

INTEGRA LIFESCIENCES HOLDINGS CORP  
Form 10-Q  
August 05, 2014

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2014

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

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

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

DELAWARE 51-0317849  
(STATE OR OTHER JURISDICTION OF (I.R.S. EMPLOYER  
INCORPORATION OR ORGANIZATION) IDENTIFICATION NO.)

311 ENTERPRISE DRIVE 08536  
PLAINSBORO, NEW JERSEY  
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES) (ZIP CODE)

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

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

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

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

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

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

The number of shares of the registrant's Common Stock, \$0.01 par value, outstanding as of July 30, 2014 was 32,598,682.

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Table of Contents

INTEGRA LIFESCIENCES HOLDINGS CORPORATION  
INDEX

	Page Number
<u>PART I. FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements</u>	<u>3</u>
<u>Condensed Consolidated Statements of Operations and Comprehensive Income for the three and six months ended June 30, 2014 and 2013 (Unaudited)</u>	<u>3</u>
<u>Condensed Consolidated Balance Sheets as of June 30, 2014 and December 31, 2013 (Unaudited)</u>	<u>4</u>
<u>Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2014 and 2013 (Unaudited)</u>	<u>6</u>
<u>Notes to Unaudited Condensed Consolidated Financial Statements</u>	<u>7</u>
<u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>23</u>
<u>Item 3. Quantitative and Qualitative Disclosures About Market Risk</u>	<u>35</u>
<u>Item 4. Controls and Procedures</u>	<u>36</u>
<u>PART II. OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	<u>38</u>
<u>Item 1A. Risk Factors</u>	<u>38</u>
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>38</u>
<u>Item 4. Mine Safety Disclosures</u>	<u>39</u>
Item 5. Other Information	<u>39</u>
<u>Item 6. Exhibits</u>	<u>39</u>
<u>SIGNATURES</u>	<u>42</u>
Exhibit 31.1	
Exhibit 31.2	
Exhibit 32.1	
Exhibit 32.2	
EX-101 INSTANCE DOCUMENT	
EX-101 SCHEMA DOCUMENT	
EX-101 CALCULATION LINKBASE DOCUMENT	
EX-101 DEFINITION LINKBASE DOCUMENT	

EX-101 LABELS LINKBASE DOCUMENT

EX-101 PRESENTATION LINKBASE DOCUMENT

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Table of Contents

## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
		(As adjusted)*		(As adjusted)*
Total revenue, net	\$231,351	\$205,547	\$446,410	\$402,199
Costs and Expenses:				
Cost of goods sold	86,976	81,829	169,359	161,441
Research and development	13,745	11,809	26,312	24,525
Selling, general and administrative	115,253	103,280	223,591	206,243
Intangible asset amortization	2,985	3,073	6,018	6,624
Total costs and expenses	218,959	199,991	425,280	398,833
Operating income	12,392	5,556	21,130	3,366
Interest income	58	289	120	352
Interest expense	(5,382)	(4,965)	(10,524)	(9,765)
Other income (expense), net	118	(307)	435	(1,281)
Income (loss) before income taxes	7,186	573	11,161	(7,328)
Income tax expense (benefit)	2,361	(947)	4,130	(2,820)
Net income (loss)	\$4,825	\$1,520	\$7,031	\$(4,508)
Basic net income (loss) per common share	\$0.15	\$0.05	\$0.22	\$(0.16)
Diluted net income (loss) per common share	\$0.15	\$0.05	\$0.21	\$(0.16)
Weighted average common shares outstanding (See Note 10):				
Basic	32,398	27,873	32,336	27,834
Diluted	32,804	28,118	32,796	27,834
Comprehensive income (loss) (See Note 11)	\$4,752	\$3,397	\$7,957	\$(9,115)

\* See Note 1 of these condensed consolidated financial statements for discussion of the impact of the change in accounting for the medical device excise tax.

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)

	June 30, 2014	December 31, 2013 (As adjusted)*
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 137,160	\$ 120,614
Trade accounts receivable, net of allowances of \$5,223 and \$6,194	118,262	118,145
Inventories, net	223,632	206,919
Deferred tax assets	48,349	48,616
Prepaid expenses and other current assets	36,758	26,858
Total current assets	564,161	521,152
Property, plant and equipment, net	206,668	200,310
Intangible assets, net	422,009	197,163
Goodwill	354,977	249,764
Deferred tax assets	6,422	15,412
Other assets	8,786	8,338
Total assets	\$ 1,563,023	\$ 1,192,139
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current Liabilities:		
Accounts payable, trade	\$ 47,004	\$ 50,752
Deferred revenue	4,411	4,197
Accrued compensation	36,595	28,079
Accrued expenses and other current liabilities	38,892	36,354
Total current liabilities	126,902	119,382
Long-term borrowings under senior credit facility	421,875	186,875
Long-term convertible securities	209,096	205,182
Deferred tax liabilities	81,540	2,083
Other liabilities	34,380	12,527
Total liabilities	873,793	526,049
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; 41,474 and 41,042 issued at June 30, 2014 and December 31, 2013, respectively	415	410
Additional paid-in capital	766,096	750,918
Treasury stock, at cost; 8,903 shares at June 30, 2014 and December 31, 2013	(367,121	) (367,121
Accumulated other comprehensive income (loss)	1,853	927
Retained earnings	287,987	280,956
Total stockholders' equity	689,230	666,090
Total liabilities and stockholders' equity	\$ 1,563,023	\$ 1,192,139



Table of Contents

\* See Note 1 of these condensed consolidated financial statements for discussion of the impact of the change in accounting for the medical device excise tax.

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

5

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Table of Contents

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

	Six Months Ended June 30,	
	2014	2013 (As adjusted)*
<b>OPERATING ACTIVITIES:</b>		
Net income (loss)	\$7,031	\$(4,508 )
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	29,164	24,025
Non-cash impairment charges	600	—
Deferred income tax provision (benefit)	(503	) (400 )
Amortization of debt issuance costs	1,243	1,094
Non-cash interest expense	3,433	3,232
Loss on disposal of property and equipment	378	1,831
(Gain) from change in fair value of contingent consideration	(998	) —
Share-based compensation	8,302	4,764
Excess tax benefits from stock-based compensation arrangements	(1,164	) (102 )
Changes in assets and liabilities, net of business acquisitions:		
Accounts receivable	106	(745 )
Inventories	(17,367	) (19,398 )
Prepaid expenses and other current assets	(2,832	) (1,294 )
Other non-current assets	(1,846	) (368 )
Accounts payable, accrued expenses and other current liabilities	4,848	2,893
Deferred revenue	188	278
Other non-current liabilities	(2,952	) (538 )
Net cash provided by operating activities	27,631	10,764
<b>INVESTING ACTIVITIES:</b>		
Purchases of property and equipment	(20,691	) (24,475 )
Sales of property and equipment	—	530
Cash used for business acquisition, net of cash acquired	(235,000	) (2,830 )
Net cash used in investing activities	(255,691	) (26,775 )
<b>FINANCING ACTIVITIES:</b>		
Borrowings under senior credit facility	235,000	20,000
Payment of debt issuance costs	—	(1,013 )
Principal payments under capital lease obligations	(245	) —
Proceeds from exercised stock options	8,317	234
Excess tax benefits from stock-based compensation arrangements	1,164	102
Net cash provided by financing activities	244,236	19,323
Effect of exchange rate changes on cash and cash equivalents	370	(1,614 )
Net change in cash and cash equivalents	16,546	1,698
Cash and cash equivalents at beginning of period	120,614	96,938
Cash and cash equivalents at end of period	\$137,160	\$98,636

\* See Note 1 of these condensed consolidated financial statements for discussion of the impact of the change in accounting for the medical device excise tax.

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

6

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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 June 30, 2014 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, 2013 included in the Company’s Current Report on Form 8-K dated June 16, 2014, which was filed with the Securities and Exchange Commission on June 20, 2014. The December 31, 2013 consolidated balance sheet was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States. Operating results for the three- and six-month periods ended June 30, 2014 are not necessarily indicative of the results to be expected for the entire year.

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

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

Change in Accounting Principle

In the first quarter of 2014, the Company changed its method of accounting for the medical device excise tax (“MDET”). Prior to the change the Company recorded the MDET in inventory at the time of the first sale in the United States and then recognized the tax in cost of goods sold when the medical device was sold to the ultimate customer. Under the new method, the MDET will be recorded in selling, general and administrative expenses in the period the first sale occurs in the United States, which could be an intercompany sale.

The Company believes that this change in accounting principle is preferable as the new method provides a better comparison with the Company’s peers, the majority of which expense the MDET at the time of the first sale in the United States.

The medical device excise tax applies to sales beginning January 1, 2013; therefore, this change affected only 2013 financial results. The cumulative effect of the change in the prior year is included in retained earnings as of December 31, 2013. We have revised the comparative periods for the three- and six-month periods ended June 30, 2013 to reflect

the retrospective application of the change in accounting principle had the new method been in effect for all periods, as follows:

7

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

## Condensed Consolidated Statements of Operations and Comprehensive Income:

	Three Months Ended June 30, 2013			Six Months Ended June 30, 2013		
	Originally Reported	Adjustments	As Adjusted	Originally Reported	Adjustments	As Adjusted
	(In thousands, except per share amounts)					
Cost of goods sold	\$83,068	\$(1,239)	\$81,829	\$163,336	\$(1,895)	\$161,441
Selling, general and administrative	99,619	3,661	103,280	199,780	6,463	206,243
Income tax expense (benefit)	(445)	(502)	(947)	(2,150)	(670)	(2,820)
Net income (loss)	3,440	(1,920)	1,520	(610)	(3,898)	(4,508)
Basic net income (loss) per common share	\$0.12		\$0.05	\$(0.02)		\$(0.16)
Diluted net income (loss) per common share	0.12		0.05	(0.02)		(0.16)
Comprehensive income (loss)	\$5,317	\$(1,920)	\$3,397	\$(5,217)	\$(3,898)	\$(9,115)

## Condensed Consolidated Balance Sheets:

	December 31, 2013		
	Originally Reported	Adjustments	As Adjusted
	(In thousands)		
Inventories	\$213,431	\$(6,512)	\$206,919
Deferred tax assets - current	46,300	2,316	48,616
Prepaid expenses and other current assets	26,752	106	26,858
Retained earnings	285,046	(4,090)	280,956

## Condensed Consolidated Statements of Cash Flows:

	Six Months Ended June 30, 2013		
	Originally Reported	Adjustments	As Adjusted
	(In thousands)		
Net income (loss)	\$(610)	\$(3,898)	\$(4,508)
Inventories	(23,966)	4,568	(19,398)
Prepaid and other current assets	(624)	(670)	(1,294)

## Realignment of Segment Revenues

In the first quarter of 2014 the Company realigned certain products between operating segments. The Company did not change its management structure and has determined that the Company still has the same five reportable segments. The impact of this immaterial change on all periods presented is that (i) the revenues and segment profit of the U.S. Extremities segment is lower, and U.S. Instruments and U.S. Spine and Other segments are higher, and (ii) the global revenues of the Orthopedics product category is lower and the Instruments product category is higher. These changes have been reflected in all periods presented. There has been no change in the Company's net revenues reported.

## Recently Issued Accounting Standards

In July 2013, the FASB issued ASU No. 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. This updated guidance requires an unrecognized tax benefit to be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, similar tax loss, or a tax credit carryforward. To the extent the tax benefit is not

available at the reporting date under the governing tax law or if the entity does not intend to use the deferred tax asset for such purpose, the unrecognized tax benefit should be presented as a liability and not combined with deferred tax assets. This ASU is effective for fiscal years and interim periods within those

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

years beginning after December 15, 2013 for public entities and early adoption is permitted. The amendments are to be applied to all unrecognized tax benefits that exist as of the effective date and may be applied retrospectively to each prior reporting period presented. The standard adoption does not have a material impact on the Company's financial statements.

In April 2014, the FASB issued amendments to guidance for reporting discontinued operations and disposals of components of an entity. The amended guidance requires that a disposal representing a strategic shift that has (or will have) a major effect on an entity's financial results or a business activity classified as held for sale should be reported as discontinued operations. The amendments also expand the disclosure requirements for discontinued operations and add new disclosures for individually significant dispositions that do not qualify as discontinued operations. The amendments are effective prospectively for fiscal years, and interim reporting periods within those years, beginning after December 15, 2014 (early adoption is permitted only for disposals that have not been previously reported). The implementation of the amended guidance is not expected to have a material impact on our consolidated financial position or results of operations.

In May 2014, the FASB issued Update No. 2014-09, Revenue from Contracts with Customers (Topic 606). The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should: 1) identify the contract(s) with a customer, 2) identify the performance obligations in the contract, 3) determine the transaction price, 4) allocate the transaction price to the performance obligations in the contract, and 5) recognize revenue when (or as) the entity satisfies a performance obligation. This update is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period, and early adoption is not permitted. The Company is in the process of evaluating the impact of this standard on its financial statements.

In June 2014, the FASB issued Update No. 2014-12, Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period (Topic 718). The amendments require that a performance target that affects vesting and that could be achieved after the requisite service period be treated as a performance condition. A reporting entity should apply existing guidance in Topic 718 as it relates to awards with performance conditions that affect vesting to account for such awards. As such, the performance target should not be reflected in estimating the grant-date fair value of the award. Compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. If the performance target becomes probable of being achieved before the end of the requisite service period, the remaining unrecognized compensation cost should be recognized prospectively over the remaining requisite service period. The requisite service period ends when the employee can cease rendering service and still be eligible to vest in the award if the performance target is achieved. This update is effective for annual reporting periods beginning after December 15, 2015, including interim periods within that reporting period, and early adoption is permitted. The Company is in the process of evaluating the impact of this standard on its financial statements.

## 2. BUSINESS ACQUISITIONS

### Confluent Surgical, Inc.

On January 15, 2014, the Company acquired all outstanding shares of Confluent Surgical, Inc., ("Confluent Surgical") - including its surgical sealant and adhesion barrier product lines - from Covidien Group S.a.r.l, ("Covidien") for an aggregate purchase price of \$255.9 million. The purchase price is comprised of an initial cash payment to Covidien of \$231.0 million upon the closing of the transaction, a separate prepayment of \$4.0 million made under a transitional supply agreement with an affiliate of Covidien, and contingent consideration with an acquisition date fair value of \$20.9 million. The potential maximum undiscounted contingent consideration of \$30.0 million consists of \$25.0 million upon obtaining certain U.S. governmental approvals and \$5.0 million upon obtaining certain European

governmental approvals, both related to the completion of the transition of the Confluent Surgical business.

The transitional supply agreement secures the supply of the acquired products from an affiliate of Covidien until the earlier of (i) the time that the transition of the Confluent Surgical business as discussed above is complete, or (ii) the fifth anniversary of the effective date of the agreement (the agreement also contains an option to extend for another two years by providing written notice at least 180 days prior to the end of the initial five-year period). This agreement contains financial incentives to the affiliate of Covidien for the timely supply of products each fiscal quarter through the third anniversary of the agreement. The prices paid under the supply agreement are essentially flat through the third anniversary of the agreement, and then increase significantly each of the following three years. The Company also entered into a transition services agreement with an affiliate of Covidien at the closing for services such as customer service, accounting and information technology management, clinical and regulatory affairs, manufacturing transition services, and other functions.

This acquisition complements the Company's global neurosurgery growth strategy aimed at providing a broader set of solutions for surgical procedures in the head.



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

The Company adjusted the preliminary purchase price allocation during the quarter ended June 30, 2014 to reduce deferred tax liabilities by \$12.4 million. This adjustment offset goodwill and was the result of the Company analyzing and revising its tax positions in certain jurisdictions. The purchase price allocation is preliminary because the Company has not yet completed the final analysis of the tax accounts. The following summarizes the preliminary allocation of the purchase price as of June 30, 2014 based on the fair value of the assets acquired and liabilities assumed:

	Preliminary Purchase Price Allocation (Dollars in thousands)	
Inventory deposit	\$4,000	
Fixed assets	438	
Intangible assets:		Wtd. Avg. Life
Technology product rights	239,800	20 years
Other	400	Less than 1 year
Deferred tax assets - long term	12	
Goodwill	105,331	
Total assets acquired	349,981	
Contingent supply liability	5,891	
Other	731	
Deferred tax liabilities - long term	87,464	
Net assets acquired	\$255,895	

Subsequent to the acquisition date, a regulatory event occurred that resulted in the full-impairment of one of the acquired technology product rights of \$0.6 million. This event was not known, or knowable, at the time of the acquisition and therefore the impairment has been included in the Company's cost of sales.

The Company accounted for the contingent supply liability by recording its fair value as a liability on the date of the acquisition based on a discounted cash-flow model. This contingent supply liability relates to contractual quarterly incentive payments that will be made to an affiliate of Covidien if certain supply minimums under the transitional supply agreement are met.

The Company accounted for the contingent consideration by recording its fair value as a liability on the date of the acquisition. The contingent consideration relates to the Company obtaining certain U.S. and European regulatory approvals. At the date of the acquisition, both of these milestones were valued using a discount rate of 2.2%, which is equivalent to the cost of debt for the estimated time horizon, and an overall probability of occurring of 95%. Accordingly, on January 15, 2014 the Company recorded a \$20.9 million liability representing the initial fair value estimate of the probability weighted contingent consideration that management believes will be paid between early 2017 and late 2018. Depending on the expected timing of the estimated payments, the acquisition date fair value of the probability adjusted payments could have been \$0.3 million higher or \$0.4 million lower. These fair value measurements were based on significant inputs not observed in the market and thus represented a Level 3 measurement. The contingent consideration is re-measured to fair value at each reporting date until the contingency is resolved, and those changes in fair value are recognized in earnings.

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

Contingent consideration

The fair value of contingent consideration during the six-months ended June 30, 2014 was (i) increased to reflect current period acquisitions, and the change in the time value of money during the period, and (ii) decreased because the Company believes that it is no longer probable that it will reach certain sales-based milestone targets. A reconciliation of the opening balances to the closing balances of these Level 3 measurements are as follows (in thousands):

10

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

		Location in Statement of Operations
Balance as of January 1, 2014	\$1,227	
Contingent consideration from Confluent Surgical acquisition	20,895	
Loss/(gain) from increase/(decrease) in fair value of contingent consideration liabilities	(998	) Selling, general and administrative
Fair value at June 30, 2014	\$21,124	

#### Pro Forma Results

The following unaudited pro forma financial information summarizes the results of operations for the three and six months ended June 30, 2013 as if the Confluent Surgical acquisition completed by the Company during 2014 had been completed as of January 1, 2013. The pro forma results are based upon certain assumptions and estimates, and they give effect to actual operating results prior to the acquisition and adjustments to reflect (i) the change in interest expense, depreciation expense, and intangible asset amortization, (ii) certain external expenses related to the acquisition as if they were incurred on January 1, 2013 that will not be recurring in the post-acquisition periods, and (iii) income taxes on the aforementioned adjustments at the Company's statutory rate. No effect has been given to other cost reductions or operating synergies. As a result, these pro forma results do not necessarily represent results that would have occurred if the acquisition had taken place on the basis assumed above, nor are they indicative of the results of future combined operations.

The pro forma impact of the Confluent Surgical pre-acquisition results were not material to the 2014 consolidated operating results of the Company; therefore the pro forma impact on the 2014 results of the Company has not been presented below. The pro forma results below also incorporate the impact of the change in accounting for the MDET on the 2013 results which is discussed in Note 1.

	Three Months Ended June 30, 2013 (In thousands)	Six Months Ended June 30, 2013
Total revenue	\$221,946	\$434,997
Net income (loss)	\$3,438	\$(2,032 )

### 3. INVENTORIES

Inventories, net consisted of the following:

	June 30, 2014 (In thousands)	December 31, 2013 (As adjusted)*
Finished goods	\$139,427	\$123,786
Work in process	48,221	47,403
Raw materials	35,984	35,730
	\$223,632	\$206,919

\* See Note 1 of these condensed consolidated financial statements for discussion of the impact of the change in accounting for the medical device excise tax.

### 4. GOODWILL AND OTHER INTANGIBLE ASSETS

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

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

Changes in the carrying amount of goodwill for the six months ended June 30, 2014 were as follows:

	U.S. Neurosurgery	U.S. Instruments	U.S. Extremities	U.S. Spine and Other	International	Total
	(In thousands)					
Goodwill, gross	\$95,165	\$58,033	\$61,079	\$56,325	\$25,900	\$296,502
Accumulated impairment losses	—	—	—	(46,738 )	—	(46,738 )
Goodwill at December 31, 2013	95,165	58,033	61,079	9,587	25,900	249,764
Confluent Surgical acquisition	95,373	—	—	—	9,958	105,331
Foreign currency translation	(63 )	(19 )	(20 )	(3 )	(13 )	(118 )
Goodwill at June 30, 2014	\$190,475	\$58,014	\$61,059	\$9,584	\$35,845	\$354,977

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

	June 30, 2014			
	Weighted Average Life	Cost	Accumulated Amortization	Net
	(Dollars in thousands)			
Completed technology	18 years	\$320,833	\$(54,339 )	\$266,494
Customer relationships	12 years	146,988	(84,400 )	62,588
Trademarks/brand names	31 years	33,686	(15,973 )	17,713
Trademarks/brand names	Indefinite	48,484	—	48,484
Supplier relationships	27 years	34,721	(10,049 )	24,672
All other <sup>(1)</sup>	4 years	4,620	(2,562 )	2,058
		\$589,332	\$(167,323 )	\$422,009

	December 31, 2013			
	Weighted Average Life	Cost	Accumulated Amortization	Net
	(Dollars in thousands)			
Completed technology	12 years	\$81,238	\$(45,343 )	\$35,895
Customer relationships	12 years	146,627	(79,624 )	67,003
Trademarks/brand names	31 years	33,703	(15,648 )	18,055
Trademarks/brand names	Indefinite	48,484	—	48,484
Supplier relationships	27 years	34,721	(9,305 )	25,416
All other <sup>(1)</sup>	5 years	4,251	(1,941 )	2,310
		\$349,024	\$(151,861 )	\$197,163

(1) At June 30, 2014 and December 31, 2013, all other included in-process research and development ("IPR&D") of \$1.4 million in both periods, which was indefinite-lived.

During the six months ended June 30, 2014, the Company recorded an impairment charge of \$0.6 million in cost of goods sold related to technology assets acquired from Confluent Surgical that will no longer be sold resulting from a regulatory event that occurred after the acquisition date.

Based on quarter-end exchange rates, annual amortization expense (including amounts reported in cost of product revenues, but excluding any possible future amortization associated with acquired in-process research and development) is expected to approximate \$31.1 million in 2014, \$28.8 million in 2015, \$26.6 million in 2016, \$24.5 million in 2017 and \$24.1 million in 2018. Identifiable intangible assets are initially recorded at fair market value at the time of acquisition using an income or cost approach.

INTEGRA LIFESCIENCES HOLDINGS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

5. DEBT

Amended and Restated Senior Credit Agreement

On August 10, 2010, the Company entered into an amended and restated credit agreement with a syndicate of lending banks (the "Senior Credit Facility"). The Company amended the Senior Credit Facility on June 8, 2011, May 11, 2012, June 21, 2013, and subsequently amended and restated the facility on July 2, 2014 (see Note 14).

The June 8, 2011 amendment:

- i. increased the revolving credit component from \$450 million to \$600 million and eliminated the \$150 million term loan component that existed under the original amended and restated credit agreement,
- ii. allowed the Company to further increase the size of the revolving credit component by an aggregate of \$200 million with additional commitments,
- iii. provided the Company with decreased borrowing rates and annual commitment fees, and provides more favorable financial covenants, and
- iv. extended the maturity date from August 10, 2015 to June 8, 2016.

The May 11, 2012 amendment:

- i. modified certain financial and negative covenants, provided that the Company's Maximum Consolidated Total Leverage Ratio (a measure of net debt to consolidated EBITDA, in each case as defined in the Senior Credit Facility, as amended) during any consecutive four quarter
- ii. period should not be greater than 3.75 to 1.00 during any such period ending on December 31, 2013 (instead of March 31, 2012), and
- iii. when calculating consolidated EBITDA for any period, the amendment permits the addition of certain costs and expenses in the calculation of consolidated net income for such period, to the extent deducted in the calculation of consolidated net income.

The June 21, 2013 amendment:

- i. modified certain financial and negative covenants, increased the Company's Maximum Consolidated Total Leverage Ratio (a measure of net debt to consolidated
- ii. EBITDA, in each case as defined in the Senior Credit Facility, as amended) to 4.25 through June 30, 2014, with a step-down to 4.00 through March 31, 2015, and then with another step-down to 3.75 thereafter, and
- iii. when calculating consolidated EBITDA for any period, the amendment permits the addition of certain costs and expenses in the calculation of consolidated net income for such period, to the extent deducted in the calculation of consolidated net income.

The Senior Credit Facility is collateralized by substantially all of the assets of the Company's U.S. subsidiaries, excluding intangible assets. The Senior Credit Facility is subject to various financial and negative covenants and at June 30, 2014 the Company was in compliance with all such covenants.

Borrowings under the Senior Credit Facility currently bear interest, at the Company's option, at a rate equal to:

- i. the Eurodollar Rate (as defined in the Senior Credit Facility, which definition has not changed) in effect from time to time plus the applicable rate (ranging from 1.00% to 1.75%), or
- ii. the highest of:
  1. the weighted average overnight Federal funds rate, as published by the Federal Reserve Bank of New York, plus 0.5%, or
  2. the prime lending rate of Bank of America, N.A. or
  3. the one-month Eurodollar Rate plus 1.0%.

The applicable rates are based on the Company's consolidated total leverage ratio (defined as the ratio of (a) consolidated funded indebtedness less cash in excess of \$40 million that is not subject to any restriction of the use or investment thereof to (b) consolidated EBITDA) at the time of the applicable borrowing.

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





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

At June 30, 2014 and December 31, 2013, there was \$421.9 million and \$186.9 million outstanding under the Senior Credit Facility at a weighted average interest rate of 1.7% and 2.0%, respectively. At June 30, 2014, there was approximately \$178.1 million available for borrowing under the Senior Credit Facility. The fair value of outstanding borrowings under the Senior Credit Facility at June 30, 2014 was approximately \$421.7 million. The fair value of the Senior Credit Facility was determined by using a discounted cash flow model based on current market interest rates available to the Company. These inputs are corroborated by observable market data for similar liabilities and therefore classified within Level 2 of the fair value hierarchy. Level 2 inputs represent inputs that are observable for the asset or liability, either directly or indirectly and are other than active market observable inputs that reflect unadjusted quoted prices for identical assets or liabilities. The Company considers the balance to be long-term in nature based on its current intent and ability to repay the borrowing outside of the next twelve-month period.

#### 2016 Convertible Senior Notes

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

At June 30, 2014, the carrying amount of the liability component was \$209.1 million, the remaining unamortized discount was \$20.9 million, and the principal amount outstanding was \$230.0 million. The fair value of the 2016 Notes at June 30, 2014 was approximately \$246.0 million. At December 31, 2013, the carrying amount of the liability component was \$205.2 million, the remaining unamortized discount was \$24.8 million and the principal amount outstanding was \$230.0 million. The fair value of the liability of the 2016 Notes was determined using a discounted cash flow model based on current market interest rates available to the Company. These inputs are corroborated by observable market data for similar liabilities and therefore classified within Level 2.

The 2016 Notes are senior, unsecured obligations of the Company, and are convertible into cash and, if applicable, shares of its common stock based on an initial conversion rate, subject to adjustment of 17.4092 shares per \$1,000 principal amount of 2016 Notes (which represents an initial conversion price of approximately \$57.44 per share). The Company will satisfy any conversion of the 2016 Notes with cash up to the principal amount of the 2016 Notes pursuant to the net share settlement mechanism set forth in the indenture and, with respect to any excess conversion value, with shares of the Company's common stock. The 2016 Notes are convertible only in the following circumstances: (1) if the closing sale price of the Company's common stock exceeds 150% of the conversion price during a period as defined in the indenture; (2) if the average trading price per \$1,000 principal amount of the 2016 Notes is less than or equal to 98% of the average conversion value of the 2016 Notes during a period as defined in the indenture; (3) at any time on or after June 15, 2016; or (4) if specified corporate transactions occur. The issue price of the 2016 Notes was equal to their face amount, which is also the amount holders are entitled to receive at maturity if the 2016 Notes are not converted. As of June 30, 2014, none of these conditions existed with respect to the 2016 Notes and as a result, the 2016 Notes are classified as long term.

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

#### Convertible Note Interest

The interest expense components of the Company's convertible notes are as follows (net of capitalized interest amounts):

Three Months Ended June 30,		Six Months Ended June 30,	
2014	2013	2014	2013

(In thousands)

2016 Notes:

Amortization of the discount on the liability component	\$1,766	\$1,622	\$3,433	\$3,232
Cash interest related to the contractual interest coupon	837	813	1,639	1,631
Total	\$2,603	\$2,435	\$5,072	\$4,863

6. DERIVATIVE INSTRUMENTS

Interest Rate Hedging

14

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

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 \$1.6 million of pre-tax losses recorded as net in AOCI related to the interest rate hedge could be reclassified to earnings within the next twelve months.

#### Foreign Currency Hedging

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

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

#### Counterparty Credit Risk

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

#### Fair Value of Derivative Instruments

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

The following table summarizes the fair value and presentation for derivatives designated as hedging instruments in the condensed consolidated balance sheets as of June 30, 2014 and December 31, 2013:

Location on Balance Sheet <sup>(1)</sup> :	Fair Value as of	
	June 30, 2014	December 31, 2013

	(In thousands)	
Derivatives designated as hedges — Liabilities:		
Interest rate swap — Accrued expenses and other current liabilities <sup>(2)</sup>	\$1,582	\$1,676
Interest rate swap — Other liabilities <sup>(2)</sup>	131	763
Total Derivatives designated as hedges — Liabilities	\$1,713	\$2,439

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

15

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

At June 30, 2014 and December 31, 2013, the notional amount related to the Company's sole interest rate swap was (2) \$105.0 million and \$112.5 million, respectively. In the next twelve months, the Company expects to reduce the notional amount by \$15.0 million.

The following presents the effect of derivative instruments designated as cash flow hedges on the accompanying condensed consolidated statements of operations during the three and six months ended June 30, 2014 and 2013:

	Balance in AOCI Beginning of Quarter	Amount of Gain (Loss) Recognized in AOCI- Effective Portion	Amount of Gain (Loss) Reclassified from AOCI into Earnings-Effective Portion	Balance in AOCI End of Quarter	Location in Statements of Operations
(In thousands)					
Three Months Ended June 30, 2014					
Interest rate swap	\$(2,097 )	\$(60 )	\$ (444 )	\$ (1,713 )	Interest (expense)
Three Months Ended June 30, 2013					
Forward currency forward contracts	\$—	\$ 162	\$ —	\$ 162	Cost of goods sold
Interest rate swap	(3,644 )	108	(506 )	(3,030 )	Interest (expense)
	\$(3,644 )	\$ 270	\$ (506 )	\$ (2,868 )	
	Balance in AOCI Beginning of Year	Amount of Gain (Loss) Recognized in AOCI- Effective Portion	Amount of Gain (Loss) Reclassified from AOCI into Earnings-Effective Portion	Balance in AOCI End of Quarter	Location in Statements of Operations
(In thousands)					
Six Months Ended June 30, 2014					
Interest rate swap	(2,439 )	(169 )	(895 )	(1,713 )	Interest (expense)
Six Months Ended June 30, 2013					
Forward currency forward contracts	(34 )	162	(34 )	\$ 162	Cost of goods sold
Interest rate swap	(4,125 )	99	(996 )	(3,030 )	Interest (expense)
	\$(4,159 )	\$ 261	\$ (1,030 )	\$ (2,868 )	

The Company recognized no gains or losses resulting from ineffectiveness of cash flow hedges during the six months ended June 30, 2014 and 2013.

#### 7. STOCK-BASED COMPENSATION

As of June 30, 2014, the Company had stock options, restricted stock awards, performance stock units, contract stock awards and restricted stock unit awards outstanding under three plans, the 2000 Equity Incentive Plan (the “2000 Plan”), the 2001 Equity Incentive Plan (the “2001 Plan”), and the 2003 Equity Incentive Plan (the “2003 Plan,” and collectively, the “Plans”).

Stock options issued under the Plans become exercisable over specified periods, generally within four years from the date of grant for officers, 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

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

years after the date of grant. The vesting of performance stock, issued under the Plans, is subject to service and performance conditions.

### Stock Options

As of June 30, 2014, there were approximately \$2.1 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 two years. There were 80,991 stock options granted during the six months ended June 30, 2014.

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

Performance stock, restricted stock and contract stock awards generally have requisite service periods of three years. Performance stock units are subject to graded vesting conditions and the Company expenses their fair value over the requisite service period. The Company expenses the fair value of restricted stock and contract stock awards on a straight-line basis over the vesting period or requisite service period, whichever is shorter. As of June 30, 2014, there were approximately \$18.3 million of total unrecognized compensation costs related to these unvested awards. The Company expects to recognize these costs over a weighted-average period of approximately two years. The Company granted 253,642 restricted stock awards/stock units and 90,025 performance shares during the six months ended June 30, 2014.

During the three months ended June 30, 2014, the Company recorded an incremental stock compensation expense of \$3.0 million in connection with the accelerated vesting of grants due to the amendment of an executive employment contract. The expense, which was comprised of both restricted shares and performance shares, was measured based on the difference between (i) the fair value of the awards on the date of modification and (ii) previously recognized compensation expense for such awards. The expense related to the acceleration of performance stock, included in the compensation expense amount above, was recorded in its entirety on the date of modification as the Company believes the performance obligation will be satisfied.

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

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

## 8. TREASURY STOCK

On October 23, 2012, the Company's Board of Directors authorized a repurchase of up to \$75.0 million of its outstanding common stock through December 2014. The Company has not repurchased any of its outstanding shares of common stock during the six month periods ended June 30, 2014 and 2013.

As of June 30, 2014, there remained \$75.0 million available for repurchases under this authorization.

## 9. INCOME TAXES

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013 (As adjusted)*	2014	2013 (As adjusted)*
Reported tax rate	32.9	% (165.3 )%	37.0	% 38.5 %

\* See Note 1 of these condensed consolidated financial statements for discussion of the impact of the change in accounting for the medical device excise tax.

The Company's effective income tax rates for the three months ended June 30, 2014 and 2013 were 32.9% and (165.3)%, respectively. For the three months ended June 30, 2014, discrete foreign income tax audit settlements of \$0.3 million, and a change in state filing positions of \$0.3 million primarily drove the tax rate. The overall rate for the three months ended June 30, 2013 was driven primarily by the impact of discrete items on an unusually low pre-tax income level. During the three months ended June 30, 2013; the Company recorded a benefit of \$0.5 million relating to the granting of Irish research credits for 2011 and 2012



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

and a benefit of \$0.8 million for the release of uncertain tax positions due to the expiration of the statute of limitation in certain state jurisdictions.

The Company's effective income tax rates for the six months ended June 30, 2014 and 2013 were 37.0% and 38.5%, respectively. For the six months ended June 30, 2014, the change in the income tax rate compared to the same period in 2013 primarily resulted from an expense of \$0.4 million for a foreign income tax audit settlement, an expense of \$0.3 million from a change in state filing positions, and an expense of \$0.7 million relating to state income tax audit settlements. For the six months ended June 30, 2013; the Company recorded a benefit of \$0.5 million relating to the granting of Irish research credits for 2011 and 2012, a benefit of \$1.2 million for the release of uncertain tax positions due to the expiration of the statute of limitation in certain state jurisdictions, and a benefit of \$0.9 million because of the extension of the Federal research credit, enacted through the American Taxpayer Relief Act. These benefits in 2013 were recorded against a book loss; accordingly, they had the effect of increasing the effective tax rate in that period.

The Company expects its effective income tax rate for the full year to be approximately 23% to 24%, resulting largely from the jurisdictional mix of pretax income in U.S.-based operations relative to foreign operations. The Company may revise this estimate in the future as additional information becomes available.

#### 10. NET INCOME (LOSS) PER SHARE

Basic and diluted net income (loss) per share was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(In thousands, except per share amounts)			
		(As adjusted)*		(As adjusted)*
Basic net income (loss) per share:				
Net income (loss)	\$4,825	\$1,520	\$7,031	\$(4,508)
Weighted average common shares outstanding	32,398	27,873	32,336	27,834
Basic net income (loss) per common share	\$0.15	\$0.05	\$0.22	\$(0.16)
Diluted net income (loss) per share:				
Net income (loss)	\$4,825	\$1,520	\$7,031	\$(4,508)
Weighted average common shares outstanding — Basic	32,398	27,873	32,336	27,834
Effect of dilutive securities:				
Stock options and restricted stock	406	245	460	—
Weighted average common shares for diluted earnings per share	32,804	28,118	32,796	27,834
Diluted net income (loss) per common share	\$0.15	\$0.05	\$0.21	\$(0.16)

\* See Note 1 of these condensed consolidated financial statements for discussion of the impact of the change in accounting for the medical device excise tax.

At June 30, 2014 and 2013, the Company had 1.4 million and 1.7 million of outstanding stock options, respectively. The Company also has warrants outstanding relating to its 2016 Notes at June 30, 2014 and 2013 and the Company's 2016 Notes are convertible to common shares in certain circumstances (see Note 5). Stock options, restricted stock,

warrants and the excess conversion value of the 2016 Notes are included in the diluted earnings per share calculation using the treasury stock method, unless the effect of including the such items would be anti-dilutive.

For the three months ended June 30, 2014 and 2013, 0.2 million, and 1.0 million, respectively, of anti-dilutive stock options were excluded from the diluted earnings per share calculation. For the six months ended June 30, 2014, 0.2 million of anti-dilutive stock options were excluded, and for the six months ended June 30, 2013, all stock options, and all restricted stock were excluded from the diluted earnings per share calculation using the treasury stock method because of their anti-dilutive effect. The effect of outstanding warrants were anti-dilutive because the strike price of the warrants exceeded the Company's average stock price for the periods, and the potential excess conversion value of the 2016 Notes were anti-dilutive because the conversion price exceeded

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

the Company's stock price; therefore, these amounts have been excluded from the diluted earnings per share calculation in all periods presented.

11. COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(In thousands)			
		(As adjusted)*		(As adjusted)*
Net income (loss)	\$4,825	\$1,520	\$7,031	\$(4,508)
Foreign currency translation adjustment	(234)	) 1,357	585	(5,423)
Change in unrealized gain on derivatives, net of tax	219	451	414	747
Pension liability adjustment, net of tax	(58)	) 69	(73)	) 69
Comprehensive income (loss)	\$4,752	\$3,397	\$7,957	\$(9,115)

\* See Note 1 of these condensed consolidated financial statements for discussion of the impact of the change in accounting for the medical device excise tax.

Changes in Accumulated Other Comprehensive Income (Loss) by component between December 31, 2013 and June 30, 2014 are presented in the table below, net of tax:

	Gains and (Losses) on Cash Flow Hedges	Defined Benefit Pension Items	Foreign Currency Items	Total
	(In thousands)			
Beginning balance	\$(1,390)	) \$(2,287)	) \$4,604	\$927
Other comprehensive income (loss) before reclassifications	(96)	) (73)	) 585	416
Amounts reclassified from accumulated other comprehensive income	510	—	—	510
Net current-period other comprehensive income (loss)	414	(73)	) 585	926
Ending balance	\$(976)	) \$(2,360)	) \$5,189	\$1,853

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

The reclassification adjustments out of Accumulated Other Comprehensive Income (Loss) during the three and six months ended June 30, 2014 were as follows:

Three Months Ended June 30, 2014

Details about Accumulated Other Comprehensive Income (Loss) Components	Amount Reclassified from Accumulated Other Comprehensive Income (Loss) (In thousands)	Affected Line Item in the Statement where Net Income (Loss) is Presented
Gains and losses on cash flow hedges		
Interest rate swap	\$ (444)	) Interest (expense)
	191	) Tax (expense) or benefit
	\$ (253)	) Net of tax

Six Months Ended June 30, 2014

Details about Accumulated Other Comprehensive Income (Loss) Components	Amount Reclassified from Accumulated Other Comprehensive Income (Loss) (In thousands)	Affected Line Item in the Statement where Net Income (Loss) is Presented
Gains and losses on cash flow hedges		
Interest rate swap	\$ (895)	) Interest (expense)
	385	) Tax (expense) or benefit
	\$ (510)	) Net of tax

## 12. SEGMENT AND GEOGRAPHIC INFORMATION

The Company internally manages and reports the results of its businesses to its chief operating decision maker through five reportable segments. The five reportable segments and a description of their activities are described below:

The U.S. Neurosurgery segment sells a full line of products specifically for neurosurgery and critical care such as tissue ablation equipment, dural repair products, cerebral spinal fluid management devices, intracranial monitoring equipment, and cranial stabilization equipment.

The U.S. Instruments business sells more than 60,000 instrument patterns and surgical and lighting products to hospitals, surgery centers, and dental, podiatry, and veterinary offices.

The U.S. Extremities segment includes the U.S. Extremity reconstruction business, which includes such offerings as skin and wound repair, bone and joint fixation, implants in the upper and lower extremities, bone grafts and nerve and tendon repair.

The U.S. Spine and Other segment includes (i) the U.S. Spine business, which focuses on spinal fusion, spinal implants, and deformity correction, together with bone graft substitutes and other related medical devices that are used to enhance the repair and regeneration of bone in various types of orthopedic surgical procedures, and (ii) the Private Label business, which sells the Company's regenerative medicine and other products to strategic partners.

The International segment sells similar products to those discussed above, but are managed through the following geographies: (i) Europe, Middle East and Africa, and (ii) Central/South America, Asia-Pacific and Canada.

The Corporate and other category includes: (i) various legal, finance, information systems, executive, and human resource functions, (ii) brand management, (iii) share-based compensation costs, and (iv) costs related to procurement, manufacturing operations and logistics for the Company's entire organization.

The operating results of the various reportable segments as presented are not comparable to one another because: (i) certain operating segments are more dependent than others on corporate functions for unallocated general and administrative and/or operational manufacturing functions, and (ii) the Company does not allocate certain manufacturing costs and general and administrative costs to the operating segment results. Net sales and profit by reportable segment for the three and six months ended June 30, 2014 and 2013 are as follows:

20

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## INTEGRA LIFESCIENCES HOLDINGS CORPORATION

## NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(In thousands)			
		(As adjusted)*		(As adjusted)*
Segment Net Sales				
U.S. Neurosurgery	\$60,559	\$41,767	\$114,942	\$80,763
U.S. Instruments	39,505	41,048	76,225	78,896
U.S. Extremities	34,424	32,009	66,337	61,971
U.S. Spine and Other	45,087	43,434	86,153	87,481
International	51,776	47,289	102,753	93,088
Total revenues	\$231,351	\$205,547	\$446,410	\$402,199
Segment Profit				
U.S. Neurosurgery	\$30,569	\$19,786	\$58,357	\$36,690
U.S. Instruments	11,832	12,136	22,313	22,250
U.S. Extremities	14,171	11,943	25,924	21,495
U.S. Spine and Other	14,716	12,636	26,693	26,199
International	17,167	14,350	34,379	27,004
Segment profit	88,455	70,851	167,666	133,638
Amortization	(2,985)	(3,073)	(6,018)	(6,624)
Corporate and other	(73,078)	(62,222)	(140,518)	(123,648)
Operating income (loss)	\$12,392	\$5,556	\$21,130	\$3,366

\* See Note 1 of these condensed consolidated financial statements for discussion of the impact of the change in accounting for the medical device excise tax.

Certain 2013 segment revenues and the related impact on segment profit above have been reclassified in order to conform with the current year's presentation.

Revenue by major product category consisted of the following:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(In thousands)			
Orthopedics	\$93,069	\$90,377	\$180,308	\$179,737
Neurosurgery	93,258	68,459	177,628	131,644
Instruments	45,024	46,711	88,474	90,818
Total Revenues	\$231,351	\$205,547	\$446,410	\$402,199

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(In thousands)			
United States	\$178,806	\$157,166	\$342,187	\$307,185
Europe	25,851	23,776	51,176	47,393
Rest of World	26,694	24,605	53,047	47,621
Total Revenues	\$231,351	\$205,547	\$446,410	\$402,199



INTEGRA LIFESCIENCES HOLDINGS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (continued)

13. COMMITMENTS AND CONTINGENCIES

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

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

On June 6, 2012, the Company was contacted by the United States Attorney's Office for the District of New Jersey regarding the activities of sales representatives in a single region within our Extremities Reconstruction division. The U.S. Attorney's Office is investigating the activities of three sales representatives, one of whom was a supervisor until terminated by the Company for failure to cooperate with this investigation. The activities at issue pertain to alleged improper billing of products for extremities indications. The Company has been cooperating with the U.S. Attorney's Office on a voluntary basis and is not a subject or target of an investigation at this time. In cooperating with the U.S. Attorney's Office, the Company has responded to multiple government requests for documents and information; and in the fall of 2013 it responded to what the government currently indicated is its final request. Representatives of the Company met with the Assistant United States Attorney in charge of the matter and an agent from the Federal Bureau of Investigation on April 11, 2014, to discuss the matter, the behavior of the sales representatives in question, and the disposition of the matter as to the Company. The Company awaits word from the U.S. Attorney's Office as to the disposition of the matter as to the Company.

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

14. SUBSEQUENT EVENTS

On July 2, 2014, the Company entered into an amendment and restatement of the Senior Credit Facility with a syndicate of lending banks, Bank of America, N.A., as Administrative Agent, Swing Line Lender and L/C Issuer, Wells Fargo Bank, National Association, as Syndication Agent and HSBC Bank USA, National Association, Royal Bank of Canada, Citizens Bank, National Association, DNB Capital LLC, Credit Agricole-Corporate and Investment Bank and TD Bank, N.A., as Co-Documentation Agents (the "2014 Amendment").

The 2014 Amendment creates an aggregate principal amount of up to \$900.0 million available to the Company through the following facilities:

- i. a \$750.0 million revolving credit facility (increased from \$600.0 million), which includes a \$60.0 million sublimit for the issuance of standby letters of credit and a \$60.0 million sublimit for swingline loans, and
- ii. a \$150.0 million term loan facility.

The 2014 Amendment allows the Company to further increase the size of either the revolving credit facility or the term loan facility, or a combination thereof, by an aggregate of \$200.0 million with additional commitments. The 2014 Amendment extends the Senior Credit Facility's maturity date from June 8, 2016 to July 2, 2019.

Borrowings under the 2014 Amendment bear interest, at the Company's option, at a rate equal to:

- i. the Eurodollar Rate (as defined in the amendment and restatement) in effect from time to time plus the applicable rate (ranging from 1.00% to 1.75%), or
- ii. the highest of:



1. the weighted average overnight Federal funds rate, as published by the Federal Reserve Bank of New York, plus 0.50%, or
2. the prime lending rate of Bank of America, N.A., or
3. the one-month Eurodollar Rate plus 1.00%.

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 \$40.0 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.

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

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

On July 2, 2014, the Company borrowed \$422.0 million under the 2014 Amendment consisting of a \$150.0 million term loan and \$272.0 million under its revolving credit facility. As a result of this borrowing, the Company has \$422.0 million of outstanding borrowings under its Senior Credit Facility on July 2, 2014. The Company used the funds to repay the balance of its prior outstanding senior secured revolving credit facility. The outstanding borrowings have one, two, three, six months, or, if available, twelve months interest periods. The weighted average interest rate of the outstanding borrowings is approximately 1.68%.

## 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, 2013 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 under the heading "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2013 and under the heading "Risk Factors" in this report. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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

### GENERAL

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

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

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

pyrocarbon implants through specialized third-party vendors.

In the United States, we have several sales channels. We sell orthopedics products through a large direct sales organization and through specialty distributors focused on their respective surgical specialties. Most Neurosurgery products are sold through directly employed sales representatives; products acquired in the Confluent Surgical acquisition were largely sold through distributors and we are now transitioning those products to our direct sales force. Instruments products are sold through two sales channels, both directly and through distributors and wholesalers, depending on the customer call point. We sell in the international markets through a combination of a direct sales organization and distributors.

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

## Table of Contents

We aspire to be a multi-billion dollar diversified global medical technology company that helps patients by limiting uncertainty for medical professionals, and is a high quality investment for shareholders. We will achieve these goals by delivering on our Brand Promises to our customers worldwide and by becoming a top player in all markets in which we compete.

Our strategy is built around three pillars - optimize, execute and accelerate growth. These three pillars support our strategic initiatives to optimize our infrastructure, to deliver on our commitments through improved planning and communication, and to grow by introducing new products to the market through internal development, expanding geographically, and strategic acquisitions.

Acquisition of Confluent Surgical, Inc.

On January 15, 2014, we acquired all outstanding shares of Confluent Surgical, Inc., ("Confluent Surgical") - including its surgical sealant and adhesion barrier product lines - from Covidien Group S.a.r.l, ("Covidien") for an aggregate purchase price of \$255.9 million. The purchase price is comprised of an initial cash payment to Covidien of \$231.0 million upon the closing of the transaction, a separate prepayment of \$4.0 million made under a transitional supply agreement with an affiliate of Covidien, and contingent consideration with an acquisition date fair value of \$20.9 million. The purchase agreement includes a potential maximum undiscounted contingent consideration of \$30.0 million which consists of \$25.0 million upon obtaining certain U.S. governmental approvals and \$5.0 million upon obtaining certain European governmental approvals, both related to the completion of the transition of the Confluent Surgical business.

The transitional supply agreement secures the supply of the acquired products from an affiliate of Covidien until the earlier of (i) the time that the transition of the Confluent Surgical business as discussed above is complete, or (ii) the fifth anniversary of the effective date of the agreement (the agreement also contains an option to extend for another two years by providing written notice at least 180 days prior to the end of the initial five-year period). This agreement contains financial incentives to the affiliate of Covidien for the timely supply of products each fiscal quarter through the third anniversary of the agreement. The prices paid under the supply agreement are essentially flat through the third anniversary of the agreement, and then increase significantly each of the following three years. We also entered into a transition services agreement with an affiliate of Covidien at the closing for services such as: customer service, accounting and information technology management, clinical and regulatory affairs, manufacturing transition services, and other functions.

This acquisition complements our global neurosurgery growth strategy aimed at providing a broader set of solutions for surgical procedures in the head.

Change in Accounting Treatment for the Medical Device Excise Tax

In the first quarter of 2014, the Company changed its method of accounting for the medical device excise tax ("MDET"). Prior to the change the Company recorded the MDET in inventory at the time of the first sale in the United States and then recognized the tax in cost of goods sold when the medical device was sold to the ultimate customer. Under the new method, the MDET is recorded in selling, general and administrative expenses in the period the first sale in the United States occurs, which could be an intercompany sale.

The Company believes that this change in accounting principle is preferable as the new method provides a better comparison with the Company's industry peers, the majority of which expense the MDET at the time of the first sale in the United States.

The medical device excise tax applies to sales beginning January 1, 2013; therefore, this change affected only 2013 financial results. The cumulative effect of the change in the prior years is included in retained earnings as of December 31, 2013 and the comparative period for the three- and six-month periods ended June 30, 2013. The financial impact of this change on 2013 has been incorporated into the amounts presented throughout this Form 10-Q and the impact on the three and six months ended June 30, 2013 is discussed in detail in Note 1 to the condensed consolidated financial statements. For a full reconciliation of the impact on the 2013 historical quarterly financial results, please refer to the investor presentations on the Investor Relations homepage of Integra's website at

[investor.integralife.com](http://investor.integralife.com).

#### Management Changes

On April 29, 2014, the Board of Directors (the "Board") of the Company appointed Glenn G. Coleman as Corporate Vice President of the Company effective as of May 2, 2014. In addition, on April 29, 2014, the Board of the Company appointed Mr. Coleman as Corporate Vice President, Chief Financial Officer and Principal Accounting Officer, which became effective on May 2, 2014. When Mr. Coleman commenced as Chief Financial Officer, John B. Henneman, III ceased to serve as the Company's Chief Financial Officer and continues to serve as Corporate Vice President, Chief Administrative Officer. Jerry Corbin ceased to serve as the Company's Principal Accounting Officer effective May 2, 2014, and continues to serve as Corporate Vice President, Corporate Controller.

Table of Contents

## Diabetic Foot Ulcer Clinical Trial

During July 2014, we completed our multicenter clinical trial evaluating the safety and effectiveness of the INTEGRA® Dermal Regeneration Template for the Treatment of Diabetic Foot Ulcers (“the DFU study”) and we are in the process of evaluating all of the data. We are currently preparing submissions in advance of our clinical publication, reimbursement and regulatory strategies. We expect to submit the data from this clinical trial to the Food and Drug Administration (FDA) by the end of 2014. In parallel, we will pursue publishing the data in a peer-reviewed journal. An FDA approval, coupled with published data, is the key to securing reimbursement. We anticipate commercializing the resulting DFU product mid-2016.

## RESULTS OF OPERATIONS

## Executive Summary

Net income for the three months ended June 30, 2014, was \$4.8 million, or \$0.15 per diluted share as compared with \$1.5 million or \$0.05 per diluted share for the three months ended June 30, 2013.

Net income for the six months ended June 30, 2014 was \$7.0 million, or \$0.21 per diluted share as compared with net loss of \$4.5 million or \$0.16 per diluted share for the six months ended June 30, 2013.

The results of operations for the three and six months ended June 30, 2013 were adversely affected by a voluntary recall of certain collagen-based products manufactured in our Añasco, Puerto Rico facility. This recall resulted in lost revenues, increased sales reserves, inventory scrap, and costs of remediation at the facility which continued throughout 2013. We resolved the issues relating to the recall by the beginning of the first quarter of 2014, and saw improved margins from DuraSeal revenues; however, the costs associated with closing the Confluent Surgical acquisition and the related integration effort impacted our 2014 financial results.

Income before taxes includes the following special charges:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(In thousands)		(In thousands)	
Global ERP implementation charges	\$6,916	\$7,616	\$13,016	\$13,765
Structural optimization charges	2,753	2,262	5,713	5,670
Manufacturing facility remediation costs	224	2,963	367	5,088
Certain expenses associated with product recalls	—	165	—	1,444
Certain employee severance charges	3,929	—	4,610	—
Discontinued product lines charges	713	—	713	—
Acquisition-related charges	1,253	286	5,006	674
Impairment charges	—	—	600	—
Convertible debt non-cash interest	1,767	1,622	3,434	3,232
Total	\$17,555	\$14,914	\$33,459	\$29,873

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(In thousands)		(In thousands)	
Cost of goods sold	\$4,192	\$4,371	\$7,069	\$8,872
Research and development	500	—	500	—
Selling, general and administrative	11,096	8,921	22,456	17,769
Interest expense	1,767	1,622	3,434	3,232
Total	\$17,555	\$14,914	\$33,459	\$29,873

We typically define special charges as items for which the amounts and/or timing of such expenses may vary significantly from period to period, depending upon our acquisition, integration and restructuring activities, and for which the amounts are non-cash in nature, or for which the amounts are not expected to recur at the same magnitude. We believe that given our ongoing strategy of seeking acquisitions, our continuing focus on rationalizing our existing manufacturing and distribution infrastructure and our

## Table of Contents

continuing review of various product lines in relation to our current business strategy, certain of the special charges discussed above could recur with similar materiality in the future. In 2010, we began investing significant resources in the global implementation of a single enterprise resource planning system. We began capitalizing certain costs for the project starting in 2011 and continued to do so during 2014.

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

### Update on Remediation Activities

The FDA inspected our neurosurgery manufacturing facility in Andover, England in June 2012. On November 5, 2012, we received a warning letter dated November 1, 2012 related to quality systems issues at that facility. The warning letter identified violations related to corrective and preventative actions, process validations, internal quality audits, and internal review of the suitability and effectiveness of the quality system at defined intervals. Since the conclusion of the FDA inspection in June 2012, we have remediated the observations that the FDA has made and continue to make further improvements in the quality system.

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

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

On October 24, 2013, the United States Food and Drug Administration began an inspection of the Añasco facility. At the end of the inspection on November 26, 2013, the FDA issued a new Form 483 with six additional observations relating to Corrective and Preventative Action (“CAPA”), quality system procedures and instructions, procedures pertaining to complaints, procedures pertaining to checking and maintaining equipment, procedures for finished device acceptance and procedures to prevent contamination of equipment or products. These observations did not impact our ability to manufacture and sell product. On March 4, 2014 we met with the FDA Office of Compliance, San Juan, Puerto Rico District to discuss the Corrective Action and remediation plan at the Añasco, Puerto Rico facility. We committed to several corporate-wide corrections and additional site corrections and will continue to complete these within the timeframes provided to the FDA in order to remediate the observations that the FDA has made.

Over the past several years we have undertaken significant efforts to remediate the observations that the FDA has made and have been working on improving and revising our quality systems. Our remediation activity expenses during the three and six months ended June 30, 2014 were \$0.2 million and \$0.4 million, respectively, and during the three and six months ended June 30, 2013, were \$3.0 million and \$5.1 million, respectively. These costs consist of consulting expenses and other work activities required to complete our remediation activities, and we expect to incur similar types of expenses during 2014, albeit at lower spending levels compared to 2013. We will provide periodic status reports to the FDA and work cooperatively with the agency to resolve any outstanding issues.





Table of Contents

## Revenues and Gross Margin on Product Revenues

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

	Three Months Ended June 30,		Six Months Ended June 30,		
	2014	2013	2014	2013	
Segment Net Sales	(Dollars in thousands)		(Dollars in thousands)		
U.S. Neurosurgery	\$60,559	\$41,767	\$114,942	\$80,763	
U.S. Instruments	39,505	41,048	76,225	78,896	
U.S. Extremities	34,424	32,009	66,337	61,971	
U.S. Spine and Other	45,087	43,434	86,153	87,481	
International *	51,776	47,289	102,753	93,088	
Total revenue	231,351	205,547	446,410	402,199	
Cost of goods sold	86,976	81,829	169,359	161,441	
Gross margin on total revenues	\$144,375	\$123,718	\$277,051	\$240,758	
Gross margin as a percentage of total revenues	62.4	% 60.2	% 62.1	% 59.9	%

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

Certain 2013 segment revenues above have been reclassified in order to conform with the current year's presentation.

## Three Months Ended June 30, 2014 as Compared to Three Months Ended June 30, 2013

## Revenues and Gross Margin

For the three months ended June 30, 2014 total revenues increased by \$25.8 million to \$231.4 million from \$205.5 million for the same period in 2013.

U.S. Neurosurgery revenues were \$60.6 million, an increase of 45% from the prior-year period. The increase largely resulted from the impact of the DuraSeal product sales arising out of the Confluent Surgical acquisition. We also saw increases from neuro critical care which benefited from strong sales of capital equipment in the quarter, and our dural repair franchise, which was up against a soft comparable as a result of the recall in 2013.

U.S. Instruments revenues were \$39.5 million, a decrease of 4% from the prior-year period. The decrease resulted primarily from lower sales in our acute-care business as hospital spending is still cautious, and product discontinuances. However, these decreases were partially offset by increases in our alternate-site business, and lighting product sales.

U.S. Extremities revenues were \$34.4 million, an increase of 8% from the prior-year period. This increase resulted primarily from dermal and wound care franchise, as a result of adding new salespeople and the launch of the ThinSkin product, and from our shoulder business as a result of the launch of new shoulder lines. These increases were partially offset by some softness in our lower extremity and nerve franchises during the quarter.

U.S. Spine and Other revenues, which include our spine hardware, orthobiologics and private label products, were \$45.1 million, a 4% increase from the prior-year period. Our overall spine business was relatively flat as increases in orthobiologics revenues were largely muted by decreases in spine hardware revenues. Sales of our private label products were up from the prior-year period primarily due to the soft comparable as a result of the recall in 2013.

International segment revenues were \$51.8 million, an increase of 9% from the prior-year period. This increase primarily resulted from the incremental impact of DuraSeal product sales, higher Duragen sales as we recover from the recall in 2013, increased skin and wound sales, and capital sales - all of which have been areas of focus for our International segment. Foreign currency also added \$1.0 million to our sales when compared to the same quarter last year primarily due to a stronger euro. These contributions to increasing sales were largely offset by weak orthopedic sales, product discontinuances, and delayed tenders in a few large markets.

Gross margin increased to \$144.4 million for the three-month period ended June 30, 2014 from \$123.7 million for the same period last year. Gross margin as a percentage of total revenue increased to 62.4% for the second quarter of 2014

from 60.2% for the

27

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Table of Contents

same period last year. The increase in gross margin percentage resulted primarily from an increase in sales of higher margin products such as DuraSeal, skin and wound products, and Duragen products which were subject to the recall in 2013, and improved manufacturing capacity utilization for our regenerative products. We also saw decreased remediation costs at our manufacturing facilities because throughout 2013 we invested in improvements to quality systems across our organization as a result of prior FDA findings. In 2014, we are seeing our spending return to a more normal level since those initial remediation efforts are largely complete. Finally we also saw gross margin improvement from product recall expenses in 2013 that did not recur in the current period.

We expect our consolidated gross margin percentage for the full year 2014 to be between 61% and 62%, up compared to 2013. We expect our gross margin will see increases from improved product mix - with more sales in the skin, wound and DuraSeal lines - and improvements in yield as we resolve FDA inspection issues.

**Operating Expenses**

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

	Three Months Ended June 30,		
	2014	2013	
Research and development	5.9	% 5.7	%
Selling, general and administrative	49.8	% 50.2	%
Intangible asset amortization	1.3	% 1.5	%
Total operating expenses	57.0	% 57.4	%

Total operating expenses, which consist of research and development expenses, selling, general and administrative expenses, and amortization expense, increased \$13.8 million, or 12%, to \$132.0 million in the three months ended June 30, 2014, compared to \$118.2 million in the same period last year.

Research and development expenses in the second quarter of 2014 increased \$1.9 million compared to the same period last year, resulting from higher product development spending in extremities and neurosurgery. We expect full-year 2014 spending on research and development to be approximately 6% of total revenues.

Selling, general and administrative expenses in the second quarter of 2014 increased by \$12.0 million to \$115.3 million compared to \$103.3 million in the same period last year. Selling and marketing expenses increased by \$5.1 million, primarily resulting from higher commissions and distributor fees related to the DuraSeal sales, and overall sales increases in general. General and administrative costs were up \$6.9 million as a result of integration costs for DuraSeal, additional depreciation as we put our ERP system in service in certain locations during May, and higher severance costs. These general and administrative increases were partially offset by \$1.2 million to reflect a decrease in the fair value of the contingent consideration liability because during the second quarter of 2014 management concluded that the sales threshold for a contingent consideration payment from a prior acquisition was no longer probable of being achieved.

Amortization expense in the second quarter of 2014 was \$3.0 million compared to \$3.1 million in the same period last year. The decrease resulted primarily from certain non-technology intangible assets becoming fully amortized in 2013.

**Non-Operating Income and Expenses**

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

	Three Months Ended June 30,		
	2014	2013	
	(In thousands)		
Interest income	\$58	\$289	
Interest expense	(5,382	) (4,965	)
Other income (expense)	118	(307	)



Table of Contents

## Interest Income and Interest Expense

Interest expense in the three months ended June 30, 2014 increased by \$0.4 million primarily because we have increased borrowings on our Senior Credit facility compared to the prior year. Additionally, we placed our ERP system in service in May 2014 and therefore no longer capitalize interest related to that project. Our reported interest expense for the three-month periods ended June 30, 2014 and 2013 includes non-cash interest related to the accounting for convertible securities of \$1.8 million and \$1.6 million, respectively.

Interest income was negligible for the three months ended June 30, 2014.

## Other Income (Expense)

Other income (expense) for both the second quarter of 2014 and 2013 was primarily attributable to the foreign exchange impact on intercompany balances.

## Income Taxes

	Three Months Ended June 30,	
	2014	2013
	(In thousands)	
Income (loss) before income taxes	\$7,186	\$573
Income tax expense (benefit)	2,361	(947)
Effective tax rate	32.9	% (165.3)

The Company's effective income tax rates for the three months ended June 30, 2014 and 2013 were 32.9% and (165.3)%, respectively. For the three months ended June 30, 2014, discrete foreign income tax audit settlements of \$0.3 million, and a change in state filing positions of \$0.3 million primarily drove the tax rate. The overall rate for the three months ended June 30, 2013 was driven primarily by the impact of discrete items on an unusually low pre-tax income level. During the three months ended June 30, 2013; the Company recorded a benefit of \$0.5 million relating to the granting of Irish research credits for 2011 and 2012 and a benefit of \$0.8 million for the release of uncertain tax positions due to the expiration of the statute of limitation in certain state jurisdictions.

We expect that our effective income tax rate for the full year to be approximately 23% to 24% resulting largely from the jurisdictional mix of pretax income in U.S.-based operations relative to foreign operations. We may revise this estimate in the future as additional information becomes available.

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

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

## Six Months Ended June 30, 2014 as Compared to Six Months Ended June 30, 2013

## Revenues and Gross Margin

For the six months ended June 30, 2014, total revenues increased by \$44.2 million to \$446.4 million from \$402.2 million during the prior-year period.

U.S. Neurosurgery revenues were \$114.9 million, an increase of 42%. The increase largely resulted from the impact of the DuraSeal product sales arising out of the Confluent Surgical acquisition. We also saw increases from our dural repair franchise, which was up against a soft comparable as a result of the recall in 2013, and neuro critical care and

tissue ablation, both of which benefited from strong sales of capital equipment in the period.

29

---

Table of Contents

U.S. Instruments revenues were \$76.2 million, a decrease of 3% from the prior year. The decrease resulted primarily from lower sales in our acute-care business and product discontinuances. Increases in our alternate site business, and lighting product line partially offset this decline.

U.S. Extremities revenues were \$66.3 million, an increase of 7% from the prior year. This increase resulted primarily from dermal and wound care products, and from our shoulder business as a result of the launch of new shoulder lines in the latter-half of 2013. We also saw some softness in our lower extremity and nerve franchises during the period.

U.S. Spine and Other revenues, which include our spine hardware, orthobiologics and private label products, were \$86.2 million, a decrease of 2% from the prior year. Our overall spine business was down slightly as decreases in spine hardware revenues were partially offset by increases in orthobiologics. Sales of our private label products were up slightly from the prior-year period.

International segment revenues were \$102.8 million, an increase of 10% from prior year. These increases primarily resulted from the incremental impact of DuraSeal product sales, Duragen sales as we recover from the recall in 2013, and skin and wound sales - all of which have been an area of focus for the International division. Foreign currency also added \$1.1 million to our sales in the period primarily due to a stronger euro. These contributions to increasing sales were largely offset by weak orthopedic sales and delayed tenders in a few large markets.

Gross margin increased to \$277.1 million for the six-month period ended June 30, 2014 from \$240.8 million for the same period last year. Gross margin as a percentage of total revenue increased to 62.1% for the first-half of 2013 from 59.9% for the same period last year. The increase in gross margin percentage resulted primarily from increases sales of higher margin products such as DuraSeal, skin and wound products, and Duragen products that were subject to the recall in 2013. Our 2014 gross margin also saw improvement from product recall expenses in 2013 that did not recur. Additionally, we had lower remediation costs at our manufacturing facilities because throughout 2013, we invested in improvements to quality systems across our organization as a result of prior FDA findings. In 2014, we are seeing our spending return to a more normal level since those initial remediation efforts are largely complete.

#### Operating Expenses

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

	Six Months Ended June 30,		
	2014	2013	
Research and development	5.9	% 6.1	%
Selling, general and administrative	50.1	% 51.3	%
Intangible asset amortization	1.3	% 1.6	%
Total operating expenses	57.3	% 59.0	%

Total operating expenses, which consist of research and development expenses, selling, general and administrative expenses, and amortization expense, increased \$18.5 million, or 8%, to \$255.9 million in the first six months of 2014, compared to \$237.4 million in the same period last year.

Research and development expenses in the first six months of 2014 increased \$1.8 million compared to the same period last year primarily resulting from higher product development spending in extremities and neurosurgery. These increases were partially offset by lower expenses earlier in the year due to headcount reductions, and lower overall project costs in other areas.

Selling, general and administrative expenses in the first six months of 2014 increased by \$17.3 million to \$223.6 million compared to \$206.2 million in the same period last year. Selling and marketing expenses increased by \$6.2 million primarily resulting from higher headcount, the impact of DuraSeal, and U.S. Extremities' commission costs which were higher as a result of increases in revenue. General and administrative costs were up \$11.2 million primarily because of higher headcount, additional depreciation as we put our ERP system in service in certain locations during May, consulting costs to support various strategic projects, and higher severance costs. These general and administrative increases were partially offset by \$1.2 million to reflect a decrease in the fair value of the contingent consideration liability because during the second quarter of 2014 management concluded that the sales threshold for a contingent consideration payment from a prior acquisition was no longer probable of being achieved.



Amortization expense in the first six months of 2014 decreased by \$0.6 million to \$6.0 million, compared to \$6.6 million in the same period last year. The decrease is primarily due to certain intangible assets becoming fully amortized in the first quarter of 2013.

Table of Contents

## Non-Operating Income and Expenses

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

	Six Months Ended June 30,	
	2014	2013
	(In thousands)	
Interest income	\$ 120	\$ 352
Interest expense	(10,524	) (9,765
Other income (expense)	435	(1,281

## Interest Income and Interest Expense

Interest expense in the six-month period ended June 30, 2014 increased by \$0.8 million primarily because we have increased borrowings on our Senior Credit facility compared to the prior year. Additionally, we placed our ERP system in service in May 2014 and therefore no longer capitalize interest related to that project. Furthermore, the amount of our 2016 Notes discount amortization increased by \$0.2 million as expected when using the effective interest method for its amortization in the six-month period ended June 30, 2013. Our reported interest expense for the six-month periods ended June 30, 2014 and 2013 includes non-cash interest related to the accounting for convertible securities of \$3.4 million and \$3.2 million, respectively.

Interest income was negligible for the six months ended June 30, 2013.

## Other Income (Expense)

Other income of \$0.4 million in 2014 was primarily attributable to foreign exchange gains on intercompany balances.

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

## Income Taxes

	Six Months Ended June 30,	
	2014	2013
	(In thousands)	
Income (loss) before income taxes	\$ 11,161	\$ (7,328
Income tax expense (benefit)	4,130	(2,820
Effective tax rate	37.0	% 38.5

The Company's effective income tax rates for the six months ended June 30, 2014 and 2013 were 37.0% and 38.5%, respectively. For the six months ended June 30, 2014, the change in the income tax rate compared to the same period in 2013 primarily resulted from an expense of \$0.4 million for a foreign income tax audit settlement, an expense of \$0.3 million from a change in state filing positions, and an expense of \$0.7 million relating to state income tax audit settlements. For the six months ended June 30, 2013; the Company recorded a benefit of \$0.5 million relating to the granting of Irish research credits for 2011 and 2012, a benefit of \$1.2 million for the release of uncertain tax positions due to the expiration of the statute of limitation in certain state jurisdictions, and a benefit of \$0.9 million because of the extension of the Federal research credit, enacted through the American Taxpayer Relief Act. These benefits in 2013 were recorded against a book loss; accordingly, they had the effect of increasing the effective tax rate in that period.

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

While it is often difficult to predict the final outcome or the timing of resolution of any particular matter with the various Federal, state and foreign tax authorities, we believe that our reserves reflect the most probable outcome of known tax contingencies. Settlement of any particular issue would usually require the use of cash. Favorable

resolution would be recognized as a reduction to our annual effective tax rate in the year of resolution. The tax reserves are presented in the balance sheet within other liabilities, except for amounts relating to items it expects to pay in the coming year which are classified as current income taxes payable.

Table of Contents

The Company expects its effective income tax rate for the full year to be approximately 23% to 24%, resulting largely from the jurisdictional mix of pretax income in U.S.-based operations relative to foreign operations. The Company may revise this estimate in the future as additional information becomes available.

**GEOGRAPHIC PRODUCT REVENUES AND OPERATIONS**

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(In thousands)		(In thousands)	
United States	\$178,806	\$157,166	\$342,187	\$307,185
Europe	25,851	23,776	51,176	47,393
Rest of World	26,694	24,605	53,047	47,621
Total Revenues	\$231,351	\$205,547	\$446,410	\$402,199

Domestic revenues increased to \$178.8 million, or 77% of total revenues, for the three months ended June 30, 2014 from \$157.2 million, or 76% of total revenues, for the three months ended June 30, 2013. International revenues increased to \$52.5 million from \$48.4 million in the prior-year period, an increase of 9%. Foreign exchange rate fluctuations increased our sales by \$1.0 million during the current quarter, primarily due to a stronger euro.

Domestic revenues increased to \$342.2 million, or 77% of total revenues, for the six months ended June 30, 2014 from \$307.2 million, or 76% of total revenues, for the six months ended June 30, 2013. International revenues increased to \$104.2 million from \$95.0 million in the prior-year period, an increase of 10%. Foreign exchange rate fluctuations increased our sales by \$1.1 million in the six-month period, primarily due to a stronger euro.

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

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

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

We had cash and cash equivalents totaling approximately \$137.2 million and \$120.6 million at June 30, 2014 and December 31, 2013, respectively. At June 30, 2014, our non-U.S. subsidiaries held approximately \$104.6 million of cash and cash equivalents that are available for use by our operations outside of the United States. If these funds were repatriated to the United States, or used for United States operations, certain amounts could be subject to tax in the United States for the incremental amount in excess of the foreign tax paid.

Table of Contents

## Cash Flows

	Six Months Ended June 30,	
	2014	2013
	(In thousands)	
Net cash provided by operating activities	\$27,631	\$10,764
Net cash used in investing activities	(255,691	) (26,775
Net cash provided by financing activities	244,236	19,323
Effect of exchange rate fluctuations on cash	370	(1,614
Net increase in cash and cash equivalents	\$16,546	\$1,698

In 2014, we anticipate that our principal uses of cash will include between \$45.0 million and \$50.0 million on capital expenditures primarily for our continued expansion of regenerative medicine manufacturing capacity, support and maintenance in our existing plants, our enterprise resource planning system implementation, and additions to our instrument kits used in sales of orthopedic products. Additionally, we will continue to build inventories in preparation for our facilities consolidations expected to occur at the end of 2014.

## Cash Flows Provided by Operating Activities

We generated operating cash flows of \$27.6 million and \$10.8 million for the six months ended June 30, 2014 and 2013, respectively.

Operating cash flows for the six months ended June 30, 2014 benefited from an increase in net income of \$11.5 million compared to the same period in 2013. Changes in working capital decreased cash flows for the six months ended June 30, 2014 by approximately \$15.1 million. Among the changes in working capital, accounts receivable provided \$0.1 million of cash, inventory used \$17.4 million of cash, prepaid expenses and other current assets used \$2.8 million of cash, and accounts payable, accrued expenses and other current liabilities provided \$4.8 million of cash.

Operating cash flow for the six months ended June 30, 2013 was negatively impacted by the net loss for the period. Changes in working capital decreased cash flows by approximately \$18.3 million. Among the changes in working capital, accounts receivable used \$0.7 million of cash, inventory used \$19.4 million of cash, prepaid expenses and other current assets used \$1.3 million of cash, and accounts payable, accrued expenses and other current liabilities provided \$2.9 million of cash.

## Cash Flows Used in Investing Activities

During the six months ended June 30, 2014, we paid \$235.0 million for the acquisition of Confluent Surgical, and \$20.7 million for capital expenditures, most of which was directed to the expansion of our regenerative medicine production capacity and global enterprise system implementation.

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

## Cash Flows Provided by Financing Activities

Our principal sources of cash for financing activities in the six months ended June 30, 2014 were \$235.0 million of borrowings under our Senior Credit Facility to fund the Confluent Surgical acquisition, and stock option exercises of \$8.3 million.

Our principal sources of cash for financing activities in the six months ended June 30, 2013 were \$20.0 million of borrowings under our senior credit facility, and our primary uses of cash for financing activities were \$1.0 million in debt issuance costs.

## Working Capital

At June 30, 2014 and December 31, 2013, working capital was \$437.3 million and \$401.8 million, respectively.

## Amended and Restated Senior Credit Agreement, Convertible Debt and Related Hedging Activities

For a discussion of our Amended and Restated Senior Credit Agreement, see Note 5 - Debt and Note 14 - Subsequent Events to the current period's condensed consolidated financial statements.

For a discussion of our convertible debt and related hedging activities, see Note 5. Debt to the current period's condensed consolidated financial statements.

Table of Contents

## Share Repurchase Plan

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

## Dividend Policy

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

## Capital Resources

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

## Contractual Obligations and Commitments

As of June 30, 2014, we were obligated to pay the following amounts under various agreements:

	Total	Payments Due by Calendar Year			
		Remaining 2014	2015-2016	2017-2018	Thereafter
	(In millions)				
Convertible Securities (1)	\$230.0	\$—	\$230.0	\$—	\$—
Revolving Credit Facility (2)	421.9	—	421.9	—	—
Interest (3)	9.4	1.9	7.5	—	—
Employment Agreements (4)	2.8	0.9	1.5	0.4	—
Operating Leases	62.5	5.8	18.2	9.9	28.6
Purchase Obligations	21.4	6.8	6.1	7.6	0.9
Other	8.1	2.7	3.2	1.0	1.2
Total	\$756.1	\$18.1	\$688.4	\$18.9	\$30.7

(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. See Note 5 "Debt" of our condensed 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) This table does not reflect the impact of the amendment to the Senior Credit Facility entered into on July 2, 2014, nor the subsequent borrowings.

(4) 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.

(5) Amounts shown under Employment Agreements do not include compensation resulting from a change in control.

## Table of Contents

The Company has excluded contingent consideration obligations related to prior acquisitions from the contractual obligations table above; this liability had a fair value of \$21.1 million at June 30, 2014. These liabilities have been excluded because the amounts to be paid and the potential payment dates are not fixed.

The Company has also excluded the liability for uncertain tax benefits from the contractual obligations table above, including interest and penalties, totaling \$3.1 million at June 30, 2014. 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.

### Off-Balance Sheet Arrangements

There were no off-balance sheet arrangements during the six months ended June 30, 2014 that have or are reasonably likely to have, a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to our interests.

### OTHER MATTERS

#### Critical Accounting Estimates

The critical accounting estimates included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2013 have not materially changed, except as noted below.

#### Inventory

In the first quarter of 2014, the Company changed its method of accounting for the medical device excise tax ("MDET"). Prior to the change the Company recorded the MDET in inventory at the time of the first sale in the United States and then recognized the tax in cost of goods sold when the medical device was sold to the ultimate customer. Under the new method, the MDET will be recorded in selling, general and administrative expenses in the period the first sale in the United States occurs, which could be an intercompany sale.

The Company believes that this change in accounting principle is preferable as the new method provides a better comparison with the Company's industry peers, the majority of which expense the MDET at the time of the first sale in the United States.

The medical device excise tax applies to sales beginning January 1, 2013; therefore, only 2013 financial results were affected by this change. The cumulative effect of the change in the prior years is included in retained earnings as of December 31, 2013 and the comparative period for the three and six months ended June 30, 2013. The financial impact of this change on 2013 has been incorporated into the amounts presented throughout this Form 10-Q and the impact on the three and six months ended June 30, 2013 is discussed in detail in Note 1 to the condensed consolidated financial statements. For a full reconciliation of the impact on the 2013 historical quarterly financial results, see the investor presentations on the Investor Relations homepage of Integra's website at [investor.integralife.com](http://investor.integralife.com).

#### Recently Issued Accounting Standards

Information regarding new accounting pronouncements is included in Note 1 to the current period's condensed consolidated financial statements.

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

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

#### Foreign Currency Exchange and Other Rate Risks

We operate on a global basis and are exposed to the risk that changes in foreign currency exchange rates could adversely affect our financial condition, results of operations and cash flows. We are primarily exposed to foreign currency exchange rate risk with respect to transactions and net assets denominated in euros, Swiss francs, British



pounds, Canadian dollars, Australian dollars and Japanese yen. We manage the foreign currency exposure centrally, on a combined basis, which allows us to net exposures and to take advantage of any natural offsets. To mitigate the impact of currency fluctuations on transactions denominated in nonfunctional currencies, we periodically enter into derivative financial instruments in the form of foreign currency exchange forward contracts with major financial institutions. We temporarily record realized and unrealized gains and losses on these contracts that qualify

## Table of Contents

as cash flow hedges in other comprehensive income, and then recognize them in other income or expense when the hedged item affects net earnings.

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

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

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

### Interest Rate Risk

**Cash and Cash Equivalents** - We are exposed to the risk of interest rate fluctuations on the interest income earned on our cash and cash equivalents. A hypothetical 100 basis point movement in interest rates applicable to our cash and cash equivalents outstanding at June 30, 2014 would increase interest income by approximately \$1.4 million on an annual basis. No significant decrease in interest income would be expected as our cash balances are earning interest at rates of approximately 25 basis points. 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 \$105.0 million outstanding as of June 30, 2014. We recognized \$0.4 million of additional interest expense related to this derivative during the three months ended June 30, 2014. The fair value of our interest rate derivative instrument was a net liability of \$1.7 million at June 30, 2014.

Based on our outstanding borrowings at June 30, 2014, a one-percentage point change in interest rates would have impacted interest expense on the unhedged portion of the debt by \$3.2 million on an annualized basis.

## ITEM 4. CONTROLS AND PROCEDURES

### Evaluation of Disclosure Controls and Procedures

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

As required by Exchange Act Rule 13a-15(b), we have carried out an evaluation, under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of June 30, 2014. Based upon this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective as of June 30, 2014 to provide such reasonable assurance.

As previously disclosed, the Company is in the process of a multi-year implementation of a global enterprise resource planning ("ERP") system. In addition, in response to business integration activities, the Company has and will continue to further align and streamline the design and operation of the financial control environment to be responsive to the

changing business model.

36

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Table of Contents

Changes in Internal Control Over Financial Reporting

During the quarter ended June 30, 2014 the Company implemented a new ERP system in certain locations in the United States and Germany. Management has performed testing of the ERP system development life-cycle controls throughout the project design and build stage. This testing had a particular emphasis on project management, cut-over, data conversions, reporting and enhancements, interfaces, system and user testing, user participation and training, and process designs and controls. Management believes that the ERP system has been designed and is functioning in a manner which ensures that financial information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported both timely and accurately.

There were no other changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that occurred during the quarter ended June 30, 2014 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 of which are described below.

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

On June 6, 2012, the Company was contacted by the United States Attorney's Office for the District of New Jersey regarding the activities of sales representatives in a single region within our Extremities Reconstruction division. The U.S. Attorney's Office is investigating the activities of three sales representatives, one of whom was a supervisor until terminated by the Company for failure to cooperate with this investigation. The activities at issue pertain to alleged improper billing of products for extremities indications. The Company has been cooperating with the U.S. Attorney's Office on a voluntary basis and is not a subject or target of an investigation at this time. In cooperating with the U.S. Attorney's Office, the Company has responded to multiple government requests for documents and information; and in the fall of 2013 it responded to what the government currently indicated is its final request. Representatives of the Company met with the Assistant United States Attorney in charge of the matter and an agent from the Federal Bureau of Investigation on April 11, 2014, to discuss the matter, the behavior of the sales representatives in question, and the disposition of the matter as to the Company. The Company awaits word from the U.S. Attorney's Office as to the disposition of the matter as to the Company.

The Company manufactures and sells certain extremities products internationally pursuant to a license agreement that the licensor has indicated it will terminate effective October 20, 2014 after the parties were unable to resolve disagreements under the license agreement. Revenues for products sold under that license agreement approximated \$5.5 million in 2013. Subject to certain conditions described in the license agreement, Integra may sell the remaining inventory of covered products after the expiration of the license agreement. In the first quarter of 2014, the parties resumed their discussions to resolve their disagreements under the license agreement and continue to have those discussions. At this time, we cannot predict whether the licensor will bring any claims against the Company or whether those claims, if successful, would have a material, adverse effect on the financial results of the Company. Should the licensor bring any claims against the Company, the Company might assert counterclaims against the licensor.

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

ITEM 1A. RISK FACTORS

The Risk Factors included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2013 have not materially changed except as noted below.

Disruptions in the financial markets may adversely affect the availability and cost of credit to us.

The Company's 2016 Notes (hereinafter defined) mature in 2016. On July 2, 2014, the Company entered into an amendment and restatement of the Senior Credit Facility (hereinafter defined as the "2014 Amendment"). As of July 2, 2014, we had approximately \$651.9 million of outstanding borrowings under these two financing arrangements. The

Company may attempt to refinance or extend, either or both of these obligations, depending on prevailing market conditions. Our ability to refinance or extend these obligations will depend on our operating and financial performance, which in turn is subject to prevailing economic conditions and financial, business and other factors beyond our control. Any disruptions in our operations, the financial markets, or overall economy may adversely affect the availability and cost of credit to us.

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

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

38

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Table of Contents

There were no repurchases of our common stock during the three months ended June 30, 2014 under this program.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

On July 2, 2014, the Company entered into an amendment and restatement of the Senior Credit Facility with a syndicate of lending banks, Bank of America, N.A., as Administrative Agent, Swing Line Lender and L/C Issuer, Wells Fargo Bank, National Association, as Syndication Agent and HSBC Bank USA, National Association, Royal Bank of Canada, Citizens Bank, National Association, DNB Capital LLC, Credit Agricole-Corporate and Investment Bank and TD Bank, N.A., as Co-Documentation Agents (the "2014 Amendment").

The 2014 Amendment creates an aggregate principal amount of up to \$900.0 million available to the Company through the following facilities:

- i. a \$750.0 million revolving credit facility (increased from \$600.0 million), which includes a \$60.0 million sublimit for the issuance of standby letters of credit and a \$60.0 million sublimit for swingline loans, and
- ii. a \$150.0 million term loan facility.

The 2014 Amendment allows the Company to further increase the size of either the revolving credit facility or the term loan facility, or a combination thereof, by an aggregate of \$200.0 million with additional commitments. The 2014 Amendment extends the Senior Credit Facility's maturity date from June 8, 2016 to July 2, 2019.

Borrowings under the 2014 Amendment bear interest, at the Company's option, at a rate equal to:

- i. the Eurodollar Rate (as defined in the amendment and restatement) in effect from time to time plus the applicable rate (ranging from 1.00% to 1.75%), or
- ii. the highest of:
  1. the weighted average overnight Federal funds rate, as published by the Federal Reserve Bank of New York, plus 0.50%, or
  2. the prime lending rate of Bank of America, N.A., or
  3. the one-month Eurodollar Rate plus 1.00%.

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 \$40.0 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 0.30%, based on the Company's consolidated total leverage ratio) on the daily amount by which the revolving credit facility exceeds the outstanding loans and letters of credit under the credit facility.

Table of Contents

ITEM 6. EXHIBITS

4.1	Third Amended and Restated Credit Agreement, dated as of July 2, 2014, among Integra LifeSciences Holdings Corporation, the other lenders party hereto, Bank of America, N.A., as Administrative Agent, Swing Line Lender and L/C Issuer, Wells Fargo Bank, National Association, as Syndication Agent and HSBC Bank USA, National Association, Royal Bank of Canada, Citizens Bank, National Association, DNB Capital LLC, Credit Agricole-Corporate and Investment Bank and TD Bank, N.A., as Co-Documentation Agents. (Incorporated by Reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed on July 9, 2014)
4.2	Ratification Agreement, dated as of July 2, 2014, between Integra LifeSciences Holdings Corporation, the Subsidiary Guarantors of Integra LifeSciences Holdings Corporation and Bank of America, N.A., as Administrative Agent. (Incorporated by Reference to Exhibit 4.2 to the Company's Current Report on Form 8-K filed on July 9, 2014)
10.1	Offer Letter between Glenn Coleman and the Company (Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on April 29, 2014)
10.2	Form of Change in Control Severance Agreement (Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on May 1, 2014)
10.3	Second Amended and Restated 2005 Employment Agreement between the Company and John B. Henneman, III (Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on May 23, 2014)
10.4	Second Amended and Restated Employment Agreement between the Company and Peter J. Arduini (Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on June 20, 2014)
18.1	Preferability letter of independent registered public accounting firm (Incorporated by Reference to Exhibit 18 to the Company's Form 10-Q for the quarter ended March 31, 2014)
*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

40

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Table of Contents

† The financial information of Integra LifeSciences Holdings Corporation Quarterly Report on Form 10-Q for the quarter ended June 30, 2014 filed on August 5, 2014 formatted in XBRL (Extensible Business Reporting Language): (i) the Condensed Consolidated Statements of Operations and Comprehensive Income, (ii) the Condensed Consolidated Balance Sheets, (iii) Parenthetical Data to the Condensed Consolidated Balance Sheets, (iv) the Condensed Consolidated Statements of Cash Flows, and (v) Notes to Condensed Consolidated Financial Statements, is furnished electronically herewith.

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: August 5, 2014

/s/ Peter J. Arduini  
Peter J. Arduini  
President and Chief Executive Officer

Date: August 5, 2014

/s/ Glenn G. Coleman  
Glenn G. Coleman  
Corporate Vice President and Chief Financial Officer

Table of Contents

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