000 square foot, medical facility in West Chester, Pennsylvania. The facilities were acquired in April 1994 by a related party and are leased and otherwise made available for use by the Company as of May 1, 1994. The lease and usage agreement provides that the Company is obligated to pay monthly non-escalating fixed amounts for the facility for a period of five years, with three five-year options to extend the lease, in exchange for operating control and 80% guaranteed majority usage of two buildings comprising approximately 22,000 square feet; and preferred access and 49% guaranteed minority usage of two buildings comprising approximately 3,000 square feet. The intent of the lease and usage agreement was to make available to the Company the lease and/or use of premises, including freeze drying facilities and production assets, warehouse space, avian collagen processing equipment and additional administration space. On January 1, 1996, the Company exercised an option under the lease and usage agreement to obtain exclusive use of the facilities.

The Company is currently leasing a 15,000 square foot portion of a facility in San Diego, California on a month-to-month basis, and is currently seeking an alternative arrangement for its San Diego, California operation.

The Company also leases a 32,000 square foot facility in Menlo Park, California. The lease terminates in March 1996 and provides for biennial rent escalations based on inflationary factors. As of August 1994, the entire facility is subleased under two separate noncancelable operating leases, expiring in March 1996. In 1994, the Company transferred all of its operations conducted at this facility to its New Jersey and Pennsylvania facilities (see Note 6).

The Company is required to pay for utilities, taxes, insurance and maintenance at its principal leased facilities.

The Company also leases facilities for storage under short-term agreements in both New Jersey and Pennsylvania.

Future minimum lease payments under operating leases and receipts under sub-lease agreements with third parties at December 31, 1995 were as follows:

	Related Parties	Third Parties	Sublease Receipts	Net
1996	$ 365,000	$115,000	$(100,000)	$ 380,000
1997	369,000	—	—	369,000
1998	390,000	—	—	390,000
1999	270,000	—	—	270,000
2000	210,000	—	—	210,000
Thereafter	2,794,000	—	—	2,794,000
Total minimum lease payments and receipts	$4,398,000	$115,000	$(100,000)	$4,413,000

All sublease receipts are related to the Menlo Park, California facility (see Note 6).

Total rental expense for the years ended December 31, 1995, 1994 and 1993 was $468,000, $618,000 and $581,000, respectively. Such amounts exclude amounts accrued in connection with the plant closing accrual for the Menlo Park, California facility. Sublease receipts for the years ended December 31, 1995, 1994 and 1993 were $601,000, $429,000 and $105,000, respectively.

11. INCOME TAXES

The temporary differences which give rise to deferred tax assets and (liabilities) are presented below:

December 31,	1995	1994
Inventory reserves and capitalization	$ 378,000	$ 211,000
Deferred revenue	—	140,000
Provision for plant closing	36,000	114,000
Intangibles and other assets	171,000	106,000
Net operating loss and tax credit carryforwards	22,956,000	6,095,000
Total deferred tax assets before valuation allowance	23,541,000	6,666,000
Valuation allowance	(23,468,000)	(6,644,000)
Net deferred tax assets	73,000	22,000
Depreciation	(73,000)	(22,000)
Total deferred tax liabilities	(73,000)	(22,000)
Net deferred tax asset	$ —	$ —

A reconciliation of the United States Federal statutory rate to the Company's effective tax rate for the years ended December 31, 1995, 1994 and 1993 is as follows:

	1995	1994	1993
Federal statutory rate	(34.0)%	(34.0)%	(34.0)%
Expenses not deductible for tax purposes:			
Acquired in-process research and development	26.3 %	(4.9)%	30.0 %
Other	(1.3)%	2.3 %	0.2 %
Increase in valuation allowance for deferred tax assets and net operating losses not recognized	9.0 %	36.6 %	3.8 %
Effective tax rate	—	—	—

At December 31, 1995, the Company has net operating loss carryforwards of approximately $13 million and $8 million for federal and state income tax purposes, respectively, to offset future taxable income, if any, which expire through 2010 and 2002, respectively.

At December 31, 1995, several of the Company's subsidiaries have unused net operating loss and tax credit carryforwards arising from periods prior to the Company's ownership. The net operating loss carryforwards (excluding Telios) of approximately $10 million for federal income tax purposes expire between 2002 and 2009. The Company's Telios subsidiary has generated approximately $73 million of net operating losses, which expire between 2002 and 2010. The amount of Telios' net operating losses that are available and the Company's ability to utilize such losses is dependent on the value of Telios at the date of acquisition. The timing and manner in which these net operating losses may be utilized in any year by the Company are severely limited by the Internal Revenue Code of 1986, as amended, Section 382 and other provisions of the Internal Revenue Code and its applicable regulations.

12. BUSINESS ACQUISITIONS

Telios Pharmaceuticals, Inc.

On April 11, 1995, the Company entered into an acquisition agreement with Telios setting forth the terms and conditions under which the Company would acquire all of the outstanding equity securities of Telios. On July 21, 1995, the United States Bankruptcy Court for the Southern District of California (the "Bankruptcy Court") confirmed the Combined Disclosure Statement and Plan of Reorganization (the "Plan") proposed by Telios and the Company. Effective August 15, 1995, the Company acquired Telios by issuing 3,573,743 shares of the Company's common stock valued at $30,912,877, or $8.65 per share. The Company's shares and certain cash disbursements were (or will be) made in conjunction with the confirmation of the Plan under US bankruptcy laws and pursuant to Section 1145 of the Bankruptcy Code.

The acquisition was accounted for by the purchase method of accounting and, accordingly, the purchase price and the expenses associated with the acquisition have been allocated to the assets acquired and the liabilities assumed at the date of acquisition as follows:

Cash and cash equivalents	$13,116,670
Accounts receivable	74,879
Prepaid expenses	343,868
Fixed assets	1,309,975
Other assets	9,413
In-process research and development	19,592,567
Accounts payable and accrued liabilities	(576,141)
Bankruptcy claims	(2,717,373)
	$31,153,858

The acquired in-process research and development has no alternative use and was charged to expense at the date of acquisition.

The bankruptcy claim liabilities include pre-petition and post-petition claims, which are to be satisfied in cash after the acquisition date. As of December 31, 1995, $2,699,781 of these claims have been paid.

The unaudited pro forma summary information presents the consolidated results of operations as if the acquisition had occurred at the beginning of the following periods:

	Year Ended December 31, 1995	Year Ended December 31, 1994
Total revenue	$ 10,261,000	$ 10,761,000
Net loss	$(10,640,000)	$(20,952,000)
Net loss per share	$(.47)	$(.93)

The unaudited pro forma summary information was prepared based on assumptions that the Company deems appropriate, but the results are not necessarily indicative of those that might have occurred had the acquisition actually occurred at the beginning of each of the years presented. Telios' results of operations and cash flows are included in the consolidated financial statements effective August 16, 1995.

Vitaphore Wound Healing, Inc.

Effective December 31, 1993 the Company acquired from Smith & Nephew Medical Limited its fifty percent (50%) interest in a joint venture with the Company's Vitaphore subsidiary and Smith & Nephew Medical Limited, in exchange for 50,000 shares of the Company's common stock valued at $359,250. In addition, as of such date Vitaphore agreed to disclose certain of its collagen technologies to Smith & Nephew Research which has agreed to hold such disclosures confidential.

The Company has a right to manufacture or receive a royalty for any products developed by Smith & Nephew Research out of such technology. The acquisition was accounted for by the purchase method of accounting and, accordingly, the purchase price has been allocated to the assets acquired and the liabilities assumed at the date of the acquisition as follows:

Cash and cash equivalents	$ 11,757
Accounts receivable	136,149
Other assets	299,427
Accounts payable and accrued liabilities	(88,083)
	$359,250

The results of operations and cash flows of Vitaphore Wound Healing, Inc. are included in the consolidated financial statements effective January 1, 1994.

Biomat Corporation

Effective June 30, 1993, a wholly-owned subsidiary of the Company acquired substantially all of the assets and assumed substantially all of the liabilities of Biomat Corporation in exchange for 80,000 shares of the common stock of the Company valued at $522,400. The acquisition was accounted for by the purchase method of accounting and, accordingly, the purchase price and the expenses associated with the acquisition have been allocated to the assets acquired and the liabilities assumed at the date of acquisition as follows:

In-process research and development	$555,910
Accounts payable and accrued liabilities	(14,368)
Notes payable	(12,000)
	$529,542

The acquired in-process research and development has no alternative use and was charged to expense at the date of acquisition.

The results of operations and cash flows of Biomat Corporation are included in the consolidated financial statements effective July 1, 1993.

Vitaphore Corporation

Effective April 30, 1993 the Company acquired all of the issued and outstanding common stock (100 shares) of Vitaphore Corporation from UCCP in exchange for 3,065,152 shares (approximately 17.5% of the then issued and outstanding shares) of the Company's common stock valued at $20,015,443. Contingently, UCCP was entitled to additional shares of the Company's common stock (see Note 8).

The acquisition was accounted for by the purchase method of accounting and, accordingly, the purchase price and the expenses associated with the acquisition have been allocated to the assets acquired and the liabilities assumed at the date of acquisition as follows:

Cash and equivalents	$ 71,490
Accounts receivable	791,293
Inventories	355,458
Prepaid expenses	19,391
Fixed assets	1,384,618
Other assets	34,907
In-process research and development	20,086,159
Accounts payable and accrued liabilities	(2,584,539)
Capital lease obligations	(101,220)
	$20,057,557

The acquired in-process research and development has no alternative use and was charged to expense at the date of acquisition.

Of the costs assigned to accounts payable and accrued liabilities, approximately $2,000,000 represents costs expected to be incurred to close the Vitaphore facility in California and to relocate all Vitaphore operations to the Company's facilities in New Jersey and Pennsylvania (see Note 6).

Colla-Tec, Inc.

As partial consideration for its 1991 acquisition of Colla-Tec from Marion Merrell Dow, Inc. ("MMDI"), MMDI is entitled to receive contingent deferred consideration payable in either cash or in common stock of Colla-Tec, at the election of MMDI, based upon the sales of certain Colla-Tec products during each year of the deferral period (the five-year period commencing July 1, 1991 and ending June 30, 1996). The yearly contingent amount is calculated as the aggregate of (i) 3% of eligible sales in excess of $2,500,000 and up to $5,000,000, (ii) 5% of eligible sales in excess of $5,000,000 and up to $10,000,000 and (iii) 3% of eligible sales in excess of $10,000,000 during each deferral year period.

Payment of any contingent deferred consideration in the form of cash will be made in five equal annual installments upon the conclusion of the deferral period, subject to restrictions on the available cash flow of Colla-Tec.

Payment of any contingent deferred consideration in the form of common stock shall not exceed 5% of the then outstanding common stock of Colla-Tec. Any payments of contingent consideration will be accounted for as an additional cost of the acquisition of Colla-Tec. However, the financial statements will not reflect this additional cost until the contingency and the value of the deferred consideration, if any, are determinable. No accruals for contingent consideration have been made through December 31, 1995 and based on levels of historical and anticipated eligible sales, the Company believes that any future contingent consideration is likely to be negligible.

13. EMPLOYEE BENEFIT PLAN

Effective January 1, 1994, the Company adopted a 401(k) Profit Sharing Plan and Trust ("401(k) Plan") for eligible employees and their beneficiaries. All employees are eligible to participate in the plan once they become full-time employees and attain the age of 21. The 401(k) Plan provides for employee contributions through a salary reduction election. Employer discretionary matching and discretionary profit sharing contributions, which are determined annually by the Company, vest over a six-year period of service. For the years ended December 31, 1995 and 1994, the Company's discretionary matching was based on a percentage of salary reduction elections not to exceed a $1,000 contribution per eligible participant, and totaled $20,800 and $11,700, respectively. No discretionary profit sharing contribution was made in 1995 or 1994.

14. ROYALTIES, LICENSE AND DEVELOPMENT AGREEMENTS

MIT Patents

In 1991, MMDI assigned to the Company its interest in certain license agreements between MMDI and MIT (the "MMDI Agreement") which gave MMDI exclusive access to patent rights for use in the field of regenerative medicine. MMDI also granted to the Company a worldwide exclusive license to utilize certain technology necessary to continue the development and commercialization of the patent rights that are the subject of the MMDI Agreement. The first product that the Company has commercialized under the MMDI Agreement

is the INTEGRA™ Artificial Skin product. As consideration for the rights and license granted to the Company, the Company has agreed to pay to MMDI royalties equal to a percentage of the net sales of any products subject to the MMDI Agreement. The Company's financial statements do not reflect any cost for this acquisition of regenerative medical technology.

As a result of the 1993 acquisition of substantially all of the assets of Biomat Corporation (see Note 12), the Company acquired rights to certain other MIT technology for use in fields related to regenerative medicine (the "Biomat License Agreement"). In December 1993, the Company entered into a license agreement with MIT (the "Integra License Agreement") in which (i) the Company and MIT agreed to amend and restate the MMDI Agreement and the Biomat License Agreement, (ii) MIT granted the Company an exclusive license to additional patent rights with broad use in the field of regenerative medicine and (iii) MIT modified the consideration payable by the Company to MIT for access to all MIT technology subject to such license. The Integra License Agreement provides for payments to MIT in the form of a common stock warrant (see Note 8) and royalties on product sales. During 1995, the Company exported limited quantities of the INTEGRA™ Artificial Skin product. Royalties associated with these sales were not material.

Rutgers Agreement

In 1993, the Company acquired an option to license from Rutgers patents describing a certain class of biodegradable polymers for medical applications. As consideration for the option, the Company paid Rutgers an option fee, which has been expensed, and agreed to fund a limited one-year research program at Rutgers to evaluate the technology.

In 1993, the Company applied for, and was awarded by the United States Department of Commerce, a three-year, $2,000,000 grant to fund the development of this technology. In December 1994, the Company exercised its option and entered into a license agreement with Rutgers (see Note 8), which grants to the Company certain exclusive proprietary rights for development and provides for the Company to pay to Rutgers a percentage royalty on the sale of all products commercialized under the license agreement. As of December 31, 1995, the Company has not commercialized products under such agreements that would be subject to royalties.

Peripheral Nerve and Cartilage Development

In 1994 and 1995, the Company sponsored clinical trials using animals to test the efficacy of collagen-based regenerative medicine products for use in peripheral nerve and cartilage regeneration. The development of peripheral nerve technology is being tested in primates at Duke University Medical Center and cartilage development is being tested at The Hospital for Joint Diseases in New York. The Company has contracted to initiate Phase I human clinical trials for its peripheral nerve regeneration product in Copenhagen, Denmark. The Company is exploring the possibility of starting human clinical trials for cartilage regeneration in the near future.

In 1992 and 1993, the Company was awarded two Phase II SBIR grants, each in the amount of $500,000, to partially fund research through 1995. As of December 31, 1995, the Company has utilized a substantial portion of these funds in the development of this research.

Brigham and Women's Hospital, Inc.

In January 1995, the Company acquired the rights to develop, manufacture and sell products resulting from cultural epithelial autograft methods patented by the Brigham and Women's Hospital, Inc., for which the Company will fund a limited one-year research effort and pay a royalty on the sales of any products that may be commercialized from the use of these technologies.

Conrad

In January 1995, the Company was awarded a one-year, $225,000 grant in collaboration with the Eastern Virginia Medical School to further develop polymer based materials for use in reproductive health applications under the Contraceptive Research and Development (CONRAD) program. The Company has the right to negotiate distribution agreements for any products developed through this collaboration.

La Jolla Cancer Research Foundation

The Company has an agreement with La Jolla Cancer Research Foundation ("LJCRF") which grants it an exclusive license to LJCRF's adhesion peptide technology and a right of first refusal to obtain a license on other technology. The term of the license agreement is for the life of the related patent rights. Any patent applications, issued patents or improvements related to LJCRF's technology, but made by the Company, belong to and are owned by LJCRF and are exclusively licensed to the Company. The licensing agreement includes a commitment to pay LJCRF 10% of all option and license fees and milestone payments paid by sublicensees (up to an aggregate of $500,000 per year) through 1995 and 20% (up to an aggregate of $1,000,000 per year) thereafter. In addition, a royalty based on net sales of product containing licensed technology is payable to LJCRF. As of December 31, 1995, the Company has not commercialized products that would be subject to royalties.

Cambridge Antibody Technology Limited

In January 1996, the Company and Cambridge Antibody Technology Limited ("CAT") entered into an agreement consisting of a license to CAT of certain rights to use anti-TGF-ß antibodies for the treatment of fibrotic diseases and the granting of a right of first refusal to CAT for certain rights relating to decorin, a molecule believed to mediate the production of TGF-ß in humans and animals. The Company received, in January 1996, a $500,000 licensing fee and is entitled to market any dermal application products developed with royalties payable to CAT. The Company will receive royalties upon the sale by CAT of licensed products other than those directed at dermal applications.

Other Royalty, License and Development Agreements

The Company has multiple-year agreements to (i) exclusively develop, manufacture and sell to Alcon certain collagen-based devices currently in development for use in the field of ophthalmics, for which the Company had product development revenue in 1994 of $393,000 and (ii) supply certain existing collagen-based devices to GI for use with GI's recombinant bone morphogenic protein technology.

As consideration for certain other technology, manufacturing, distribution and selling rights and licenses granted to the Company, the Company has agreed to pay royalties on the sales of products that are commercialized relative to the granted rights and licenses. Royalty payments by the Company were not significant for any of the periods presented.

15. LEGAL MATTERS

The Company and its former insurance carrier were involved in litigation in which a former employee claimed damages resulting in lost income in excess of $2,000 per month from November 1992 to August 2007. This matter was settled during 1995 with the former employee withdrawing all claims.

In January 1994, one of the Company's subsidiaries entered into a five-year distribution agreement with the distributor of the Company's Chronicure product pursuant to which the distributor is obligated to purchase certain minimum quantities of wound care products. In October 1995, the Company's subsidiary filed a complaint in the United States District Court for the District of New Jersey claiming the distributor breached the distribution agreement by, among others things, not paying the subsidiary for certain products delivered. In November 1995, the distributor filed an affirmative defense and counterclaim alleging, among other things, fraudulent misrepresentation and breach of contract and seeking damages of approximately $1.2 million plus unspecified punitive damages. The Company intends to defend the counterclaim vigorously.

16. CONSULTING AND EMPLOYMENT AGREEMENTS

In December 1992, the Company entered into two separate agreements with one of the inventors (the "Inventor") of INTEGRA™ Artificial Skin whereby the Inventor will act as an exclusive advisor and consultant with respect to all matters concerning INTEGRA™ Artificial Skin and the development of Regenerative Templates for a wide variety of tissue regeneration applications. After December 31, 1997, the consulting agreement is renewable at the option of the Company. The Company's agreements with its consultants require payments through December 1999 in the aggregate amount of $177,000.

At December 31, 1995, the Company has employment agreements with four employees that expire at specified dates through 1997 and require the Company to make total aggregate payments in the amount of $618,750 through that date.

17. MAJOR CUSTOMER DATA

A substantial portion of the Company's products are sold to customers under the terms of multiple-year marketing and distribution agreements that provide for purchase and supply commitments on the part of the customer and the Company, respectively. In many cases, marketing customers have paid license fees to the Company for the marketing and distribution rights. Of the reported product sales for the years ended December 31, 1995, 1994 and 1993, four customers accounted for 56% (Customer A 21%, Customer B 12%, Customer C 12% and Customer D 11%), four customers accounted for 62% (Customer A 27%, Customer D 15%, Customer B 10% and Customer E 10%) and three customers accounted for 57% (Customer A 28%, Customer D 16% and Customer F 13%), respectively. One of the major customers in 1994 also paid $393,000 in contract product development for the year ended December 31, 1994. For the years ended December 31, 1995, 1994 and 1993, the Company's foreign export sales, primarily to Europe and Japan, were 11%, 13% and 5% of total product sales, respectively.

18. SUPPLEMENTAL CASH FLOW INFORMATION

Cash paid for interest, excluding capitalized interest of $78,599 in 1994, was $187,583, $416,621 and $2,100 for the years ended December 31, 1995, 1994 and 1993, respectively. There was no cash paid for income taxes during the periods presented.

Included in other current liabilities at December 31, 1995 and 1994 is $97,355 and $581,000, respectively, related to fixed asset additions and leasehold improvements which were paid after year end.

In 1994 and 1993, the Contractor for the Integra Project provided $945,896 and $632,703, respectively, of financing under the Integra Project Credit Line (see Note 7).

Common stock of the Company valued at $82,900 was issued to Rutgers in connection with a licensing agreement in 1994 (see Note 14). Common stock of the Company valued at $70,000 and $97,950 was issued to three investment banks for advisory services rendered during 1995 and 1993, respectively.

A warrant was issued in 1993 to purchase 45,000 shares of the Company's common stock with such warrant valued at $11,250 (see Note 8).

In connection with three business acquisitions during 1993 the Company issued 3,195,152 of its common stock with an aggregate value of $20,897,093 (see Note 12).

In connection with the August 1995 acquisition of Telios, the Company issued 3,573,743 of its common stock with an aggregate value of $30,912,877 (see Note 12).

As part of an executive compensation agreement, notes receivable-related parties of $120,000 were forgiven, $60,000 of which was a non-cash transaction for the year ended December 31, 1994.

A $30,000 note receivable-related parties collateralized by common stock of a subsidiary of the Company was converted to a $34,875 note receivable from the same officer and collateralized by common stock of the Company in 1993.

In 1995, the Company and the Lender (see Note 7) agreed to convert $1,500,005 of the Revolving Credit to common stock at a price of $8.65 per share.

MARKET FOR THE COMPANY'S COMMON STOCK AND RELATED STOCKHOLDER MATTERS

Market for Common Stock

Integra LifeSciences Corporation began trading on The Nasdaq National Market on August 16, 1995 under the symbol IART. The following table represents the high and low sales prices for the Company's Common Stock for each quarter since its initial trading date. On March 19, 1996, the last reported sale price of the Company's Common Stock was $12.00.

	High	Low
1995: Third Quarter	$10.00	$4.50
Fourth Quarter	$ 8.75	$6.25

Holders of Record

The number of shareholders of record of the Company's Common Stock as of December 31, 1995 was 318.

Dividends

The Company does not currently pay dividends on its Common Stock and does not anticipate paying dividends in the foreseeable future.

EXECUTIVE/SENIOR OFFICERS

Richard E. Caruso, Ph.D.
Chairman, President and Chief Executive Officer **

Robert J. Towarnicki
Executive Vice President, Technology and Business Development and Director

Frederick Cahn, Ph.D.
Senior Vice President, Technology

Andre P. Decarie
Senior Vice President, Marketing and Sales

John R. Emery
Senior Vice President, Operations and Finance

Michael D. Pierschbacher, Ph.D.
Senior Vice President, Research and Development

Judith E. O'Grady
Vice President, Regulatory Affairs

George L. Brode, Ph.D.
Distinguished Research Fellow

Surendra P. Batra, Ph.D.
Vice President, Production Development

Robert G. Runckel
Vice President, International Marketing

OUTSIDE DIRECTORS

Keith Bradley, Ph.D.
Director **,***
Professor of International Management and Director of Business Research, The Open University Business School, Milton Keynes, England

William M. Goldstein, Esq.
Director and Secretary ***
Managing Partner and Chairman of the Tax Department, Drinker Biddle & Reath

Frederic V. Malek
Director
Chairman of Thayer Capital Partners

George W. McKinney, III, Ph.D
Director
President and Chief Executive Officer, Gel Sciences, Inc. and Managing Director, Beacon Venture Management Corporation

James M. Sullivan
Director *
Senior Vice President, Marriott Lodging and Marriott Hotels, Resorts and Suites

Edmund L. Zalinski, Ph.D.
Director *
Retired, formerly Chairman of the Board, American Capital Open End Funds

*Audit Committee Member
**Compensation Committee Member
***Stock Option Committee Member

CORPORATE INFORMATION

Annual Meeting
Integra LifeSciences Corporation will hold its fiscal 1996 Annual Meeting of Shareholders at 10:00 a.m., Monday, May 6, 1996, at the Nassau Inn, 10 Palmer Square, Princeton, New Jersey.

Transfer Agent
Chemical Mellon Shareholder Services L.L.C.
New York, New York

Independent Auditors
Coopers & Lybrand L.L.P.
Princeton Forrestal Village
136-300 Main Street
Princeton, New Jersey 08540

Corporate Counsel
Drinker Biddle & Reath
47 Hulfish Street
Princeton, New Jersey 08542

Shareholders may obtain, without charge, a copy of the Company's Annual Report on Form 10-K for 1995 upon written request delivered to:
Investor Relations
Integra LifeSciences Corporation
105 Morgan Lane
Plainsboro, New Jersey 08536

Left to right: John R. Emery, Robert J. Towarnicki, Richard E. Caruso, Ph.D., and Andre P. Decarie are members of the President's Business Management Team.

Integra LifeSciences Corporation
105 Morgan Lane
Plainsboro, New Jersey 08536