

INTEGRA LIFESCIENCES HOLDINGS CORP  
Form 10-Q  
October 31, 2011  
Table of Contents

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

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended September 30, 2011

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

For the transition period from            to

COMMISSION FILE NO. 0-26224

**INTEGRA LIFESCIENCES HOLDINGS CORPORATION**

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

Edgar Filing: INTEGRA LIFESCIENCES HOLDINGS CORP - Form 10-Q

<b>DELAWARE</b> (STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	<b>51-0317849</b> (I.R.S. EMPLOYER IDENTIFICATION NO.)
<b>311 ENTERPRISE DRIVE</b>	
<b>PLAINSBORO, NEW JERSEY</b> (ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)	<b>08536</b> (ZIP CODE)
<b>REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (609) 275-0500</b>	

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

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

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

Large accelerated filer <input checked="" type="checkbox"/>	Accelerated filer <input type="checkbox"/>
Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company <input type="checkbox"/>

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

The number of shares of the registrant's Common Stock, \$0.01 par value, outstanding as of October 27, 2011 was 26,821,221

**Table of Contents**

**INTEGRA LIFESCIENCES HOLDINGS CORPORATION**

**INDEX**

	Page Number
<b><u>PART I. FINANCIAL INFORMATION</u></b>	
<b><u>Item 1. Financial Statements</u></b>	3
<u>Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2011 and 2010 (Unaudited)</u>	3
<u>Condensed Consolidated Balance Sheets as of September 30, 2011 and December 31, 2010 (Unaudited)</u>	4
<u>Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2011 and 2010 (Unaudited)</u>	5
<u>Notes to Unaudited Condensed Consolidated Financial Statements</u>	6
<b><u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>	20
<b><u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u></b>	32
<b><u>Item 4. Controls and Procedures</u></b>	32
<b><u>PART II. OTHER INFORMATION</u></b>	
<b><u>Item 1. Legal Proceedings</u></b>	34
<b><u>Item 1A. Risk Factors</u></b>	34
<b><u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u></b>	34
<b><u>Item 4. Reserved and Removed</u></b>	
<b><u>Item 6. Exhibits</u></b>	35
<b><u>SIGNATURES</u></b>	36
<b><u>Exhibit 31.1</u></b>	
<b><u>Exhibit 31.2</u></b>	
<b><u>Exhibit 32.1</u></b>	
<b><u>Exhibit 32.2</u></b>	
<b><u>EX-101 INSTANCE DOCUMENT</u></b>	
<b><u>EX-101 SCHEMA DOCUMENT</u></b>	
<b><u>EX-101 CALCULATION LINKBASE DOCUMENT</u></b>	
<b><u>EX-101 DEFINITION LINKBASE DOCUMENT</u></b>	
<b><u>EX-101 LABELS LINKBASE DOCUMENT</u></b>	
<b><u>EX-101 PRESENTATION LINKBASE DOCUMENT</u></b>	

**Table of Contents****PART I. FINANCIAL INFORMATION**

## Item 1. Financial Statements

**INTEGRA LIFESCIENCES HOLDINGS CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

**(UNAUDITED)**

(In thousands, except per share amounts)

	Three Months Ended September 30, 2011		Nine Months Ended September 30, 2010	
	2011	2010	2011	2010
Total Revenue	\$ 202,185	\$ 186,641	\$ 576,555	\$ 537,934
Costs and Expenses:				
Cost of product revenues	78,651	69,194	216,410	196,882
Research and development	13,187	11,721	38,049	34,783
Selling, general and administrative	87,508	75,738	263,324	222,465
Intangible asset amortization	4,548	2,679	11,609	9,273
Total costs and expenses	183,894	159,332	529,392	463,403
Operating income	18,291	27,309	47,163	74,531
Interest income	154	59	354	172
Interest expense	(7,587)	(4,390)	(19,778)	(13,231)
Other income (expense), net	429	(707)	379	1,202
Income before income taxes	11,287	22,271	28,118	62,674
Income tax expense	44	5,788	4,689	15,812
Net income	\$ 11,243	\$ 16,483	\$ 23,429	\$ 46,862
Basic net income per common share	\$ 0.39	\$ 0.56	\$ 0.80	\$ 1.57
Diluted net income per common share	\$ 0.39	\$ 0.55	\$ 0.79	\$ 1.54
Weighted average common shares outstanding (See Note 11):				
Basic	28,583	29,572	29,234	29,638
Diluted	29,029	30,072	29,820	30,226

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

**Table of Contents****INTEGRA LIFESCIENCES HOLDINGS CORPORATION****CONDENSED CONSOLIDATED BALANCE SHEETS****(UNAUDITED)**

(In thousands)

	September 30, 2011	December 31, 2010
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 110,991	\$ 128,763
Trade accounts receivable, net of allowances of \$7,063 and \$7,322	117,777	106,005
Inventories, net	181,430	146,928
Deferred tax assets	37,800	35,284
Prepaid expenses and other current assets	28,330	27,869
Total current assets	476,328	444,849
Property, plant and equipment, net	122,435	99,456
Intangible assets, net	243,934	194,904
Goodwill	294,529	261,928
Deferred tax assets	24,766	7,894
Other assets	12,674	10,102
Total assets	\$ 1,174,666	\$ 1,019,133
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current Liabilities:		
Borrowings under senior credit facility	\$	\$ 108,438
Accounts payable, trade	35,475	27,783
Deferred revenue	3,629	4,444
Accrued compensation	26,491	27,562
Accrued expenses and other current liabilities	38,838	33,630
Total current liabilities	104,433	201,857
Long-term borrowings under senior credit facility	192,500	139,688
Long-term convertible securities	349,104	155,154
Deferred tax liabilities	8,614	10,645
Other liabilities	18,494	11,826
Total liabilities	673,145	519,170
Commitments and contingencies		
Stockholders Equity:		
Preferred Stock; no par value; 15,000 authorized shares; none outstanding		
Common stock; \$0.01 par value; 60,000 authorized shares; 35,899 and 35,745 issued at September 30, 2011 and December 31, 2010, respectively	359	359
Additional paid-in capital	600,852	552,227
Treasury stock, at cost; 8,722 shares and 7,212 shares at September 30, 2011 and December 31, 2010, respectively	(352,669)	(283,658)

## Edgar Filing: INTEGRA LIFESCIENCES HOLDINGS CORP - Form 10-Q

Accumulated other comprehensive (loss) income:

Foreign currency translation adjustment	(183)	(870)
Pension liability adjustment, net of tax	(571)	(771)
Unrealized loss on derivatives, net of tax	(2,526)	(154)
Retained earnings	256,259	232,830

Total stockholders' equity	501,521	499,963
----------------------------	---------	---------

Total liabilities and stockholders' equity	\$ 1,174,666	\$ 1,019,133
--	--------------	--------------

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

**Table of Contents**

**INTEGRA LIFESCIENCES HOLDINGS CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(UNAUDITED)

(In thousands)

	Nine Months Ended September 30,	
	2011	2010
<b>OPERATING ACTIVITIES:</b>		
Net income	\$ 23,429	\$ 46,862
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	37,303	28,668
Deferred income tax benefit	(4,450)	(1,664)
Amortization of debt issuance costs	2,630	1,065
Non-cash interest expense	7,119	5,519
Payment of accreted interest		(6,599)
Loss on disposal of property and equipment		163
Share-based compensation	18,897	11,453
Excess tax benefits from stock-based compensation arrangements	(844)	(3,475)
Changes in assets and liabilities, net of business acquisitions:		
Accounts receivable	(777)	(4,257)
Inventories	(6,788)	(8,403)
Prepaid expenses and other current assets	(546)	4,104
Other non-current assets	(61)	(209)
Accounts payable, accrued expenses and other current liabilities	(4,185)	12,349
Deferred revenue	(816)	(567)
Other non-current liabilities	(1,278)	(7,868)
 Net cash provided by operating activities	 69,633	 77,141
<b>INVESTING ACTIVITIES:</b>		
Cash used in business acquisition, net of cash acquired	(149,420)	(4,171)
Purchases of property and equipment	(25,381)	(18,897)
 Net cash used in investing activities	 (174,801)	 (23,068)
<b>FINANCING ACTIVITIES:</b>		
Borrowings under senior credit facility	135,000	75,000
Repayments under senior credit facility	(190,625)	(15,000)
Proceeds from liability component of convertible notes	186,830	
Proceeds from equity component of convertible notes	43,170	
Repurchase of liability component of convertible notes		(71,351)
Proceeds from the sale of stock purchase warrants	28,451	
Purchase of option hedge on convertible notes	(42,895)	
Debt issuance costs	(8,064)	(6,796)
Purchases of treasury stock	(69,011)	(31,278)
Proceeds from exercised stock options	3,544	5,702
Excess tax benefits from stock-based compensation arrangements	844	3,475

## Edgar Filing: INTEGRA LIFESCIENCES HOLDINGS CORP - Form 10-Q

Net cash provided by (used in) financing activities	87,244	(40,248)
Effect of exchange rate changes on cash and cash equivalents	152	(2,884)
Net change in cash and cash equivalents	(17,772)	10,941
Cash and cash equivalents at beginning of period	128,763	71,891
Cash and cash equivalents at end of period	\$ 110,991	\$ 82,832

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



---

**Table of Contents**

**INTEGRA LIFESCIENCES HOLDINGS CORPORATION**

**NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**1. BASIS OF PRESENTATION**

**General**

The terms we, our, us, Company and Integra refer to Integra LifeSciences Holdings Corporation, a Delaware corporation, and its subsidiaries unless the context suggests otherwise.

In the opinion of management, the September 30, 2011 unaudited condensed consolidated financial statements contain all adjustments (consisting only of normal recurring adjustments) necessary for a fair statement of the financial position, results of operations and cash flows of the Company. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted in accordance with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. These unaudited condensed consolidated financial statements should be read in conjunction with the Company's consolidated financial statements for the year ended December 31, 2010 included in the Company's Annual Report on Form 10-K. The December 31, 2010 condensed consolidated balance sheet was derived from audited financial statements but does not include all disclosures required by accounting principles generally accepted in the United States. Operating results for the three- and nine-month periods ended September 30, 2011 are not necessarily indicative of the results to be expected for the entire year.

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, the disclosure of contingent liabilities, and the reported amounts of revenues and expenses. Significant estimates affecting amounts reported or disclosed in the consolidated financial statements include allowances for doubtful accounts receivable and sales returns and allowances, net realizable value of inventories, valuation of intangible assets including in-process research and development, amortization periods for acquired intangible assets, discount rates and estimated projected cash flows used to value and test impairments of long-lived assets and goodwill, estimates of projected cash flows and depreciation and amortization periods for long-lived assets, computation of taxes, valuation allowances recorded against deferred tax assets, the valuation of stock-based compensation, valuation of pension assets and liabilities, valuation of derivative instruments, valuation of the equity component of convertible debt instruments, the fair value debt instruments, and loss contingencies. These estimates are based on historical experience and on various other assumptions that are believed to be reasonable under the current circumstances. Actual results could differ from these estimates.

Certain amounts from the prior year's financial statements have been reclassified in order to conform to the current year's presentation.

**Recently Issued Accounting Standards**

On September 15, 2011 the Financial Accounting Standards Board issued *Accounting Standards Update No. 2011-08, Intangibles - Goodwill and Other (Topic 350), Testing Goodwill for Impairment*. The revised standard is intended to reduce the cost and complexity of the annual goodwill impairment test by providing the option of performing a qualitative assessment to determine whether further impairment testing is necessary. Under this standard, the Company has the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, the Company determines that it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, performing the two-step impairment test under Topic 350 is unnecessary. However, if the Company concludes otherwise, it is required to perform the first step of the two-step impairment test, as described in Topic 350. If the carrying amount of a reporting unit exceeds its fair value under the first step, the Company is required to perform the second step of the goodwill impairment test to measure the amount of the impairment loss, if any. The Company also has the option to bypass the qualitative assessment for any reporting unit in any period and to proceed directly to performing the first step of the two-step goodwill impairment test. The Company may resume performing the qualitative assessment in any subsequent period. This standard is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, and early adoption is permitted. The Company believes that the adoption of this standard will not have a material impact on the Company's financial statements.

On June 16, 2011 the Financial Accounting Standards Board issued *Accounting Standards Update No. 2011-05, Presentation of Comprehensive Income*. This standard eliminates the option to report other comprehensive income and its components in the statement of changes in equity. The Company may elect to present items of net income and other comprehensive income in one continuous statement or in two consecutive statements. Each component of net income and each component of other comprehensive income, together with totals for comprehensive income and its two parts - net income and other comprehensive income - would need to be displayed under either alternative, and the statements would

## Edgar Filing: INTEGRA LIFESCIENCES HOLDINGS CORP - Form 10-Q

need to be presented with equal prominence as the other primary financial statements. This standard does not change 1) the items that constitute net income and other comprehensive income, 2) when an item of other comprehensive income must be reclassified to net income, or 3) the computation for earnings per share - which will continue to be based on net income. This standard is effective for fiscal years beginning after December 15, 2011, and the Company has not yet determined which method it will elect upon adoption.

**Table of Contents**

On May 12, 2011 the Financial Accounting Standards Board issued *Accounting Standards Update No. 2011-04 - Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS*. This standard merges many aspects of fair value measurement guidance by amending U.S. GAAP and creating a new standard under International Financial Reporting Standards. The primary changes to U.S. GAAP include 1) clarifying the valuation premise of highest and best use, 2) clarifying how portfolios of financial instruments are measured, 3) clarifying the use of blockage factors and other premiums and discounts, and 4) increasing the disclosure requirements in a number of circumstances. This standard is effective for fiscal years beginning after December 15, 2011, and the Company believes the standard will not have a material impact on the Company's financial statements.

**Supplemental Cash Flow Information**

During the nine months ended September 30, 2010, 282,086 stock options were exercised, whereby in lieu of a cash payment for the exercise price, an option holder tendered 73,546 shares of Company stock that had a fair market value of approximately \$3.1 million. These tendered shares were then immediately retired.

**2. BUSINESS ACQUISITIONS****Ascension Orthopedics, Inc.**

On September 23, 2011, the Company acquired Ascension Orthopedics, Inc. ( Ascension ) for \$66.5 million, which includes amounts paid into escrow, subject to certain working capital adjustments. Ascension, based in Austin, Texas, develops and distributes a range of implants for the shoulder, elbow, wrist, hand, foot and ankle.

The following summarizes the preliminary allocation of the purchase price based on fair value of the assets acquired and liabilities assumed (in thousands):

Cash	\$ 627	
Inventory	13,283	
Accounts receivable	2,917	
Other current assets	2,398	
Property, plant and equipment	4,649	
Other long-term assets	70	
Deferred tax asset - long term	13,075	
Intangible assets:		Wtd. Avg. Life:
Technology	7,885	10 years
Customer relationships	5,750	12 years
In-process research and development	1,739	Indefinite
Supplier relationship	4,510	10 years
Brand name	560	1 year
Goodwill	14,854	
<b>Total assets acquired</b>	<b>72,317</b>	
Accounts payable and other liabilities	5,827	
<b>Net assets acquired</b>	<b>\$ 66,490</b>	

**Table of Contents**

Management determined the preliminary fair value of net assets acquired during the third quarter of 2011. The goodwill recorded in connection with this acquisition is based on the benefits that the Company expects to generate from Ascension's future cash flows. The goodwill acquired will not be deductible for tax purposes.

**SeaSpine, Inc.**

On May 23, 2011, the Company acquired all of the outstanding common stock of SeaSpine, Inc. ( SeaSpine ) for \$89.0 million, subject to certain working capital adjustments and indemnification holdbacks totaling \$8.0 million, which are accrued at September 30, 2011. SeaSpine is based in Vista, California and designs, develops and manufactures spinal fixation products and synthetic bone substitute products.

The following summarizes the preliminary allocation of the purchase price based on fair value of the assets acquired and liabilities assumed (in thousands):

Cash	\$ 201	
Inventory	14,900	
Accounts receivable	7,608	
Other current assets	623	
Property, plant and equipment	9,177	
Deferred tax asset - long term	302	
Intangible assets:		Wtd. Avg. Life:
Technology	3,000	8 years
Customer relationships	41,200	13 years
Non-compete agreements	1,900	4 years
Brand name	300	1 year
Goodwill	14,897	
<b>Total assets acquired</b>	<b>94,108</b>	
Accounts payable and other liabilities	5,108	
<b>Net assets acquired</b>	<b>\$ 89,000</b>	

Management determined the preliminary fair value of net assets acquired during the second quarter of 2011. The goodwill recorded in connection with this acquisition is based on the benefits that the Company expects to generate from SeaSpine's future cash flows. For tax purposes, the Company is treating the acquisition as an asset acquisition; therefore, the goodwill will be deductible for tax purposes.

**Integra Neurosciences Pty Ltd.**

In October 2008, the Company acquired Integra Neurosciences Pty Ltd. in Australia and Integra Neurosciences Pty Ltd. in New Zealand for \$4.0 million (6.0 million Australian dollars) in cash at closing, \$0.3 million in acquisition expenses and working capital adjustments, and up to \$2.1 million based on the exchange rates in effect at the time of the acquisition (3.1 million Australian dollars) in future payments based on the performance of business in the three years after closing. The Company paid approximately \$0.9 million (1.0 million Australian dollars) of this potential revenue performance obligation in November 2009 for the first revenue performance year, and another \$1.0 million (1.0 million Australian dollars) in December 2010 for the second revenue performance year. The Company accrued \$1.0 million (1.0 million Australian dollars) at September 30, 2011 for the third revenue performance year.

**Theken**

In August 2008, the Company acquired Theken Spine, LLC, Theken Disc, LLC and Therics, LLC (collectively, Integra Spine ) for \$75.0 million in cash, subject to certain adjustments, acquisition expenses of \$2.4 million, working capital adjustments of \$3.9 million, and up to \$125.0 million in future payments based on the revenue performance of the business in each of the two years after closing. The Company paid approximately \$52.0 million for the first-year revenue performance obligation in November 2009. From November 2009 through June 30, 2011

the Company had accrued a total of \$4.6 million to settle a dispute related to a disagreement

**Table of Contents**

in the calculation of trade sales used in determining the revenue performance payment for the first year revenue performance obligation; the Company settled the dispute and paid this entire obligation in August 2011 (see Note 14, Commitments and Contingencies). There are no amounts due for the second performance year.

**Pro Forma Results**

The following unaudited pro forma financial information summarizes the results of operations for the three months and nine months ended September 30, 2011 and 2010 as if the acquisitions completed by the Company during 2011 had been completed as of January 1, 2010. The acquisitions consummated during 2010 were not considered material and therefore, their impact has not been included below. The pro forma results are based upon certain assumptions and estimates, and they give effect to actual operating results prior to the acquisitions and adjustments to reflect (i) increased interest expense, depreciation expense, intangible asset amortization and fair value inventory step-up, (ii) decreases in certain expenses that will not be recurring in the post-acquisition entity, and (iii) income taxes at a rate consistent with the Company's statutory rate. No effect has been given to other cost reductions or operating synergies. The supplemental pro-forma earnings for the three and nine months ended September 30, 2011 were adjusted to exclude \$1.7 million and \$3.2 million, respectively, of nonrecurring expenses for acquisition-related costs, the fair value adjustment to acquisition-date inventory, and amortization. As a result, these pro forma results do not necessarily represent results that would have occurred if the acquisitions had taken place on the basis assumed above, nor are they indicative of the results of future combined operations.

	<b>Three Months Ended September 30,</b>		<b>Nine Months Ended September 30,</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
	(In thousands, except per share amounts)			
Total Revenue	\$ 206,048	\$ 203,795	\$ 608,375	\$ 589,505
Net income	\$ 9,924	\$ 13,418	\$ 17,945	\$ 36,866
Net income per share:				
Basic	\$ 0.35	\$ 0.45	\$ 0.61	\$ 1.24
Diluted	\$ 0.34	\$ 0.44	\$ 0.60	\$ 1.21

**3. INVENTORIES**

Inventories, net consisted of the following:

	<b>September 30,</b>	<b>December 31,</b>
	<b>2011</b>	<b>2010</b>
	(In thousands)	
Finished goods	\$ 112,552	\$ 87,508
Work-in process	39,184	31,536
Raw materials	29,694	27,884
	\$ 181,430	\$ 146,928

**Table of Contents****4. GOODWILL AND OTHER INTANGIBLE ASSETS**

Changes in the carrying amount of goodwill for the nine months ended September 30, 2011 were as follows (in thousands):

Goodwill	\$ 261,928
Accumulated impairment losses	
<b>Goodwill at December 31, 2010</b>	<b>261,928</b>
Ascension acquisition	14,854
SeaSpine acquisition	14,897
Integra Spine earnout	1,200
Integra Neurosciences Pty Ltd. earnout	1,059
Foreign currency translation	591
<b>Goodwill at September 30, 2011</b>	<b>\$ 294,529</b>

The Company performs its assessment of the recoverability of goodwill annually during the second quarter and it is based upon a comparison of the carrying value of goodwill with its estimated fair value. The Company performed its most recent assessment during the second quarter of 2011, and that assessment resulted in no impairment.

The Company performs its assessment of the recoverability of indefinite-lived intangible assets annually during the second quarter, and it is based upon a comparison of the carrying value of such assets to their estimated fair values. The Company performed its most recent assessment during the second quarter of 2011, which resulted in an impairment of \$0.9 million related to one brand name asset that it will no longer use as a result of its rebranding strategy. This charge has been recorded as a component of amortization expense.

During the nine months ended September 30, 2011, the Company recorded impairment charges to definite-lived intangible assets of \$1.6 million related to technology assets whose related products are being discontinued and \$0.2 million related to a brand name that will no longer be used because of its rebranding strategy. The Company has recorded the charges as a component of cost of product revenues and amortization expense, respectively.

The components of the Company's identifiable intangible assets were as follows (dollars in thousands):

	Weighted Average Life	September 30, 2011			December 31, 2010		
		Cost	Accumulated Amortization	Net	Cost	Accumulated Amortization	Net
Completed technology	12 years	\$ 77,644	\$ (31,585)	\$ 46,059	\$ 69,261	\$ (28,062)	\$ 41,199
Customer relationships	12 years	147,032	(54,289)	92,743	99,290	(45,505)	53,785
Trademarks/brand names	35 years	33,697	(9,720)	23,977	33,448	(8,467)	24,981
Trademarks/brand names	Indefinite	48,484		48,484	49,384		49,384
Supplier relationships	30 years	33,810	(5,258)	28,552	29,300	(4,525)	24,775
All other*	15 years	12,059	(7,940)	4,119	8,440	(7,660)	780
		\$ 352,726	\$ (108,792)	\$ 243,934	\$ 289,123	\$ (94,219)	\$ 194,904

## Edgar Filing: INTEGRA LIFESCIENCES HOLDINGS CORP - Form 10-Q

\* At September 30, 2011, all other included in-process research and development of \$1.7 million, which was indefinite lived. At December 31, 2010 all other included in-process research and development of \$0.3 million which was indefinite lived. During the second quarter of 2011, this asset was placed in service as a component of completed technology.

Based on quarter-end exchange rates, annual amortization expense is expected to approximate \$24.2 million in 2011, \$25.2 million in 2012, \$19.2 million in 2013, \$18.3 million in 2014 and \$16.3 million in 2015. Identifiable intangible assets are initially recorded at fair market value at the time of acquisition using an income or cost approach.



---

**Table of Contents****5. DEBT****2016 Convertible Senior Notes**

On June 15, 2011, the Company issued \$230.0 million aggregate principal amount of its 1.625% Convertible Senior Notes due 2016 (the 2016 Notes). The 2016 Notes mature on December 15, 2016, and bear interest at a rate of 1.625% per annum payable semi-annually in arrears on December 15 and June 15 of each year. The portion of the debt proceeds that the Company had classified as equity at the time of the offering was \$43.2 million, and the Company is amortizing that amount to interest expense using the effective interest method through December 2016. The effective interest rate implicit in the liability component is 5.6%. In connection with this offering, the Company capitalized approximately \$6.3 million of financing fees. At September 30, 2011, the carrying amount of the liability component was \$188.9 million, the remaining unamortized discount was \$41.1 million, and the principal amount outstanding was \$230.0 million. The fair value of the 2016 Notes at September 30, 2011 was approximately \$201.3 million.

The 2016 Notes are senior, unsecured obligations of the Company, and are convertible into cash and, if applicable, shares of its common stock based on an initial conversion rate, subject to adjustment of 17.4092 shares per \$1,000 principal amount of 2016 Notes (which represents an initial conversion price of approximately \$57.44 per share). The Company will satisfy any conversion of the 2016 Notes with cash up to the principal amount of the 2016 Notes pursuant to the net share settlement mechanism set forth in the indenture and, with respect to any excess conversion value, with shares of the Company's common stock. The 2016 Notes are convertible only in the following circumstances: (1) if the closing sale price of the Company's common stock exceeds 150% of the conversion price during a period as defined in the indenture; (2) if the average trading price per \$1,000 principal amount of the 2016 Notes is less than or equal to 98% of the average conversion value of the 2016 Notes during a period as defined in the indenture; (3) at any time on or after June 15, 2016; or (4) if specified corporate transactions occur. The issue price of the 2016 Notes was equal to their face amount, which is also the amount holders are entitled to receive at maturity if the 2016 Notes are not converted. As of September 30, 2011, none of these conditions existed with respect to the 2016 Notes and as a result, the 2016 Notes are classified as long term.

Holders of the 2016 Notes who convert their notes in connection with a qualifying fundamental change, as defined in the related indenture, may be entitled to a make-whole premium in the form of an increase in the conversion rate. Additionally, following the occurrence of a fundamental change, holders may require that the Company repurchase some or all of the 2016 Notes for cash at a repurchase price equal to 100% of the principal amount of the notes being repurchased, plus accrued and unpaid interest, if any.

The 2016 Notes, under the terms of the private placement agreement, are guaranteed fully by Integra LifeSciences Corporation, a subsidiary of the Company. The Notes are the Company's direct senior unsecured obligations and rank equal in right of payment to all of the Company's existing and future unsecured and unsubordinated indebtedness.

In connection with the issuance of the 2016 Notes, the Company entered into call transactions and warrant transactions, primarily with affiliates of the initial purchasers of the Notes (the hedge participants). The cost of the call transactions to the Company was approximately \$42.9 million, representing options to buy 4.0 million shares from the hedge participants at an initial strike price of \$57.44 per share, subject to customary anti-dilution adjustments. These transactions are expected to reduce the potential dilution upon conversion of the 2016 Notes. The Company received approximately \$28.5 million of proceeds from the warrant transactions, representing an obligation to potentially deliver 4.0 million shares to the hedge participants at an initial strike price of \$70.05 per share, subject to customary anti-dilution adjustments. The earliest expiration of these warrant transactions is March 15, 2017 and they continue to expire through the 100th scheduled trading day thereafter, as defined in the indenture. The warrants could separately have a dilutive effect on the Company's earnings per share if the market price of its common stock exceeds the strike price of the warrants.

**Amended and Restated Senior Credit Agreement**

On August 10, 2010, the Company entered into an amended and restated credit agreement with a syndicate of lending banks (the Senior Credit Facility) and further amended the Senior Credit Facility on June 8, 2011. The June 8, 2011 amendment increased the revolving credit component from \$450.0 million to \$600.0 million and eliminated the \$150.0 million term loan component that existed under the original amended and restated credit agreement, allows the Company to further increase the size of the revolving credit component by an aggregate of \$200.0 million with additional commitments, provides the Company with decreased borrowing rates and annual commitment fees, and provides more favorable financial covenants. The Senior Credit Facility's maturity was extended from August 10, 2015 to June 8, 2016 and is collateralized by substantially all of the assets of the Company's U.S. subsidiaries, excluding intangible assets. In connection with the June 8, 2011 amendment, the Company capitalized \$1.3 million of incremental financing costs, expensed \$0.4 million of incremental financing costs, and expensed \$0.4 million of previously capitalized financing costs. The Senior Credit Facility is subject to various financial and negative covenants and at September 30, 2011, the Company was in compliance with all such covenants.

## Edgar Filing: INTEGRA LIFESCIENCES HOLDINGS CORP - Form 10-Q

Borrowings under the Senior Credit Facility currently bear interest, at the Company's option, at a rate equal to (i) the Eurodollar Rate (as defined in the Senior Credit Facility, which definition has not changed) in effect from time to time plus the applicable rate (ranging from 1.00% to 1.75%) or (ii) the highest of (x) the weighted average overnight Federal funds rate, as published by the Federal Reserve

**Table of Contents**

Bank of New York, plus 0.5%, (y) the prime lending rate of Bank of America, N.A. or (z) the one-month Eurodollar Rate plus 1.0%. The applicable rates are based on the Company's consolidated total leverage ratio (defined as the ratio of (a) consolidated funded indebtedness less cash in excess of \$40 million that is not subject to any restriction of the use or investment thereof to (b) consolidated EBITDA) at the time of the applicable borrowing.

The Company will also pay an annual commitment fee (ranging from 0.15% to 0.3%, based on the Company's consolidated total leverage ratio) on the daily amount by which the revolving credit facility exceeds the outstanding loans and letters of credit under the credit facility.

At September 30, 2011 and December 31, 2010, there was \$192.5 million and \$100.0 million outstanding, respectively, under the revolving credit component of the Senior Credit Facility at a weighted average interest rate of 1.7% and 2.5%, respectively. At September 30, 2011, there was approximately \$407.5 million available for borrowing under the Senior Credit Facility. The fair value of outstanding borrowings under the Senior Credit Facility at September 30, 2011 was approximately \$172.6 million. The Company considers the balance to be long-term in nature based on its current intent and ability to repay the borrowing outside of the next twelve-month period.

At December 31, 2010, there was \$148.1 million outstanding under the term loan component of the Senior Credit Facility at an interest rate of 2.6%, and as noted above, this portion of the credit facility was eliminated and replaced with borrowings under the revolving credit component in June 2011.

**2010 and 2012 Senior Convertible Notes**

On June 11, 2007, the Company issued \$165.0 million aggregate principal amount of its 2010 Notes and \$165.0 million aggregate principal amount of its 2012 Notes (the 2010 Notes and the 2012 Notes, collectively the Notes). The 2010 Notes and the 2012 Notes bear interest at a rate of 2.75% per annum and 2.375% per annum, respectively, in each case payable semi-annually in arrears on December 1 and June 1 of each year. The portion of the debt proceeds that the Company had classified as equity at the time of the offering was \$16.4 million for the 2010 Notes and \$30.6 million for the 2012 Notes. The Company is amortizing those amounts to interest expense using the effective interest method through June 2010 for the 2010 Notes, and through June 2012 for the 2012 Notes. The effective interest rate implicit in the liability component was 6.5% for the 2010 Notes and 6.8% for the 2012 Notes. The 2010 Notes were paid off in June 2010 in accordance with their terms. At September 30, 2011, the carrying amount of the liability component of the 2012 Notes was \$160.2 million, the remaining unamortized discount was \$4.8 million, and the principal amount outstanding was \$165.0 million. At December 31, 2010, the carrying amount of the liability component of the 2012 Notes was \$155.2 million, the remaining unamortized discount was \$9.8 million, and the principal amount outstanding was \$165.0 million. The entire carrying amount of the 2012 Notes is classified as long-term in the September 30, 2011 balance sheet as the Company has the intent and ability to settle the obligation with long-term borrowings from its Senior Credit Facility. The fair value of the 2012 Notes at September 30, 2011 was approximately \$162.6 million.

The 2012 Notes are senior, unsecured obligations of the Company, and are convertible into cash and, if applicable, shares of its common stock based on an initial conversion rate, subject to adjustment, of 15.3935 shares per \$1,000 principal amount of notes (which represents an initial conversion price of approximately \$64.96 per share). The Company will satisfy any conversion of the 2012 Notes with cash up to the principal amount pursuant to the net share settlement mechanism set forth in the indenture and, with respect to any excess conversion value, with shares of the Company's common stock. The 2012 Notes are convertible only in the following circumstances: (1) if the closing sale price of the Company's common stock exceeds 130% of the conversion price during a period as defined in the indenture; (2) if the average trading price per \$1,000 principal amount of the 2012 Notes is less than or equal to 97% of the average conversion value of the 2012 Notes during a period as defined in the indenture; (3) anytime after December 15, 2011; or (4) if specified corporate transactions occur. None of these conditions existed with respect to the 2012 Notes as of September 30, 2011. The 2012 Notes are classified as long-term based on the Company's intent and ability to settle the obligation with long-term borrowings from its Senior Credit Facility. The issue price of the 2012 Notes was equal to their face amount, which is also the amount holders are entitled to receive at maturity if the 2012 Notes are not converted.

In connection with the issuance of the 2012 Notes, the Company entered into call transactions and warrant transactions, primarily with affiliates of the initial purchasers of the Notes (the hedge participants). The cost of the call transactions to the Company was approximately \$30.4 million, representing options to buy 2.5 million shares from the hedge participants at an initial strike price of approximately \$64.96 per share, subject to customary anti-dilution adjustments. These transactions are expected to reduce the potential dilution upon conversion of the notes. The Company received approximately \$12.2 million of proceeds from the warrant transactions, representing an obligation to potentially deliver 2.5 million shares to the hedge participants at an initial strike price of approximately \$77.96 per share, subject to customary anti-dilution adjustments. These warrant transactions expire on various dates between August 30, 2012 and January 23, 2013 and could separately have a dilutive effect on the Company's earnings per share if the market price of its common stock exceeds the strike price of the warrants.



**Table of Contents****Convertible Note Interest**

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

	Three Months Ended September 30, 2011		Nine Months Ended September 30, 2010	
	2011	2010	2011	2010
	(amounts in thousands)			
<b>2016 Notes :</b>				
Non-cash interest	\$ 1,691	\$	\$ 2,026	\$
Cash Interest	934		1,090	
Total	\$ 2,625	\$	\$ 3,116	\$
<b>2012 Notes :</b>				
Non-cash interest	\$ 1,726	\$ 1,614	\$ 5,093	\$ 4,760
Cash Interest	980	980	2,940	2,940
Total	\$ 2,706	\$ 2,594	\$ 8,033	\$ 7,700
<b>2010 Notes :</b>				
Non-cash interest	\$	\$	\$	\$ 1,190
Cash Interest				830
Total	\$	\$	\$	\$ 2,020

**6. DERIVATIVE INSTRUMENTS****Interest Rate Hedging**

The Company's interest rate risk relates to U.S. dollar denominated variable LIBOR interest rate borrowings. The Company uses an interest rate swap derivative instrument entered into on August 10, 2010 with an effective date of December 31, 2010 to manage its earnings and cash flow exposure to changes in interest rates by converting a portion of its floating-rate debt into fixed-rate debt beginning on December 31, 2010. This interest rate swap expires on August 10, 2015.

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

The Company expects that approximately \$1.9 million of pre-tax losses recorded as net in AOCI related to the interest rate hedge could be reclassified to earnings within the next twelve months.

**Foreign Currency Hedging**

From time to time the Company enters into foreign currency hedge contracts intended to protect the U.S. dollar value of certain forecasted foreign currency denominated transactions. There were no foreign currency hedge contracts outstanding as of September 30, 2011 or December 31, 2010. The Company records the effective portion of any change in the fair value of foreign currency cash flow hedges in AOCI, net of tax, until the hedged item affects earnings. Once the related hedged item affects earnings, the Company reclassifies the effective portion of any related unrealized gain or loss on the foreign currency cash flow hedge to earnings. If the hedged forecasted transaction does not occur, or if

## Edgar Filing: INTEGRA LIFESCIENCES HOLDINGS CORP - Form 10-Q

it becomes probable that it will not occur, the Company will reclassify the amount of any gain or loss on the related cash flow hedge to earnings at that time.

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

**Table of Contents**Counterparty Credit Risk

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

Fair Value of Derivative Instruments

The Company has classified all of its derivative instruments within Level 2 of the fair value hierarchy because observable inputs are available for substantially the full term of the derivative instruments. The following table summarizes the fair value, notional amounts presented in U.S. dollars, and presentation in the consolidated balance sheet for derivatives designated as hedging instruments as of September 30, 2011 and December 31, 2010:

Location on Balance Sheet (a):	Fair Value as of	
	September 30, 2011	December 31, 2010
	(In thousands)	
<b>Derivative Assets:</b>		
Interest rate swap    Other assets (b)	\$	\$ 1,825
<b>Derivative Liabilities:</b>		
Interest rate swap    Accrued expenses and other current liabilities (b)	\$ 1,860	\$ 2,095
Interest rate swap    Other liabilities (b)	\$ 2,572	\$

- (a) The Company classifies derivative assets and liabilities as current based on the cash flows expected to be incurred within the following 12 months.
- (b) At September 30, 2011 and December 31, 2010, the notional amount related to the Company's sole interest rate swap was \$142.5 million and \$148.1 million, respectively. In the subsequent twelve months, the Company expects to reduce these amounts by \$11.2 million and \$8.4 million, respectively.

The following presents the effect of derivative instruments designated as cash flow hedges on the accompanying consolidated statements of operations during the three and nine months ended September 30, 2011 and 2010:

	Amount of Gain (Loss) Recognized in AOCI- Effective Portion (In thousands)	Amount of Gain (Loss) Reclassified from AOCI Into Earnings- Effective Portion (In thousands)	Location in Statements of Operations
<b>Three Months Ended September 30, 2011</b>			
Interest rate swap	\$ (3,116)	\$ (591)	Interest (expense)

Edgar Filing: INTEGRA LIFESCIENCES HOLDINGS CORP - Form 10-Q

<b>Three Months Ended September 30, 2010</b>			
Currency hedge contracts	\$ 3,430	\$ 3,437	Other income (expense)
Interest rate swap	(2,644)		Interest (expense)
	\$ 786	\$ 3,437	
<b>Nine Months Ended September 30, 2011</b>			
Interest rate swap	\$ (5,897)	\$ (1,735)	Interest (expense)
<b>Nine Months Ended September 30, 2010</b>			
Currency hedge contracts	\$ 1,695	\$ 1,718	Other income (expense)
Interest rate swap	(2,644)		Interest (expense)
	\$ (949)	\$ 1,718	



## **Table of Contents**

The Company recognized no gains or losses resulting from ineffectiveness of cash flow hedges during the three and nine months ended September 30, 2011 and 2010.

### **7. STOCK-BASED COMPENSATION**

As of September 30, 2011, the Company had stock options, restricted stock awards, performance stock awards, contract stock awards and restricted stock unit awards outstanding under six plans, the 1996 Incentive Stock Option and Non-Qualified Stock Option Plan (the 1996 Plan ), the 1998 Stock Option Plan (the 1998 Plan ), the 1999 Stock Option Plan (the 1999 Plan ), the 2000 Equity Incentive Plan (the 2000 Plan ), the 2001 Equity Incentive Plan (the 2001 Plan ), and the 2003 Equity Incentive Plan (the 2003 Plan, and collectively, the Plans ). No new awards may be granted under the 1996 Plan, the 1998 Plan, the 1999 Plan and the 2000 Plan.

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

#### **Stock Options**

The Company granted approximately 34,000 and 59,000 stock options during the nine months ended September 30, 2011 and September 30, 2010, respectively. As of September 30, 2011, there were approximately \$0.7 million of total unrecognized compensation costs related to unvested stock options. These costs are expected to be recognized over a weighted-average period of approximately 2 years. The Company received net proceeds of \$3.5 million and \$5.7 million from stock option exercises for the nine months ended September 30, 2011 and 2010, respectively.

#### **Awards of Restricted Stock, Performance Stock and Contract Stock**

Performance stock awards have performance features associated with them. Performance stock, restricted stock and contract stock awards generally have requisite service periods of three years. The Company expenses the fair value of these awards on a straight-line basis over the vesting period or requisite service period, whichever is shorter. As of September 30, 2011, there were approximately \$12.4 million of total unrecognized compensation costs related to unvested awards. The Company expects to recognize these costs over a weighted-average period of approximately 2 years.

On May 17, 2011, in connection with the extension of the employment agreement with the chief executive officer, the Company provided a grant of 165,000 contract stock/stock units ( SUs ). As the SUs vested at the grant date, the Company recognized a charge of approximately \$8.4 million upon issuance, which was included in selling, general and administrative expenses.

The Company has no formal policy related to the repurchase of shares for the purpose of satisfying stock-based compensation obligations.

The Company also maintains an Employee Stock Purchase Plan (the ESPP ), which provides eligible employees with the opportunity to acquire shares of common stock at periodic intervals by means of accumulated payroll deductions. The ESPP is a non-compensatory plan based on its terms.

### **8. TREASURY STOCK**

On October 29, 2010, the Company's Board of Directors authorized the Company to repurchase shares of the Company's common stock for an aggregate purchase price not to exceed \$75.0 million through December 31, 2012. Shares may be purchased either in the open market or in privately negotiated transactions. As of September 30, 2011, there remained \$43.6 million available for share repurchases under this authorization. In addition to the authorization above, on June 3, 2011, the Company's Board of Directors separately authorized the Company to repurchase shares of common stock from the proceeds of the 2016 Notes in connection with that offering.

## Edgar Filing: INTEGRA LIFESCIENCES HOLDINGS CORP - Form 10-Q

The following table sets forth the Company's treasury stock activity:

	<b>Nine Months Ended September 30, 2011</b>	
	<b>\$</b>	<b># of Shares</b>
	<b>(In thousands)</b>	
Shares repurchased in the open market in connection with the Board approved buyback program authorized on October 29, 2010	\$ 31,441	704
Shares repurchased in connection with the issuance of the 2016 Notes	37,570	805
<b>Total</b>	<b>\$ 69,011</b>	<b>1,509</b>

The Company repurchased an additional 0.4 million shares between October 1, 2011 and October 20, 2011 for an aggregate amount of \$14.4 million.

**Table of Contents****9. RETIREMENT BENEFIT PLANS**

The Company maintains defined benefit pension plans that cover employees in its manufacturing plants located in Andover, United Kingdom (the UK Plan) and Tuttlingen, Germany (the Germany Plan). The Company closed the Tuttlingen, Germany plant in December 2005. The Company did not terminate the Germany Plan, and the Company remains obligated for the accrued pension benefits related to this plan. The plans cover certain current and former employees.

Effective March 31, 2011, the Company froze the benefits due to the participants of the UK Plan in their entirety; this curtailment resulted in a \$0.3 million reduction in the projected benefit obligations which the Company recorded on that date. The Company recorded the entire curtailment gain as an offset to the unrecognized net actuarial loss in accumulated other comprehensive income; therefore, this gain had no impact on the condensed consolidated statements of operations.

Net periodic benefit costs for the Company's defined benefit pension plans included the following amounts (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Service cost	\$	\$ 26	\$ 53	\$ 79
Interest cost	167	166	501	479
Expected return on plan assets	(147)	(124)	(443)	(368)
Recognized net actuarial loss		38		112
<b>Net period benefit cost</b>	<b>\$ 20</b>	<b>\$ 106</b>	<b>\$ 111</b>	<b>\$ 302</b>

The Company made \$0.9 million and \$0.7 million of contributions to its defined benefit pension plans during the nine months ended September 30, 2011 and 2010, respectively.

**10. Income Taxes**

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

	Three Months Ended September 30,	
	2011	2010
Reported tax rate	0.4%	26.0%
	Nine Months Ended September 30,	
	2011	2010
Reported tax rate	16.7%	25.2%

**Table of Contents**

The Company's effective income tax rates for the three months ended September 30, 2011 and 2010 were 0.4% and 26.0%, respectively. Income tax expense for the three months ended September 30, 2011 included a \$0.8 million reversal of accruals for uncertain tax positions due to the expiration of the statute of limitations, which represented a sizeable adjustment to the tax expense recorded during the quarter. Further, the Company's projection of full-year income in the United States decreased compared to last year due to costs and expenses recorded in the third quarter and year-to-date and the projection of similar costs and expenses for the remainder of the year. This change in estimate of the expected full year tax rate resulted in a year-to-date reduction of income tax expense recorded in the quarter.

The Company's effective income tax rates for the nine months ended September 30, 2011 and 2010 were 16.7% and 25.2%, respectively. The income tax expense for the nine months ended September 30, 2011 includes additional tax expense related to a \$1.7 million correction to a deferred tax asset relating to 2009 that was recorded during the nine-month period. This increase is partially offset because the Tax Relief, Unemployment Insurance and Job Creation Act of 2010 was passed during the fourth quarter of 2010, which lowered the tax rate used to determine the tax provision for the first nine months of 2011 versus the rate that was in effect for the first nine months of 2010. Additionally, during the nine months ended September 30, 2011 and 2010, we recorded reversals of \$1.1 million and \$3.7 million, respectively, of accruals for uncertain tax positions resulting from matters which were considered effectively settled and the expiration of the statute of limitations for certain matters, which further lowered the effective tax rate for the prior-year period. Further, the Company's projection of full year income decreased significantly, especially in the United States because of certain costs and expenses recorded in the nine months and the projection of similar costs and expenses for the remainder of the year.

**11. NET INCOME PER SHARE**

Certain of the Company's unvested restricted share units contain rights to receive nonforfeitable dividends, and thus, are participating securities requiring the two-class method of computing earnings per share. The participating securities had an insignificant impact on the calculation of earnings per share (impacts the rounding by less than \$0.01 per share) on all of the periods presented; therefore, the Company does not present the full calculation below.

Basic and diluted net income per share was as follows (in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
<b>Basic net income per share:</b>				
Net income	\$ 11,243	\$ 16,483	\$ 23,429	\$ 46,862
Weighted average common shares outstanding	28,583	29,572	29,234	29,638
Basic net income per common share	\$ 0.39	\$ 0.56	\$ 0.80	\$ 1.57
<b>Diluted net income per share:</b>				
Net income	\$ 11,243	\$ 16,483	\$ 23,429	\$ 46,862
Weighted average common shares outstanding - Basic	28,583	29,572	29,234	29,638
Effect of dilutive securities:				
Stock options and restricted stock	446	500	586	588
Weighted average common shares for diluted earnings per share	29,029	30,072	29,820	30,226
Diluted net income per common share	\$ 0.39	\$ 0.55	\$ 0.79	\$ 1.54

At September 30, 2011 and 2010, the Company had 1.5 million and 1.9 million of outstanding stock options, respectively. The Company also has warrants outstanding relating to its 2016 Notes and 2012 Notes. Stock options, restricted stock and warrants are included in the diluted earnings per share calculation using the treasury stock method, unless the effect of including the stock options would be anti-dilutive. For the three months ended September 30, 2011 and 2010, 0.5 million and 0.8 million anti-dilutive stock options, respectively, were excluded from the diluted earnings per share calculation. For the nine months ended September 30, 2011 and 2010, 0.2 million and 0.7 million anti-dilutive stock options, respectively, were excluded from the diluted earnings per share calculation. As the strike price of the warrants exceeded the Company's average stock price for the period, the warrants are anti-dilutive and the entire number of warrants was also excluded from the diluted earnings per share calculation.



**Table of Contents****12. COMPREHENSIVE (LOSS) INCOME**

Comprehensive (loss) income was as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net Income	\$ 11,243	\$ 16,483	\$ 23,429	\$ 46,862
Foreign currency translation adjustment	(17,712)	21,979	688	(5,954)
Change in unrealized gain on derivatives, net of tax	(1,439)	(1,514)	(2,372)	(1,525)
Pension liability adjustment, net of tax	14		200	
Comprehensive income (loss)	\$ (7,894)	\$ 36,948	\$ 21,945	\$ 39,383

**13. SEGMENT AND GEOGRAPHIC INFORMATION**

The Company's chief operating decision maker reviews financial results and manages the business on an aggregate basis. Therefore, the Company presents financial results in a single reporting segment - the development, manufacture and distribution of medical devices.

Revenue consisted of the following (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Orthopedics	\$ 86,435	\$ 72,970	\$ 239,248	\$ 215,976
Neurosurgery	72,426	69,816	212,886	200,896
Instruments	43,324	43,855	124,421	121,062
Total revenues	\$ 202,185	\$ 186,641	\$ 576,555	\$ 537,934

The Company attributes revenues to geographic areas based on the location of the customer. We summarize total revenues by major geographic area below (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
United States	\$ 158,233	\$ 145,257	\$ 436,405	\$ 413,380
Europe	20,308	20,847	70,603	65,075
Asia Pacific	11,308	11,042	33,680	29,453
Other Foreign	12,336	9,495	35,867	30,026
Total revenues	\$ 202,185	\$ 186,641	\$ 576,555	\$ 537,934

**14. COMMITMENTS AND CONTINGENCIES**

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

## Edgar Filing: INTEGRA LIFESCIENCES HOLDINGS CORP - Form 10-Q

The Company has settled, or has pending against it, various other lawsuits, claims and proceedings. We describe the most significant of these below.

In January 2010, the Company received a notice from the seller's representative of the former Theken companies of a disagreement in the calculation of trade sales used in calculating a revenue performance payment that the Company made in November 2009 related to the first performance year that ended September 30, 2009. The notice alleged that the Company owed an additional \$6.7 million, and the Company recorded an accrual of \$3.4 million for the settlement at that time. In January 2011, the Company received a notice from the seller's representative that the alleged amount owed had been reduced to \$5.7 million, and in June 2011 the Company and the seller agreed to settle the matter for \$4.6 million, which was accrued at that time. The \$4.6 million settlement was paid in August 2011. There are no amounts due under the asset purchase agreement for the second performance year that ended September 30, 2010.

**Table of Contents**

The Company has various product liability claims pending against it. During 2011, the most significant of these matters was settled for approximately \$4.6 million. The Company's insurance policies covered this matter and the Company had recorded a corresponding receivable; therefore, there was no net impact on the Company's consolidated statements of operations.

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

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



---

**Table of Contents**

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and the related notes thereto appearing elsewhere in this report and our consolidated financial statements for the year ended December 31, 2010 included in our Annual Report on Form 10-K.

We have made statements in this report which constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 (the Exchange Act). These forward-looking statements are subject to a number of risks, uncertainties and assumptions about the Company. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of many factors, including but not limited to those set forth above under the heading Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2010. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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

**GENERAL**

Integra is a world leader in medical devices and is focused on limiting uncertainty for surgeons so they can concentrate on providing the best patient care. Integra offers innovative solutions in orthopedic surgery, neurosurgery, spine surgery, and reconstructive and general surgery.

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

We manage these product groups and distribution channels on a centralized basis. Accordingly, we present our financial results under a single reporting segment the development, manufacture and distribution of medical devices.

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

In the United States, we have three sales channels. Within our Orthopedics sales channel, we sell through a large direct sales organization, and through specialty distributors focused on their respective surgical specialties. Neurosurgery sells products through directly employed sales representatives. Instruments sells through two sales channels, both directly and through distributors and wholesalers, depending on the customer call point.

We also market certain products through strategic corporate partners.

Our goal is to become a global leader in the development, manufacture and marketing of medical devices, implants and instruments by developing or acquiring innovative medical devices to sell through our sales channels. Our strategy therefore entails substantial growth in revenues through both internal means launching new products and selling existing products more intensively and by acquiring existing businesses or acquiring or in-licensing already successful product lines. We distinguish ourselves by emphasizing the importance of the relatively new field of regenerative medicine, which we define as surgical implants derived from our proprietary collagen matrix technology.

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

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

*Developing, manufacturing and selling regenerative medicine products.* We have a broad technology platform for

**Table of Contents**

developing products that regenerate or repair soft tissue and bone. We believe that we have a particular advantage in developing, manufacturing and selling tissue repair products derived from bovine collagen. These products constituted 23% of revenues for the nine months ended September 30, 2011 and 2010, respectively.

*Developing metal implants for bone and joint repair, fixation and fusion.* We have significant expertise in developing metal implants for use in bone and joint repair, fixation and fusion and in successfully bringing those products to market.

*Acquiring and integrating new product lines and complementary businesses.* Since 2008, we have acquired and integrated nine product lines or businesses through a disciplined acquisition program. We emphasize acquiring product lines at reasonable valuations which complement our existing products or can be used to gain greater advantages from our broad technology platform in tissue regeneration and metal implants. Our management is experienced at successfully integrating acquired product lines and businesses.

**ACQUISITIONS**

On September 23, 2011, the Company acquired Ascension Orthopedics, Inc. ( Ascension ) for \$66.5 million, which includes amounts paid into escrow, subject to certain working capital adjustments. Ascension, based in Austin, Texas, develops and distributes a range of implants for the shoulder, elbow, wrist, hand, foot and ankle. In particular, Ascension will add a significant number of new and differentiated products to our extremities portfolio and access to the shoulder market.

In May 2011, we acquired SeaSpine, Inc. ( SeaSpine ) for approximately \$89.0 million, subject to customary working capital adjustments and indemnification holdbacks totaling \$8.0 million. SeaSpine, based in Vista, California, offers spinal fusion products to customers across the U.S. and in select markets in Europe. The addition of the SeaSpine business effectively doubles our distribution footprint and customer base in the U.S. spine hardware market.

**RESULTS OF OPERATIONS****Executive Summary**

Net income for the three months ended September 30, 2011 was \$11.2 million, or \$0.39 per diluted share as compared with net income of \$16.5 million or \$0.55 per diluted share for the three months ended September 30, 2010.

Net income for the nine months ended September 30, 2011 was \$23.4 million, or \$0.79 per diluted share as compared with net income of \$46.9 million or \$1.54 per diluted share for the nine months ended September 30, 2010.

For both of these periods, the decrease in net income resulted primarily from higher selling, general and administrative expenses in the United States, in particular from our orthopedics products and the implementation of our global enterprise resource planning system, higher manufacturing costs and higher interest expense. Additionally, during the nine months ended September 30, 2011, we incurred an incremental stock-based compensation charge of \$8.4 million related to the renewal of our chief executive officer's employment agreement, and impairments of intangible assets. Lower income tax expenses resulting principally from substantially lower taxable income in the United States helped offset some of the decrease in net income.

Our costs and expenses include the following charges (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Acquisition-related charges	\$ 1,665	\$ 889	\$ 4,227	\$ 2,084
Charges related to extending our Chief Executive Officer's employment contract			8,379	
Certain employee termination and related charges		531	846	1,159
Facility consolidation, acquisition integration, manufacturing and distribution transfer charges	34	1,347	2,127	2,593
Systems implementation charges	6,245		11,832	

Edgar Filing: INTEGRA LIFESCIENCES HOLDINGS CORP - Form 10-Q

Expenses associated with remediation and related unplanned idle time and underutilization at our Plainsboro, New Jersey manufacturing facility	1,748		1,748	
Intangible asset impairment charges		59	2,648	856
Charges related to our Chief Operating Officer joining the Company	100		100	
Charges associated with discontinued product lines	485		3,664	74
Expenses related to issuance costs in connection with the revised credit agreement			790	
Non-cash amortization of imputed interest for convertible debt	3,417	1,578	7,049	5,519
Charges related to restructuring our European entities		395	378	395
<b>Total</b>	<b>\$ 13,694</b>	<b>\$ 4,799</b>	<b>\$ 43,788</b>	<b>\$ 12,680</b>

**Table of Contents**

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Cost of product revenues	\$ 3,518	\$ 1,196	\$ 8,372	\$ 2,554
Research and development			300	102
Selling, general and administrative	6,759	1,966	26,129	3,649
Intangible asset amortization		59	1,148	856
Interest expense	3,417	1,578	7,839	5,519
Total	\$ 13,694	\$ 4,799	\$ 43,788	\$ 12,680

We typically define special charges as items for which the amounts and/or timing of such expenses may vary significantly from period-to-period, depending upon our acquisition, integration, and restructuring activities and for certain items where the amounts are non-cash in nature. We believe that, given our ongoing strategy of seeking acquisitions, our continuing focus on rationalizing our existing manufacturing and distribution infrastructure and our continuing review of various product lines in relation to our current business strategy, certain of the special charges discussed above could recur with similar materiality in the future. During 2010, we started investing significant resources in the global implementation of a single enterprise resource planning system. Once the project reaches the application development stage, we will begin to capitalize the related expenditures.

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

**Revenues and Gross Margin on Product Revenues**

Our revenues and gross margin on product revenues were as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Orthopedics	\$ 86,435	\$ 72,970	\$ 239,248	\$ 215,976
Neurosurgery	72,426	69,816	212,886	200,896
Instruments	43,324	43,855	124,421	121,062
Total revenue	202,185	186,641	576,555	537,934
Cost of product revenues	78,651	69,194	216,410	196,882
Gross margin on total revenues	\$ 123,534	\$ 117,447	\$ 360,145	\$ 341,052
Gross margin as a percentage of total revenues	61.1%	62.9%	62.5%	63.4%

**THREE MONTHS ENDED SEPTEMBER 30, 2011 AS COMPARED TO THREE MONTHS ENDED SEPTEMBER 30, 2010****Revenues and Gross Margin**

For the three months ended September 30, 2011, total revenues increased by \$15.6 million, or 8%, to \$202.2 million from \$186.6 million for the same period during 2010. Domestic revenues increased 9% to \$158.2 million for the three months ended September 30, 2011 from

## Edgar Filing: INTEGRA LIFESCIENCES HOLDINGS CORP - Form 10-Q

\$145.3 million for the three months ended September 30, 2010. During both of these periods, domestic revenues represented 78% of total revenues. International revenues increased to \$44.0 million from \$41.4 million in the prior-year period, an increase of 6%, driven exclusively by foreign exchange rate fluctuations, especially from a stronger euro versus the U.S. dollar.

**Table of Contents**

Orthopedics revenues were \$86.4 million, an increase of 18% over the prior-year period. Most of the increase came from sales of spinal implants from our SeaSpine acquisition, and from sales of orthobiologics. However, we are beginning to see softness in our extremity reconstruction business, which is the largest component of our orthopedics category. Our sales of foot and ankle, and skin products were weaker than expected in the quarter. Finally sales of our private label products were down slightly from the same period last year.

Neurosurgery revenues were \$72.4 million, up 4% from the prior-year period. Sales of critical care and cranial stabilization products drove much of the increase. International neurosurgery revenues benefited from changes in foreign exchange rates, especially the euro.

Revenues in the Instruments category were \$43.3 million, down slightly from the prior year. Sales in the acute setting were down slightly across almost all product lines, which were offset in part by increases in sales of instruments to the office-based sales channel.

Gross margin increased by \$6.1 million to \$123.5 million for the three-month period ended September 30, 2011, from \$117.4 million for the same period last year. Gross margin as a percentage of total revenue was 61.1% compared to 62.9% in the prior year period. Gross margin as a percentage of revenue declined over the prior year period primarily because we recorded higher write-offs and reserves for excess and obsolete inventory in our orthopedics products and higher costs of manufacturing than in the prior year period. Additionally, the FDA inspected our Plainsboro, New Jersey collagen device manufacturing facility during the third quarter of 2011, at the conclusion of which it issued FDA 483 inspectional observations that described violations of quality system regulations. We have incurred, and will incur in the fourth quarter and early 2012, substantial expenses to remediate those observations and related unplanned idle time and underutilization. Finally, cost of product revenues included a portion of the amortization of the SeaSpine inventory at acquisition value; the impact of Ascension was negligible.

We expect that our gross margin for the full year 2011 will be below our full-year 2010 gross margin. This decrease is expected due to higher costs as the Ascension and SeaSpine inventory is amortized at acquisition value. Additionally, we expect that the remediation activities discussed above will continue throughout the fourth quarter and into 2012, and that the Plainsboro facility will continue to record expenses associated with unplanned idle time and underutilization. If such remediations cannot be completed in a timely manner we may not be able to produce certain products for a period of time or may not be able to sell such products in certain markets, either of which could have an adverse effect on revenues and gross margins.

**Operating Expenses**

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

	<b>Three Months Ended September 30,</b>	
	<b>2011</b>	<b>2010</b>
Research and development	6.6%	6.3%
Selling, general and administrative	43.3%	40.6%
Intangible asset amortization	2.2%	1.4%
Total operating expenses	52.1%	48.3%

Total operating expenses, which consist of research and development expenses, selling, general and administrative expenses, and amortization expenses, increased \$15.1 million, or 17%, to \$105.2 million in the third quarter of 2011 compared to \$90.1 million in the third quarter of 2010.

Research and development expenses in the third quarter of 2011 increased by \$1.5 million to \$13.2 million compared to \$11.7 million in the same period last year. This increase resulted primarily from our acquisition of SeaSpine acquisition. We are targeting our research and development spending to be about 6.5% to 7% of revenues for the full-year 2011.

Selling, general and administrative expenses in the third quarter of 2011 increased by \$11.8 million to \$87.5 million compared to \$75.7 million in the same period last year. Selling expenses increased by \$7.3 million primarily due to the expansion of our orthopedic product sales organization as well as the SeaSpine acquisition. General and administrative costs increased \$4.5 million primarily due to charges related to the implementation of our global enterprise resource planning system of \$6.2 million, and costs related to our acquisitions of \$0.6 million; these increases were partially offset by lower stock based compensation costs in the period. We continue to expect that selling, general and administrative spending excluding all special charges will be between 40% and 42% of revenues for the full-year 2011.

## Edgar Filing: INTEGRA LIFESCIENCES HOLDINGS CORP - Form 10-Q

Amortization expense in the third quarter of 2011 was \$4.5 million compared to \$2.7 million in the same period last year. This increase is related primarily to amortization expense on additional intangible assets acquired through business combinations and accelerated amortization on several trade names. We have previously identified several trade names that we will phase out through the end of 2012 as part of our rebranding strategy; therefore, their useful lives were shortened. Accordingly, this change in useful life will result in incremental amortization expense of \$0.8 million in the fourth quarter of 2011 and \$2.7 million for the full year of 2012 when compared to historical trends. As our rebranding strategy continues to evolve, we may make further decisions about our trade names and incur additional impairment charges or accelerated amortization.



**Table of Contents****Non-Operating Income and Expenses**

The following is a summary of non-operating income and expenses (in thousands):

	<b>Three Months Ended September 30,</b>	
	<b>2011</b>	<b>2010</b>
Interest income	\$ 154	\$ 59
Interest expense	\$ (7,587)	\$ (4,390)
Other income (expense)	\$ 429	\$ (707)

**Interest Income**

Interest income increased in the three months ended September 30, 2011 compared to the same period last year, primarily as a result of higher overall cash balances.

**Interest Expense**

Interest expense in the three months ended September 30, 2011 increased primarily because of additional borrowings during the period on our senior credit facility, and interest related to our convertible debt issued during June 2011. Also, the impact of our interest rate swap increased interest expense by \$0.6 million. Our reported interest expense for the three-month periods ended September 30, 2011 and 2010 includes non-cash interest related to the accounting for convertible securities of \$3.4 million and \$1.6 million, respectively.

**Other Income**

Other income for the third quarter of 2011 of \$0.4 million consists primarily of foreign exchange gains on intercompany balances. Other expenses for the third quarter of 2010 of \$0.7 million consists primarily of foreign exchange losses on intercompany balances.

**Income Taxes**

	<b>Three Months Ended September 30,</b>	
	<b>2011</b>	<b>2010</b>
	<b>(In thousands)</b>	
Income before income taxes	\$ 11,287	\$ 22,271
Income tax expense	\$ 44	\$ 5,788
Effective tax rate	0.4%	26.0%

Our effective income tax rates for the three months ended September 30, 2011 and 2010 were 0.4% and 26.0%, respectively. Income tax expense for the three months ended September 30, 2011 included a \$0.8 million reversal of accruals for uncertain tax positions due to the expiration of the statute of limitations, which represented a sizeable adjustment to the tax expense recorded in the quarter. Further, our projection of full year income decreased significantly, especially in the United States because of certain costs and expenses recorded in the third quarter and year-to-date, and resulted in a year-to-date reduction of income tax expense recorded in the quarter. This change in estimate of the expected full year tax rate resulted in a year-to-date reduction of income tax expense recorded in the quarter.

Our effective tax rate may vary from period to period depending on, among other factors, the geographic and business mix of taxable earnings and losses. We consider these factors and others, including our history of generating taxable earnings, in assessing our ability to realize deferred tax assets. We expect our effective income tax rate for the full year 2011 to be approximately 8.5% versus the 2010 full year effective tax rate of 20.0%.

**NINE MONTHS ENDED SEPTEMBER 30, 2011 AS COMPARED TO NINE MONTHS ENDED SEPTEMBER 30, 2010****Revenues and Gross Margin**

## Edgar Filing: INTEGRA LIFESCIENCES HOLDINGS CORP - Form 10-Q

For the nine-month period ended September 30, 2011, total revenues increased by \$38.7 million or 7%, to \$576.6 million from \$537.9 million during the prior-year period. Domestic revenues increased by 6% to \$436.4 million and were 76% and 77% of total revenues for the nine months ended September 30, 2011 and 2010, respectively. International revenues increased \$15.6 million to \$140.2 million, an increase of 13% compared to the same period in 2010. Foreign exchange fluctuations accounted for a \$7.9 million increase in revenues for the nine month period ended September 30, 2011.

Orthopedics revenues were \$239.2 million, an increase of 11% over the prior-year period. Spine and orthobiologics products led the growth in this category primarily as a result of our SeaSpine acquisition. Other increases resulted from sales of engineered collagen products for skin and wound repair, from our peripheral nerve repair products, and as a result of extremities reconstruction products for the forefoot. As discussed above, we are beginning to see softness in our extremity reconstruction business, which is the largest component of our orthopedics category, especially sales of foot and ankle and skin products.

**Table of Contents**

Neurosurgery revenues were \$212.9 million, an increase of 6% over the prior-year period, resulting primarily from increases in sales of ultrasonic tissue ablation systems, neuromonitoring devices used in the critical care setting, duraplasty products, and instrumentation.

Instruments revenues were \$124.4 million, an increase of 3% over the prior year period. Sales of handheld instruments in the office based channel and surgical lighting systems primarily drove the growth in this category.

Gross margin increased by \$19.1 million to \$360.1 million for the nine-month period ended September 30, 2011, from \$341.1 million for the same period last year. Gross margin as a percentage of total revenue was 62.5% for the first three quarters of 2011, compared to 63.4% for this same period during 2010. Higher sales of orthopedics products resulted in an increase of about 1 percentage point. However, a decrease of about 2 percentage points resulted from higher write-offs and reserves for excess and obsolete inventory in our orthopedics products, impairments of intangible technology assets, amortization of the SeaSpine inventory at acquisition value, and product discontinuance costs. Additionally, as discussed in the three-month results, we incurred higher manufacturing costs associated with the remediation of our Plainsboro, New Jersey collagen device facility and related unplanned idle time and underutilization.

**Operating Expenses**

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

	<b>Nine Months Ended September 30,</b>	
	<b>2011</b>	<b>2010</b>
Research and development	6.6%	6.5%
Selling, general and administrative	45.7%	41.3%
Intangible asset amortization	2.0%	1.7%
Total operating expenses	54.3%	49.5%

Total operating expenses, which consist of research and development expenses, selling, general and administrative expenses and amortization expenses, increased \$46.5 million, or 17%, to \$313.0 million in the first three quarters of 2011, compared to \$266.5 million in the same period last year.

Research and development expenses in the first three quarters of 2011 increased by \$3.3 million to \$38.1 million compared to \$34.8 million in the same period last year. This increase resulted primarily from our SeaSpine acquisition, and to a lesser extent, headcount increases to focus on projects in our neurosurgery and extremity reconstruction product lines.

Selling, general and administrative expenses in the first three quarters of 2011 increased by \$40.9 million to \$263.3 million compared to \$222.5 million in the same period last year. Selling expenses increased by \$14.0 million primarily because of an increase in revenues and the corresponding commission costs, as well as the impact of our SeaSpine acquisition. General and administrative costs increased \$26.8 million because of an incremental stock-based compensation charge of \$8.4 million related to the renewal of our chief executive officer's employment agreement, charges related to the implementation of our global enterprise resource planning system of \$11.8 million, acquisition related costs of \$2.0 million, severance costs, and to a lesser extent, increases in compensation costs brought on by increased headcount.

Amortization expense in the first three quarters of 2011 increased by \$2.3 million to \$11.6 million compared to \$9.3 million in the same period last year. The increase was primarily related to the impairment of trade names totaling \$1.1 million, amortization on additional intangible assets acquired through business combinations and accelerated amortization on several trade names, which was partially offset by the completion of the amortization period for certain intangible assets. We had previously identified several trade names that we will phase out through the end of 2012; therefore, their useful lives were shortened. Accordingly, this change in useful life will result in incremental amortization expense of \$0.8 million in the fourth quarter of 2011 and \$2.7 million in the full year of 2012 when compared to historical trends. As our re-branding strategy continues to evolve, we may make further decisions about our trade names and incur additional impairment charges or accelerated amortization.

**Non-Operating Income and Expenses**

The following is a summary of non-operating income and expenses (in thousands):

	Nine Months Ended September 30,	
	2011	2010
Interest income	\$ 354	\$ 172
Interest expense	(19,778)	(13,231)
Other income (expense)	379	1,202

**Table of Contents****Interest Income**

Interest income increased in the nine-month period ended September 30, 2011, compared to the same period last year, primarily due to higher average cash balances.

**Interest Expense**

Interest expense increased in the nine-month period ended September 30, 2011, compared to the same period last year, primarily because of increased average borrowings under our Senior Credit Facility during the period and interest related to our convertible debt issued in June 2011. Additionally, the impact of our interest rate swap resulted in additional interest expense of \$1.7 million during the period. Furthermore, the nine-month period ended September 30, 2011 includes approximately \$0.8 million of debt issuance costs that were immediately expensed upon the refinancing of our Senior Credit Facility. Our reported interest expense for the nine-month periods ended September 30, 2011 and 2010 also includes non-cash interest related to the accounting for convertible securities of \$7.1 million and \$5.9 million, respectively.

**Other Income (Expense)**

Other income (expense) in the nine months ended September 30, 2011 consisted of research and development reimbursements from third party partners and foreign governments, which was almost entirely offset by foreign exchange losses. Other income (expense) in the nine months ended September 30, 2010 consisted primarily of foreign exchange gains.

**Income Taxes**

	Nine Months Ended September 30,	
	2011	2010
	(In thousands)	
Income before income taxes	\$ 28,118	\$ 62,674
Income tax expense	\$ 4,689	\$ 15,812
Effective tax rate	16.7%	25.2%

Our effective income tax rates for the nine months ended September 30, 2011 and 2010 were 16.7% and 25.2%, respectively. Income tax expense for the nine months ended September 30, 2011 reflects additional tax expense related to a \$1.7 million correction to a deferred tax asset relating to 2009 that was recorded during the nine-month period. Also, during the nine months ended September 30, 2011 and 2010, we recorded a reversal of \$1.1 million and \$3.7 million, respectively, of accruals for uncertain tax positions due to matters that were considered effectively settled. The Tax Relief, Unemployment Insurance and Job Creation Act of 2010 passed during the fourth quarter of 2010, and had the effect of lowering the tax rate used to determine the tax provision for 2011 versus the rate that was in effect during the same period 2010. In addition, our projection of full year income in 2011 decreased significantly, especially in the United States because of certain costs and expenses recorded in the nine months and the projection of similar costs and expenses for the remainder of the year. This change in estimate of the expected full year tax rate resulted in a year-to-date reduction of income tax expense recorded during the nine-month period.

**GEOGRAPHIC PRODUCT REVENUES AND OPERATIONS**

Product revenues by major geographic area are summarized below (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
United States	\$ 158,233	\$ 145,257	\$ 436,405	\$ 413,380
Europe	20,308	20,847	70,603	65,075
Asia Pacific	11,308	11,042	33,680	29,453
Other Foreign	12,336	9,495	35,867	30,026
Total Revenues	\$ 202,185	\$ 186,641	\$ 576,555	\$ 537,934

Most of our revenues are from customers within the United States. Sales to U.S. customers were up approximately 9% for the three month period ended September 30, 2011 primarily due to a full quarter's sales from our acquisition of SeaSpine. Over the past several quarters, revenues from our European customers have been affected by the austerity measures put in place by various European governments which have impacted their healthcare spending levels. Sales to customers in Europe were down 3% compared to the same period last year. Sales to customers in the Asia Pacific region were up 2% during the three month period ended September 30, 2011 across all product groups. Sales to our other foreign customers (primarily in the Middle East and Africa) increased approximately 30% for the three month period ended September 30, 2011.

**Table of Contents**

Sales to U.S. customers were also up approximately 6% for the nine-month period ended September 30, 2011, primarily due to the incremental impact of the SeaSpine acquisition, while instruments and neurosurgery product sales grew slightly. We had an increase in European sales of approximately 8% for the nine-month period ended September 30, 2011 due primarily to foreign exchange fluctuations, which had an impact on our neurosurgery products, and to a lesser extent, orthopedics and instruments. However, the austerity measures discussed above continue to be a drag on growth. Sales to customers in the Asia Pacific region increased approximately 14% for the nine-month period ended September 30, 2011 largely due to neurosurgery and orthopedics, while instruments revenues grew modestly. Sales to our other foreign customers increased approximately 20% for the nine-month period ended September 30, 2011, this increase was seen in all product lines across all other foreign geographies.

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

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

**LIQUIDITY AND CAPITAL RESOURCES****Cash and Marketable Securities**

We had cash and cash equivalents totaling approximately \$111.0 million and \$128.8 million at September 30, 2011 and December 31, 2010, respectively. At September 30, 2011, our non-U.S. subsidiaries held approximately \$89.1 million of cash and cash equivalents that are available for use by all of our operations outside of the United States. We currently do not intend to repatriate these funds to the United States; however, if these funds were repatriated to the United States, or used for United States operations, certain amounts could be subject to tax in the United States for the incremental amount in excess of the foreign tax paid.

**Cash Flows**

	<b>Nine Months Ended September 30,</b>	
	<b>2011</b>	<b>2010</b>
	<b>(In thousands)</b>	
Net cash provided by operating activities	\$ 69,633	\$ 77,141
Net cash used in investing activities	(174,801)	(23,068)
Net cash provided by (used in) financing activities	87,244	(40,248)
Effect of exchange rate fluctuations on cash	152	(2,884)
Net (decrease) increase in cash and cash equivalents	\$ (17,772)	\$ 10,941

**Cash Flows Provided by Operating Activities**

We generated operating cash flows of \$69.6 million and \$77.1 million for the nine months ended September 30, 2011 and 2010, respectively. Operating cash flows were lower than the same period in 2010 largely because of the decreased net income for the period. Net income for the nine months ended September 30, 2011, plus items included in those earnings that did not result in a change to our cash balance, amounted to approximately \$84.1 million. Changes in working capital reduced cash flows by approximately \$13.1 million. Among the changes in working capital, accounts receivable used \$0.8 million of cash, inventory used \$6.8 million of cash, prepaid and other current assets used \$0.5 million, accounts payable, accrued expenses and other current liabilities used \$4.2 million of cash, and deferred revenue used \$0.8 million of cash.

Net income for the nine months ended September 30, 2010, plus items included in those earnings that did not result in a change to our cash balance, amounted to approximately \$88.6 million. Additionally, we paid \$6.6 million in accreted interest related to the repurchase of our 2010 Notes. Changes in working capital reduced cash flows by \$3.2 million. Among the changes in working capital, prepaid expenses contributed \$4.1 million and accounts payable and accrued expenses contributed another \$12.3 million, while accounts receivable and inventories used \$12.7 million.





## **Table of Contents**

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

During the nine months ended September 30, 2011, we paid \$149.4 million (net of \$0.8 million of cash acquired) related to our acquisitions of Ascension Orthopedics, Inc. and SeaSpine, Inc. and incurred \$25.4 million in capital expenditures related primarily to expanding our regenerative medicine manufacturing capacity and costs related to the implementation of our global enterprise resource planning system. During the nine months ended September 30, 2010, we paid \$18.9 million in cash for capital expenditures and \$4.2 million for business acquisitions.

### **Cash Flows Provided by (Used in) Financing Activities**

Our principal sources of cash from financing activities relates to \$230.0 million in borrowings under the 2016 Notes issued in June 2011, and proceeds from the related warrant sale of \$28.5 million. These amounts were offset by \$55.6 million in net repayments under our Senior Credit Facility, \$42.9 million for the call option on our 2016 Notes, debt issuance costs of \$8.1 million, treasury stock purchases of \$69.0 million and proceeds from stock option exercises and the tax impact of stock based compensation of \$4.4 million.

Our principal uses of cash for financing activities in the nine months ended September 30, 2010 were for the repayment of the liability component of our 2010 Notes of \$71.4 million and treasury stock purchases of \$31.3 million; proceeds from net borrowings under our Senior Credit Facility of \$60.0 million partially offset these uses. Additionally, we generated proceeds from stock option exercises and the tax impact of stock-based compensation of \$9.2 million in 2010.

### **Working Capital**

At September 30, 2011 and December 31, 2010, working capital was \$371.9 million and \$243.0 million, respectively. The increase in working capital resulted primarily from financing the acquisition of Ascension and SeaSpine with long term borrowings under our Senior Credit Facility and additional cash generated during the period.

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

During 2010, we entered into an amended and restated credit agreement with a syndicate of lending banks (the Senior Credit Facility ) and further amended the Senior Credit Facility in June 2011. The June 2011 amendment increased the revolving credit component from \$450.0 million to \$600.0 million by reallocating and eliminating the \$150.0 million term loan component that existed under the original amended and restated credit agreement, allows us to further increase the size of the revolving credit component by an aggregate of \$200.0 million with additional commitments, provides us with decreased borrowing rates and annual commitment fees, and provides more favorable financial covenants. The Senior Credit Facility's maturity was extended from August 10, 2015 to June 8, 2016 and is collateralized by substantially all of the assets of the Company's U.S. subsidiaries, excluding intangible assets. The Senior Credit Facility is subject to various financial and negative covenants.

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

The Company will also pay an annual commitment fee (ranging from 0.15% to 0.3%, based on the Company's consolidated total leverage ratio) on the daily amount by which the revolving credit facility exceeds the outstanding loans and letters of credit under the credit facility.

We plan to utilize the Senior Credit Facility for working capital, capital expenditures, share repurchases, acquisitions, debt repayments and other general corporate purposes. At September 30, 2011 and December 31, 2010, there was \$192.5 million and \$100.0 million outstanding, respectively, under the revolving credit component of the Senior Credit Facility at a weighted average interest rate of 1.7% and 2.5%, respectively. The Company considers the balance to be long-term in nature based on its current intent and ability to repay the borrowing outside of the next twelve-month period. At September 30, 2011, there was approximately \$407.5 million available for borrowing under the Senior Credit Facility.

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

## Edgar Filing: INTEGRA LIFESCIENCES HOLDINGS CORP - Form 10-Q

We pay interest each June 1 and December 1 on our \$165.0 million senior convertible notes due June 2012 ( 2012 Notes ) at an annual rate of 2.375%, and each June 15 and December 15 on our \$230.0 million senior convertible notes due December 2016 ( 2016

---

## **Table of Contents**

Notes ) at an annual interest rate of 1.625% (collectively, the Notes ). The 2012 Notes and 2016 Notes are senior, unsecured obligations of Integra, and are convertible into cash and, if applicable, shares of our common stock based on an initial conversion rate, subject to adjustment, of 15.3935 shares and 17.4092 shares, respectively, per \$1,000 principal amount of notes (which represents an initial conversion price of approximately \$64.96 per share and \$57.44 per share, respectively). We expect to satisfy any conversion of the Notes with cash up to the principal amount pursuant to the net share settlement mechanism set forth in the respective indenture and, with respect to any excess conversion value, with shares of our common stock. The 2012 Notes and 2016 Notes are convertible only in the following circumstances: (1) if the closing sale price of our common stock exceeds 130% and 150%, respectively, of the conversion price during a period as defined in the applicable indenture; (2) if the average trading price per \$1,000 principal amount of the Notes is less than or equal to 97% or 98%, respectively, of the average conversion value of the Notes during a period as defined in the applicable indenture; (3) at any time on or after December 15, 2011, or June 15, 2016, respectively; or (4) if specified corporate transactions occur. The issue price of the Notes was equal to their face amounts, which is also the amount holders are entitled to receive at maturity if the Notes are not converted. None of these conditions existed with respect to the Notes; therefore the 2016 Notes are classified as long-term. The 2012 Notes are classified as long-term based on the Company's intent and ability to settle the obligation with long-term borrowings from its Senior Credit Facility.

The Notes, under the terms of the applicable private placement agreement, are guaranteed fully by Integra LifeSciences Corporation, a subsidiary of Integra. The Notes are Integra's direct senior unsecured obligations and will rank equal in right of payment to all of our existing and future unsecured and unsubordinated indebtedness.

In connection with the issuance of the Notes, we entered into call transactions and warrant transactions, primarily with affiliates of the initial purchasers of the Notes (the hedge participants ). The cost of the call transactions to us was approximately \$30.4 million for the 2012 Notes and \$42.9 million for the 2016 Notes. We received approximately \$12.2 million and \$28.5 million of proceeds from the warrant transactions for the 2012 Notes and 2016 Notes, respectively. The call transactions involved our purchasing call options from the hedge participants, and the warrant transactions involved us selling call options to the hedge participants with a higher strike price than the purchased call options. The initial strike price of the call transactions is approximately \$64.96 for the 2012 Notes and \$57.44 for the 2016 Notes, subject to anti-dilution adjustments substantially similar to those in the Notes. The initial strike price of the warrant transactions is approximately \$90.95 for the 2012 Notes and \$70.05 for the 2016 Notes, in each case subject to customary anti-dilution adjustments.

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

### **Share Repurchase Plan**

On October 29, 2010, our Board of Directors authorized us to repurchase shares of our common stock for an aggregate purchase price not to exceed \$75.0 million through December 31, 2012. Shares may be purchased either in the open market or in privately negotiated transactions. Under this program during the first three quarters of 2011, we repurchased approximately 0.7 million shares at a cost of \$31.4 million; \$43.6 million remains available under the authorization.

In addition to the authorization above, on June 3, 2011 the Company's Board of Directors separately authorized the Company to repurchase shares of common stock from the proceeds of the 2016 Notes in connection with that debt offering. The Company repurchased 0.8 million shares for an aggregate purchase price of \$37.6 million under that authorization during the third quarter of 2011.

### **Dividend Policy**

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

### **Capital Resources**

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



**Table of Contents****Contractual Obligations and Commitments**

As of September 30, 2011, we were obligated to pay the following amounts under various agreements:

	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
	(In millions)				
Convertible Securities(1)	\$ 395.0	\$ 165.0	\$	\$ 230.0	\$
Revolving Credit Facility(2)	192.5			192.5	
Interest(3)	22.5	6.6	8.4	7.5	
Employment Agreements(4)	3.6	1.9	1.7		
Operating Leases	47.6	10.6	18.8	11.7	6.5
Acquisition consideration(5)	9.1	4.1	5.0		
Purchase Obligations	28.5	10.6	6.0	5.0	6.9
Other	1.6	1.2	0.1	0.1	0.2
<b>Total</b>	<b>\$ 700.4</b>	<b>\$ 200.0</b>	<b>\$ 40.0</b>	<b>\$ 446.8</b>	<b>\$ 13.6</b>

- (1) The estimated debt service obligation of the senior convertible securities includes interest expense representing the amortization of the discount on the liability component of the senior convertible notes in accordance with the authoritative guidance. We have the ability and intent to settle the \$165.0 million 2012 Notes that are due within one year with long-term borrowing under our Senior Credit Facility, and have therefore classified these borrowings as long-term in our September 30, 2011 condensed consolidated balance sheet. See Note 5, Debt, of our consolidated financial statements for additional information.
- (2) The Company may borrow and make payments against the credit facility from time to time and considers all of the outstanding amounts to be long-term based on its current intent and ability to repay the borrowing outside of the next twelve-month period.
- (3) Interest is calculated on the convertible securities based on current interest rates paid by the Company. As the revolving credit facility can be repaid at any time, no interest has been included in the calculation.
- (4) Amounts shown under Employment Agreements do not include compensation resulting from a change in control.
- (5) The acquisition consideration is comprised of amounts that may be due to the sellers of SeaSpine, Inc. upon the finalization of the working capital adjustment and indemnification holdback releases, and the earnout for Integra Neurosciences Pty Ltd.

Excluded from the contractual obligations table is the liability for uncertain tax benefits, including interest and penalties, totaling \$7.1 million. This liability for uncertain tax benefits has been excluded because we cannot make a reliable estimate of the period in which the uncertain tax benefits may be realized.

## **Table of Contents**

### **OTHER MATTERS**

#### **Critical Accounting Estimates**

The critical accounting estimates included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010 have not materially changed.

#### **Recently Issued Accounting Standards**

On September 15, 2011 the Financial Accounting Standards Board issued *Accounting Standards Update No. 2011-08, Intangibles - Goodwill and Other (Topic 350), Testing Goodwill for Impairment*. The revised standard is intended to reduce the cost and complexity of the annual goodwill impairment test by providing the option of performing a qualitative assessment to determine whether further impairment testing is necessary. Under this standard, we have the option to first assess qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. If, after assessing the totality of events or circumstances, we determine it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, performing the two-step impairment test under Topic 350 is unnecessary. However, if we conclude otherwise, we are required to perform the first step of the two-step impairment test, as described in Topic 350. If the carrying amount of a reporting unit exceeds its fair value under the first step, we are required to perform the second step of the goodwill impairment test to measure the amount of the impairment loss, if any. We also have the option to bypass the qualitative assessment for any reporting unit in any period and to proceed directly to performing the first step of the two-step goodwill impairment test. We may resume performing the qualitative assessment in any subsequent period. This standard is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, and early adoption is permitted. We believe that the adoption of this standard will not have a material impact on our financial statements.

On June 16, 2011 the Financial Accounting Standards Board issued *Accounting Standards Update No. 2011-05, Presentation of Comprehensive Income*. This standard eliminates the option to report other comprehensive income and its components in the statement of changes in equity. We may elect to present items of net income and other comprehensive income in one continuous statement or in two consecutive statements. Each component of net income and each component of other comprehensive income, together with totals for comprehensive income and its two parts net income and other comprehensive income would need to be displayed under either alternative, and the statements would need to be presented with equal prominence as the other primary financial statements. This standard does not change 1) the items that constitute net income and other comprehensive income, 2) when an item of other comprehensive income must be reclassified to net income, or 3) the computation for earnings per share - which will continue to be based on net income. This standard is effective for fiscal years beginning after December 15, 2011, and we have not yet determined which method we will elect upon adoption.

On May 12, 2011 the Financial Accounting Standards Board issued *Accounting Standards Update No. 2011-04 - Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS*. This standard merges many aspects of fair value measurement guidance by amending U.S. GAAP and creating a new standard under International Financial Reporting Standards. The primary changes to U.S. GAAP include 1) clarifying the valuation premise of highest and best use, 2) clarifying how portfolios of financial instruments are measured, 3) clarifying the use of blockage factors and other premiums and discounts, and 4) increasing the disclosure requirements in a number of circumstances. This standard is effective for fiscal years beginning after December 15, 2011, and we believe the standard will not have a material impact on our results.

---

**Table of Contents**

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

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

**Foreign Currency Exchange and Other Rate Risks**

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

From time to time, we enter into foreign currency forward exchange contracts with terms of up to 12 months to manage currency exposures for transactions denominated in a currency other than an entity's functional currency. As a result, the impact of foreign currency gains/losses recognized in earnings are partially offset by gains/losses on the related foreign currency forward exchange contracts in the same reporting period. There were no foreign currency forward contracts outstanding at September 30, 2011. During October 2011, we entered into several foreign currency forward exchange contracts which expire at various dates through January 2012.

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

**Interest Rate Risk**

*Cash and Cash Equivalents* - We are exposed to the risk of interest rate fluctuations on the interest income earned on our cash and cash equivalents. A hypothetical 100 basis point movement in interest rates applicable to our cash and cash equivalents outstanding at September 30, 2011 would increase interest income by approximately \$1.1 million on an annual basis. No significant decrease in interest income would be expected as our cash balances are earning interest at rates close to zero. We are subject to foreign currency exchange risk with respect to cash balances maintained in foreign currencies.

*Senior Credit Facility* - Our interest rate risk relates primarily to U.S. dollar LIBOR-indexed borrowings. We have used an interest rate derivative instrument to manage our earnings and cash flow exposure to changes in interest rates by utilizing a forward-starting interest rate swap that began to offset a portion of our interest payments in the first quarter of 2011. This interest rate derivative instrument fixed the interest rate on a portion of our expected LIBOR-indexed floating-rate borrowings beginning on December 31, 2010. The interest rate swap had a notional amount of \$142.5 million outstanding as of September 30, 2011. We recognized \$1.7 million of additional interest expense related to this derivative during the first three quarters of 2011. The fair value of our interest rate derivative instrument was a net liability of \$4.4 million at September 30, 2011.

Based on our outstanding borrowings at September 30, 2011, the impact of a one percent increase in the interest rate on the unhedged portion of our variable rate debt would be \$0.5 million on an annualized basis.

**ITEM 4. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures**

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

## Edgar Filing: INTEGRA LIFESCIENCES HOLDINGS CORP - Form 10-Q

and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Management has designed our disclosure controls and procedures to provide reasonable assurance of achieving the desired control objectives.

As required by Exchange Act Rule 13a-15(b), we have carried out an evaluation, under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, of the effectiveness of the design and



**Table of Contents**

operation of our disclosure controls and procedures as of September 30, 2011. Based upon this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective as of September 30, 2011 to provide such reasonable assurance.

**Changes in Internal Control Over Financial Reporting**

There were no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that occurred during the quarter ended September 30, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

---

**Table of Contents**

**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

Various lawsuits, claims and proceedings are pending or have been settled by us. The most significant items are described below.

In January 2010, we received a notice from the seller's representative of the former Theken companies of a disagreement in the calculation of trade sales used in calculating a revenue performance payment that we made in November 2009 related to the first performance year that ended September 30, 2009. The notice alleged that we owed an additional \$6.7 million. In January 2011, the Company received a notice from the seller's representative that the alleged amount owed had been reduced to \$5.7 million, and in June 2011 the Company and the seller agreed to settle the matter for \$4.6 million, which was paid in August 2011. There are no amounts due under the asset purchase agreement for the second performance year that ended September 30, 2010.

We have various product liability claims pending against us. During 2011, the most significant of these matters was settled for approximately \$4.6 million. Our insurance policies covered this matter and we had recorded a corresponding receivable; therefore, there was no impact on our consolidated statements of operations.

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

**ITEM 1A. RISK FACTORS**

The Risk Factors included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010 have not materially changed other than the modifications to the risk factors as set forth below.

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

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

Our products under development are subject to FDA approval or clearance prior to marketing for commercial use. The process of obtaining necessary FDA approvals or clearances can take years and is expensive and uncertain. The FDA has announced a reform of the 510(k) Premarket Notification process that could make it more difficult to obtain clearance for our medical devices, especially for innovative devices. The FDA has proposed changes for which FDA clearance to market would possibly require clinical data, more extensive manufacturing information and postmarket data. The FDA is also proposing that an FDA inspection of the manufacturing facility may be required for certain products prior to clearance of the 510(k), which is similar to the requirements of a Class III device. As part of the 510(k) reform, the FDA proposes to issue regulations defining grounds and procedures for rescission of 510(k) applications that have previously been cleared to market. The FDA may also require clinical trial data as well as the more extensive PMA process for certain products.

Our inability to obtain required regulatory approval on a timely or acceptable basis could harm our business. Further, approval or clearance may place substantial restrictions on the indications for which the product may be marketed or to whom it may be marketed, warnings that may be required to accompany the product or additional restrictions placed on the sale and/or use of the product. Further studies, including clinical trials and FDA approvals, may be required to gain approval for the use of a product for clinical indications other than those for which the product was initially approved or cleared or for significant changes to the product. These studies could take years to complete and could be expensive, and there is no guarantee that the results will convince the FDA to approve or clear the additional indication. Any negative outcome in our clinical trials, including as a result of any interim analysis which we may do with respect to our clinical trials from time to time, could adversely affect

## Edgar Filing: INTEGRA LIFESCIENCES HOLDINGS CORP - Form 10-Q

our ability to launch new products, which could affect our sales and our ability to achieve reimbursement for new or existing products. In addition, for products with an approved PMA, the FDA requires annual reports and may require post-approval surveillance programs and/or studies to monitor the products' safety and effectiveness. Results of post-approval programs may limit or expand the further marketing of the product. We are also seeing third-party payors require clinical trial data for products cleared through the 510(k) process in order to continue reimbursement coverage. These clinical trials could take years to complete and be expensive and there is no guarantee that the FDA will approve the additional indications for use. There is also no guarantee that the payors will agree to continue reimbursement or provide additional coverage based upon these clinical trials. If the FDA does not approve the additional indications for use, our ability to obtain reimbursement for these products and our ability to compete against alternative products or technologies could suffer and, consequently, affect our sales.

Another risk of application to the FDA relates to the regulatory classification of new products or proposed new uses for existing products. In the filing of each application, we make a judgment about the appropriate form and content of the application. If the FDA disagrees with our judgment in any particular case and, for example, requires us to file a PMA application rather than allowing us to market for approved uses while we seek broader approvals or requires extensive additional clinical data, the time and expense required to obtain the required approval might be significantly increased or approval might not be granted.

Our manufacturing facilities must be in compliance with FDA Quality System Regulations (current Good Manufacturing Practices). In addition, approved products are subject to continuing FDA requirements relating to quality control and quality assurance, maintenance of records, reporting of adverse events and product recalls, documentation, and labeling and promotion of medical devices. For example, some of our orthobiologics products are subject to FDA and certain state regulations regarding human cells, tissues, and cellular or tissue-based products, which include requirements for establishment registration and listing, donor eligibility, current good tissue practices, labeling, adverse-event reporting, and inspection and enforcement. Some states have their own tissue banking regulation. We are licensed or have permits as a tissue bank in California, Florida, New York and Maryland. In addition, tissue banks may undergo voluntary accreditation by the AATB. The AATB has issued operating standards for tissue banking. Compliance with these standards is a requirement in order to become a licensed tissue bank.

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

All of our manufacturing facilities, both international and domestic, are also subject to inspections by or under the authority of the FDA and other regulatory agencies. Failure to comply with applicable regulatory requirements could subject us to issuance of FDA 483 observations, warning letters or enforcement action by the FDA or other agencies, including product seizures, recalls, withdrawal of clearances or approvals, restrictions on or injunctions against marketing our product or products based on our technology, denials of requests for exportation certificates to foreign governments, cessation of operations and civil and criminal penalties, any of which could materially affect our business. The FDA inspected our Plainsboro, New Jersey collagen device manufacturing facility and our Burlington, Massachusetts facility during the third quarter of 2011, at the conclusion of which it issued FDA 483 inspectional observations that described violations of quality system regulations. We have incurred, and will incur, substantial expenses to remediate those observations and others issued in connection with other inspections at other facilities, and to prepare our manufacturing facilities for anticipated FDA inspections. In addition, the FDA has notified us that it will not grant requests for exportation certificates to foreign governments until the violations identified in the 483 observations with regard to both facilities have been corrected. If such remediations cannot be completed in a timely manner we may not be able to produce certain products for a period of time or may not be able to sell such products in certain markets. There can be no assurance that such remediation and preparation activities will address all such observations to the FDA's satisfaction, or that the FDA will not impose additional regulatory sanctions with respect to such observations.

We are also subject to the regulatory requirements of countries outside the United States where we do business. For example, under the European Union Medical Device Directive, all medical devices must meet the Medical Device Directive standards in order to obtain CE Mark Certification prior to marketing in the EU. CE Mark Certification requires a comprehensive Quality System program, comprehensive technical and clinical documentation and data on the product, which a Notified Body in the EU reviews. In addition, we must be certified to the ISO 13485:2003 Quality System standards and maintain this certification in order to market our products in the EU, Canada, Japan, Latin America, countries in the Asia-Pacific region and most other countries outside the United States. The EU has revised the Medical Device Directive (93/42/EC as amended by 2007/47/EC). Compliance with these regulations requires extensive documentation, clinical reports for all products sold in the EU and other requirements. Requirements to meet these regulations can be costly and are mandatory to market our products in the EU. Many other countries have instituted new medical device regulations and/or revised current medical device regulations. These regulations often require extensive documentation, including clinical data and may require audits of our manufacturing facilities in order to gain approval to sell our products in that country. There are also associated fees with these new regulations. These regulations are required for all new products and re-registration of our medical devices, and may involve lengthy and expensive reviews.

Our products that contain human derived tissue, including those containing demineralized bone matrices, are not medical devices in the EU as defined in the Medical Device Directive (93/42/EC). They are also not medicinal products as defined in Directive 2001/83/EC. Today,

## Edgar Filing: INTEGRA LIFESCIENCES HOLDINGS CORP - Form 10-Q

regulations, if applicable, differ from one EU member state to the next. Because of the absence of a harmonized regulatory framework and the proposed regulation for advanced therapy medicinal products in the EU, as well as for other countries, the approval process for human-derived cell or tissue based medical products may be extensive, lengthy, expensive, and unpredictable. Among others, some of our orthobiologics products are subject to EU member states' regulations that govern the donation, procurement, testing, coding, traceability, processing, preservation, storage, and distribution of human tissues and cells and cellular or tissue-based products. These EU member states' regulations include requirements for registration, listing, labeling, adverse-event reporting, and inspection and enforcement. Some EU member states have their own tissue banking regulations. In addition, certain EU member states have instituted new requirements for additional testing that may be prohibitive to obtaining approval in those member states.

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

On October 29, 2010, our Board of Directors adopted a program that authorizes us to repurchase shares of our common stock for an aggregate purchase price not to exceed \$75.0 million through December 31, 2012. Shares may be repurchased either in the open market or in privately negotiated transactions.

In addition to the authorization above, on June 3, 2011 the Company's Board of Directors separately authorized the Company to repurchase shares of common stock from the proceeds of the 2016 Notes in connection with that debt offering.

A summary of repurchases during the year is as follows (amounts in thousands, except per share amounts):

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares that May Be Purchased Under the Plans or Programs
Beginning Balance				\$ 75,000
February 1, 2011 to February 28, 2011	42	\$ 49.84	42	\$ 72,884
March 1, 2011 to March 31, 2011	44	\$ 50.14	44	\$ 70,680
June 1, 2011 to June 30, 2011	1,127 (1)	\$ 46.79	322	\$ 55,561
August 1, 2011 to August 31, 2011	200	\$ 42.00	200	\$ 47,161
September 1, 2011 to September 30, 2011	96	\$ 37.22	96	\$ 43,559
	1,509		704	

(1) On June 15, 2011 the Company purchased approximately 0.8 million shares at an average price of \$46.70 in connection with the issuance of its 2016 Notes.

We repurchased an additional 0.4 million shares between October 1, 2011 and October 20, 2011 for an aggregate amount of \$14.4 million.

**Table of Contents**

**ITEM 6. EXHIBITS**

- \*31.1 Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
  - \*31.2 Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
  - \*32.1 Certification of Principal Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
  - \*32.2 Certification of Principal Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
  - \* 101.INS XBRL Instance Document
  - \* 101.SCH XBRL Taxonomy Extension Schema Document
  - \* 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
  - \* 101.DEF XBRL Definition Linkbase Document
  - \* 101.LAB XBRL Taxonomy Extension Labels Linkbase Document
  - \* 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document
- \* Filed herewith  
The financial information of Integra LifeSciences Holdings Corporation Quarterly Report on Form 10-Q for the quarter ended September 30, 2011 filed on October 31, 2011 formatted in XBRL (Extensible Business Reporting Language): (i) the Condensed Consolidated Statements of Operations, (ii) the Condensed Consolidated Balance Sheets, (iii) Parenthetical Data to the Condensed Consolidated Balance Sheets, (iv) the Condensed Consolidated Statements of Cash Flows, and (v) Notes to Condensed Consolidated Financial Statements, is furnished electronically herewith.

**Table of Contents**

**SIGNATURES**

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

**INTEGRA LIFESCIENCES HOLDINGS CORPORATION**

Date: October 31, 2011

*/s/ Stuart M. Essig*  
*Stuart M. Essig*  
*Chief Executive Officer*

Date: October 31, 2011

*/s/ John B. Henneman, III*  
*John B. Henneman, III*  
*Executive Vice President, Finance and Administration, and Chief Financial Officer*

**Table of Contents**

**Exhibits**

*31.1	Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
*31.2	Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
*32.1	Certification of Principal Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
*32.2	Certification of Principal Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
* 101.INS	XBRL Instance Document
* 101.SCH	XBRL Taxonomy Extension Schema Document

**Table of Contents**

- \* 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- \* 101.DEF XBRL Definition Linkbase Document
- \* 101.LAB XBRL Taxonomy Extension Labels Linkbase Document
- \* 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

\* Filed herewith

The financial information of Integra LifeSciences Holdings Corporation Quarterly Report on Form 10-Q for the quarter ended September 30, 2011 filed on October 31, 2011 formatted in XBRL (Extensible Business Reporting Language): (i) the Condensed Consolidated Statements of Operations, (ii) the Condensed Consolidated Balance Sheets, (iii) Parenthetical Data to the Condensed Consolidated Balance Sheets, (iv) the Condensed Consolidated Statements of Cash Flows, and (v) Notes to Condensed Consolidated Financial Statements, is furnished electronically herewith.