CHESAPEAKE ENERGY CORP
Form S-3
June 14, 2004
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As filed with the Securities and Exchange Commission on June 14, 2004

Registration No. 333-

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM S-3

REGISTRATION STATEMENT

Under

THE SECURITIES ACT OF 1933

CHESAPEAKE ENERGY CORPORATION

(Name of Registrant as specified in its charter)

Oklahoma **(State or other jurisdiction of incorporation or organization)**	**73-1395733** **(I.R.S. Employer Identification No.)**
	Aubrey K. McClendon **Chairman of the Board and** **Chief Executive Officer**
6100 North Western Avenue **Oklahoma City, Oklahoma 73118** **(405) 848-8000** **(Address, including zip code, and telephone number, including area code, of Registrant s principal executive offices)**	**6100 North Western Avenue** **Oklahoma City, Oklahoma 73118** **(405) 848-8000** **(Name, address, including zip code, and telephone number, including area code, of agent for service)**

Copy to:

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Approximate date of commencement of proposed sale to the public: From time to time after this Registration Statement becomes effective.

If the only securities being registered on this Form are being offered pursuant to dividend or interest reinvestment plans, please check the following box. ¨

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, other than securities offered only in connection with dividend or interest reinvestment plans, check the following box. x

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. ¨

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box. ¨

CALCULATION OF REGISTRATION FEE

Title of each class of securities to be registered	Amount to be registered	Proposed maximum offering price per share (1)	Proposed maximum aggregate offering price (1)	Amount of registration fee
4.125% Cumulative Convertible Preferred Stock	313,250 shares	$ 1,000	$ 313,250,000	$ 39,689
Common Stock, $.01 per share	(2)	(3)	(3)	(3)

(1) Estimated solely for purposes of calculating the registration fee.
(2) There are being registered hereunder an indeterminate number of shares of common stock issuable upon conversion of the Preferred Stock. Initially, 18,812,385 shares of common stock are issuable upon conversion of the Preferred Stock. Each share of Preferred Stock is convertible into 60.0555 shares of common stock, subject to adjustments under certain circumstances. Pursuant to Rule 416 under the Securities Act, such number of shares of common stock registered hereby shall include an indeterminate number of shares of common stock that may be issued in connection with a stock split, stock dividend, recapitalization, or similar event or adjustment in the number of shares issuable as provided in the certificate of designations of the Preferred Stock.
(3) The shares of common stock issuable upon conversion of the Preferred Stock will be issued for no additional consideration, and therefore no registration fee is required pursuant to Rule 457(i).

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the Registration Statement shall become effective on such date as the Securities and Exchange Commission, acting pursuant to said Section 8(a), may determine.

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The information in this prospectus is not complete and may be changed. We may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any jurisdiction where the offer or sale is not permitted.

Subject to Completion, Dated , 2004

PRELIMINARY PROSPECTUS

313,250 Shares

of

Chesapeake Energy Corporation

4.125% Cumulative Convertible Preferred Stock

(Liquidation Preference $1,000 per share)

and

Common Stock

(Par Value $.01 per share)

This prospectus relates to the offering for resale of Chesapeake Energy Corporation s 4.125% Cumulative Convertible Preferred Stock (liquidation preference $1,000 per share) and the shares of our common stock issuable upon conversion of the preferred stock. In this prospectus, the terms Chesapeake , we , or us will each refer to Chesapeake Energy Corporation and its subsidiaries. We issued and sold 293,250 shares of the preferred stock to qualified institutional buyers in reliance on Rule 144A and to certain persons in offshore transactions in reliance on Regulation S, in transactions exempt from, or not subject to, the registration requirements of the Securities Act, through the initial purchasers, Lehman Brothers Inc., Banc of America Securities LLC, Bear, Stearns & Co. Inc., Credit Suisse First Boston LLC, Citigroup Global Markets Inc., Deutsche Bank Securities Inc., Morgan Stanley & Co. Incorporated, Raymond James & Associates, Inc., UBS Securities LLC, Howard Weil Incorporated, Johnson Rice & Company L.L.C., RBC Capital Markets Corporation and Simmons & Company International. We sold an additional 20,000 shares of the preferred stock directly to Mr. McClendon, our chief executive officer, and Mr. Ward, our chief operating officer, in a separate private placement at the same price sold to other investors. This prospectus will be used by selling securityholders to resell their shares of our preferred stock and shares of our common stock issuable upon conversion of their preferred stock. We will not receive any proceeds from sales by the selling securityholders.

We are an Oklahoma corporation. Our principal offices are located at 6100 North Western Avenue, Oklahoma City, Oklahoma 73118, and our telephone number is (405) 848-8000.

Convertibility of the Preferred Stock:

Under certain circumstances, holders may convert their preferred stock initially into 60.0555 shares of common stock of Chesapeake per share of preferred stock. The conversion rate may be adjusted upon the occurrence of certain events. The common stock currently trades on the New York Stock Exchange under the symbol CHK. The closing price of the common stock on the New York Stock Exchange was $13.47 per share on June 10, 2004.

Mandatory Conversion of the Preferred Stock at Our Option:

On or after March 15, 2009, we may, at our option, cause each share of preferred stock to be automatically converted into that number of shares of common stock equal to $1,000.00 divided by the then prevailing conversion price. We may exercise our conversion right only if, for 20 trading days within any period of 30 consecutive trading days (including the last trading day of such period), the closing price of our common stock exceeds 130% of the then prevailing conversion price of the preferred stock.

In addition, if there are less than 25,000 shares of preferred stock outstanding, we may, on or after March 15, 2009, at our option, cause the preferred stock to be automatically converted into that number of shares of common stock equal to the liquidation preference divided by the lesser of the then prevailing conversion price or the average closing price of the common stock for the five trading day period ending on the second day immediately preceding the date fixed for conversion.

Investing in our preferred or common stock involves risks. Please read carefully the section entitled Risk Factors beginning on page 5.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

, 2004

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You should rely only on the information contained or incorporated by reference in this prospectus. We have not authorized anyone to provide you with different information. You should not assume that the information contained in this prospectus is accurate as of any date other than the date on the front of this prospectus.

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ABOUT THIS PROSPECTUS

This prospectus is part of a registration statement that we filed with the Securities and Exchange Commission utilizing a shelf registration process or continuous offering process. Under this shelf registration process, the selling securityholders may, from time to time, sell the securities described in this prospectus in one or more offerings. This prospectus provides you with a general description of the securities which may be offered by the selling securityholders. Each time a selling securityholder sells securities, the selling securityholder is required to provide you with this prospectus and, in certain cases, a prospectus supplement containing specific information about the selling securityholder and the terms of the securities being offered. That prospectus supplement may include additional risk factors or other special considerations applicable to those securities. Any prospectus supplement may also add, update, or change information in this prospectus. If there is any inconsistency between the information in this prospectus and any prospectus supplement, you should rely on the information in that prospectus supplement. You should read both this prospectus and any prospectus supplement together with additional information described under Where You Can Find More Information.

PROSPECTUS SUMMARY

This summary may not contain all the information that may be important to you. You should read this entire prospectus and the documents to which we have referred you before making an investment decision. You should carefully consider the information set forth under Risk Factors. In addition, certain statements include forward-looking information which involves risks and uncertainties. See Forward-Looking Statements.

Chesapeake

We are one of the six largest independent natural gas producers in the United States in terms of natural gas produced, owning interests in approximately 17,000 producing oil and gas wells. Our internally-estimated proved oil and natural gas reserves as of March 31, 2004, pro forma for our recent acquisition of Greystone Petroleum LLC, were approximately 3.8 tcfe. Approximately 89% of our pro forma proved reserves by volume at March 31, 2004 were natural gas, and approximately 80% of our proved oil and natural gas reserves by volume at March 31, 2004 were located in our primary operating area the Mid-Continent region of the United States, which includes Oklahoma, western Arkansas, southwestern Kansas and the Texas Panhandle. In addition, we are building secondary operating areas in the Permian Basin of western Texas and eastern New Mexico, in the Ark-La-Tex basin of eastern Texas and northern Louisiana and in the South Texas and Texas Gulf Coast regions.

Since January 1, 1998, we have been one of the most active consolidators of onshore U.S. natural gas assets, having purchased or agreed to purchase approximately 3.3 tcfe at a total cost of approximately $3.9 billion (excluding the impact of deferred taxes in connection with certain corporate acquisitions). In 2004 to date, we have remained active in the acquisitions market. In January 2004, we purchased Permian Basin and Mid-Continent oil and gas assets by acquiring privately-held Concho Resources Inc. for cash consideration of $420 million (excluding employee severance and other miscellaneous costs). We also completed five other smaller acquisitions in 2004 for $165 million. Through these six acquisitions, we acquired an internally estimated 366 bcfe of proved oil and natural gas reserves and added 82 mmcfe to our estimated daily production.

Most recently, on June 2, 2004, we acquired Greystone Petroleum LLC, a privately-held oil and natural gas company, for $425 million in cash. In this transaction, we acquired an internally-estimated 214 bcfe of proved reserves and added 45 mmcfe to our estimated daily production.

Our executive offices are located at 6100 North Western Avenue, Oklahoma City, Oklahoma 73118, and our telephone number is (408) 848-8000.

The Offering

On March 30, 2004, we sold 255,000 shares of the preferred stock to the initial purchasers and 20,000 shares of the preferred stock to certain of our officers in separate private offerings. On April 5, 2004, we sold an additional 38,250 shares of the preferred stock to the initial purchasers following the exercise of the initial purchasers over-allotment option. We entered into a registration rights agreement with the initial purchasers in the private offering in which we agreed, for the benefit of the holders of the preferred stock, to file a shelf registration statement with the SEC by July 28, 2004 with respect to resales of the preferred stock and common stock issued upon the conversion thereof. We also agreed to use our reasonable best efforts to cause the shelf registration statement to be declared effective under the Securities Act by November 26, 2004 and to keep the shelf registration statement effective until March 30, 2006 or such earlier date as of which the preferred stock and common stock issued upon the conversion thereof have been sold pursuant to the shelf registration statement.

Securities Offered	313,250 shares of 4.125% cumulative convertible preferred stock.

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Dividends	Cumulative annual dividends of $41.25 per share payable quarterly in cash on each March 15, June 15, September 15 and December 15, commencing June 15, 2004, when, as and if declared by the board of directors. Dividends will be paid in arrears on the basis of a 360-day year consisting of twelve 30-day months. Dividends on the preferred stock will accumulate and be cumulative from the date of issuance thereof. Accumulated dividends on the preferred stock will not bear interest.
Liquidation Preference	$1,000 per share, plus accumulated and unpaid dividends.
Ranking	The preferred stock will rank with respect to dividend rights and rights upon our liquidation, winding-up or dissolution:

- senior to all of our common stock and to all of our other capital stock issued in the future unless the terms of that stock expressly provide that it ranks senior to, or on a parity with, the preferred stock;
- on a parity with our existing 6.75% Cumulative Convertible Preferred Stock, our existing 6.00% Cumulative Convertible Preferred Stock, our existing 5.00% Cumulative Convertible Preferred Stock and with any of our capital stock issued in the future the terms of which expressly provide that it will rank on a parity with the preferred stock; and
- junior to all of our capital stock the terms of which expressly provide that such stock will rank senior to the preferred stock.

We currently have 2,997,800 shares of 6.75% Cumulative Convertible Preferred Stock issued and outstanding, with an aggregate liquidation preference of $149.9 million, 4,600,000 shares of 6.00% Cumulative Convertible Preferred Stock issued and outstanding with an aggregate liquidation preference of $230.0 million and 1,725,000 shares of 5.00% Cumulative Convertible Preferred Stock issued and outstanding with an aggregate liquidation preference of $172.5 million.

Redemption	Shares of the preferred stock are not redeemable by us.
Conversion Rights	A holder may convert its preferred stock into a number of shares of our common stock equal to the conversion rate only under the following circumstances:

- during any fiscal quarter after the fiscal quarter ending June 30, 2004 and only during such quarter, if the closing sale price of our common stock for at least 20 trading days in a period of 30 consecutive trading days ending on the last trading day of the preceding fiscal quarter exceeds 130% of the applicable conversion price on such trading day (initially 130% of $16.65, or $21.65);
- during the five business day period after any five consecutive trading-day period in which the trading price per share of the

preferred stock for each day of that period was less than 98% of the product of the closing sale price of our common stock and the applicable conversion rate on each such day; or

upon the occurrence of certain corporate transactions described under Description of Preferred Stock Conversion Rights Events Triggering Conversion Rights Conversion Rights upon Occurrence of Certain Corporation Transactions.

Mandatory Conversion	On or after March 15, 2009, we may, at our option, cause the preferred stock to be automatically converted into that number of shares of common stock that are issuable at the then prevailing conversion price. We may exercise our conversion right only if, for 20 trading days within any period of 30 consecutive trading days (including the last trading day of such period), the closing price of our common stock exceeds 130% of the then prevailing conversion price of the preferred stock.
Change of Control	Except as provided below, upon a change of control, each holder of preferred stock shall, in the event that the market value of our common stock at such time is less than the conversion price, have a one-time option to convert all of its shares of preferred stock into shares of common stock at an adjusted conversion price equal to the greater of (x) the market value of the common stock (determined as described herein) and (y) $8.0733.

In lieu of issuing the shares of common stock issuable upon conversion in the event of a change of control, we may, at our option, make a cash payment equal to the market value of such common stock otherwise issuable as of the change of control date.

Notwithstanding the foregoing, upon a change of control in which (1) each holder of our common stock receives consideration consisting solely of common stock of the successor, acquiror or other third party that is listed on a national securities exchange or quoted on the NASDAQ National Market and (2) all our common stock has been exchanged for, converted into or acquired for common stock of the successor, acquiror or other third party and the preferred stock becomes convertible solely into such common stock, the conversion price will not be adjusted as described above.

Voting Rights	Except as required by Oklahoma law and our certificate of incorporation, which includes the certificate of designation for the preferred stock, the holders of preferred stock will have no voting rights unless dividends payable on the preferred stock are in arrears for six or more quarterly periods. In that event, the holders of the preferred stock, voting as a single class with the shares of any other preferred stock or preference securities having similar voting rights (including the existing preferred stock), will be entitled at the next regular or special meeting of our stockholders to elect two directors and the number of directors that comprise our board will be increased by the number of directors so elected. These voting rights and the

	terms of the directors so elected will continue until such time as the dividend arrearage on the preferred stock has been paid in full. The affirmative consent of holders of at least 66 $^{2}/3$% of the outstanding preferred stock will be required for the issuance of any class or series of stock (or security convertible into stock) ranking senior to the preferred stock as to dividend rights or rights upon our liquidation, winding-up or dissolution and for amendments to our certificate of incorporation that would affect adversely the rights of holders of the preferred stock.
Tax Consequences	The U.S. Federal income tax consequences of purchasing, owning and disposing of the preferred stock and any common stock received upon its conversion are described in Federal Income Tax Considerations. Prospective investors are urged to consult their own tax advisors regarding the tax consequences of purchasing, owning and disposing of the preferred stock and any common stock received upon its conversion in light of their personal investment circumstances, including consequences resulting from the possibility that actual or constructive distributions on the preferred stock may exceed our current and accumulated earnings and profits, as calculated for U.S. Federal income tax purposes, in which case they would not be treated as dividends for U.S. Federal income tax purposes.
Common Stock	Our common stock is listed for trading on the NYSE under the symbol CHK.

Risk Factors

An investment in the preferred stock involves certain risks that a potential investor should carefully evaluate prior to making an investment in the preferred stock. See Risk Factors.

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RISK FACTORS

In addition to the other information set forth elsewhere or incorporated by reference in this prospectus, the following factors relating to our company, our preferred stock and our common stock should be considered carefully before making an investment decision.

Risks Relating to Our Business

Oil and gas prices are volatile. A decline in prices could adversely affect our financial position, financial results, cash flows, access to capital and ability to grow.

Our revenues, operating results, profitability, future rate of growth and the carrying value of our oil and gas properties depend primarily upon the prices we receive for the oil and gas we sell. Prices also affect the amount of cash flow available for capital expenditures and our ability to borrow money or raise additional capital. The amount we can borrow from banks is subject to periodic redeterminations based on prices specified by our bank group at the time of redetermination. In addition, we may have ceiling test write-downs in the future if prices fall significantly.

Historically, the markets for oil and gas have been volatile and they are likely to continue to be volatile. Wide fluctuations in oil and gas prices may result from relatively minor changes in the supply of and demand for oil and natural gas, market uncertainty and other factors that are beyond our control, including:

- worldwide and domestic supplies of oil and gas;
- weather conditions;
- the level of consumer demand;
- the price and availability of alternative fuels;
- the availability of pipeline capacity;
- the price and level of foreign imports;
- domestic and foreign governmental regulations and taxes;
- the ability of the members of the Organization of Petroleum Exporting Countries to agree to and maintain oil price and production controls;

political instability or armed conflict in oil-producing regions; and

the overall economic environment.

These factors and the volatility of the energy markets make it extremely difficult to predict future oil and gas price movements with any certainty. Declines in oil and gas prices would not only reduce revenue, but could reduce the amount of oil and gas that we can produce economically and, as a result, could have a material adverse effect on our financial condition, results of operations and reserves. Further, oil and gas prices do not necessarily move in tandem. Because approximately 89% of our proved reserves at March 31, 2004 are natural gas reserves, we are more affected by movements in natural gas prices.

Our level of indebtedness and preferred stock may adversely affect operations and limit our growth, and we may have difficulty making debt service and preferred stock dividend payments on our indebtedness and preferred stock, including the preferred stock offered hereby, as such payments become due.

As of March 31, 2004, we had long-term indebtedness of $2.0 billion, none of which was bank indebtedness. Our long-term indebtedness represented 46% of our total book capitalization at March 31, 2004. We expect to continue to be highly leveraged in the foreseeable future.

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Our level of indebtedness and preferred stock affects our operations in several ways, including the following:

- a significant portion of our cash flows must be used to service our indebtedness and pay dividends on preferred stock, and our business may not generate sufficient cash flow from operations to enable us to continue to meet our obligations under our indebtedness and our stated dividends on our preferred stock;
- a high level of debt and preferred stock increases our vulnerability to general adverse economic and industry conditions;
- the covenants contained in the agreements governing our outstanding indebtedness may limit our ability to borrow additional funds, dispose of assets, pay dividends and make certain investments;
- our debt covenants may also affect our flexibility in planning for, and reacting to, changes in the economy and in our industry, and the rights and preferences applicable to our preferred stock may limit our ability to pay dividends on our preferred stock; and
- a high level of debt and preferred stock may impair our ability to obtain additional financing in the future for working capital, capital expenditures, acquisitions, or other general corporate purposes.

We may incur additional debt, including significant secured indebtedness or issue additional series of preferred stock, in order to make future acquisitions or to develop our properties. A higher level of indebtedness and additional preferred stock increases the risk that we may default on our existing debt obligations. Our ability to meet our debt obligations and to reduce our level of indebtedness depends on our future performance. General economic conditions, oil and gas prices and financial, business and other factors affect our operations and our future performance. Many of these factors are beyond our control. We may not be able to generate sufficient cash flow to pay the interest on our debt, and future working capital, borrowings or equity financing may not be available to pay or refinance such debt. Factors that will affect our ability to raise cash through an offering of our capital stock or a refinancing of our debt include financial market conditions, the value of our assets and our performance at the time we need capital.

In addition, our bank borrowing base is subject to periodic redeterminations. We could be forced to repay a portion of our bank borrowings due to redeterminations of our borrowing base. If we are forced to do so, we may not have sufficient funds to make such repayments. If we do not have sufficient funds and are otherwise unable to negotiate renewals of our borrowings or arrange new financing, we may have to sell significant assets. Any such sale could have a material adverse effect on our business and financial results.

Competition in the oil and natural gas industry is intense, and many of our competitors have greater financial and other resources than we do.

We operate in the highly competitive areas of oil and natural gas acquisition, development, exploitation, exploration and production. We face intense competition from both major and other independent oil and natural gas companies in each of the following areas:

- seeking to acquire desirable producing properties or new leases for future exploration; and
- seeking to acquire the equipment and expertise necessary to develop and operate our properties.

Many of our competitors have financial and other resources substantially greater than ours, and some of them are fully integrated oil companies. These companies may be able to pay more for development prospects and productive oil and natural gas properties and may be able to define, evaluate, bid for and purchase a greater number of properties and prospects than our financial or human resources permit. Our ability to develop and exploit our oil and natural gas properties and to acquire additional properties in the future will depend upon our ability to successfully conduct operations, evaluate and select suitable properties and consummate transactions in this highly competitive environment.

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Our hedging activities may reduce the realized prices received for our oil and gas sales and require us to provide collateral for hedging liabilities.

In order to manage our exposure to price volatility in marketing our oil and gas, we enter into oil and gas price risk management arrangements for a portion of our expected production. Commodity price hedging may limit the prices we actually realize and therefore reduce oil and gas revenues in the future. The fair value of our oil and gas derivative instruments outstanding as of March 31, 2004 was a liability of approximately $169 million. In addition, our commodity price risk management transactions may expose us to the risk of financial loss in certain circumstances, including instances in which:

- our production is less than expected;
- there is a widening of price differentials between delivery points for our production and the delivery point assumed in the hedge arrangement; or
- the counterparties to our contracts fail to perform under the contracts.

Some of our commodity price and interest rate risk management arrangements require us to deliver cash collateral or other assurances of performance to the counterparties in the event that our payment obligations exceed certain levels. As of March 31, 2004, we were required to post a total of $75.0 million of collateral with our counterparties through letters of credit issued under our bank credit facility with respect to commodity price and financial risk management transactions. As of June 10, 2004, we were required to post a total of $92.0 million of collateral. Future collateral requirements are uncertain and will depend on arrangements with our counterparties, highly volatile natural gas and oil prices and fluctuations in interest rates.

The actual quantities and present value of our proved reserves may prove to be lower than we have estimated.

This prospectus and the documents incorporated by reference herein contain estimates of our proved reserves and the estimated future net revenues from our proved reserves and estimates relating to recent acquisitions. These estimates are based upon various assumptions, including assumptions required by the SEC relating to oil and gas prices, drilling and operating expenses, capital expenditures, taxes and availability of funds. The process of estimating oil and gas reserves is complex. The process involves significant decisions and assumptions in the evaluation of available geological, geophysical, engineering and economic data for each reservoir. Therefore, these estimates are inherently imprecise.

Actual future production, oil and gas prices, revenues, taxes, development expenditures, operating expenses and quantities of recoverable oil and gas reserves most likely will vary from these estimates. Such variations may be significant and could materially affect the estimated quantities and present value of our proved reserves. In addition, we may adjust estimates of proved reserves to reflect production history, results of exploration and development drilling, prevailing oil and gas prices and other factors, many of which are beyond our control. Our properties may also be susceptible to hydrocarbon drainage from production by operators on adjacent properties.

At December 31, 2003, approximately 26% of our estimated proved reserves by volume were undeveloped. Recovery of undeveloped reserves requires significant capital expenditures and successful drilling operations. These reserve estimates include the assumption that we will make significant capital expenditures to develop the reserves, including $351 million in 2004. You should be aware that the estimated costs may not be accurate, development may not occur as scheduled and results may not be as estimated.

You should not assume that the present values referred to in this prospectus and the documents incorporated by reference herein represent the current market value of our estimated oil and gas reserves. In accordance with SEC requirements, the estimates of our present values are based on prices and costs as of the date of the estimates. The December 31, 2003 present value is based on weighted average oil and gas prices of $30.22 per barrel of oil and $5.68 per mcf of natural gas. Actual future prices and costs may be materially higher or lower than the prices and costs as of the date of an estimate.

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Any changes in consumption by oil and gas purchasers or in governmental regulations or taxation will also affect actual future net cash flows.

The timing of both the production and the costs for the development and production of oil and gas properties will affect both the timing of actual future net cash flows from our proved reserves and their present value. In addition, the 10% discount factor, which is required by the SEC to be used in calculating discounted future net cash flows for reporting purposes, is not necessarily the most accurate discount factor. Future interest rates and the risks associated with our business or the oil and gas industry in general will affect the accuracy of the 10% discount factor.

Reserve estimates of properties acquired in 2004 have not been prepared by independent petroleum engineers. Our internal estimates may not be as reliable as estimates of those reserves by independent engineers.

Our estimates of proved reserves attributed to our 2004 acquisitions, including our recent acquisitions, included herein or incorporated by reference in this prospectus have not been reviewed or reported on by independent petroleum engineers. These estimates were prepared by our own engineers and professionals using criteria otherwise in compliance with SEC rules. Furthermore, our internal reserve estimates for these acquisitions are based upon data available to us which may not be as complete as data available on our other properties. Oil and gas pricing can affect estimates of quantities of proved reserves due to the impact of pricing on ultimate economic recovery. Estimates prepared by independent engineers might be different than our internal estimates.

We may not have funds sufficient to make the significant capital expenditures required to replace our reserves.

Our exploration, development and acquisition activities require substantial capital expenditures. Historically, we have funded our capital expenditures through a combination of cash flows from operations, our bank credit facility and debt and equity issuances. Future cash flows are subject to a number of variables, such as the level of production from existing wells, prices of oil and gas, and our success in developing and producing new reserves. If revenue were to decrease as a result of lower oil and gas prices or decreased production, and our access to capital were limited, we would have a reduced ability to replace our reserves. If our cash flows from operations are not sufficient to fund our capital expenditure budget, we may not be able to access additional bank debt, debt or equity or other methods of financing to meet these requirements.

If we are not able to replace reserves, we may not be able to sustain production.

Our future success depends largely upon our ability to find, develop or acquire additional oil and gas reserves that are economically recoverable. Unless we replace the reserves we produce through successful development, exploration or acquisition activities, our proved reserves will decline over time. In addition, approximately 26% of our total estimated proved reserves by volume at December 31, 2003 were undeveloped. By their nature, estimates of undeveloped reserves are less certain. Recovery of such reserves will require significant capital expenditures and successful drilling operations. We may not be able to successfully find and produce reserves economically in the future. In addition, we may not be able to acquire proved reserves at acceptable costs.

Acquisitions may prove to be worth less than we paid because of uncertainties in evaluating recoverable reserves and potential liabilities.

A significant portion of our recent growth is due to acquisitions of exploration and production companies, producing properties and undeveloped leasehold. We expect acquisitions will also contribute to our future growth. Successful acquisitions require an assessment of a number of factors, including estimates of recoverable

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reserves, exploration potential, future oil and gas prices, operating costs and potential environmental and other liabilities. Such assessments are inexact and their accuracy is inherently uncertain. In connection with our assessments, we perform a review of the acquired properties which we believe is generally consistent with industry practices. However, such a review will not reveal all existing or potential problems. In addition, our review may not permit us to become sufficiently familiar with the properties to fully assess their deficiencies and capabilities. We do not inspect every well. Even when we inspect a well, we do not always discover structural, subsurface and environmental problems that may exist or arise.

We are generally not entitled to contractual indemnification for preclosing liabilities, including environmental liabilities. Normally, we acquire interests in properties on an as is basis with limited remedies for breaches of representations and warranties.

Competition for producing oil and gas properties is intense and many of our competitors have financial and other resources that are substantially greater than those available to us. Therefore, we may not be able to acquire oil and gas properties that contain economically recoverable reserves or be able to complete such acquisitions on acceptable terms.

Additionally, significant acquisitions can change the nature of our operations and business depending upon the character of the acquired properties, which may have substantially different operating and geological characteristics or be in different geographic locations than our existing properties. It is our current intention to continue focusing on acquiring properties with development and exploration potential located in the Mid-Continent, South Texas, Ark-La-Tex and Permian regions. To the extent that we acquire properties substantially different from the properties in our primary operating regions or acquire properties that require different technical expertise, we may not be able to realize the economic benefits of these acquisitions as efficiently as in our prior acquisitions.

Future price declines may result in a writedown of our asset carrying values.

We utilize the full cost method of accounting for costs related to our oil and gas properties. Under this method, all such costs (for both productive and nonproductive properties) are capitalized and amortized on an aggregate basis over the estimated lives of the properties using the unit-of-production method. However, these capitalized costs are subject to a ceiling test which limits such pooled costs to the aggregate of the present value of future net revenues attributable to proved oil and gas reserves discounted at 10% plus the lower of cost or market value of unproved properties. The full cost ceiling is evaluated at the end of each quarter using the prices for oil and gas at that date, adjusted for the impact of derivatives accounted for as cash flow hedges. A significant decline in oil and gas prices from current levels, or other factors, without other mitigating circumstances, could cause a future writedown of capitalized costs and a non-cash charge against future earnings. Our aggregate present value of future net revenues plus the value of the unproved properties would equal the recorded net book value of our oil and gas properties at December 31, 2003, assuming an index price of approximately $3.25 per mcf for gas and $32.25 per barrel for oil. If index prices were to fall below these levels, we could experience a writedown of the book value of our oil and gas assets.

Oil and gas drilling and producing operations are hazardous and expose us to environmental liabilities.

Oil and gas operations are subject to many risks, including well blowouts, cratering and explosions, pipe failure, fires, formations with abnormal pressures, uncontrollable flows of oil, natural gas, brine or well fluids, and other environmental hazards and risks. Our drilling operations involve risks from high pressures and from mechanical difficulties such as stuck pipes, collapsed casings and separated cables. If any of these risks occurs, we could sustain substantial losses as a result of:

injury or loss of life;

severe damage to or destruction of property, natural resources and equipment;

pollution or other environmental damage;

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- clean-up responsibilities;
- regulatory investigations and penalties; and
- suspension of operations.

Our liability for environmental hazards includes those created either by the previous owners of properties that we purchase or lease or by acquired companies prior to the date we acquire them. We maintain insurance against some, but not all, of the risks described above. Our insurance may not be adequate to cover casualty losses or liabilities. Also, in the future we may not be able to continue to obtain insurance at premium levels that justify its purchase.

Exploration and development drilling may not result in commercially productive reserves.

We do not always encounter commercially productive reservoirs through our drilling operations. The new wells we drill or participate in may not be productive and we may not recover all or any portion of our drilling costs. The seismic data and other technologies we use do not allow us to know conclusively prior to drilling a well that oil or gas is present or may be produced economically. The cost of drilling, completing and operating a well is often uncertain, and cost factors can adversely affect the economics of a project. Our efforts will be unprofitable if we drill dry wells or wells that are productive but do not produce enough reserves to return a profit after drilling, operating and other costs. Further, our drilling operations may be curtailed, delayed or canceled as a result of a variety of factors, including:

- unexpected drilling conditions;
- title problems;
- pressure or irregularities in formations;
- equipment failures or accidents;
- adverse weather conditions;
- compliance with environmental and other governmental requirements; and
- the high cost, or shortages or delays in the availability of drilling rigs and equipment.

The loss of key personnel could adversely affect our ability to operate.

We depend, and will continue to depend in the foreseeable future, on the services of our officers and key employees with extensive experience and expertise in evaluating and analyzing producing oil and gas properties and drilling prospects, maximizing production from oil and gas properties, marketing oil and gas production, and developing and executing financing and hedging strategies. Our ability to retain our officers and key employees is important to our continued success and growth. The unexpected loss of the services of one or more of these individuals could have a detrimental effect on our business. We do not maintain key person life insurance on any of our personnel.

Lower oil and gas prices could negatively impact our ability to borrow.

Our bank credit facility limits our borrowings to $500 million based on current bank commitments as of the date of this prospectus. The borrowing base, currently $600 million, is determined periodically at the discretion of a majority of the banks and is based in part on oil and gas prices. Additionally, some of our indentures contain covenants limiting our ability to incur indebtedness in addition to that incurred under our bank credit facility. These indentures limit our ability to incur additional indebtedness unless we meet one of two alternative tests. The first alternative is based on our adjusted consolidated net tangible assets (as defined in all of our indentures), which is determined using discounted future net revenues from proved oil and gas reserves as of the end of each year. The second alternative is based on the ratio of our adjusted consolidated EBITDA (as defined in all of our indentures) to our adjusted consolidated interest expense over a trailing twelve-month period. As of the date of this prospectus, we are permitted to incur significant additional indebtedness under both of these debt incurrence tests. Lower oil and gas prices in the future could reduce our adjusted consolidated EBITDA, as well as our adjusted consolidated net tangible assets, and thus could reduce our ability to incur additional indebtedness.

Risks Relating to Our Preferred Stock

We may not be able to pay cash dividends on the preferred stock.

We are required to pay all declared dividends on the preferred stock in cash. Our existing indentures limit, and any indentures that we enter into in the future will likely limit, our ability to pay cash dividends on our capital stock. Specifically, under our existing indentures, we may pay cash dividends and make other distributions on or in respect of our capital stock, including the preferred stock, only if certain financial tests are met. In the event that any of our indentures or other financing agreements in the future restrict our ability to pay cash dividends on the preferred stock, we will be unable to pay cash dividends on the preferred stock unless we can refinance amounts outstanding under those agreements.

Under Oklahoma law, cash dividends on capital stock may only be paid from surplus or, if there is no surplus, from the corporation s net profits for the then current or the preceding fiscal year. Unless we continue to operate profitably, our ability to pay cash dividends on the preferred stock would require the availability of adequate surplus, which is defined as the excess, if any, of our net assets (total assets less total liabilities) over our capital. Further, even if adequate surplus is available to pay cash dividends on the preferred stock, we may not have sufficient cash to pay dividends on the preferred stock.

You may be unable to convert the preferred stock into our common stock.

You may convert shares of preferred stock into common stock only if (1) the closing sale price of our common stock reaches, or the trading price of the preferred stock falls below, specified thresholds or (2) specified corporate transactions have occurred. Your inability to convert the preferred stock may adversely affect its value.

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RATIOS OF EARNINGS TO COMBINED FIXED CHARGES AND PREFERRED DIVIDENDS

For purposes of determining the ratio of earnings to fixed charges and preferred dividends, earnings are defined as net income before income taxes, cumulative effect of accounting change, pretax gain or loss of equity investees, amortization of capitalized interest and fixed charges, less capitalized interest. Fixed charges consist of interest (whether expensed or capitalized and excluding the effect of unrealized gains or losses on interest rate derivatives), and amortization of debt expenses and discount or premium relating to any indebtedness. Preference dividends consist of preferred stock dividends grossed up to reflect the pre-tax amount.

	Year Ended December 31,					Quarter Ended March 31,
	1999	2000	2001	2002	2003	2004
Ratio of earnings to fixed charges and preferred dividends	1.1x	2.8x	4.2x	1.3x	3.3x	3.8x

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USE OF PROCEEDS

We will not receive any of the proceeds from the sale of the preferred stock or the common stock contemplated by this prospectus. Please read Selling Securityholders for a list of the persons receiving proceeds from the sale of the preferred stock or the underlying common stock.

BUSINESS

We are one of the six largest independent natural gas producers in the United States in terms of natural gas produced, owning interests in approximately 17,000 producing oil and gas wells. Our internally-estimated proved oil and natural gas reserves as of March 31, 2004, pro forma for our recent acquisition of Greystone Petroleum LLC, were approximately 3.8 tcfe. Approximately 89% of our pro forma proved reserves by volume at March 31, 2004 were natural gas, and approximately 80% of our proved oil and natural gas reserves by volume at March 31, 2004 were located in our primary operating area the Mid-Continent region of the United States, which includes Oklahoma, western Arkansas, southwestern Kansas and the Texas Panhandle. In addition, we are building secondary operating areas in the Permian Basin of western Texas and eastern New Mexico, in the Ark-La-Tex basin of eastern Texas and northern Louisiana and in the South Texas and Texas Gulf Coast regions.

Since January 1, 1998, we have been one of the most active consolidators of onshore U.S. natural gas assets, having purchased or agreed to purchase approximately 3.3 tcfe at a total cost of approximately $3.9 billion (excluding the impact of deferred taxes in connection with certain corporate acquisitions). In 2004 to date, we have remained active in the acquisitions market. In January 2004, we purchased Permian Basin and Mid-Continent oil and gas assets by acquiring privately-held Concho Resources Inc. for cash consideration of $420 million (excluding employee severance and other miscellaneous costs). We also completed five other smaller acquisitions in 2004 for $165 million. Through these six acquisitions, we acquired an internally estimated 366 bcfe of proved oil and natural gas reserves and added 82 mmcfe to our estimated daily production.

Most recently, on June 2, 2004, we acquired Greystone Petroleum LLC, a privately-held oil and natural gas company, for $425 million in cash. In this transaction, we acquired an internally-estimated 214 bcfe of proved reserves and added 45 mmcfe to our estimated daily production.

Additional information concerning our company is included in our reports and other documents incorporated by reference in this prospectus. Please read Where You Can Find More Information.

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DESCRIPTION OF THE PREFERRED STOCK

The following is a summary of certain provisions of the certificate of designation for our 4.125% Cumulative Convertible Preferred Stock (which we will refer to as the Convertible Preferred Stock). A copy of the certificate of designation and the form of Convertible Preferred Stock share certificate are available upon request from us at the address set forth under Where You Can Find More Information. The following summary of the terms of Convertible Preferred Stock does not purport to be complete and is subject to, and qualified in its entirety by reference to, the provisions of the certificate of designation. As used in this section, the terms the Company, us , we or our refer to Chesapeake Energy Corporation and not any of its subsidiaries.

General

Under our certificate of incorporation, our board of directors is authorized, without further stockholder action, to issue up to 20,000,000 shares of preferred stock, par value $.01 per share, in one or more series, with such voting powers or without voting powers, and with such designations, preferences and relative, participating, optional or other special rights, and qualifications, limitations or restrictions, as shall be set forth in the resolutions providing therefor. We have 10,013,950 shares of authorized preferred stock that are undesignated. We have 2,997,800 shares of preferred stock that are designated as 6.75% Cumulative Convertible Preferred Stock, of which all are currently outstanding, 4,600,000 shares of preferred stock that are designated as 6.00% Cumulative Convertible Preferred Stock, of which all are currently outstanding, 1,725,000 shares of preferred stock that are designated as 5.00% Cumulative Convertible Preferred Stock, of which all are currently outstanding and 313,250 shares of preferred stock that are designated as 4.125% Cumulative Convertible Preferred Stock, of which all are currently outstanding. The board of directors has also authorized the issuance of up to 350,000 shares of Series A Junior Participating Convertible Preferred Stock in connection with the adoption of our share rights plan in July 1998. None of these shares are currently outstanding.

When issued, the Convertible Preferred Stock and any common stock issued upon the conversion of the Convertible Preferred Stock will be fully paid and nonassessable. The holders of the Convertible Preferred Stock will have no preemptive or preferential right to purchase or subscribe to stock, obligations, warrants or other securities of the Company of any class. The transfer agent, registrar, redemption, conversion and dividend disbursing agent for shares of both the Convertible Preferred Stock and common stock is UMB Bank, N.A.

The Convertible Preferred Stock is subject to mandatory conversion, as described below in Mandatory Conversion, but is not redeemable by us.

Ranking

The Convertible Preferred Stock, with respect to dividend rights or rights upon our liquidation, winding-up or dissolution, ranks:

- senior to all classes of our common stock and to the Series A Junior Participating Convertible Preferred Stock and each other class of capital stock or series of preferred stock established after the original issue date of the Convertible Preferred Stock (which we will refer to as the Issue Date), the terms of which do not expressly provide that such class or series ranks senior to or on a parity with the Convertible Preferred Stock as to dividend rights or rights upon our liquidation, winding-up or dissolution (which we will refer to collectively as Junior Stock);

on a parity, in all respects, with our existing 6.75% Cumulative Convertible Preferred Stock, our existing 6.00% Cumulative Convertible Preferred Stock, our existing 5.00% Cumulative Convertible Preferred Stock and with any class of capital stock or series of preferred stock established after the Issue Date, the terms of which expressly provide that such class or series will rank on a parity with the Convertible Preferred Stock as to dividend rights or rights upon our liquidation, winding-up or dissolution (which we will refer to collectively as Parity Stock); and

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junior to each class of capital stock or series of preferred stock established after the Issue Date, the terms of which expressly provide that such class or series will rank senior to the Convertible Preferred Stock as to dividend rights or rights upon our liquidation, winding-up or dissolution (which we will refer to collectively as Senior Stock).

While any shares of Convertible Preferred Stock are outstanding, we may not authorize or issue any class or series of Senior Stock (or any security convertible into Senior Stock) without the affirmative vote or consent of the holders of at least 66 $^{2}/3$% of the outstanding shares of Convertible Preferred Stock. Without the consent of any holder of Convertible Preferred Stock, however, we may authorize, increase the authorized amount of, or issue any class or series of Parity Stock or Junior Stock. See Voting Rights below.

Dividends

Holders of shares of Convertible Preferred Stock will be entitled to receive, when, as and if declared by our board of directors out of funds legally available for payment, cumulative cash dividends at the rate per annum of 4.125% per share on the liquidation preference thereof of $1,000 per share of Convertible Preferred Stock (equivalent to $41.25 per annum per share). Dividends on the Convertible Preferred Stock will be payable quarterly on March 15, June 15, September 15 and December 15 of each year, commencing June 15, 2004 (each, a Dividend Payment Date) at such annual rate, and shall accumulate from the most recent date as to which dividends shall have been paid or, if no dividends have been paid, from the Issue Date of the Convertible Preferred Stock, whether or not in any dividend period or periods there have been funds legally available for the payment of such dividends. Dividends will be payable to holders of record as they appear on our stock register on the immediately preceding March 1, June 1, September 1 and December 1 (each, a Record Date). Accumulations of dividends on shares of Convertible Preferred Stock do not bear interest. Dividends payable on the Convertible Preferred Stock for any period less than a full dividend period (based upon the number of days elapsed during the period) are computed on the basis of a 360-day year consisting of twelve 30-day months.

No dividend will be declared or paid upon, or any sum set apart for the payment of dividends upon, any outstanding share of the Convertible Preferred Stock with respect to any dividend period unless all dividends for all preceding dividend periods have been declared and paid or declared and a sufficient sum set apart for the payment of such dividend, upon all outstanding shares of Convertible Preferred Stock.

No dividends or other distributions (other than a dividend or distribution payable solely in shares of Parity Stock or Junior Stock (in the case of Parity Stock) or Junior Stock (in the case of Junior Stock) and cash in lieu of fractional shares) may be declared, made or paid, or set apart for payment upon, any Parity Stock or Junior Stock, nor may any Parity Stock or Junior Stock be redeemed, purchased or otherwise acquired for any consideration (or any money paid to or made available for a sinking fund for the redemption of any Parity Stock or Junior Stock) by us or on our behalf (except by conversion into or exchange for shares of Parity Stock or Junior Stock (in the case of Parity Stock) or Junior Stock (in the case of Junior Stock)) unless all accumulated and unpaid dividends have been or contemporaneously are declared and paid, or are declared and a sum sufficient for the payment thereof is set apart for such payment, on the Convertible Preferred Stock and any Parity Stock for all dividend payment periods terminating on or prior to the date of such declaration, payment, redemption, purchase or acquisition. Notwithstanding the preceding, if full dividends have not been paid on the Convertible Preferred Stock and any Parity Stock, dividends may be declared and paid on the Convertible Preferred Stock and such Parity Stock so long as the dividends are declared and paid pro rata so that the amounts of dividends declared per share on the Convertible Preferred Stock and such Parity Stock will in all cases bear to each other the same ratio that accumulated and unpaid dividends per share on the shares of the Convertible Preferred Stock and such Parity Stock bear to each other. Holders of shares of the Convertible Preferred Stock will not be entitled to any dividend, whether payable in cash, property or stock, in excess of full cumulative dividends.

Our ability to declare and pay cash dividends and make other distributions with respect to our capital stock, including the Convertible Preferred Stock, is limited by the terms of the Company s outstanding indebtedness. In

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addition, our ability to declare and pay dividends may be limited by applicable Oklahoma law. See Risk Factors Risks Relating to Our Preferred Stock We may not be able to pay cash dividends on the preferred stock.

Liquidation Preference

In the event of our voluntary or involuntary liquidation, winding-up or dissolution, each holder of Convertible Preferred Stock will be entitled to receive and to be paid out of our assets available for distribution to our stockholders, before any payment or distribution is made to holders of Junior Stock (including common stock), a liquidation preference in the amount of $1,000 per share of the Convertible Preferred Stock, plus accumulated and unpaid dividends on the shares to the date fixed for liquidation, winding-up or dissolution. If, upon our voluntary or involuntary liquidation, winding-up or dissolution, the amounts payable with respect to the liquidation preference of the Convertible Preferred Stock and all Parity Stock are not paid in full, the holders of the Convertible Preferred Stock and the Parity Stock will share equally and ratably in any distribution of our assets in proportion to the full liquidation preference and accumulated and unpaid dividends to which they are entitled. After payment of the full amount of the liquidation preference and accumulated and unpaid dividends to which they are entitled, the holders of the Convertible Preferred Stock will have no right or claim to any of our remaining assets. Neither the sale of all or substantially all our assets or business (other than in connection with our liquidation, winding-up or dissolution), nor our merger or consolidation into or with any other person, will be deemed to be our voluntary or involuntary liquidation, winding-up or dissolution.

The certificate of designation will not contain any provision requiring funds to be set aside to protect the liquidation preference of the Convertible Preferred Stock even though it is substantially in excess of the par value thereof.

Voting Rights

The holders of the Convertible Preferred Stock will have no voting rights except as set forth below or as otherwise required by Oklahoma law from time to time.

If dividends on the Convertible Preferred Stock are in arrears and unpaid for six or more quarterly periods (whether or not consecutive), the holders of the Convertible Preferred Stock, voting as a single class with any other preferred stock or preference securities having similar voting rights that are exercisable (including our existing 6.75% Cumulative Convertible Preferred Stock, our existing 6.00% Cumulative Convertible Preferred Stock and our existing 5.00% Cumulative Convertible Preferred Stock), will be entitled at our next regular or special meeting of stockholders to elect two additional directors to our board of directors. Upon the election of any additional directors, the number of directors that comprise our board shall be increased by such number of additional directors. Such voting rights and the terms of the directors so elected will continue until such time as the dividend arrearage on the Convertible Preferred Stock has been paid in full.

In addition, the affirmative vote or consent of the holders of at least 66 $^{2}/3$% of the outstanding Convertible Preferred Stock will be required for the authorization or issuance of any class or series of Senior Stock (or any security convertible into Senior Stock) and for amendments to our certificate of incorporation that would affect adversely the rights of holders of the Convertible Preferred Stock. The certificate of designation will provide that the authorization of, the increase in the authorized amount of, or the issuance of any shares of any class or series of Parity Stock or Junior Stock will not require the consent of the holders of the Convertible Preferred Stock, and will not be deemed to affect adversely the rights of the holders of the Convertible Preferred Stock.

In all cases in which the holders of Convertible Preferred Stock shall be entitled to vote, each share of Convertible Preferred Stock shall be entitled to one vote.

Conversion Rights

Each share of Convertible Preferred Stock will be convertible only on or after the occurrence of the conversion triggering events described below at the option of the holder thereof into 60.0555 shares of common

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stock (which is calculated using an initial conversion price of $16.65 per share of common stock) subject to adjustment as described below (and we refer to such price or adjusted price as the Conversion Price). See Events Triggering Conversion Rights below.

With respect to any shares of Convertible Preferred Stock that are restricted securities on the date of conversion, the shares of common stock distributed upon conversion will be treated as restricted securities, will bear a legend to such effect and will not be transferable by the recipient thereof except pursuant to an effective registration statement or pursuant to an exemption from the registration requirements of the Securities Act. All such shares will be issued in physical certificated form and will not be eligible for receipt in global form through the facilities of the Depositary. With respect to shares of Convertible Preferred Stock that are no longer restricted securities on a conversion date, either as a result of a resale of the Convertible Preferred Stock pursuant to the shelf registration statement of which this prospectus forms a part or otherwise, all shares of common stock distributed upon conversion will be freely transferable without restriction under the Securities Act (other than by our affiliates), and such shares will be eligible for receipt in global form through the facilities of the Depositary.

The holders of shares of Convertible Preferred Stock at the close of business on a Record Date will be entitled to receive the dividend payment on those shares on the corresponding Dividend Payment Date notwithstanding the conversion of such shares following that Record Date or our default in payment of the dividend due on that Dividend Payment Date. However, shares of Convertible Preferred Stock surrendered for conversion during the period between the close of business on any Record Date and the close of business on the business day immediately preceding the applicable Dividend Payment Date must be accompanied by payment of an amount equal to the dividend payable on such shares on that Dividend Payment Date. A holder of shares of Convertible Preferred Stock on a Record Date who (or whose transferee) tenders any shares for conversion on the corresponding Dividend Payment Date will receive the dividend payable by us on the Convertible Preferred Stock on that date, and the converting holder need not include payment in the amount of such dividend upon surrender of shares of Convertible Preferred Stock for conversion. Except as provided above with respect to a voluntary conversion, we will make no payment or allowance for unpaid dividends, whether or not in arrears, on converted shares or for dividends on the shares of common stock issued upon conversion.

Events Triggering Conversion Rights

A holder s right to convert its shares of Convertible Preferred Stock will arise only upon the occurrence of the events specified in this section.

Conversion Rights Based on Trading Price of Our Common Stock. A holder may surrender shares of Convertible Preferred Stock for conversion into shares of common stock during any fiscal quarter after the fiscal quarter ending June 30, 2004 (and only during such fiscal quarter) if the Closing Sale Price of our common stock for at least 20 Trading Days in a period of 30 consecutive Trading Days ending on the last Trading Day of the immediately preceding fiscal quarter is more than 130% of the Conversion Price on such Trading Day. If this Closing Sale Price condition is not satisfied at the end of any fiscal quarter, then conversion pursuant to this provision will not be permitted in the following fiscal quarter.

The term Trading Day means a day during which trading in securities generally occurs on the New York Stock Exchange or, if our common stock is not listed on the New York Stock Exchange, on the principal other national or regional securities exchange on which our common stock is then listed or, if our common stock is not listed on a national or regional securities exchange, on Nasdaq or, if our common stock is not quoted on Nasdaq, on the principal other market on which our common stock is then traded.

The Closing Sale Price of our common stock on any date means the closing sale price per share (or if no closing sale price is reported, the average of the closing bid and ask prices or, if more than one in either case, the average of the average closing bid and the average closing ask prices) on such date as reported on the principal

United States securities exchange on which our common stock is traded or, if our common stock is not listed on a United States national or regional securities exchange, as reported by Nasdaq or by the National Quotation Bureau Incorporated. In the absence of such a quotation, we will determine the Closing Sale Price on the basis we consider appropriate.

Conversion Upon Satisfaction of Trading Price Condition. Holders may surrender their shares of Convertible Preferred Stock for conversion into common stock during the five business day period after any five consecutive Trading-Day period in which the Trading Price of the Convertible Preferred Stock for each day of that five Trading Day period was less than 98% of the product of the Closing Sale Price of our common stock and the conversion rate in effect on each such day.

The Trading Price of the Convertible Preferred Stock on any date of determination means the average of the secondary market bid quotations obtained by us or the calculation agent for 5,000 shares of Convertible Preferred Stock at approximately 3:30 p.m., New York City time, on such determination date from three independent nationally recognized securities dealers that we or the calculation agent selects; provided that if three such bids cannot reasonably be obtained by us or the calculation agent, but two such bids are obtained, then the average of the two bids shall be used, and if only one such bid can reasonably be obtained by us or the calculation agent, that one bid shall be used. If we or the calculation agent cannot reasonably obtain at least one bid for 5,000 shares of Convertible Preferred Stock from a nationally recognized securities dealer, then the Trading Price per share of Convertible Preferred Stock will be deemed to be less than 98% of the product of the Closing Sale Price of our common stock and the conversion rate.

Conversion Rights Upon Occurrence of Certain Corporate Transactions. If we are party to a consolidation, merger, binding share exchange or sale of all or substantially all of our assets, in each case pursuant to which our common stock would be converted into cash, securities or other property, a holder may surrender shares of Convertible Preferred Stock for conversion into common stock at any time from and after the date that is 15 days prior to the anticipated effective date of the transaction until 15 days after the actual date of such transaction and, at the effective time, the right to convert shares of Convertible Preferred Stock into common stock will be changed into a right to convert such Convertible Preferred Stock into the kind and amount of cash, securities or other property of us or another person that the holder would have received if the holder had converted the holder s Convertible Preferred Stock immediately prior to the transaction.

In addition, upon a Change of Control (as defined below under Change of Control), holders of Convertible Preferred Stock shall, if the Market Value (as defined below under Conversion Price Adjustment) at such time is less than the Conversion Price, have a one-time option to convert all of their outstanding shares of Convertible Preferred Stock into common stock as described in Change of Control.

If we elect to:

- distribute to all holders of our common stock rights or warrants entitling them to purchase, for a period expiring within 45 days of the record date for such distribution, our common stock at less than the average Closing Sale Price for the ten consecutive Trading Days immediately preceding the declaration date for such distribution; or

- distribute to all holders of our common stock, cash, assets, debt securities or rights to purchase our securities, which distribution has a per share value exceeding 5% of the Closing Sale Price of our common stock on the day immediately preceding the declaration date for such distribution;

we must notify you at least 20 days prior to the ex-dividend date for such distribution. Once we have given such notice, you may surrender your shares of Convertible Preferred Stock for conversion at any time until the earlier of the close of business on the business day immediately preceding the ex-dividend date or any announcement by us that such distribution will not take place. No adjustment to the conversion rate will be made and you will not be able to convert pursuant to this provision if you otherwise participate in the distribution without conversion.

Upon determination that holders of Convertible Preferred Stock are or will be entitled to convert their Convertible Preferred Stock into common stock in accordance with any of the foregoing provisions, we will issue a press release and publish such information on our website on the World Wide Web.

Mandatory Conversion

At any time on or after March 15, 2009, we may at our option cause the Convertible Preferred Stock to be automatically converted into that number of shares of common stock for each share of Convertible Preferred Stock equal to $1,000.00 (the liquidation preference per share of Convertible Preferred Stock) divided by the then prevailing Conversion Price. We may exercise this right only if the Closing Sale Price of our common stock exceeds 130% of the then prevailing Conversion Price for at least 20 Trading Days in a period of 30 consecutive Trading Days, including the last Trading Day of such 30-day period, ending on the Trading Day prior to our issuance of a press release announcing the mandatory conversion as described below.

To exercise the mandatory conversion right described above, we must issue a press release for publication on the Dow Jones News Service prior to the opening of business on the first Trading Day following any date on which the conditions described in the preceding paragraph are met, announcing such a mandatory conversion. We will also give notice by mail or by publication (with subsequent prompt notice by mail) to the holders of the Convertible Preferred Stock (not more than four business days after the date of the press release) of the mandatory conversion announcing our intention to convert the Convertible Preferred Stock. The conversion date will be a date selected by us (which we will refer to as the Mandatory Conversion Date) and will be no more than five days after the date on which we issue such press release.

In addition to any information required by applicable law or regulation, the press release and notice of a mandatory conversion shall state, as appropriate:

- the Mandatory Conversion Date;
- the number of shares of common stock to be issued upon conversion of each share of Convertible Preferred Stock;
- the number of shares of Convertible Preferred Stock to be converted; and
- that dividends on the Convertible Preferred Stock to be converted will cease to accrue on the Mandatory Conversion Date.

On and after the Mandatory Conversion Date, dividends will cease to accrue on the Convertible Preferred Stock called for a mandatory conversion and all rights of holders of such Convertible Preferred Stock will terminate except for the right to receive the shares of common stock issuable upon conversion thereof. The dividend payment with respect to the Convertible Preferred Stock called for a mandatory conversion on a date during the period between the close of business on any Record Date for the payment of dividends to the close of business on the corresponding Dividend Payment Date will be payable on such Dividend Payment Date to the record holder of such share on such Record Date if such share has been converted after such Record Date and prior to such Dividend Payment Date. Except as provided in the immediately preceding sentence with respect to a mandatory conversion, no payment or adjustment will be made upon conversion of Convertible Preferred Stock for accumulated and unpaid dividends or for dividends with respect to the common stock issued upon such conversion.

We may not authorize, issue a press release or give notice of any mandatory conversion unless, prior to giving the conversion notice, all accumulated and unpaid dividends on the Convertible Preferred Stock for periods ended prior to the date of such conversion notice shall have been paid in cash.

In addition to the mandatory conversion provision described above, if there are fewer than 25,000 shares of Convertible Preferred Stock outstanding, we may, at any time on or after March 15, 2009, at our option, cause the Convertible Preferred Stock to be automatically converted into that number of shares of common stock equal to $1,000.00 (the liquidation preference per share of Convertible Preferred Stock) divided by the lesser of the then prevailing Conversion Price and the Market Value for the five Trading Day period ending on the second Trading Day immediately prior to the Mandatory Conversion Date. The provisions of the immediately preceding four paragraphs shall apply to any such mandatory conversion; *provided, however*, that (1) the Mandatory Conversion Date will not be less than 15 days nor more than 30 days after the date on which we issue a press release announcing such mandatory conversion and (2) the press release and notice of mandatory conversion will not state the number of shares of common stock to be issued upon conversion of each share of Convertible Preferred Stock.

Fractional Shares

No fractional shares of common stock or securities representing fractional shares of common stock will be issued upon conversion, whether voluntary or mandatory. Any fractional interest in a share of common stock resulting from conversion will be paid in cash based on the last reported sale price of the common stock on the New York Stock Exchange (or such other national securities exchange or automated quotation system on which the common stock is then listed or authorized for quotation or, if not so listed or authorized for quotation, an amount determined in good faith by our board of directors to be the fair value of the common stock) at the close of business on the Trading Day next preceding the date of conversion.

Conversion Price Adjustment

The Conversion Price is subject to adjustment (in accordance with formulas set forth in the certificate of designation) in certain events, including:

- any payment of a dividend (or other distribution) payable in shares of common stock on any class of our capital stock;

- any issuance to all holders of shares of common stock of rights, options or warrants entitling them to subscribe for or purchase shares of common stock or securities convertible into or exchangeable for shares of common stock at less than the Market Value for the period ending on the date of issuance; provided, however, that no adjustment shall be made with respect to such a distribution if the holder of shares of Convertible Preferred Stock would be entitled to receive such rights, options or warrants upon conversion at any time of shares of Convertible Preferred Stock into common stock; provided further, however, that if such rights, options or warrants are only exercisable upon the occurrence of certain triggering events, then the Conversion Price will not be adjusted until such triggering events occur;

- any subdivision, combination or reclassification of the common stock;

- any dividend or distribution to all holders of shares of common stock (other than a dividend or distribution referred to in the second bullet point above) made pursuant to any shareholder rights plan, poison pill or similar arrangement and excluding dividends payable upon the Convertible Preferred Stock;

- any distribution by us consisting exclusively of cash to all holders of our common stock, excluding any cash dividend on our common stock to the extent that the aggregate cash dividend per share of our common stock in any quarterly period does not exceed $0.055 (the dividend threshold amount); the dividend threshold amount is subject to adjustment under the same circumstances under which the Conversion Price is subject to adjustment; provided, however, that no adjustment will be made to the dividend threshold amount for any adjustment made to the Conversion Price pursuant to this clause, in which event the Conversion Price will be adjusted by multiplying:

(1) the Conversion Price by

(2) a fraction, the numerator of which will be the current market price of a share of our common stock minus the amount per share of such dividend increase (as determined below) or distribution and the denominator of which will be the current market price of a share of our common stock.

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If an adjustment is required to be made under this clause as a result of a cash dividend in any quarterly period that exceeds the dividend threshold amount, the adjustment would be based upon the amount by which the distribution exceeds the dividend threshold amount (the dividend increase). If an adjustment is otherwise required to be made under this clause, the adjustment would be based upon the full amount of the distribution;

- the completion of a tender or exchange offer made by us or any of our subsidiaries for shares of common stock that involves an aggregate consideration that, together with (a) any cash and other consideration payable in a tender or exchange offer by us or any of our subsidiaries for shares of common stock expiring within the then-preceding 12 months in respect of which no adjustment has been made and (b) the aggregate amount of any such all-cash distributions referred to in the preceding bullet point to all holders of shares of common stock within the then-preceding 12 months in respect of which no adjustments have been made, exceeds 15% of our market capitalization on the expiration of such tender offer; or

- a distribution to all holders of common stock consisting of evidences of indebtedness, shares of capital stock other than common stock or assets (including securities, but excluding those dividends, rights, options, warrants and distributions referred to above).

No adjustment of the Conversion Price will be required unless such adjustment would require an increase or decrease of at least 1.0% of the Conversion Price then in effect. Any lesser adjustment shall be carried forward and shall be made at the time of and together with the next subsequent adjustment, if any, which, together with any adjustment or adjustments so carried forward, shall amount to an increase or decrease of at least 1.0% of such Conversion Price; provided, however, that with respect to adjustments to be made to the Conversion Price in connection with cash dividends paid by us, we will make such adjustments, regardless of whether such aggregate adjustments amount to 1.0% or more of the Conversion Price, no later than March 15 of each calendar year. We reserve the right to make such reductions in the Conversion Price in addition to those required in the foregoing provisions as we consider to be advisable in order that any event treated for federal income tax purposes as a dividend of stock or stock rights will not be taxable to the recipients. If we elect to make such a reduction in the Conversion Price, we will comply with the requirements of securities laws and regulations thereunder if and to the extent that such laws and regulations are applicable in connection with the reduction of the Conversion Price.

The term Market Value means the average Closing Sale Price of the common stock for a five consecutive Trading Day period on the New York Stock Exchange (or such other national securities exchange or automated quotation system on which the common stock is then listed or authorized for quotation or, if not so listed or authorized for quotation, an amount determined in good faith by our board of directors to be the fair value of the common stock).

If we distribute rights or warrants (other than those referred to in the second bullet point of the third preceding paragraph) pro rata to holders of shares of common stock, so long as any such rights or warrants have not expired or been redeemed by us, the holder of any Convertible Preferred Stock surrendered for conversion will be entitled to receive upon such conversion, in addition to the shares of common stock then issuable upon such conversion (which we will refer to as the Conversion Shares), a number of rights or warrants to be determined as follows:

- if such conversion occurs on or prior to the date for the distribution to the holders of rights or warrants of separate certificates evidencing such rights or warrants (which we will refer to as the Distribution Date), the same number of rights or warrants to which a holder of a number of shares of common stock equal to the number of Conversion Shares is entitled at the time of such conversion in accordance with the terms and provisions applicable to the rights or warrants; and

- if such conversion occurs after such Distribution Date, the same number of rights or warrants to which a holder of the number of shares of common stock into which such Convertible Preferred Stock was convertible immediately prior to such Distribution Date would have been entitled on such Distribution

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Date had such Convertible Preferred Stock been converted immediately prior to such Distribution Date in accordance with the terms and provisions applicable to the rights or warrants.

The Conversion Price will not be subject to adjustment on account of any declaration, distribution or exercise of such rights or warrants.

Following any reclassification, consolidation or merger of our company with or into another person or any merger of another person with or into us (with certain exceptions), or any sale or other disposition of all or substantially all of our assets (computed on a consolidated basis), a holder of a share of Convertible Preferred Stock then outstanding will, upon conversion of such Convertible Preferred Stock, be entitled to receive the kind and amount of securities, cash and other property receivable upon such reclassification, consolidation, merger, sale or other disposition by a holder of the number of shares of common stock into which such Convertible Preferred Stock was convertible immediately prior thereto, after giving effect to any adjustment event.

Change of Control

Except as provided below, upon a Change of Control (as defined below), holders of Convertible Preferred Stock shall, if the Market Value at such time is less than the Conversion Price, have a one-time option to convert all of their outstanding shares of Convertible Preferred Stock into shares of common stock at an adjusted Conversion Price equal to the greater of (1) the Market Value as of the Change of Control Date and (2) $8.0733. This option shall be exercisable during a period of not less than 30 days nor more than 60 days commencing on the third business day after notice of the Change of Control is given by us in the manner specified in the certificate of designation. In lieu of issuing the shares of common stock issuable upon conversion in the event of a Change of Control, we may, at our option, make a cash payment equal to the Market Value for each share of such common stock otherwise issuable determined for the period ending on the Change of Control Date. Notwithstanding the preceding, upon a Change of Control in which (x) each holder of our common stock receives consideration consisting solely of common stock of the successor, acquiror or other third party (and cash paid in lieu of fractional shares) that is listed on a national securities exchange or quoted on Nasdaq and (y) all our common stock has been exchanged for, converted into or acquired for common stock of the successor, acquiror or other third party (and cash in lieu of fractional shares), and the Convertible Preferred Stock becomes convertible solely into such common stock, the Conversion Price will not be adjusted as described in this paragraph.

The certificate of designation defines Change of Control as any of the following events:

the sale, lease or transfer, in one or a series of related transactions, of all or substantially all of our assets (determined on a consolidated basis) to any person or group (as such term is used in Section 13(d)(3) of the Securities Exchange Act of 1934, as amended (the Exchange Act)), other than to Permitted Holders;

the adoption of a plan the consummation of which would result in our liquidation or dissolution;

the acquisition, directly or indirectly, by any person or group (as such term is used in Section 13(d)(3) of the Exchange Act), other than Permitted Holders, of beneficial ownership (as defined in Rule 13d-3 under the Exchange Act) of more than 50% of the aggregate voting power of our voting stock; provided, however, that the Permitted Holders beneficially own (as defined in Rules 13d-3 and 13d-5 under the Exchange Act), directly or indirectly, in the aggregate a lesser percentage of the total voting power of our voting stock than such other person or group and do not have the right or ability by voting power, contract or otherwise to elect or designate for election a majority of our board of directors (for the purposes of this definition, such other person or group shall be deemed to beneficially own any voting stock of a specified corporation held by a parent corporation, if such other person or group is the beneficial owner (as defined above), directly or indirectly, of more than 35% of the voting power of the voting stock of such parent corporation and the Permitted Holders beneficially own (as defined in this

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proviso), directly or indirectly, in the aggregate a lesser percentage of the voting power of the voting stock of such parent corporation and do not have the right or ability by voting power, contract or otherwise to elect or designate for election a majority of the board of directors of such parent corporation); or

during any period of two consecutive years, individuals who at the beginning of such period comprised our board of directors (together with any new directors whose election by such board of directors or whose nomination for election by our shareholders was approved by a vote of 66 2/3% of our directors then still in office who were either directors at the beginning of such period or whose election or nomination for election was previously so approved) cease for any reason to constitute a majority of our board of directors then in office.

For purposes of the definition of Change of Control, the term Permitted Holders means Aubrey K. McClendon and Tom L. Ward and their respective Affiliates (as defined in Rule 405 of the Securities Act).

The phrase all or substantially all of our assets is likely to be interpreted by reference to applicable state law at the relevant time, and will be dependent on the facts and circumstances existing at such time. As a result, there may be a degree of uncertainty in ascertaining whether a sale or transfer is of all or substantially all of our assets.

Consolidation, Merger and Sale of Assets

The certificate of designation provides that we may, without the consent of the holders of any of the outstanding Convertible Preferred Stock, consolidate with or merge into any other person or convey, transfer or lease all or substantially all our assets to any person or may permit any person to consolidate with or merge into, or transfer or lease all or substantially all its properties to, us; provided, however, that (a) the successor, transferee or lessee is organized under the laws of the United States or any political subdivision thereof; (b) the shares of Convertible Preferred Stock will become shares of such successor, transferee or lessee, having in respect of such successor, transferee or lessee the same powers, preferences and relative participating, optional or other special rights and the qualification, limitations or restrictions thereon, the Convertible Preferred Stock had immediately prior to such transaction; and (c) certain procedural conditions are met.

Under any consolidation by us with, or merger by us into, any other person or any conveyance, transfer or lease of all or substantially all our assets as described in the preceding paragraph, the successor resulting from such consolidation or into which we are merged or the transferee or lessee to which such conveyance, transfer or lease is made, will succeed to, and be substituted for, and may exercise every right and power of, ours under the shares of Convertible Preferred Stock, and thereafter, except in the case of a lease, the predecessor (if still in existence) will be released from its obligations and covenants with respect to the Convertible Preferred Stock.

SEC Reports

Whether or not we are required to file reports with the SEC, if any shares of Convertible Preferred Stock are outstanding, we must file with the SEC all such reports and other information as we would be required to file with the SEC by Sections 13(a) or 15(d) under the Exchange Act. See Where You Can Find More Information. We must supply each holder of Convertible Preferred Stock, upon request, without cost to such holder, copies of such reports or other information.

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DESCRIPTION OF CHESAPEAKE CAPITAL STOCK

Set forth below is a description of the material terms of our capital stock. However, this description is not complete and is qualified by reference to our certificate of incorporation (including our certificates of designation) and bylaws. Copies of our certificate of incorporation (including our certificates of designation) and bylaws are available from us upon request. These documents have also been filed with the SEC. Please read Where You Can Find More Information.

Authorized Capital Stock

Our authorized capital stock consists of 500,000,000 shares of common stock, par value $.01 per share, and 20,000,000 shares of preferred stock, par value $.01 per share, of which 350,000 shares are designated as Series A Junior Participating Preferred Stock, 2,997,800 shares are designated as 6.75% Cumulative Convertible Preferred Stock, 4,600,000 shares are designated as 6.00% Cumulative Convertible Preferred Stock, 1,725,000 shares are designated as 5.00% Cumulative Convertible Preferred Stock and 313,250 shares are designated as 4.125% Cumulative Convertible Preferred Stock.

Common Stock

Holders of our common stock are entitled to one vote for each share held of record on all matters submitted to a vote of shareholders. Subject to preferences that may be applicable to any outstanding preferred stock, holders of our common stock are entitled to receive ratably such dividends as may be declared by the board of directors out of funds legally available for dividends. In the event of our liquidation or dissolution, holders of our common stock are entitled to share ratably in all assets remaining after payment of liabilities and the liquidation preference of any outstanding preferred stock.

Holders of our common stock have no preemptive rights and have no rights to convert their common stock into any other securities. All of the outstanding shares of common stock are duly authorized, validly issued, fully paid and nonassessable.

Preferred Stock

We have 10,013,950 shares of authorized but unissued preferred stock that are undesignated. Currently 2,997,800 shares of preferred stock are designated as 6.75% Cumulative Convertible Preferred Stock, all of which are currently outstanding; 4,600,000 shares of preferred stock are designated as 6.00% Cumulative Convertible Preferred Stock, all of which are currently outstanding; 1,725,000 shares of preferred stock are designated as 5.00% Cumulative Convertible Preferred Stock, all of which are currently outstanding and 313,250 shares of preferred stock are designated as 4.125% Cumulative Convertible Preferred Stock, all of which are currently outstanding. Our board of directors has also authorized the issuance of up to 350,000 shares of Series A Junior Participating Preferred Stock in connection with the adoption of our shareholder rights plan in July 1998. None of these shares are currently outstanding. The Series A Preferred Stock is described below under Share Rights Plan.

Our board of directors has the authority, without further shareholder approval, to issue shares of preferred stock from time to time in one or more series, with such voting powers or without voting powers, and with such designations, preferences and relative, participating, optional or other special rights, and qualifications, limitations or restrictions, as shall be set forth in the resolutions providing thereof.

While providing desirable flexibility for possible acquisitions and other corporate purposes, and eliminating delays associated with a shareholder vote on specific issuances, the issuance of preferred stock could adversely affect the voting power of holders of common stock, as well as dividend and liquidation payments on both common and preferred stock. It also could have the effect of delaying, deferring or preventing a change in control.

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Anti-Takeover Provisions

Our certificate of incorporation and bylaws and the Oklahoma General Corporation Act include a number of provisions which may have the effect of encouraging persons considering unsolicited tender offers or other unilateral takeover proposals to negotiate with our board of directors rather than pursue non-negotiated takeover attempts. These provisions include a classified board of directors, authorized blank check preferred stock, restrictions on business combinations and the availability of authorized but unissued common stock.

Classified Board of Directors. Our certificate of incorporation and bylaws contain provisions for a staggered board of directors with only one-third of the board standing for election each year. Directors can only be removed for cause. A staggered board makes it more difficult for shareholders to change the majority of the directors.

Oklahoma Business Combination Statute. Section 1090.3 of the Oklahoma General Corporation Act prevents an interested shareholder from engaging in a business combination with an Oklahoma corporation for three years following the date the person became an interested shareholder, unless:

- prior to the date the person became an interested shareholder, the board of directors of the corporation approved the transaction in which the interested shareholder became an interested shareholder or approved the business combination;
- upon consummation of the transaction that resulted in the interested shareholder becoming an interested shareholder, the interested shareholder owns stock having at least 85% of all voting power of the corporation at the time the transaction commenced, excluding stock held by directors who are also officers of the corporation and stock held by certain employee stock plans; or
- on or subsequent to the date of the transaction in which the person became an interested shareholder, the business combination is approved by the board of directors of the corporation and authorized at a meeting of shareholders by the affirmative vote of the holders of two-thirds of all voting power not attributable to shares owned by the interested shareholder.

The statute defines a business combination to include:

- any merger or consolidation involving the corporation and an interested shareholder;
- any sale, lease, exchange, mortgage, pledge, transfer or other disposition to or with an interested shareholder of 10% or more of the assets of the corporation;
- subject to certain exceptions, any transaction which results in the issuance or transfer by the corporation of any stock of the corporation to an interested shareholder;
- any transaction involving the corporation which has the effect of increasing the proportionate share of the stock of any class or series or voting power of the corporation owned by the interested shareholder;

the receipt by an interested shareholder of any loans, guarantees, pledges or other financial benefits provided by or through the corporation; or

any share acquisition by the interested shareholder pursuant to Section 1090.1 of the Oklahoma General Corporation Act.

For purposes of Section 1090.3, the term corporation also includes the corporation s majority-owned subsidiaries.

In addition, Section 1090.3 defines an interested shareholder, generally, as any person that owns stock having 15% or more of all voting power of the corporation, any person that is an affiliate or associate of the corporation and owned stock having 15% or more of all voting power of the corporation at any time within the three-year period prior to the time of determination of interested shareholder status, and any affiliate or associate of such person.

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Stock Purchase Provisions. Our certificate of incorporation includes a provision which requires the affirmative vote of two-thirds of the votes cast by the holders, voting together as a single class, of all then outstanding shares of capital stock, excluding the votes by an interested shareholder, to approve the purchase of any of our capital stock from the interested shareholder at a price in excess of fair market value, unless the purchase is either (1) made on the same terms offered to all holders of the same securities or (2) made on the open market and not the result of a privately negotiated transaction.

Share Rights Plan

The Rights. On July 7, 1998, our board of directors declared a dividend distribution of one preferred stock purchase right for each outstanding share of common stock. The distribution was paid on July 27, 1998 to the shareholders of record on that date. Each right entitles the registered holder to purchase from us one one-thousandth of a share of Series A Preferred Stock at a price of $25.00, subject to adjustment.

The following is a summary of these rights. The full description and terms of the rights are set forth in a rights agreement with UMB Bank, N.A., as rights agent. Copies of the rights agreement and the certificate of designation for the Series A Preferred Stock are available free of charge. This summary description of the rights and the Series A Preferred Stock does not purport to be complete and is qualified in its entirety by reference to all the provisions of the rights agreement and the certificate of designation for the Series A Preferred Stock.

Initially, the rights attached to all certificates representing shares of our outstanding common stock, and no separate rights certificates were distributed. The rights will separate from our common stock and the distribution date will occur upon the earlier of:

- ten days following the date of public announcement that a person or group of persons has become an acquiring person; or

- ten business days (or a later date set by the board of directors prior to the time a person becomes an acquiring person) following the commencement of, or the announcement of an intention to make, a tender offer or exchange offer upon consummation of which the offeror would, if successful, become an acquiring person.

The earlier of these dates is called the distribution date.

The term acquiring person means any person who or which, together with all of its affiliates and associates, is the beneficial owner of 15% or more of our outstanding common stock, but does not include:

- us or any of our subsidiaries or employee benefit plans;

- Aubrey K. McClendon, his spouse, lineal descendants and ascendants, heirs, executors or other legal representatives and any trusts established for the benefit of the foregoing or any other person or entity in which the foregoing persons or entities are at the time of determination the direct record and beneficial owners of all outstanding voting securities (each a McClendon shareholder);

Tom L. Ward, his spouse, lineal descendants and ascendants, heirs, executors or other legal representatives and any trusts established for the benefit of the foregoing, or any other person or entity in which the foregoing persons or entities are at the time of determination the direct record and beneficial owners of all outstanding voting securities (each a Ward shareholder);

Morgan Guaranty Trust Company of New York, in its capacity as pledgee of shares beneficially owned by a McClendon or Ward shareholder, or both, under any pledge agreement in effect on September 11, 1998, to the extent that upon the exercise by the pledgee of any of its rights or duties as pledgee, other than the exercise of any voting power by the pledgee or the acquisition of ownership by the pledgee, such pledgee becomes a beneficial owner of pledged shares; or any person (other than the pledgee just described) that is neither a McClendon nor Ward shareholder, but who or which is the beneficial owner of common stock beneficially owned by a McClendon or Ward shareholder (a second tier shareholder), but only if the shares of common stock otherwise beneficially owned by a second tier shareholder (second tier holder shares) do not exceed the sum of (A) the holder s second tier holder shares held on September 11, 1998 and (B) 1% of the shares of our common stock then outstanding (collectively, exempt persons).

The rights agreement provides that, until the distribution date, the rights will be transferred with and only with the common stock. Until the distribution date (or earlier redemption or expiration of the rights), new common stock certificates issued after July 27, 1998, upon transfer or new issuance of common stock, will contain a notation incorporating the rights agreement by reference. Until the distribution date or earlier redemption or expiration of the rights, the surrender for transfer of any certificate for common stock, outstanding as of July 27, 1998, even without a notation or a copy of a summary of the rights being attached, will also constitute the transfer of the rights associated with the common stock represented by the certificate. As soon as practicable following the distribution date, separate certificates evidencing the rights will be mailed to holders of record of the common stock as of the close of business on the distribution date and these separate rights certificates alone will evidence the rights.

The rights are not exercisable until the distribution date. The rights will expire on July 27, 2008.

The purchase price payable, and the number of one one-thousandths of a share of Series A Preferred Stock or other securities or property issuable, upon exercise of the rights are subject to adjustment from time to time to prevent dilution:

in the event of a stock dividend on, or a subdivision, combination or reclassification of, the Series A Preferred Stock;

upon the grant to holders of the Series A Preferred Stock of certain rights or warrants to subscribe for or purchase shares of Series A Preferred Stock at a price, or securities convertible into Series A Preferred Stock with a conversion price, less than the then current market price of the Series A Preferred Stock; or

upon the distribution to holders of the Series A Preferred Stock of evidences of indebtedness or assets (excluding regular periodic cash dividends paid or dividends payable in Series A Preferred Stock) or of subscription rights or warrants (other than those referred to above).

The number of outstanding rights and the number of one one-thousandths of a share of Series A Preferred Stock issuable upon exercise of each right are also subject to adjustment in the event of a stock split of the common stock or a stock dividend on the common stock payable in the common stock or subdivisions, consolidations or combinations of the common stock occurring, in any such case, prior to the distribution date.

In the event that following the date of public announcement that a person has become an acquiring person, we are acquired in a merger or other business combination transaction or more than 50% of our consolidated assets or earning power is sold, proper provision will be made so that each holder of a right will thereafter have the right to receive, upon the exercise of the right at the then current exercise price of the right, that number of shares of common stock of the acquiring company which at the time of such transaction will have a market value of two times the exercise price of the right (the flip-over right).

In the event that a person, other than an exempt person, becomes an acquiring person, proper provision will be made so that each holder of a right, other than the acquiring person and its affiliates and associates, will thereafter have the right to receive upon exercise that number of shares of common stock, or, if applicable, cash, other equity securities or property of us, having a market value equal to two times the purchase price of the rights (the flip-in right). Any rights that are or were at any time owned by an acquiring person will then become void.

With certain exceptions, no adjustment in the purchase price will be required until cumulative adjustments require an adjustment of at least 1% in the purchase price. Upon exercise of the rights, no fractional shares of

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Series A Preferred Stock will be issued other than fractions which are integral multiples of one one-hundredth of a share of Series A Preferred Stock. Cash will be paid in lieu of fractional shares of Series A Preferred Stock that are not integral multiples of one one-hundredth of a share of Series A Preferred Stock.

At any time prior to the earlier to occur of (1) 5:00 p.m., Oklahoma City, Oklahoma time on the tenth day after the stock acquisition date or (2) the expiration of the rights, we may redeem the rights in whole, but not in part, at a price of $0.01 per right; provided, that (a) if the board of directors authorizes redemption on or after the time a person becomes an acquiring person, then the authorization must be by board approval and (b) the period for redemption may, upon board approval, be extended by amending the rights agreement. Board approval means the approval of a majority of our directors. Immediately upon any redemption of the rights described in this paragraph, the right to exercise the rights will terminate and the only right of the holders of rights will be to receive the redemption price.

Our board of directors may amend the terms of the rights without the consent of the holders of the rights at any time and from time to time provided that any amendment does not adversely affect the interests of the holders of the rights. In addition, during any time that the rights are subject to redemption, the terms of the rights may be amended by the approval of a majority of the directors, including an amendment that adversely affects the interests of the holders of the rights, without the consent of the holders of rights.

Until a right is exercised, a holder will have no rights as a shareholder, including, without limitation, the right to vote or to receive dividends. While the distribution of the rights will not be taxable to us or our shareholders, shareholders may, depending upon the circumstances, recognize taxable income in the event that the rights become exercisable for Series A Preferred Stock, or other consideration.

The Series A Preferred Stock. Each one-thousandth of a share of the Series A Preferred Stock (a preferred share fraction) that may be acquired upon exercise of the rights will be nonredeemable and junior to any other shares of preferred stock that we may issue.

Each preferred share fraction will have a minimum preferential quarterly dividend rate of $0.01 per preferred share fraction but will, in any event, be entitled to a dividend equal to the per share dividend declared on the common stock.

In the event of liquidation, the holder of a preferred share fraction will receive a preferred liquidation payment equal to the greater of $0.01 per preferred share fraction or the per share amount paid in respect of a share of common stock.

Each preferred share fraction will have one vote, voting together with the common stock. The holders of preferred share fractions, voting as a separate class, will be entitled to elect two directors if dividends on the Series A Preferred Stock are in arrears for six fiscal quarters.

In the event of any merger, consolidation or other transaction in which shares of common stock are exchanged, each preferred share fraction will be entitled to receive the per share amount paid in respect of each share of common stock.

The rights of holders of the Series A Preferred Stock to dividends, liquidation and voting, and in the event of mergers and consolidations, are protected by customary antidilution provisions.

Because of the nature of the Series A Preferred Stock s dividend, liquidation and voting rights, the economic value of one preferred share fraction that may be acquired upon the exercise of each right should approximate the economic value of one share of our common stock.

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Shareholder Action

Except as otherwise provided by law or in our certificate of incorporation or bylaws, the approval by holders of a majority of the shares of common stock present in person or represented by proxy at a meeting and entitled to vote is sufficient to authorize, affirm, ratify or consent to a matter voted on by shareholders. Our bylaws provide that all questions submitted to shareholders will be decided by a plurality of the votes cast, unless otherwise required by law, our certificate of incorporation, stock exchange requirements or any certificate of designation. The Oklahoma General Corporation Act requires the approval of the holders of a majority of the outstanding stock entitled to vote for certain extraordinary corporate transactions, such as a merger, sale of substantially all assets, dissolution or amendment of the certificate of incorporation. Our certificate of incorporation provides for a vote of the holders of two-thirds of the issued and outstanding stock having voting power, voting as a single class, to amend, repeal or adopt any provision inconsistent with the provisions of the certificate of incorporation limiting director liability and stock purchases by us, and providing for staggered terms of directors and indemnity for directors. The same vote is also required for shareholders to amend, repeal or adopt any provision of our bylaws.

Under Oklahoma law, shareholders may take actions without the holding of a meeting by written consent or consents signed by the holders of a sufficient number of shares to approve the transaction had all of the outstanding shares of our capital stock entitled to vote thereon been present at a meeting. If shareholder action is taken by written consent, the rules and regulations of the SEC require us to send each shareholder entitled to vote on the matter, but whose consent was not solicited, an information statement containing information substantially similar to that which would have been contained in a proxy statement.

Transfer Agent and Registrar

UMB Bank, N.A. is the transfer agent and registrar for our common stock, our 6.75% Cumulative Convertible Preferred Stock, our 6.00% Cumulative Convertible Preferred Stock, our 5.00% Cumulative Convertible Preferred Stock and our 4.125% Cumulative Convertible Preferred Stock.

U.S. FEDERAL INCOME TAX CONSIDERATIONS

The following discussion summarizes the material U.S. federal income tax consequences to holders (as defined below) of the purchase, ownership and disposition of the preferred stock and any common stock received upon its conversion. This discussion is based upon the provisions of the Internal Revenue Code of 1986, as amended (the Code), the final and temporary Treasury Regulations promulgated thereunder and administrative rulings and judicial decisions now in effect, all of which are subject to change (possibly with retroactive effect) or different interpretations. This summary does not purport to deal with all aspects of U.S. federal income taxation that may be relevant to an investor s decision to purchase shares of preferred stock, nor any tax consequences arising under the laws of any state, locality or foreign jurisdiction. This summary is not intended to be applicable to all categories of investors, such as dealers in securities, banks, insurance companies, tax-exempt organizations, persons that hold the preferred stock or common stock as part of a straddle or conversion transaction or holders subject to the alternative minimum tax, each of which may be subject to special rules. In addition, this discussion is limited to persons who hold the preferred stock and common stock as capital assets (generally, property held for investment) within the meaning of Section 1221 of the Code. As used in this section, a U.S. holder is a beneficial owner of preferred stock or common stock that is for U.S. federal income tax purposes:

- an individual U.S. citizen or resident alien;
- a corporation, or entity taxable as a corporation that was created or organized in or under the laws of the United States, any state thereof or the District of Columbia;
- an estate whose world-wide income is subject to U.S. federal income tax; or
- a trust if a court within the United States is able to exercise primary supervision over the administration of the trust and one or more United States persons have the authority to control all substantial decisions of the trust, or that has a valid election in effect under applicable U.S. Treasury Regulations to be treated as a United States person.

A non-U.S. holder is a beneficial owner of preferred stock or common stock that is not a U.S. holder.

If a partnership holds preferred stock or common stock, the tax treatment of a partner will generally depend upon the status of the partner and upon the activities of the partnership.

YOU SHOULD CONSULT YOUR OWN TAX ADVISOR REGARDING THE FEDERAL, STATE, LOCAL AND FOREIGN TAX CONSEQUENCES OF THE PURCHASE, OWNERSHIP, CONVERSION AND DISPOSITION OF PREFERRED STOCK AND COMMON STOCK RECEIVED AS A RESULT OF A CONVERSION OF PREFERRED STOCK.

Consequences to U.S. Holders of Preferred Stock or Common Stock

Distributions. The amount of any distribution to you with respect to preferred stock or common stock will be treated as a dividend, to the extent of our current or accumulated earnings and profits (earnings and profits) as determined under U.S. federal income tax principles. Dividends are generally taxed as ordinary income; however, dividends received by non-corporate holders in taxable years beginning on or before December 31, 2008, may qualify for taxation at lower rates applicable to long-term capital gains provided certain holding period and other requirements are satisfied. Non-corporate holders should consult their own tax advisors regarding the applicability of such lower rates under their particular factual situation. To the extent the amount of any distribution to you with respect to preferred stock or common stock exceeds our earnings and profits, the excess will be applied against and will reduce your tax basis (on a dollar-for-dollar basis) in the preferred stock or common stock, as the case may be. Any amount in excess of your tax basis will be treated as capital gain. If we are not able to make distributions on the preferred stock, the accreted liquidation preference of the preferred stock will increase and such increase may give rise to deemed dividend income to holders of the preferred stock in the amount of all, or a portion of, such increase.

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Dividends to Corporate Shareholders. In general, a distribution which is treated as a dividend for U.S. federal income tax purposes and is made to a corporate shareholder with respect to the preferred stock or common stock will qualify for the 70% dividends-received deduction under Section 243 of the Code. Corporate shareholders should note, however, there can be no assurance that the amount of distributions made with respect to the preferred stock or the common stock will not exceed the amount of our earnings and profits in the future. Accordingly, there can be no assurance that the dividends-received deduction will be available in respect of distributions on the preferred stock or common stock.

In addition, there are many exceptions and restrictions relating to the availability of such dividends-received deduction such as restrictions relating to:

- the holding period of stock the dividends on which are sought to be deducted;
- debt-financed portfolio stock;
- dividends treated as extraordinary dividends for purposes of Section 1059 of the Code; and
- taxpayers that pay corporate alternative minimum tax.

Corporate shareholders should consult their own tax advisors regarding the extent, if any, to which such exceptions and restrictions may apply to their particular factual situation.

Sale or Other Disposition. Upon a sale or other disposition of preferred stock or common stock (other than an exchange of preferred stock for common stock pursuant to the conversion privilege), you generally will recognize capital gain or loss equal to the difference between the amount of cash and the fair market value of property you receive on the sale or other disposition and your adjusted tax basis in the preferred stock or common stock. Such capital gain or loss will be long-term capital gain or loss if your holding period for the preferred stock or common stock, as applicable, is more than one year. Long-term capital gains may qualify for reduced rates under U.S. federal income tax laws.

If, following a change of control, a holder of the preferred stock exercises the option described in Description of Preferred Stock Change of Control and we elect to satisfy payment in cash, the transaction will generally be treated as a redemption for U.S. federal income tax purposes. The U.S. federal income tax treatment of such a redemption to a holder will depend on the particular facts relating to such holder at the time of the redemption. The receipt of cash in connection with such redemption will be treated as capital gain or loss from the sale or other disposition of the preferred stock (as discussed in the preceding paragraph), if, taking into account stock that is actually or constructively owned as determined under Section 318 of the Code:

- your interest in our common and preferred stock is completely terminated as a result of such redemption;
- your percentage ownership in our voting stock immediately after such redemption is less than 80% of your percentage ownership immediately before such redemption; or
- such redemption is not essentially equivalent to a dividend (within the meaning of Section 302(b)(1) of the Code).

If none of the above tests giving rise to sale treatment is satisfied, then a payment made in redemption of the preferred stock will be treated as a distribution that is taxable in the same manner as described above under Distributions, and your adjusted tax basis in the redeemed preferred stock will be transferred to any remaining shares you hold in us. If you do not retain any stock ownership in us following such redemption, then you may lose your basis completely.

Conversion of Preferred Stock in Exchange for Common Stock. You generally will not recognize gain or loss by reason of receiving common stock in exchange for preferred stock upon conversion of the preferred stock, except gain or loss will be recognized with respect to any cash received in lieu of fractional shares and the fair market value of any shares of common stock attributable to dividend arrearages will be treated as a constructive distribution (to the extent not otherwise previously taken into account as a deemed dividend) as described above under Distributions. The adjusted tax basis of the common stock so acquired (and any fractional share interests treated as received and then exchanged for cash) will be equal to the tax basis of the shares of preferred stock exchanged, and the holding period of the common stock received will include the holding period of the preferred stock exchanged. The tax basis of any common stock treated as a constructive distribution will be equal to its fair market value on the date of the exchange, and the holding period of such stock will commence on the day after such exchange.

Adjustment of Conversion Price. Holders of preferred stock may, in certain circumstances, be deemed to have received constructive distributions of stock if the conversion rate for the preferred stock is adjusted. Adjustments to the conversion price made pursuant to a bona fide reasonable adjustment formula which has the effect of preventing the dilution of the interest of the holders of the preferred stock, however, generally will not be considered to result in a constructive distribution of stock. Certain of the possible adjustments provided in the anti-dilution provisions of the preferred stock, including, without limitation, adjustments in respect of stock dividends or the distribution of rights to subscribe for common stock should qualify as being pursuant to a bona fide reasonable adjustment formula and should not result in a constructive distribution. In contrast, adjustments in respect of distributions of our indebtedness, cash or assets to our stockholders (including adjustments with respect to distributions to common stockholders in excess of the dividend threshold amount), for example, will not qualify as being pursuant to a bona fide reasonable adjustment formula. In addition, an adjustment triggered by a change of control as described under Description of Preferred Stock may not so qualify. If such adjustments are made, the holders generally will be deemed to have received constructive distributions in amounts based upon the value of such holders increased interests in our equity resulting from such adjustments. The amount of the distribution will be treated as a distribution to a holder with the tax consequences specified above under Distributions. Accordingly, you could be considered to have received distributions taxable as dividends to the extent of our earnings and profits even though you did not receive any cash or property as a result of such adjustments.

Conversion of Preferred Stock After Dividend Record Date. If a holder exercises its right to convert the preferred stock into shares of common stock after a dividend record date but before payment of the dividend, then upon conversion, the holder generally will be required to pay to us in cash an amount equal to the portion of such dividend attributable to the current quarterly dividend period, which amount would increase the tax basis of the common stock received. When the dividend is received, the holder would recognize the dividend payment in accordance with the rules described under Distributions above.

Backup Withholding. Under the backup withholding provisions of the Code and applicable Treasury Regulations, you may be subject to backup withholding with respect to dividends paid on, or the proceeds of a sale, exchange or redemption of, preferred stock or common stock unless:

- you are a corporation or come within certain other exempt categories and when required demonstrate this fact, or

- within a reasonable period of time, you provide a taxpayer identification number, certified under penalties of perjury as well as certain other information or otherwise establish an exemption from the backup withholding rules.

The amount of any backup withholding from a payment to you will be allowed as a credit against your U.S. federal income tax liability and may entitle you to a refund, provided that the required information is furnished to the Internal Revenue Service.

Consequences to Non-U.S. Holders of Preferred or Common Stock

Dividends. In general, dividends paid to you with respect to our preferred stock or common stock will be subject to withholding of U.S. federal income tax at a 30% rate, unless such rate is reduced by an applicable income tax treaty. Dividends that are effectively connected with your conduct of a trade or business in the United States (and if a tax treaty applies, dividends that are attributable to a U.S. permanent establishment) are generally subject to U.S. federal income tax on a net income basis and are exempt from the 30% withholding tax (assuming compliance with certain certification requirements). Any such effectively connected dividends received by a non-U.S. holder that is a corporation may also, under certain circumstances, be subject to an additional branch profits tax at a 30% rate or such lower rate as may be applicable under an income tax treaty.

For purposes of obtaining a reduced rate of withholding under an income tax treaty, you generally will be required to provide a U.S. taxpayer identification number as well as certain information concerning your country of residence and entitlement to tax treaty benefits. Generally, this will be accomplished by providing a properly executed IRS Form W-8BEN. If you instead are claiming an exemption from withholding with respect to dividends effectively connected with the conduct of a trade or business within the United States, you will be required to provide an appropriate certification to us or our paying agent (generally by providing a properly completed IRS Form W-8ECI).

Sale or Other Disposition. As a non-U.S. Holder, you generally will not be subject to U.S. federal income tax on any gain recognized on the sale or other disposition of preferred stock or common stock unless:

the gain is considered effectively connected with the conduct of a trade or business by you within the United States and, where a tax treaty applies, is attributable to a U.S. permanent establishment of yours (and, in which case, if you are a foreign corporation, you may be subject to an additional branch profits tax equal to 30% or a lower rate as may be specified by an applicable income tax treaty);

you are an individual who holds the preferred stock or common stock as a capital asset and are present in the United States for 183 or more days in the taxable year of the sale or other disposition and other conditions are met; or

we are, or have been within the five years preceding your disposition of the preferred stock or common stock, a United States real property holding corporation, or a USRPHC, for U.S. federal income tax purposes.

We believe we currently are a USRPHC. In general, gain on the sale or other disposition of stock of a USRPHC that is regularly traded on an established securities market will be subject to U.S. federal income tax only in the case of a holder that owns more than 5% of that class of stock at any time during the five-year period ending on the date of disposition. If a non-regularly traded class of stock is convertible into a regularly traded class of stock, gain on the sale of that non-regularly traded stock will be subject to U.S. federal income tax only if, on any date on which such stock was acquired by the holder, tn stock offered under this prospectus will be passed upon for the underwriters by Willkie Farr & Gallagher, New York, New York. 63 EXPERTS The financial statements as of December 31, 2000 and 1999 and for each of the three years in the period ended December 31, 2000 included in this prospectus have been so included in reliance on the report of PricewaterhouseCoopers LLP, independent accountants, given on the authority of said firm as experts in auditing and accounting. 64 WHERE YOU CAN FIND MORE INFORMATION Integra is subject to the informational requirements of the Securities Exchange Act of 1934, and files annual, quarterly and special reports, proxy statements and other information with the SEC. You may read and copy any reports, proxy statements and other information we file at the SEC's public reference room at 450 Fifth Street, N.W., Washington, D.C. 20549 and at the SEC's regional offices at Seven World Trade Center, 13th Floor, New York, New York 10048 and Citicorp Center, 500 West Madison Street, Suite 1400, Chicago, Illinois 60661-2511. Please call the SEC at 1-800-SEC-0300 for further information on the public reference rooms. You may also access filed documents at the SEC's Website at www.sec.gov. We have filed a registration statement on Form S-3 and related exhibits with the SEC under the Securities Act of 1933. The registration statement contains additional information about Integra and the securities. You may inspect the registration statement and exhibits without charge and obtain copies from the SEC at prescribed rates at the locations above. The SEC allows us to incorporate by reference the information we file with it, which means that we can disclose important information to you by referring to those documents. The information incorporated by reference is an important part of this prospectus, and information that we file later with the SEC will automatically update and supersede this information. We incorporate by reference the following documents we have filed, or may file, with the SEC: o Our 2000 Annual Report on Form 10-K/A filed with the SEC on May 24, 2001; o Our Quarterly Report for the quarterly period ended March 31, 2001, on Form 10-Q filed with the SEC on May 15, 2001; o Our Proxy Statement for the 2001 Annual Meeting of Stockholders filed with the SEC on April 20, 2001; o Our Current Reports and Amendments thereto on Form 8-K filed with the SEC on January 8, 2001, May 25, 2001, August 2, 2001 and August 6, 2001; and o All documents filed by us with the SEC under Sections 13(a), 13(c), 14 or

15(d) of the Securities Exchange Act of 1934 after the date of this prospectus and before the termination of this offering. A statement contained in a document incorporated by reference herein shall be deemed to be modified or superceded for purposes of this prospectus to the extent that a statement contained herein or in any other subsequently filed document which is also incorporated herein modifies or replaces such statement. Any statements so modified or superceded shall not be deemed, except as so modified or superceded, to constitute a part of this prospectus. You may request a free copy of any of the documents incorporated by reference in this prospectus by writing or telephoning us at the following address: Integra LifeSciences Holdings Corporation 311 Enterprise Drive Plainsboro, NJ 08536 (609) 275-0500 Attn: Director of Finance You should rely only on the information incorporated by reference or provided in this prospectus and any supplement. We have not authorized anyone else to provide you with different information. You should not assume that the information in this prospectus is accurate as of any date other than the dates on the front of these documents. 65 INDEX TO FINANCIAL STATEMENTS PAGE F-1 INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS MARCH 31, 2001 DECEMBER 31, 2000 -- (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS) (UNAUDITED) ASSETS Current Assets: Cash and cash equivalents .... $15,392 $14,086 Short-term investments .... 3,982 1,052 Accounts receivable, net of allowances of $902 and $1,003 .... 12,647 13,087 Inventories .... 18,509 16,508 Prepaid expenses and other current assets .... 1,937 1,484 ---------- ---------- Total current assets .... 52,467 46,217 Property, plant, and equipment, net .... 11,173 11,599 Goodwill and other intangible assets, net .... 24,378 25,299 Other assets .... 3,061 3,399 ---------- ---------- Total assets .... $91,079 $86,514 ========== ========== LIABILITIES AND STOCKHOLDERS' EQUITY Current Liabilities: Short-term debt .... $9,150 $8,872 Accounts payable, trade .... 3,651 3,363 Income taxes payable .... 1,233 1,200 Customer advances and deposits .... 3,213 823 Deferred revenue .... 1,879 1,675 Accrued expenses and other current liabilities .... 5,349 5,107 ---------- ---------- Total current liabilities .... 24,475 21,040 Long-term debt .... 3,121 4,758 Deferred revenue .... 4,543 4,728 Deferred income taxes .... 1,717 1,788 Other liabilities .... 349 419 ---------- ---------- Total liabilities .... 34,205 32,733 Commitments and contingencies Stockholders' Equity: Preferred stock; $0.01 par value; 15,000 authorized shares; 100 Series B Convertible shares issued and outstanding at March 31, 2001 and December 31, 2000, $12,000 including a 10% annual cumulative dividend liquidation preference; 54 Series C Convertible shares issued and outstanding at March 31, 2001 and December 31, 2000, $5,940 including a 10% annual cumulative dividend liquidation preference .... 2 2 Common stock; $0.01 par value; 60,000 authorized shares; 17,658 and 17,334 issued and outstanding at March 31, 2001 and December 31, 2000, respectively .... 177 173 Additional paid-in capital .... 161,564 160,134 Treasury stock, at cost; 20 shares at March 31, 2001 and December 31, 2000 .... (180) (180) Other .... (58) (66) Accumulated other comprehensive loss .... (898) (553) Accumulated deficit .... (103,733) (105,729) ---------- ---------- Total stockholders' equity .... 56,874 53,781 ---------- ---------- Total liabilities and stockholders' equity .... $91,079 $86,514 ========== ========== The accompanying notes are an integral part of these consolidated financial statements F-2 INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED) THREE MONTHS ENDED MARCH 31, -------------------------- 2001 2000 ---------- ---------- (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS) REVENUES Product sales .... $ 20,284 $ 13,332 Other revenue .... 1,400 1,199 -------- -------- Total revenue .... 21,684 14,531 COSTS AND EXPENSES Cost of product sales .... 8,594 6,687 Research and development .... 2,073 1,890 Selling and marketing .... 4,751 2,949 General and administrative .... 3,204 3,747 Amortization .... 680 480 -------- -------- Total costs and expenses .... 19,302 15,753 Operating income (loss) .... 2,382 (1,222) Other income (expense), net .... (140) 249 -------- -------- Net income (loss) before income taxes .... 2,242 (973) Provision for income taxes .... 246 62 -------- -------- Net income (loss) before accounting change .... 1,996 (1,035) Cumulative effect of accounting change .... -- (470) -------- -------- Net income (loss) .... $ 1,996 $ (1,505) ======== ======== Basic net income (loss) per share: Before accounting change .... $ 0.08 $ (0.32) Cumulative effect of accounting change .... $ -- $ (0.03) Basic net income (loss) per share .... $ 0.08 $ (0.35) Diluted net income (loss) per share: Before accounting change .... $ 0.07 $ (0.32) Cumulative effect of accounting change .... $ -- $ (0.03) Diluted net income (loss) per share .... $ 0.07 $ (0.35) Weighted average common shares outstanding Basic .... 19,618 17,224 Diluted .... 21,849 17,224 The accompanying notes are an integral part of these consolidated financial statements F-3 INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED) THREE MONTHS ENDED MARCH 31, ---------------------------- 2001 2000 ---------- ---------- (IN THOUSANDS) OPERATING ACTIVITIES: Net income (loss) .... $ 1,996 $ (1,505) Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities: Depreciation and amortization .... 1,431 1,082 Gain on sale of product line and investments .... -- (326) Other .... (11) 24 Changes in assets and liabilities, net of business acquisitions: Accounts receivable .... 393 (353) Inventories .... (2,212) 104 Prepaid expenses and other current assets .... (99) (31) Non-current assets .... 301 (221) Accounts payable, accrued expenses and other liabilities .... 342 734 Customer advances and deposits .... 2,390 (801) Deferred revenue .... 19 33 -------- -------- Net cash provided by (used in) operating activities .... 4,550 (1,260) -------- -------- INVESTING ACTIVITIES: Proceeds from sale of product line and other assets .... -- 150 Proceeds from sale/maturity of investments .... -- 15,072 Purchases of available-for-sale investments .... (2,891) (10,601) Cash used in business acquisition, net of cash acquired .... -- (4,075) Purchases of property and equipment .... (396) (1,351) -------- -------- Net cash used in investing activities .... (3,287) (805) -------- -------- FINANCING ACTIVITIES: Net proceeds from revolving credit facility .... 770 97 Repayment of term loan .... (625) (375) Repayment of note payable .... (1,540) -- Proceeds from sale of preferred stock .... -- 5,375 Proceeds from exercised stock options and warrants .... 1,434 1,053 Preferred dividends paid .... -- (20) -------- -------- Net cash provided by financing activities .... 39 6,130 -------- -------- Effect of exchange rate changes on cash .... 4 -- Net increase in cash and cash equivalents .... 1,306 4,065 Cash and cash equivalents at beginning of period .... 14,086 19,301 -------- -------- Cash and cash equivalents at end of period .... $ 15,392 $ 23,366 ======== ======== Non-cash investing activities: Note issued in a business acquisition .... $-- $ 2,654 The accompanying notes are an integral part of these consolidated financial statements F-4 INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) 1. BASIS OF PRESENTATION In the opinion of management, the March 31 unaudited consolidated financial statements contain all adjustments (consisting only of normal recurring accruals) which the Company considers necessary for a fair presentation of the financial position and results of operations of the Company. Operating results for the three-month period ended March 31, 2001 are not necessarily indicative of the results to be expected for the entire year. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, including disclosures of contingent assets and liabilities and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates. As of December 31, 2000, the Company had provided a $44.8 million valuation allowance against its consolidated deferred tax asset due to the uncertainty of its realization. Because the Company has generated taxable income during recent quarters, management is continuing to reassess the potential realizability of this asset through the generation of future taxable income. The recognition of the deferred tax asset could affect the Company's income tax provision in the near term. These unaudited consolidated financial statements should be read in conjunction with the Company's consolidated financial statements for the year ended December 31, 2000 included in the Company's Annual Report on Form 10-K/A. Certain prior year amounts have been reclassified to conform with the current year's presentation. 2. NEW ACCOUNTING PRONOUNCEMENTS In December 1999 (as amended in March 2000 and June 2000) the staff of the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin 101, Revenue Recognition (the "SAB"). As the result of the adoption of the SAB, the Company recorded a $470,000 cumulative effect of an accounting change to defer a portion of a nonrefundable, up-front fee received and recorded in other revenue in 1998. The cumulative effect of this accounting change was measured and recorded as of January 1, 2000. In June 1998, the Financial Accounting Standards Board issued Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities." Statement No. 133, as amended by Statement No. 138 "Accounting for Certain Derivative Instruments and Certain Hedging Activities," requires companies to recognize all derivatives as either assets or liabilities in the balance sheet and measure such instruments at fair value. The Company's adoption of Statement No. 133 as of January 1, 2001 did not have a material impact on the Company's results of operations or financial position during the first quarter of 2001. F-5 INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) 3. INCOME (LOSS) PER SHARE Basic and diluted net income (loss) per share for the three months ended March 31 were as follows: 2001 2000 --------- ------- (IN THOUSANDS) Net income (loss) .... $ 1,996 $ (1,505) Dividends on Preferred Stock .... (385) (270) Beneficial conversion feature on Preferred Stock ... -- (4,170) -------- -------- Net income (loss) available to common stock .... $ 1,611 $ (5,945) ======== ======== Average number of shares outstanding: Basic .... 19,618 17,224 Effect of dilutive stock options and warrants ...... 2,231 -- -------- -------- Diluted .... 21,849 17,224 ======== ======== Net income (loss) per share: Basic .... $ 0.08 $ (0.35) ======== ======== Diluted .... $ 0.07 $ (0.35) ======== ======== Options to purchase 146,000 shares of common stock and preferred stock convertible into 3,218,000 shares of common stock at March 31, 2001 were not included in the computation of diluted net income per share for the three months ended March 31, 2001 because their effect would have been antidilutive. The exercise price of the options ranged from $13.88 to $20.75, which was in excess of the average market price of the common stock for the period. Options and warrants to purchase 3,732,600 shares of common stock and preferred stock convertible into 3,468,000 shares of common stock at March 31, 2000 were not included in the computation of diluted net loss per share for the three months ended March 31, 2000 because their effect would have been antidilutive. In connection with the issuance of 54,000 shares of Series C Preferred and common stock warrants in March 2000, the Company reflected a $4.2 million nonrecurring, non-cash dividend related to the beneficial conversion feature of the Series C Preferred in the calculation of net loss per share applicable to common stock for the three month period ended March 31, 2000. The beneficial conversion feature is based upon the excess of the price of the underlying common stock as compared to the fixed conversion price of the Series C Preferred, after taking into account the value assigned to the common stock warrants. 4. COMPREHENSIVE INCOME (LOSS) Comprehensive income (loss) for the three months ended March 31 was as follows: 2001 2000 ----------------- (IN THOUSANDS) Net income (loss) .... $

1,996 $(1,505) Unrealized gains (loss) on investments .... (14) 124 Foreign currency translation adjustment .... (331) -- ------- --------- Comprehensive income (loss) .... $ 1,651 $(1,381) ======= ========= F-6 INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) 5. INVENTORIES Inventories consist of the following: MARCH 31, DECEMBER 31, 2001 2000 ---------- ------------ (IN THOUSANDS) Raw materials .... $ 6,734 $ 5,805 Work-in process .... 3,450 3,825 Finished goods .... 8,325 6,878 --------- --------- $18,509 $16,508 ========= ========= 6. STOCKHOLDERS' EQUITY In March 2001, warrants to purchase 240,000 shares of common stock at $3.82 per share were exercised, for which the Company received proceeds of $916,800. 7. SEGMENT AND GEOGRAPHIC REPORTING The Company's reportable business segments consist of the Integra NeuroSciences division, which is a leading provider of implants, devices and monitors used in neurosurgery, neurotrauma, and related critical care, and the Integra LifeSciences division, which develops and manufactures a variety of medical products and devices, including products based on the Company's proprietary tissue regeneration technology, which are used to treat soft-tissue and orthopedic conditions. Integra NeuroSciences sells primarily through a direct sales organization, and Integra LifeSciences sells primarily through strategic alliances and distributors. The Company has reclassified certain items within its segments to conform to the current methodology for determining segment profitability. These reclassifications were not material and did not change the basic nature of the business segments. Selected financial information on the Company's business segments is reported below (in thousands): INTEGRA INTEGRA TOTAL NEURO- LIFE REPORTABLE SCIENCES SCIENCES SEGMENTS --------- --------- ----------- (IN THOUSANDS) First quarter ended March 31, 2001 Product sales .... $14,477 $ 5,807 $20,284 Total revenue .... 14,755 6,929 21,684 Operating expenses .... 11,353 5,202 16,555 Operating income .... 3,402 1,727 5,129 Depreciation included in segment operating expenses .... 417 298 715 First quarter ended March 31, 2000 Product sales .... $ 8,820 $ 4,512 $13,332 Total revenue .... 9,098 5,433 14,531 Operating expenses .... 8,015 4,703 12,718 Operating income .... 1,083 730 1,813 Depreciation included in segment operating expenses .... 260 285 545 F-7 INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED) 7. SEGMENT AND GEOGRAPHIC REPORTING (CONTINUED) A reconciliation of the amounts reported for total reportable segments to the consolidated financial statements is as follows: ENDED FIRST QUARTER MARCH 31, 2001 2000 ---------- ---------- (IN THOUSANDS) Operating expenses: Total reportable segments .... $ 16,555 $ 12,718 Plus: Corporate general and administrative expenses 2,067 2,555 Amortization .... 680 480 --------- --------- Consolidated total operating expenses .... $ 19,302 $ 15,753 Operating income (loss): Total reportable segments .... $ 5,129 $ 1,813 Less: Corporate general and administrative expenses 2,067 2,555 Amortization .... 680 480 --------- --------- Consolidated operating income (loss) .... $ 2,382 $ (1,222) Product sales by major geographic area are summarized below: UNITED ASIA OTHER STATES EUROPE PACIFIC FOREIGN TOTAL ---------- ---------- ---------- ---------- ---------- (IN THOUSANDS) First quarter 2001 .... $15,931 $ 2,384 $ 1,115 $ 854 $20,284 First quarter 2000 .... 10,587 1,080 1,270 395 13,332 8. SUBSEQUENT EVENTS On April 4, 2001, the Company acquired all of the outstanding stock of GMSmbH, the German manufacturer of the LICOX(R) Brain Tissue Oxygen Monitoring System, for $2.9 million, of which $2.3 million was paid at closing. Prior to the acquisition, the Company's Integra NeuroSciences division had exclusive marketing rights to the LICOX(R) products in the United States and certain other markets. Revenues of the acquired GMS business were approximately $1.2 million in 2000, consisting primarily of sales of the LICOX(R) products in Germany and to various international distributors, including Integra. On April, 27, 2001, the Company acquired Satelec Medical, a subsidiary of the Satelec-Pierre Rolland group, for $3.6 million in cash. Satelec Medical, based in France, manufactures and markets the Dissectron(R) ultrasonic surgical aspirator console and a broad line of related handpieces. The Dissectron(R) product is the leading ultrasonic surgical system in France. The Dissectron(R) product has United States FDA 510(k) clearance for neurosurgical applications and CE Mark Certification in the European Union. Revenues of the acquired business were approximately $1.5 million in 2000. On May 4, 2001, the Company notified the holders of the 100,000 shares of Series B Preferred of its intention to redeem these shares on June 29, 2001 for $12.3 million. The holders of the Series B Preferred have the right to convert their shares into common stock prior to this redemption. Because the conversion price of $3.82 per share is substantially below the current market value of the Company's common stock, we expect that the holders of the Series B Preferred will convert their shares into common stock, although there can no assurance in this regard. The Series B Preferred shares are convertible into 2,617,801 shares of common stock. F-8 REPORT OF INDEPENDENT ACCOUNTANTS To the Board of Directors and Stockholders of Integra LifeSciences Holdings Corporation and Subsidiaries: In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, stockholders' equity and cash flows present fairly, in all material respects, the financial position of Integra LifeSciences Holdings Corporation and Subsidiaries (the "Company") at December 31, 2000 and 1999 and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2000, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America, which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion expressed above. As discussed more fully in Note 2 to the consolidated financial statements, the Company has restated its 2000 and 1999 consolidated financial statements to account for the redemption features of the Series B and Series C Convertible Preferred Stock ("Series B and Series C Preferred") issued in March 1999 and March 2000, respectively. The carrying value of the Series B and Series C Preferred, which was previously presented as redeemable preferred stock, outside of stockholders' equity, has been reclassified as a component of stockholders' equity. The restatement of the 2000 and 1999 consolidated financial statements had no effect on the Company's net loss, net loss per share, total assets or total liabilities. As discussed more fully in Note 2 to the consolidated financial statements, the Company changed its method of accounting for nonrefundable fees received under its various research, license and distribution agreements. PRICEWATERHOUSECOOPERS LLP Florham Park, New Jersey February 23, 2001, except for Note 18, as to which the date is March 16, 2001, and Note 2, as to which the date is May 14, 2001 F-9 INTEGRA LIFESCIENCES

HOLDINGS CORPORATION AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS DECEMBER 31, --------------------------------- 2000 1999 ------------- ------------- (RESTATED--SEE NOTE 2) (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS) ASSETS Current Assets: Cash and cash equivalents .... $ 14,086 $ 19,301 Short-term investments .... 1,052 4,311 Accounts receivable, net of allowances of $1,003 and $944 .... 13,087 8,365 Inventories .... 16,508 10,111 Prepaid expenses and other current assets .... 1,484 718 ---------- ---------- Total current assets .... 46,217 42,806 Property, plant, and equipment, net .... 11,599 9,699 Goodwill and other intangible assets, net .... 25,299 13,219 Other assets .... 3,399 529 ---------- ---------- Total assets .... $ 86,514 $ 66,253 ========== ========== LIABILITIES AND STOCKHOLDERS' EQUITY Current Liabilities: Short-term debt .... $ 8,872 $ 2,254 Accounts payable, trade .... 3,363 994 Income taxes payable .... 1,200 643 Customer advances and deposits .... 823 3,901 Deferred revenue .... 1,675 1,460 Accrued expenses and other current liabilities .... 5,107 5,540 ---------- ---------- Total current liabilities .... 21,040 14,792 Long-term debt .... 4,758 7,625 Deferred revenue .... 4,728 5,049 Deferred income taxes .... 1,788 392 Other liabilities .... 419 406 ---------- ---------- Total liabilities .... 32,733 28,264 Commitments and contingencies Stockholders' Equity: Preferred stock; $0.01 par value; 15,000 authorized shares; 0 and 500 Series A Convertible shares issued and outstanding at December 31, 2000 and 1999, respectively; 100 Series B Convertible shares issued and outstanding at December 31, 2000 and 1999, $11,750 including a 10% annual cumulative dividend liquidation preference; 54 Series C Convertible shares issued and outstanding at December 31, 2000, $5,805 including a 10% annual cumulative dividend liquidation preference .... 2 6 Common stock; $.01 par value; 60,000 authorized shares; 17,334 and 16,131 issued and outstanding at December 31, 2000 and 1999 .... 173 161 Additional paid-in capital .... 160,134 132,340 Treasury stock, at cost; 20 and 1 shares at December 31, 2000 and 1999, respectively .... (180) (7) Other .... (66) (143) Accumulated other comprehensive loss .... (553) (64) Accumulated deficit .... (105,729) (94,304) ---------- ---------- Total stockholders' equity .... 53,781 37,989 ---------- ---------- Total liabilities and stockholders' equity .... $ 86,514 $ 66,253 ========== ========== The accompanying notes are an integral part of these consolidated financial statements F-10 INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF OPERATIONS YEARS ENDED DECEMBER 31, -------------------------------------- 2000 1999 1998 ----------- ----------- ----------- (IN THOUSANDS, EXCEPT PER SHARE AMOUNTS) REVENUES Product sales ....$ 64,987 $ 40,047 $ 14,182 Other revenue .... 6,662 2,829 3,379 -------- --------- --------- Total revenue .... 71,649 42,876 17,561 COSTS AND EXPENSES Cost of product sales .... 29,511 22,678 7,580 Research and development .... 7,524 8,893 8,424 Selling and marketing .... 15,371 9,487 5,901 General and administrative .... 28,483 13,324 9,787 Amortization .... 2,481 874 49 -------- --------- --------- Total costs and expenses .... 83,370 55,256 31,741 Operating loss .... (11,721) (12,380) (14,180) Interest income .... 804 1,006 1,250 Interest expense .... (1,277) (712) - Gain on dispositions of product lines .... 1,146 4,161 - Other income .... 201 141 588 -------- --------- --------- Net loss before income taxes .... (10,847) (7,784) (12,342) Income tax expense (benefit) .... 108 (1,818) - -------- --------- --------- Net loss before cumulative effect of accounting change .... (10,955) (5,966) (12,342) Cumulative effect of change in accounting for nonrefundable fees received under research, license and distribution arrangements .... (470) -- -- -------- --------- --------- Net loss ....$(11,425) $ (5,966) $(12,342) ======== ========= ========= Basic and diluted net loss per share: Before cumulative effect of accounting change ....$ (0.95) $ (0.40) $ (0.77) Accounting change .... (0.02) -- -- -------- --------- --------- Net loss per share ....$ (0.97) $ (0.40) $ (0.77) ======== ========= ========= Weighted average common shares outstanding .... 17,553 16,802 16,139 ======== ========= ========= Pro forma amounts assuming retroactive application of accounting change: Total revenues ....$ 71,649 $ 42,974 $ 16,993 Net loss .... (10,955) (5,868) (12,910) Basic and diluted net loss per share .... (0.95) (0.40) (0.80) The accompanying notes are an integral part of these consolidated financial statements F-11 INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF CASH FLOWS YEARS ENDED DECEMBER 31, -------------------------------------- 2000 1999 1998 ----------- ----------- ----------- (IN THOUSANDS) OPERATING ACTIVITIES: Net loss ....$(11,425) $ (5,966) $(12,342) Adjustments to reconcile net loss to net cash (used in) provided by operating activities: Depreciation and amortization .... 5,357 3,104 1,438 Gain on sale of product line and other assets .... (1,316) (3,998) (64) Deferred tax benefit .... -- (1,807) -- Amortization of discount and interest on investments .... (181) (291) (481) Stock based compensation .... 13,587 370 319 Other, net .... 43 -- 145 Changes in assets and liabilities, net of business acquisitions: Accounts receivable .... (3,475) (510) (287) Inventories .... (3,061) 2,829 527 Prepaid expenses and other current assets .... (571) 217 65 Non-current assets .... (3,565) (80) 64 Accounts payable, accrued expenses and other current liabilities .... 2,831 (677) 802 Customer advances and deposits .... (3,078) 3,652 -- Deferred revenue .... (106) 5,659 -- -------- --------- --------- Net cash (used in) provided by operating activities .... (4,960) 2,502 (9,814) -------- --------- --------- INVESTING ACTIVITIES: Proceeds from sale of product line and other assets .... 1,600 6,354 48 Proceeds from the sales/maturities of investments .... 16,981 26,000 33,020 Purchases of available for sale investments .... (13,391) (14,737) (23,774) Purchases of property and equipment .... (3,268) (2,309) (1,166) Cash acquired in a business acquisition .... -- -- 1,118

Cash used in business acquisition, net of cash acquired .... (16,187) (14,944) -- Loans made .... (238) -- -- -------- --------- --------- Net cash (used in) provided by investing activities .... (14,503) 364 9,246 -------- --------- --------- The accompanying notes are an integral part of these consolidated financial statements F-12 INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED) YEARS ENDED DECEMBER 31, -------------------------------------- 2000 1999 1998 ----------- ----------- ----------- (IN THOUSANDS) FINANCING ACTIVITIES: Net proceeds from revolving credit facility .... $ 3,143 $ 4 $-- Repayments of term loan .... (2,250) (1,125) -- Proceeds from sales of preferred stock and warrants .... 5,375 9,942 4,000 Proceeds from the issuance of common stock .... 5,000 -- -- Proceeds from exercise of common stock purchase warrants .... 50 1,950 -- Proceeds from stock issued under employee benefit plans .... 3,156 467 95 Purchases of treasury stock .... (170) -- (286) Collection of related party note receivable .... 35 -- -- Preferred dividends paid .... (67) (80) (47) --------- --------- --------- Net cash provided by financing activities .... 14,272 11,158 3,762 Effect of exchange rate changes on cash and cash equivalents .... (24) -- -- --------- --------- --------- Net increase (decrease) in cash and cash equivalents .... $ (5,215) $ 14,024 $ 3,194 Cash and cash equivalents at beginning of period .... 19,301 5,277 2,083 --------- --------- --------- Cash and cash equivalents at end of period .... $ 14,086 $ 19,301 $ 5,277 ========= ========= ========= Cash paid during the year for interest .... $ 922 $ 654 $-- Cash paid during the year for income taxes .... 508 124 -- Supplemental disclosure of non-cash investing and financing activities: Issuance of Restricted Units .... $ 13,515 $-- $-- Note issued in a business acquisition .... 2,598 -- -- Common stock and warrants issued in settlement of obligations .... 641 15 56 Term loan assumed in connection with a business acquisition .... -- 11,000 -- Common stock and warrants issued in business acquisition .... -- -- 3,886 The accompanying notes are an integral part of these consolidated financial statements F-13 INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY ACCUMU- PREFERRED LATED COMMON STOCK STOCK ADDITIONAL COMPRE- ------------------------------------- TREASURY PAID-IN HENSIVE ACCUMULATED TOTAL SHARES AMOUNT SHARES AMOUNT STOCK CAPITAL OTHER LOSS DEFICIT EQUITY -------- --- ------- --------------------- (IN THOUSANDS) Balance, December 31, 1997................ 14,952 $150 -- $-- $-- $111,877 $(301) $(26) $(75,945) $35,755 ====== ====== ==== ======= ======== ====== ======= ======= ========= -------- Net loss............ -- -- -- -- -- -- -- -- (12,342) (12,342) Unrealized losses on investments..... -- -- -- -- -- -- -- (14) -- (14) Issuance of Series A Preferred Stock .... -- -- 500 5 -- 3,995 -- -- -- 4,000 Issuance of common stock under employee benefit plans.............. 31 -- -- -- -- 95 -- -- -- 95 Common stock and warrants issued in connection with a business acquisition 800 8 -- -- -- 3,878 -- -- -- 3,886 Unearned compensation related to non-employee stock options............ -- -- -- -- -- 145 (145) -- -- -- Amortization of unearned compensation....... -- -- -- -- -- -- 263 -- -- 263 Warrant issued for services rendered -- -- -- -- -- 56 -- -- -- 56 Dividends paid on Series A Preferred Stock.............. -- -- -- -- -- (47) -- -- -- (47) Purchases of treasury stock..... -- -- -- -- (286) -- -- -- -- (286) Balance, December 31, 1998............... 15,783 $158 500 $ 5 $(286) $119,999 $(183) $(40) $(88,287) $31,366 ====== ====== ==== ======= ======== ====== ======= ======= ========= ======= The accompanying notes are an integral part of these consolidated financial statements F-14 INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (CONTINUED) ACCUMU- PREFERRED LATED COMMON STOCK STOCK ADDITIONAL COMPRE- ------------------------------------- TREASURY PAID-IN HENSIVE ACCUMULATED TOTAL SHARES AMOUNT SHARES AMOUNT STOCK CAPITAL OTHER LOSS DEFICIT EQUITY -------- --- ------- ----------------------- (IN THOUSANDS) Net loss............ -- $-- -- $-- $-- $-- $-- $-- $ (5,966) $ (5,966) Unrealized losses on investments........ -- -- -- -- -- -- -- (24) -- (24) Issuance of Series B Preferred Stock and warrants........... -- -- 100 1 -- 9,941 -- -- -- 9,942 Issuance of common stock under employee benefit plans...... 48 -- -- -- 264 203 -- -- (51) 416 Warrants exercised for cash........... 300 3 -- -- -- 1,947 -- -- -- 1,950 Issuance of stock in settlement of obligation......... -- -- -- -- -- 15 -- -- -- -- 15 Unearned compensation related to non--employee stock options............ -- -- -- -- -- 241 (241) -- -- -- Amortization of unearned compensation....... -- -- -- -- -- -- 281 -- -- 281 Compensation recorded in connection with stock options granted to employees....... -- -- -- -- -- 89 -- -- -- 89 Dividends paid on Series A Preferred Stock............... -- -- -- -- -- (80) -- -- -- (80) Balance, December 31, 1999............... 16,131 $161 600 $ 6 $ (7) $132,340 $(143) $(64) $(94,304) $37,989 ====== ====== ==== ======= ======== ======= ====== ======== ======= ====== The accompanying notes are an integral part of these consolidated financial statements F-15 INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (CONTINUED) ACCUMU- PREFERRED LATED COMMON STOCK STOCK ADDITIONAL COMPRE- ------------------------------------- TREASURY PAID-IN HENSIVE ACCUMULATED TOTAL SHARES AMOUNT SHARES AMOUNT STOCK CAPITAL OTHER LOSS DEFICIT EQUITY -------- --- ------- ----------------------- (IN THOUSANDS) Net loss............ -- $-- -- $-- $-- $-- $-- $-- $ (11,425) $(11,425) Unrealized losses on investments........ -- -- -- -- -- -- -- (32) -- (32) Foreign currency translation adjustment -- -- -- -- -- -- -- (457) -- (457) Issuance of Series C Preferred Stock and warrants....... -- -- 54 1 -- 5,374 -- -- -- 5,375 Conversion of Series A Preferred Stock 250 3 (500) (5) -- 2 -- -- -- -- Private placement of common stock....... 333 3 -- -- -- 4,997 -- -- -- 5,000 Issuance of common stock under employee benefit plans...... 564 6 -- -- -- 3,201 -- -- -- 3,207 Warrants exercised for cash........... 11 -- -- -- -- 50 -- -- -- 50 Issuance of stock in settlement of obligation......... 45 -- -- -- -- 641 -- -- -- 641 Amortization of unearned compensation....... -- -- -- -- -- -- 72 -- -- 72 Tax benefit related to stock options...... -- -- -- -- -- 51 -- -- -- 51 Issuance of Restricted Units............. -- -- -- -- -- 13,515 -- -- -- 13,515 Unearned compensation related to non--employee stock options............ -- -- -- -- -- 30 (30) -- -- -- Dividends paid on Series A Preferred Stock.............. -- -- -- -- -- (67) -- -- -- (67) Purchases of treasury stock............ -- -- -- -- (173) -- -- -- -- (173) Collection of related party note receivable -- -- -- -- -- -- 35 -- -- 35 Balance, December 31, 2000............... 17,334 $173 154 $ 2 $(180) $160,134 $ (66) $(553) $(105,729) $ 53,781 ====== ====== ==== ======= ======== ======= ======= ======== ======== ========= The accompanying notes are an integral part of these consolidated financial statements F-16 INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS 1. BUSINESS Integra LifeSciences Holdings Corporation (the "Company") develops, manufactures and markets medical devices, implants and biomaterials. The Company's operations consist of (1) Integra NeuroSciences, which is a leading provider of implants, devices, and monitors used in neurosurgery, neurotrauma, and related critical care and (2) Integra LifeSciences, which develops and manufactures a variety of medical products and devices, including products based on our proprietary tissue regeneration technology which are used to treat soft tissue and orthopedic conditions. Integra NeuroSciences sells primarily through a direct sales organization and Integra LifeSciences sells primarily through strategic alliances and distributors. There are certain risks and uncertainties inherent in the Company's business. To date, the Company has experienced significant operating losses in funding the research, development, manufacturing and marketing of its products and may continue to incur operating losses. The industry and market segments in which the Company operates are highly competitive, and the Company may not be able to compete effectively with other companies with greater financial resources. In general, the medical technology industry is characterized by intense competition, which comes from established pharmaceutical and medical technology companies and early stage companies that have alternative technological solutions for the Company's primary clinical targets, as well as universities, research institutions and other non-profit entities. The Company's competitive position and profitability will depend on its ability to achieve market acceptance for its products, implement production and marketing plans, secure regulatory approval for products under development, obtain patent protection and secure adequate capital resources. The Company believes that current cash balances and funds available from existing revenue sources will be sufficient to finance the Company's anticipated operations for at least the next twelve months. The Company may in the future seek to issue equity securities or enter into other financing arrangements with strategic partners to raise funds in excess of its anticipated liquidity and capital requirements. 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES PRINCIPLES OF CONSOLIDATION The consolidated financial statements include the accounts of the Company and its subsidiaries, all of which are wholly owned. All intercompany accounts and transactions are eliminated in consolidation. RECLASSIFICATIONS Certain prior year amounts have been reclassified to conform with the current year presentation. CASH AND CASH EQUIVALENTS The Company considers all highly liquid investments purchased with original maturities of three months or less to be cash equivalents. INVESTMENTS The Company's current investment policy is to invest available cash balances in high quality debt securities with maturities not to exceed 18 months. Realized gains and losses are determined on the specific identification cost basis. All investments are classified as available for sale, with unrealized gains and losses reported in other comprehensive loss. INVENTORIES Inventories, consisting of purchased materials, direct labor and manufacturing overhead, are stated at the lower of cost, determined on the first-in, first-out method, or market. F-17 INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED) PROPERTY, PLANT AND EQUIPMENT Property, plant and equipment is stated at cost. The Company provides for depreciation using the straight-line method over the estimated useful lives of the assets as follows: buildings, 30 to 40 years; machinery and equipment, 3 to 15 years; furniture and fixtures, 5 to 7 years; and leasehold improvements, over the lesser of the minimum lease term or the remaining life of the asset. The cost of major additions and improvements is capitalized. Maintenance and repair costs that do not improve or extend the lives of the respective assets are charged to operations as incurred. GOODWILL AND OTHER INTANGIBLE ASSETS Goodwill other intangible assets are stated at cost and are amortized on a straight-line basis over periods ranging from two to fifteen years. long-lived assets Long-lived assets held and used by the Company, including goodwill and other intangibles, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. For purposes of evaluating the recoverability of long-lived assets to be held and used, a recoverability test is performed using projected undiscounted net cash flows applicable to the long-lived assets. If an impairment exists, the amount of such impairment is calculated based on the estimated fair value of the asset. Impairments to long-lived assets to be disposed of are recorded based upon the fair value of the applicable assets. PREFERRED STOCK As described in Note 9, the Company issued 100,000 shares of Series B Convertible Preferred Stock ("Series B Preferred") and warrants in March 1999 and 54,000 shares of Series C Convertible Preferred Stock ("Series C Preferred" and, collectively, the "Series B and Series C Preferred") and warrants in March 2000. The Company has restated its 2000 and 1999 financial statements to account for the redemption features of the Series B and Series C Preferred. The carrying value of the Series B and Series C Preferred, which was previously presented as redeemable preferred stock, outside of stockholders' equity, has been reclassified as a component of stockholders equity. The effect of these restatements are to increase stockholders' equity by $15.9 million and $10.3 million at December 31, 2000 and 1999, respectively, to the following amounts (in thousands): DECEMBER 31, --------------------- 2001 2000 ----------- --------- Before restatement .... $37,863 $27,659 After restatement .... 53,781 37,989 After further consideration, the Company has determined that the redemption features of the Series B and Series C Preferred are within the control of the Company and therefore, the carrying amount should be reflected in stockholders' equity. These restatements had no effect on the Company's net loss or net loss per share, total assets or total liabilities for the years ended December 31, 2000 or 1999. FOREIGN CURRENCY TRANSLATION All assets and liabilities of foreign subsidiaries are translated at the rate of exchange at year-end, while sales and expenses are translated at the average exchange rates in effect during the year. The net effect of these translation adjustments is shown as a component of accumulated other comprehensive loss. F-18 INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED) INCOME TAXES Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. REVENUE RECOGNITION Product sales are recognized when delivery has occurred and title has passed to the customer, there is a fixed or determinable sales price, and collectibility of that sales price is reasonably assured. Research grant revenue is recognized when the related expenses are incurred. Under the terms of existing research grants, the Company is reimbursed for allowable direct and indirect research expenses. Non-refundable fees received under research, licensing and distribution arrangements are recognized as revenue when received if the Company has no continuing obligations to the other party. For those arrangements where the Company has continuing performance obligations, revenue is recognized using the lesser of the amount of non-refundable cash received or the result achieved using percentage of completion accounting based upon the estimated cost to complete its obligations. Royalty revenue is recognized over the period the royalty products are sold. SHIPPING AND HANDLING FEES AND COSTS Amounts billed to customers for shipping and handling are included in products sales. The related shipping and handling fees and costs incurred by the Company are included in cost of product sales. RESEARCH AND DEVELOPMENT Research and development costs are expensed in the period in which they are incurred. CONCENTRATION OF CREDIT RISK Financial instruments, which potentially subject the Company to concentrations of credit risk, consist principally of cash and cash equivalents and short-term investments, which are held at major financial institutions, and trade receivables. The Company's products are sold on an uncollateralized basis and on credit terms based upon a credit risk assessment of each customer. NET LOSS PER SHARE Amounts used in the calculation of basic and diluted net loss per share were as follows (in thousands, except per share data): 2000 1999 1998 ----- ----- ----- Net loss .... $(11,425) $ (5,966) $(12,342) Preferred stock dividends: Series A Convertible Preferred Stock ..... (67) (80) (47) Series B Convertible Preferred Stock ..... (1,000) (750) -- Series C Convertible Preferred Stock ..... (405) -- -- Beneficial conversion feature on Series C Convertible Preferred Stock .... (4,170) -- -- ----------- ---------- ----------- Net loss applicable to common stock .... $(17,067) $ (6,796) $(12,389) Weighted average common shares outstanding .... 17,553 16,802 16,139 Basic and diluted net loss per share .... $ (0.97) $ (0.40) $ (0.77) F-19 INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED) Basic loss per share is computed by dividing net loss applicable to common stock by the weighted average number of common shares outstanding for the period. Diluted per share amounts reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock. Options and warrants to purchase 5,067,726, 4,401,000, and 3,095,000 shares of common stock and preferred stock convertible into 3,217,800, 2,867,800, and 250,000 shares of common stock at December 31, 2000, 1999 and 1998, respectively were not included in the computation of diluted loss per share because their effect would be antidilutive. Restricted Units issued by the Company (see Note 10) that entitle the holder to 2,250,000 shares of common stock are included from their date of issuance in the weighted average calculation because no further consideration is due related to the issuance of the underlying common shares. COMPREHENSIVE LOSS Comprehensive loss consists of net loss plus all other changes in net assets from non-owner sources. Components of comprehensive loss consist of the following: YEAR ENDED DECEMBER 31, ----------------------------------- 2000 1999 1998 ----------- ---------- ---------- (IN THOUSANDS) Net loss .... $(11,425) $ (5,966) $(12,342) Unrealized losses on investments .... (32) (24) (14) Foreign currency translation adjustment .... (457) -- -- Comprehensive loss .... $(11,914) $ (5,990) $(12,356) STOCK BASED COMPENSATION Employee stock based compensation is recognized using the intrinsic value method prescribed by Accounting Principles Board Opinion No. 25 "Accounting for Stock Issued to Employees" and Financial Accounting Standards Board Interpretation No. 44 "Accounting for Certain Transactions Involving Stock Compensation -an interpretation of APB Opinion No. 25". For disclosures purposes, pro forma net loss and loss per share are presented as if the fair value method had been applied. USE OF ESTIMATES The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, including disclosures of contingent assets and liabilities, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates. NEW ACCOUNTING PRONOUNCEMENTS In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133 "Accounting for Derivative Investments and Hedging Activities" ("SFAS No. 133"). SFAS No. 133 establishes accounting and reporting standards for derivatives and hedging activities and supercedes several existing standards. SFAS No. 133, as amended by SFAS No. 137, is effective for all fiscal quarters of fiscal years beginning after June 15, 2000. The adoption of SFAS No. 133 will not have a material impact on the consolidated financial statements. In December 1999 (as amended in March 2000 and June 2000) the staff of the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin 101, Revenue Recognition (the "SAB"). As the result of the adoption of the SAB, we recorded a $470,000 cumulative effect of an accounting change to defer a portion F-20 INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED) of a nonrefundable, up-front fee received and recorded in other revenue in 1998 (see Note 14). The cumulative effect of this accounting change was measured as of January 1, 2000. As a result of this accounting change, other revenue for the year ended December 31, 2000 includes $112,000 of amortization of the amount deferred as of January 1, 2000. In March 2000, the Financial Accounting Standards Board issued Interpretation No. 44 "Accounting for Certain Transactions Involving Stock Compensation -an interpretation of APB Opinion No. 25" ("FIN No. 44"). FIN No. 44 clarifies the application of APB Opinion 25 for certain issues. FIN No. 44 became effective July 1, 2000, but certain conclusions cover specific events that occurred after either December 15, 1998, or January 12, 2000. The adoption of FIN No. 44 did not have an impact on our consolidated financial statements. In September 2000, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 140 "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities-a replacement of FASB Statement No. 125" ("SFAS No. 140"). SFAS No. 140 provides accounting and reporting standards for transfers and servicing of financial assets and extinguishments of liabilities. SFAS No. 140 is effective for fiscal years ending after December 15, 2000. The adoption of SFAS No. 140 did not have any impact on the Company's consolidated financial statements. 3. BUSINESS ACQUISITIONS AND DISPOSITIONS On April 6, 2000, the Company purchased the Selector(R) Ultrasonic Aspirator, Ruggles_ hand-held neurosurgical instruments and Spembly Medical cryosurgery product lines, including certain assets and liabilities, from NMT Medical, Inc. ("NMT") for $11.6 million in cash. On January 17, 2000, the Company purchased the business, including certain assets and liabilities, of Clinical Neuro Systems, Inc. ("CNS") for $6.8 million. CNS designs, manufactures and sells neurosurgical external ventricular drainage systems, including catheters and drainage bags, as well as cranial access kits. The purchase price of the CNS business consisted of $4.0 million in cash and a 5% $2.8 million promissory note issued to the seller. The promissory note, which is payable in two principal payments of $1.4 million each, plus accrued interest, in January 2001 and 2002, is collateralized by inventory, property and equipment of the CNS business and by a collateral assignment of a $2.8 million promissory note from one of the Company's subsidiaries. On March 29, 1999 the Company acquired the business, including certain assets and liabilities, of the NeuroCare group of companies ("NeuroCare"), a leading provider of neurosurgical products. The $25.2 million acquisition price was comprised of $14.2 million of cash and $11.0 million of assumed indebtedness under a term loan from Fleet Capital Corporation ("Fleet"). The cash portion of the purchase price was financed in part by affiliates of Soros Private Equity Partners LLC, through the sale of $10.0 million of Series B Convertible Preferred Stock. On September 28, 1998, the Company acquired Rystan Company, Inc. ("Rystan") for 800,000 shares of common stock of the Company and two warrants each having the right to purchase 150,000 shares of the Company's common stock. The total purchase price was valued at $4.0 million. In January 1999, the Company subsequently sold a Rystan product line, including the brand name and related production equipment, for $6.4 million in cash and recognized a pre-tax gain of $4.2 million after adjusting for the net cost of the assets sold and for expenses associated with the divestiture. These acquisitions have been accounted for using the purchase method of accounting, and the results of operations of the acquired businesses have been included in the consolidated financial statements since their F-21 INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS 3. BUSINESS ACQUISITIONS AND DISPOSITIONS (CONTINUED) respective dates of acquisition. As adjusted for the sale of one of the Rystan product lines in 1999, the allocation of the purchase price of these acquisitions resulted in acquired intangible assets, consisting primarily of completed technology, customer lists and trademarks of approximately $19.8 million, which are being amortized on a straight-line basis over lives ranging from 2 to 15 years, and residual goodwill of approximately $9.1 million, which is being amortized on a straight-line basis over 15 years. Historical results of operations include the following (charges) / benefits related to acquisitions: YEAR ENDED DECEMBER 31, ---------------------------------- 2000 1999 1998 ---------- ---------- --------- (IN THOUSANDS) Inventory fair value purchase accounting adjustments .... $ (429) $(2,508) $ (300) Severance costs associated with the closure of an acquired facility .... -- (1,024) -- Deferred tax benefits .... -- 1,807 -- The following unaudited pro forma financial information summarizes the results of operations for the periods indicated as if the acquisitions consummated in 2000 had been completed as of the beginning of each period: YEAR ENDED DECEMBER 31, ------------------------- 2000 1999 ----------- ------------ (IN THOUSANDS) (UNAUDITED) Total revenue .... $ 74,665 $ 57,425 Net loss .... (11,111) (4,135) Basic and diluted net loss per share .... $ (0.96) $ (0.32) The historical and pro forma amounts for years ended December 31, 2000 and 1999, respectively, include $1.1 million ($0.07 per share) and $3.7 million ($0.22 per share) gains, net of tax, from the sale of product lines. These pro forma amounts are based upon certain assumptions and estimates. The 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. 4. INVESTMENTS The Company's current investment balances are classified as available for sale and all debt securities have maturities within one year. Investment balances as of December 31, 2000 and 1999 were as follows: UNREALIZED UNREALIZED FAIR COST GAINS LOSSES VALUE -------- ---------- ---------- ----- (IN THOUSANDS) 2000: U.S. Government agency securities .... $ 977 $-- $-- $ 977 Equity securities .... 173 10 (108) 75 ---------------- -------- -------- Total .... $1,150 $ 10 $ (108) $1,052 1999: U.S. Government agency securities .... $3,975 $-- $-- $3,975 Equity securities .... 400 -- (64) 336 --------------- -------- -------- Total .... $4,375 $-- $ (64) $4,311 F-22 INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS 5. INVENTORIES Inventories consist of the following: DECEMBER 31, ------------------------- 2000 1999 ------- -------- (IN THOUSANDS) Finished goods .... $ 6,878 $ 3,786 Work-in-process .... 3,825 2,224 Raw materials .... 5,805 4,101 -------- -------- $16,508 $10,111 6. PROPERTY, PLANT AND EQUIPMENT Property, plant and equipment, net, consists of the following: DECEMBER 31, ------------------------- 2000 1999 ------- -------- (IN THOUSANDS) Buildings and leasehold improvements .... $ 9,632 $ 7,805 Machinery and equipment .... 11,371 8,923 Furniture and fixtures .... 810 559 Construction in progress .... 470 390 -------- ------- 22,283 17,677 Less: Accumulated depreciation and amortization .... (10,684) (7,978) -------- ------- $ 11,599 $ 9,699 Depreciation and amortization expense associated with property, plant and equipment for the years ended December 31, 2000, 1999 and 1998 was $2,876,000, $2,229,000, and $1,413,000, respectively. 7. GOODWILL AND OTHER INTANGIBLES Goodwill and other intangibles, net, consists of the following: DECEMBER 31, ------------------------- 2000 1999 ------- -------- (IN THOUSANDS) Technology .... $ 10,761 $ 3,730 Customer base .... 3,227 1,810 Trademarks .... 1,770 1,570 Other identifiable intangible assets .... 3,899 2,661 Goodwill .... 9,050 4,348 -------- -------- 28,707 14,119 Less: Accumulated depreciation and amortization .... (3,408) (900) --------- -------- $ 25,299 $ 13,219 Amortization expense associated with goodwill and other intangibles for the years ended December 31, 2000, 1999 and 1998 was $2,481,000, $874,000, $49,000, respectively. F-23 INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS 8. Debt The Company's borrowings consisted of the following: DECEMBER 31, ------------------------- 2000 1999 ------- -------- (IN THOUSANDS) Short term debt: Bank loans Current portion of term loan ....$4,071 $2,250 Revolving credit facility .... 3,147 4 Current portion of note payable .... 1,654 -- --------- --------- $8,872 $2,254 Long term debt: Bank loans Term loan ....$3,554 $7,625 Note payable .... 1,204 -- --------- --------- $4,758 $7,625 The NeuroCare acquisition was partially funded through an $11.0 million term loan provided by Fleet. Fleet has also provided a $4.0 million revolving credit facility to fund working capital requirements. The term loan and revolving credit facility (collectively, the "Fleet Credit Facility") generally bear interest at a variable rate that is based upon the prime lending rate charged for commercial loans in the United States. An option is available to the Company to borrow certain portions of the Fleet Credit Facility at variable rates based upon the London Interbank Overnight Rate ("LIBOR"), subject to certain limitations and restrictions. At December 31, 2000 and 1999, respectively, the weighted average interest rate on balances outstanding under the Fleet Credit Facility was 9.8% and 9.5%, respectively. The Fleet Credit Facility is collateralized by all the assets and ownership interests of various subsidiaries of the company including Integra NeuroCare LLC and NeuroCare Holding Corporation (the parent company of Integra NeuroCare LLC) has guaranteed Integra NeuroCare LLC's obligations. Integra NeuroCare LLC is subject to various financial and non-financial covenants under the Fleet Credit Facility, including significant restrictions on its ability to transfer funds to the Company or the Company's other subsidiaries. At December 31, 2000 and 1999, respectively, approximately $20.5 million and $15.6 million of Integra NeuroCare LLC's net assets were restricted under the provisions of the Fleet Credit Facility. The financial covenants specify minimum levels of interest and fixed charge coverage and net worth, and also specify maximum levels of capital expenditures and total indebtedness to operating cash flow, among others. Effective September 29, 1999 and December 31, 1999, certain of these financial covenants were amended. These amendments did not change any other terms of the Fleet Credit Facility. While the Company anticipates that Integra NeuroCare LLC will be able to satisfy the requirements of these amended financial covenants, there can be no assurance that Integra NeuroCare LLC will generate sufficient earnings before interest, taxes, depreciation and amortization to meet the requirements of such covenants. Term loan repayments are due as follows (in thousands): 2001............. $4,071 2002............. 2,254 2003............. 1,300 ------- $7,625 F-24 INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS 8. DEBT (CONTINUED) Notwithstanding the originally scheduled repayments, the term loan is subject to mandatory prepayment amounts if certain levels of cash flow are achieved. Included in the 2001 amount is approximately $2.1 million of anticipated principal prepayment. In connection with the purchase of the business, including certain assets and liabilities, of CNS, the Company issued a 5% $2.8 million promissory note to the seller. The promissory note, which is payable in two principal payments of $1.4 million each, plus accrued interest, in January 2001 and 2002, is collateralized by inventory, property and equipment of the CNS business and by a collateral assignment of a $2.8 million promissory note from one of the Company's subsidiaries. 9. COMMON AND PREFERRED STOCK PREFERRED STOCK TRANSACTIONS The Company is authorized to issue up to 15,000,000 shares of preferred stock in one or more series, of which 2,000,000 shares have been designated as Series A, 120,000 shares have been designated as Series B, and 54,000 shares have been designated as Series C. On March 29, 2000, the Company issued 54,000 shares of Series C Convertible Preferred Stock ("Series C Preferred") and warrants to purchase 300,000 shares of common stock at $9.00 per share to affiliates of Soros Private Equity Partners LLC ("Soros") for $5.4 million, net of issuance costs. The Series C Preferred ranks on a parity with the Company's Series B Convertible Preferred Stock, and is senior to the Company's common stock and all other preferred stock of the Company. The Series C Preferred is convertible into 600,000 shares of common stock and has a liquidation preference of $5.8 million, including a 10% cumulative annual dividend. This liquidation preference is payable upon i) the redemption of the preferred shares at the Company's option, ii) the redemption of the preferred shares in the event of the Company's sale of all or substantially all of its assets or certain mergers or consolidations of the Corporation into or with any other corporation, or iii) a legal liquidation of the Company. The Series C Preferred was issued with a beneficial conversion feature that resulted in a nonrecurring, non-cash dividend of $4.2 million, which has been reflected in the net loss per share applicable to common stock for the year ended December 31, 2000. The beneficial conversion dividend is based upon the excess of the price of the underlying common stock as compared to the fixed conversion price of the Series C Preferred, after taking into account the value assigned to the common stock warrants. The warrants issued with the Series C Preferred expire on December 31, 2001. In connection with the NeuroCare acquisition, the Company issued 100,000 shares of Series B Convertible Preferred Stock ("Series B Preferred") and warrants to purchase 240,000 shares of common stock at $3.82 per share to Soros for $9.9 million, net of issuance costs. The Series B Preferred ranks on a parity with the Series C Preferred, and is senior to the Company's common stock and all other preferred stock of the Company. The Series B Preferred is convertible into 2,617,800 shares of common stock and has a liquidation preference of $11.8 million, including a 10% cumulative annual dividend. This liquidation preference is payable upon i) the redemption of the preferred shares at the Company's option, ii) the redemption of the preferred shares in the event of the Company's sale of all or substantially all of its assets or certain mergers or consolidations of the Corporation into or with any other corporation, or iii) a legal liquidation of the Company. The warrants issued with the Series B Preferred were exercised in March 2001. During the second quarter of 1998, the Company sold 500,000 shares of Series A Convertible Preferred Stock ("Series A Preferred") for $4.0 million to Century Medical, Inc. ("CMI"). CMI converted the Series A Preferred into 250,000 shares of the Company's common stock in October 2000. The Series A Preferred paid an annual F-25 INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS 9. COMMON AND PREFERRED STOCK (CONTINUED) dividend of $0.16 per share, payable quarterly, and had a liquidation preference of $4.0 million that was payable only upon the liquidation of the Company. COMMON STOCK TRANSACTIONS In September 2000, the Company completed a $5.0 million private placement of 333,334 shares of common stock to ArthroCare Corporation. In September 1998, the Company issued 800,000 shares of common stock and two warrants, each having the right to purchase 150,000 shares of the Company's common stock at $6.00 and $7.00 per share, respectively, to GWC Health, Inc., a subsidiary of Elan Corporation, plc., as consideration for the acquisition of Rystan. Both of these warrants were exercised in October 1999. STOCK SPLIT The Company's stockholders approved a one-for-two reverse split of the Company's common stock at the annual stockholders meeting held on May 18, 1998. All outstanding common share and per share amounts have been retroactively adjusted to reflect the reverse split. STOCKHOLDERS' RIGHTS As stockholders of the Company, Union Carbide Corporation affiliates of Soros Private Equity Partners LLC, and GWC Health are entitled to certain registration rights. The Company's President and Chief Executive Officer also has demand registration rights under the Restricted Units issued in December 1997 and December 2000 (see Note 10). 10. STOCK PURCHASE AND AWARD PLANS EMPLOYEE STOCK PURCHASE PLAN The Company received stockholder approval for its Employee Stock Purchase Plan ("ESPP") in May 1998. The purpose of the ESPP is to provide eligible employees of the Company with the opportunity to acquire shares of common stock at periodic intervals by means of accumulated payroll deductions. Under the ESPP, a total of 500,000 shares of common stock have been reserved for issuance. These shares will be made available either from the Company's authorized but unissued shares of common stock or from shares of common stock reacquired by the Company as treasury shares. At December 31, 2000, approximately 354,000 shares remain available for purchase under the ESPP. STOCK OPTION PLANS As of December 31, 2000, the Company had stock options outstanding under six plans, the 1992 Stock Option Plan (the "1992 Plan"), the 1993 Incentive Stock Option and Non-Qualified Stock Option Plan (the "1993 Plan"), the 1996 Incentive Stock Option and Non-Qualified Stock Option Plan (the "1996 Plan"), the 1998 Stock Option Plan (the "1998 Plan"), the 1999 Stock Option Plan (the "1999 Plan") and the 2000 Equity Incentive Plan (the "2000 Plan" and collectively, the "Plans"). No additional options can be granted out of the 1992 Plan and 175,000 shares reserved under the 1992 Plan were cancelled. The Company has reserved 750,000 shares of common stock for issuance under both the 1993 Plan and 1996 Plan, 1,000,000 shares under the 1998 Plan, and 2,000,000 shares each under the 1999 Plan and the 2000 Plan. The 1993 Plan, 1996 Plan, 1998 Plan, and the 1999 Plan permit the Company to grant both incentive and non-qualified stock options to designated directors, officers, employees and associates of the Company. The 2000 F-26 INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS 10. STOCK PURCHASE AND AWARD PLANS (CONTINUED) Plan permits the Company to grant incentive and non-qualified stock options, stock appreciation rights, restricted stock, performance stock, or dividend equivalent rights to designated directors, officers, employees and associates of the Company. Options issued under the Plans become exercisable over specified periods, generally within four years from the date of grant, and generally expire six years from the grant date. For the three years ended December 31, 2000, option activity for all the Plans was as follows: WEIGHTED AVERAGE EXERCISE PRICE SHARES ------------ --------- (SHARES IN THOUSANDS) Shares Outstanding: December 31, 1997 .... $7.68 1,541 Granted .... $4.35 1,045 Exercised .... $8.00 (1) Cancelled .... $8.21 (138) December 31, 1998 .... $6.26 2,447 Granted .... $5.10 1,757 Exercised .... $4.24 (61) Cancelled .... $5.56 (352) December 31, 1999 .... $5.82 3,791 Granted .... $11.62 1,548 Exercised .... $5.68 (493) Cancelled .... $6.90 (327) December 31, 2000 .... $7.74 4,519 Shares Exercisable: December 31, 1998 .... $8.45 730 December 31, 1999 .... $6.76 1,422 December 31, 2000 .... $6.27 1,759 Share available for grant, December 31, 2000 307 In June 1999, the Company granted fully vested non-qualified stock options with an intrinsic value of $90,000 on the grant date to certain employees for which a corresponding charge was recorded to general and administrative expense. Otherwise, the exercise price of all other stock options granted under the Plans was equal to or greater than the fair market value of the common stock on dates of grant. The weighted average exercise price and fair market value of options granted in 2000, 1999 and 1998 were as follows: MARKET PRICE MARKET PRICE MARKET PRICE ---------------------------- --------------------------- ---------------------------- EXERCISE EXERCISE EXERCISE PRICE FAIR VALUE PRICE FAIR VALUE PRICE FAIR VALUE ------------ ------------- ------------- ------------- ------------- ------------- 2000 .... $ -- $ -- $11.61 $8.20 $-- $-- 1999 .... $3.46 $3.46 $ 5.11 $3.77 $7.61 $0.06 1998 .... $ -- $ -- $ 4.19 $2.59 $8.00 $1.98 F-27 INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS 10. STOCK PURCHASE AND AWARD PLANS (CONTINUED) The following table summarizes information about stock options outstanding as of December 31, 2000: OPTIONS OUTSTANDING OPTIONS EXERCISABLE -- --------------------- WEIGHTED WEIGHTED WEIGHTED AVERAGE AVERAGE AVERAGE RANGE OF AS OF REMAINING EXERCISE AS OF EXERCISE EXERCISE PRICES 12/31/00 CONTRACTUAL LIFE PRICE 12/31/00 PRICE ------------------ ---------- ------------------- ----------- --------- ----------- (OPTIONS IN THOUSANDS) $3.375-$5.125 1,075 3.9 years $ 3.77 537 $ 3.81 $5.375-$5.875 1,224 5.6 years $ 5.86 605 $ 5.86 $5.906-$11.00 1,432 5.5 years $ 8.96 572 $ 7.87 $11.12-$23.00 788 5.5 years $ 13.86 45 $ 20.90 ------- ------- 4,519 1,759 The Company has adopted the disclosure-only provisions of SFAS No. 123 "Accounting for Stock Based Compensation" ("SFAS 123"). Had the compensation cost for the Company's stock option plans been determined based on the fair value at the grant date for awards in grant since 1995 consistent with the provisions of SFAS No. 123, the Company's net loss and basic and diluted net loss per share would have increased to the pro forma amounts indicated below: 2000 1999 1998 --------- ---------- ---------- (IN THOUSANDS) Net loss applicable to common stock $(17,067) $6,796 $(12,389) Pro forma net loss applicable to common stock .... (20,503) (9,991) (15,070) Basic and diluted net loss per share $(0.97) $(0.40) $(0.77) Pro forma basic and diluted net loss per share .... (1.17) (0.59) (0.93) As options vest over a varying number of years and awards are generally made each year, the pro forma impacts shown here may not be representative of future pro forma expense amounts. The pro forma additional compensation expense was calculated based on the fair value of each option grant using the Black-Scholes model with the following weighted-average assumptions: 2000 1999 1998 ------- ------- ------- Dividend yield .... 0 0 0 Expected volatility ... 90% 90% 80% Risk free interest rate 6.5% 5.4% 5.2% Expected option lives . 4.5 years year4 years RESTRICTED UNITS In December 2000, the Company issued 1,250,000 restricted units ("Restricted Units") under the 2000 Plan as a fully vested equity based bonus to the Company's President and Chief Executive Officer ("Executive") in connection with the extension of his employment agreement. Each Restricted Unit represents the right to receive one share of the Company's common stock. In connection with the issuance of the Restricted Units, the Company incurred a non-cash compensation charge of $13.5 million in the fourth quarter of 2000, which is f-28 INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS 10. STOCK PURCHASE AND AWARD PLANS (CONTINUED) included in general and administrative expenses. The Executive also received 1,000,000 Restricted Units in December 1997, each of which entitles him to receive one share of the Company's common stock. The Restricted Units issued in December 1997 were not issued under any of the Plans. No other stock-based awards are outstanding under any of the Plans. 11. FINANCIAL INSTRUMENTS Fair value of the Company's financial instruments are estimated as follows (in thousands): DECEMBER 31, 2000 DECEMBER 31, 1999 -------------------- ------------------- FAIR CARRYING FAIR CARRYING VALUE AMOUNT VALUE AMOUNT --------- ---------- ---------- ------- Nonderivatives: Cash and cash equivalents .... $14,086 $14,086 $19,301 $19,301 Short-term investments .... 1,052 1,052 4,311 4,311 Term loans and revolving credit facility 10,772 10,772 9,879 9,879 Note payable .... 2,874 2,858 -- -- Fair value represents an estimate of the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced sale or liquidation. The fair value of cash and cash equivalents and short-term investments were estimated based on market prices. The carrying value of the Company's term loan and borrowings under its revolving credit facility approximate fair value because the interest rates on these financial instruments are reset periodically to reflect current market rates. The carrying value of the 5% note payable issued to the seller of the CNS business was discounted to fair value to reflect a rate that the Company could obtain on similar debt. 12. LEASES The Company leases administrative, manufacturing, research and distribution facilities and various manufacturing, office and transportation equipment through operating lease agreements. In November 1992, a corporation whose shareholders are trusts whose beneficiaries include beneficiaries of the Company's Chairman acquired from independent third parties a 50% interest in the general partnership from which the Company leases its manufacturing facility in Plainsboro, New Jersey. The lease provides for rent escalations of 10.1% and 8.5% in the years 2002 and 2007, respectively, and expires in October 2012. The lease agreement related to the Company's research facility in San Diego provides for annual escalations. In June 2000, the Company signed a ten year lease related to certain production equipment from a corporation whose sole stockholder is a general partnership, for which the Company's Chairman is a partner and the President. Under the terms of the lease, the Company paid $45,000 to Medicus Corporation during 2000. In May 1994, the Company entered into a 5 year lease agreement with a related party of the Company's Chairman for a facility in West Chester, Pennsylvania. In January 1998, the Company suspended its operations at this facility and in June 1998, entered into a lease termination agreement related to the facility that required the Company to pay $330,000 for the facility's maintenance, certain operating costs and other commitments through April 1999. Additionally, the Company recorded an asset impairment charge of $145,000 in 1998 F-29 INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS 12. LEASES (CONTINUED) related to certain leasehold improvements made at the West Chester facility. This charge was included in general and administrative expense. Future minimum lease payments under operating leases at December 31, 2000 were as follows (in thousands): RELATED THIRD PARTIES PARTIES TOTAL --------- ---------- ---------- 2001 .... $ 300 $1,053 $1,353 2002 .... 303 920 1,223 2003 .... 321 915 1,236 2004 .... 321 737 1,058 2005 .... 321 283 604 Thereafter....................... 2,075 577 2,652 ------- ------- ------- Total minimum lease payments..... $3,641 $4,485 $8,126 ======= ======= ======= Total rental expense for the years ended December 31, 2000, 1999, and 1998 was $1,422,000, $958,000, and $780,000, respectively, and included $255,000, $219,000, and $267,000 in related party expense, respectively. 13. Income Taxes The income tax expense (benefit) consisted of the following (in thousands): 2000 1999 1998 --------- ------------ ---------- Current: Federal .... $ 100 $ 100 $-- State .... (131) (111) -- Foreign .... 139 - -- Total current .... $ 108 $ (11) $-- Deferred: Federal .... $ -- $(1,671) $-- State .... -- (136) --

Total deferred .... $ -- $(1,807) $-- Income tax expense (benefit) .... $ 108 $(1,818) $-- F-30 INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS 13. INCOME TAXES (CONTINUED) The temporary differences which give rise to deferred tax assets and (liabilities) are presented below (in thousands): DECEMBER 31, -------------------- 2000 1999 -------- --------- Net operating loss and tax credit carryforwards .... $ 33,676 $ 36,800 Inventory reserves and capitalization .... 1,740 1,021 Other .... 8,594 2,615 Depreciation and amortization .... -- -- Deferred revenue .... 2,380 2,560 -------- -------- Total deferred tax assets before valuation allowance . 46,390 42,996 Valuation allowance .... (44,776) (41,434) Depreciation and amortization .... (3,010) (1,562) Other .... (392) (392) -------- -------- Net deferred tax liabilities .... $ (1,788) $ (392) ======== ======== The Company's valuation allowance was provided against the deferred tax assets due to the uncertainty of realization. The net change in the Company's valuation allowance was $3,342,000, $18,000, and $4,380,000 in 2000, 1999, and 1998, respectively. The 1999 change in valuation allowance includes a non-cash benefit of $1.8 million resulting from the deferred tax liabilities recorded in the NeuroCare acquisition to the extent that consolidated deferred tax assets were generated subsequent to the acquisition. A reconciliation of the United States Federal statutory rate to the Company's effective tax rate for the years ended December 31, 2000, 1999, and 1998 is as follows: 2000 1999 1998 -------- ------- ------- Federal statutory rate .... (34.0%) (34.0%) (34.0%) Increase (reduction) in income taxes resulting from: State income taxes .... 3.1% 6.9% -- Benefit from sale of state net operating loss, net of federal effect .... (4.3%) (5.5%) -- Foreign taxes booked at different rates .... (0.5%) -- -- Alternative minimum tax, net of state benefit .... 0.9% 1.3% -- Nondeductible items .... 2.1% 8.2% 1.8% Other .... 2.9% -- -- Change in valuation allowance .... 30.8% (0.2%) 32.2% ------- ------- ----- Effective tax rate .... 1.0% (23.3%) -- ======= ======= ===== At December 31, 2000, the Company had net operating loss carryforwards ("NOL's") of approximately $41.6 million and $18.2 million for federal and state income tax purposes, respectively, to offset future taxable income, if any. The federal and state NOL's expire through 2018 and 2007, respectively. During 2000 and 1999, respectively, the Company recognized a tax benefit of $467,000 and $645,000 from the sale of certain state net operating loss carryforwards through a special program offered by the State of New Jersey. F-31 INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS 13. INCOME TAXES (CONTINUED) At December 31, 2000, several of the Company's subsidiaries had unused NOL and tax credit carryforwards arising from periods prior to the Company's ownership. Excluding the Company's Telios Pharmaceuticals, Inc. subsidiary ("Telios")), approximately $9 million of these NOL's for federal income tax purposes expire between 2001 and 2005. The Company's Telios subsidiary has approximately $84 million of net operating losses, which expire between 2002 and 2010. The amount of Telios' net operating loss that is available and the Company's ability to utilize such loss is dependent on the determined value of Telios at the date of acquisition. The Company's has a valuation allowance of $45 million recorded against all deferred tax assets, including the net operating losses, due to the uncertainty of realization. The timing and manner in which these acquired net operating losses may be utilized in any year by the Company are severely limited by the Internal Revenue Code of 1986, as amended, Section 382 and other provisions of the Internal Revenue Code and its applicable regulations. 14. DEVELOPMENT, DISTRIBUTION, AND LICENSE AGREEMENTS AND GOVERNMENT GRANTS The Company has various development, distribution, and license agreements and government grant awards under which it receives payments. Significant agreements and grant awards include the following: -- In 1999, the Company and Ethicon, Inc., a division of Johnson & Johnson, signed an agreement (the "Ethicon Agreement") providing Ethicon with exclusive marketing and distribution rights to INTEGRA(R) Dermal Regeneration Template worldwide, excluding Japan. Under the Ethicon Agreement, the Company will continue to manufacture INTEGRA(R) Dermal Regeneration Template and will collaborate with Ethicon to conduct research and development and clinical research aimed at expanding indications and developing future products in the field of skin repair and regeneration. Upon signing the Ethicon Agreement, the Company received a nonrefundable payment from Ethicon of $5.3 million for the exclusive use of the Company's trademarks and regulatory filings related to INTEGRA(R) Dermal Regeneration Template and certain other rights. This amount was initially recorded as deferred revenue and is being recognized as revenue in accordance with the Company's revenue recognition policy for nonrefundable, up-front fees received. The unamortized balance of $4.5 million at December 31, 2000 is recorded in deferred revenue, of which $0.5 million is classified as short-term. Additionally, the Ethicon Agreement requires Ethicon to make nonrefundable payments to the Company each year based upon minimum purchases of INTEGRA(R) Dermal Regeneration Template. The Ethicon Agreement also provides for annual research funding of $2.0 million for the years 2000 through 2004, after which such funding amounts will be determined based on a formula. Additional funding will be received upon the occurrence of certain clinical and regulatory events and for funding certain expansions of the Company's INTEGRA(R) Dermal Regeneration Template production capacity. In 2000, the Company received $750,000 of event-related payments from Ethicon which were recorded in Other revenue in accordance with the Company's revenue recognition policy. -- The Company was awarded a three-year, $2.0 million Department of Commerce grant award in April 1998 under the National Institute of Standards and Technology program for continued work on a class of biodegradable polymers licensed from Rutgers University. -- In March 1998, the Company entered into a series of agreements with Century Medical, Inc ("CMI"), a wholly-owned subsidiary of ITOCHU Corporation, under which CMI is underwriting the costs of the Japanese clinical trials and regulatory approval processes for certain of the Company's neurosurgical products and will distribute these products in Japan. In connection with these agreements, CMI paid the Company a $1.0 million non-refundable, upfront fee as partial reimbursement of research and development costs previously expended by the Company, which was recorded in Other revenue when received in 1998. In connection with the adoption of SAB 101 in 2000, the Company recorded a $470,000 cumulative effect of an accounting change to defer a portion of this up-front fee (see Note 2). F-32 INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS 14. DEVELOPMENT, DISTRIBUTION, AND LICENSE AGREEMENTS AND GOVERNMENT GRANTS (CONTINUED) -- In January 1996, the Company and Cambridge Antibody Technology Limited ("CAT") entered into an agreement consisting of a license to CAT of certain rights to use anti-TGF-(beta) antibodies for the treatment of fibrotic diseases. The Company will receive royalties upon the sale by CAT of licensed products. In September, 2000, Genzyme General ("Genzyme") and CAT announced a broad collaboration for the development of human anti-TGF-beta monocloncal antibodies, which collaboration would include the use of the intellectual property licensed by the Company from The Burnham Institute ("Burnham"). In return for certain payments to the Company and Burnham, and certain rights to other intellectual property owned by or licensed to CAT, the Company and Burnham transferred various rights to anti-TGF-(beta) antibodies to CAT and Genzyme. The Company received a nonrefundable payment of $720,000 from CAT in connection with this transaction, which was recorded in Other revenue in accordance with the Company's revenue recognition policy. 15. COMMITMENTS AND CONTINGENCIES As consideration for certain technology, manufacturing, distribution and selling rights and licenses granted to the Company, the Company has agreed to pay royalties on the sales of products that are commercialized relative to the granted rights and licenses. Royalty payments under these agreements by the Company were not significant for any of the periods presented. Various lawsuits claims and proceedings are pending or have been settled by the Company. The most significant of those are described below. In July 1996, the Company filed a patent infringement lawsuit in the United States District Court for the Southern District of California against Merck KGaA, a German corporation, Scripps Research Institute, a California nonprofit corporation, and David A. Cheresh, Ph.D., a research scientist with Scripps, seeking damages and injunctive relief. The complaint charged, among other things, that the defendant Merck KGaA willfully and deliberately induced, and continues to willfully and deliberately induce, defendants Scripps Research Institute and Dr. David A. Cheresh to infringe certain of the Company's patents. These patents are part of a group of patents granted to The Burnham Institute and licensed by the Company that are based on the interaction between a family of cell surface proteins called integrins and the arginine-glycine-aspartic acid (known as "RGD") peptide sequence found in many extracellular matrix proteins. The defendants filed a countersuit asking for an award of defendants' reasonable attorney fees. This case went to trial in February 2000, and on March 17, 2000, a jury returned a unanimous verdict for the Company, finding that Merck KGaA had willfully infringed and induced the infringement of the Company's patents, and awarded $15,000,000 in damages. The court dismissed Scripps and Dr. Cheresh from the case. On October 6, 2000, the United States District Court for the Southern District of California entered judgment in the Company's favor and against Merck KGaA in the case. In entering the judgment, the court also granted the Company pre-judgment interest of approximately $1,350,000, bringing the total amount to approximately $16,350,000, plus post-judgment interest. Various post-trial motions are pending, including requests by Merck KGaA for a new trial or a judgment as a matter of law notwithstanding the verdict, which could have the effect of reducing the judgment or reversing the verdict of the jury. In addition, if the Company wins these post-trial motions, we expect Merck KGaA to appeal various decisions of the Court. No amounts for this favorable verdict have been reflected in the Company's financial statements. Bruce D. Butler, Ph.D., Bruce A. McKinley, Ph.D., and C. Lee Parmley (the "Optex Claimants"), each parties to a Letter Agreement (the "Letter Agreement") with Camino NeuroCare, Inc., a wholly-owned subsidiary of the Company ("Camino"), dated as of December 18, 1996, alleged that Camino breached the terms of the Letter Agreement prior to the Company's acquisition of the NeuroCare Group (Camino's prior parent company). In August, 2000, the Company and the Optex Claimants reached an agreement whereby the Company paid the Optex Claimants $250,000 cash and issued 45,000 shares of the Company's common stock, valued at $641,250, in settlement of all claims under the Letter Agreement. Subsequent to the settlement of this matter, the Company F-33 INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS 15. COMMITMENTS AND CONTINGENCIES (CONTINUED) received $350,000 from the seller of the NeuroCare Group through assertion of the Company's right of indemnification. The Company did not record any provision for this matter, as liabilities recorded at the time of the Company's acquisition of the NeuroCare Group and the $350,000 indemnification payment were adequate to cover this liability. In 1995, the Company's subsidiary filed a complaint against a distributor claiming the distributor breached a distribution agreement by, among other things, not paying the Company's subsidiary for certain products delivered. In 1998, the Company and the distributor entered into a settlement agreement in which the distributor agreed to pay an aggregate of $550,000 in installments over the remainder of 1998. The Company recorded a net gain in other income in 1998 of $550,000 as a result of the settlement. The Company is also subject to other claims and lawsuits in the ordinary course of our business, including claims by employees or former employees and with respect to our products. In the opinion of management, such other claims are either adequately covered by insurance or otherwise indemnified, and are not expected, individually or in the aggregate, to result in a material adverse effect on the Company's financial condition. The Company's financial statements do not reflect any material amounts related to possible unfavorable outcomes of the matters above or others. 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. 16. SEGMENT AND GEOGRAPHIC INFORMATION The Company's operations consist of (1) Integra NeuroSciences, which is a leading provider of implants, devices, and monitors used in neurosurgery, neurotrauma, and related critical care and (2) Integra LifeSciences, which develops and manufactures a variety of medical products and devices, including products based on the Company's proprietary tissue regeneration technology which are used to treat soft tissue and orthopedic conditions. Integra NeuroSciences sells primarily through a direct sales organization and Integra LifeSciences sells primarily through strategic alliances and distributors. Selected financial information on the Company's business segments is reported below: INTEGRA INTEGRA TOTAL NEURO- LIFE REPORTABLE SCIENCES SCIENCES SEGMENTS ----------- ----------- ----------- (IN THOUSANDS) 2000 ------ Product sales .... $ 44,845 $ 20,142 $ 64,987 Total revenue .... 46,045 25,604 71,649 Operating expenses .... 39,516 21,670 61,186 Operating income .... 6,529 3,934 10,463 Depreciation included in segment operating expenses .... 1,457 1,158 2,615 1999 ------ Product sales .... $ 22,412 $ 17,635 $ 40,047 Total revenue .... 22,662 20,214 42,876 Operating expenses .... 25,943 22,274 48,217 Operating loss .... (3,281) (2,060) (5,341) Depreciation included in segment operating expenses .... 1,062 870 1,932 F-34 INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS 16. SEGMENT AND GEOGRAPHIC INFORMATION (CONTINUED) INTEGRA INTEGRA TOTAL NEURO- LIFE REPORTABLE SCIENCES SCIENCES SEGMENTS ----------- ----------- ----------- (IN THOUSANDS) 1998 ------ Product sales .... $-- $ 14,182 $ 14,182 Total revenue .... 1,027 16,534 17,561 Operating expenses .... 2,010 22,443 24,453 Operating loss .... (983) (5,909) (6,892) Depreciation included in segment operating expenses .... 41 1,034 1,075 Product sales and the related cost of product sales between segments are eliminated in computing segment operating results. The Company does not disaggregate nonoperating revenues and expenses nor identifiable assets on a segment basis. A reconciliation of the amounts reported for total reportable segments to the consolidated financial statements is as follows: 2000 1999 1998 ------- --------- ---------- (IN THOUSANDS) Operating expenses: Total reportable segments .... $ 61,186 $ 48,217 $ 24,453 Plus: Corporate general and administrative expenses .... 19,703 6,165 7,239 Amortization .... 2,481 874 49 --------- --------- --------- Consolidated total operating expenses ...... $ 83,370 $ 55,256 $ 31,741 Operating income (loss): Total reportable segments .... $ 10,463 $ (5,341) $ (6,892) Less: Corporate general and administrative expenses .... 19,703 6,165 7,239 Amortization .... 2,481 874 49 --------- --------- --------- Consolidated operating loss .... $(11,721) $(12,380) $(14,180) Included in corporate general and administrative expenses in 2000 was the $13.5 million stock-based charge recorded in connection with the issuance of the Restricted Units in the fourth quarter of 2000. Product sales and long-lived assets by major geographic area are summarized below: UNITED ASIA OTHER CONSOLI- STATES EUROPE PACIFIC FOREIGN DATED ---------- ---------- ---------- ---------- ---------- (IN THOUSANDS) Product sales: 2000 .... $51,379 $ 6,759 $ 4,628 $ 2,221 $64,987 1999 .... 30,982 4,664 3,299 1,102 40,047 1998 .... 11,867 1,799 507 9 14,182 Long-lived assets: 2000 .... $33,428 $ 6,869 $-- $-- $40,297 1999 .... 23,447 -- -- -- 23,447 1998 .... 7,780 -- -- -- 7,780 F-35 INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS 17. SELECTED QUARTERLY INFORMATION (UNAUDITED) FOURTH QUARTER THIRD QUARTER SECOND QUARTER FIRST QUARTER ---------- --------------------- --------------------- -------------------- PREVIOUSLY PREVIOUSLY PREVIOUSLY REPORTED REPORTED RESTATED REPORTED RESTATED REPORTED RESTATED ---------- ---------- ---------- ---------- --------- ---------- -------- (IN THOUSANDS, EXCEPT PER SHARE DATA) Year Ended December 31, 2000: Total revenue .... $ 20,251 $ 19,559 $ 19,781 $ 16,915 $ 17,086 $ 14,407 $ 14,531 Cost of product sales .... 8,108 7,345 7,504 7,062 7,212 6,592 6,687 Total other operating expenses .... 24,037 10,258 10,294 10,469 10,462 9,065 9,066 Operating income (loss) .... (11,894) 1,956 1,983 (616) (588) (1,250) (1,222) Net income (loss) before cumulative effect of accounting change .... (11,776) 1,717 1,744 84 112 (1,063) (1,035) Cumulative effect of accounting change .... -- -- -- -- -- -- (470) -------- -------- -------- -------- -------- -------- -------- Net income (loss) .... $(11,776) $ 1,717 $ 1,744 $ 84 $ 112 $ (1,063) $ (1,505) Basic net income (loss) per share before cumulative effect of accounting change .... $ (0.67) $ 0.08 $ 0.08 $ (0.02) $ (0.02) $ (0.32) $ (0.32) Cumulative effect of accounting change .... -- -- -- -- -- -- (0.03) -------- -------- -------- -------- -------- -------- -------- Basic net income (loss) per share .... $ (0.67) $ 0.08 $ 0.08 $ (0.02) $ (0.02) $ (0.32) $ (0.35) Diluted net income (loss) per share before cumulative effect of accounting change .... $ (0.67) $ 0.07 $ 0.07 $ (0.02) $ (0.02) $ (0.32) $ (0.32) Cumulative effect of accounting change .... -- -- -- -- -- -- (0.03) -------- -------- -------- -------- -------- -------- -------- Diluted net income (loss) per share .... $ (0.67) $ 0.07 $ 0.07 $ (0.02) $ (0.02) $ (0.32) $ (0.35) F-36 INTEGRA LIFESCIENCES HOLDINGS CORPORATION AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS 17. SELECTED QUARTERLY INFORMATION (UNAUDITED) (CONTINUED) FOURTH QUARTER THIRD QUARTER SECOND QUARTER FIRST QUARTER ------------------- --------------------- --------------------- -------------------- PREVIOUSLY PREVIOUSLY PREVIOUSLY PREVIOUSLY REPORTED RESTATED REPORTED RESTATED REPORTED RESTATED REPORTED RESTATED -------- ---------- ---------- ---------- ----------- --------- ---------- -------- (IN THOUSANDS, EXCEPT PER SHARE DATA) Year Ended December 31, 1999: Total revenue .... $ 12,845 $ 12,963 $ 12,127 $ 12,243 $ 12,550 $ 12,681 $ 4,968 $ 4,989 Cost of product sales .... 5,785 5,921 6,051 6,192 7,689 7,842 2,694 2,723 Total other operating expenses .... 8,383 8,365 8,773 8,748 9,693 9,671 5,802 5,794 --------- --------- --------- --------- --------- --------- --------- --------- Operating income (loss) .... (1,323) (1,323) (2,697) (2,697) (4,832) (4,832) (3,528) (3,528) Net income (loss).... $ (1,277) $ (1,277) $ (2,570) $ (2,570) $(4,823) $ (4,823) $ 886 $ 886 Basic net income (loss) per share .... $ (0.06) $ (0.06) $ (0.14) $ (0.14) $ (0.23) $ (0.23) $ 0.02 $ 0.02 Diluted net income (loss) per share $ (0.06) $ (0.06) $ (0.14) $ (0.14) $ (0.23) $ (0.23) $ 0.02 $ 0.02 As the result of the adoption of SEC Staff Accounting Bulletin No. 101 Revenue Recognition, the Company recorded a $470,000 cumulative effect of an accounting change in the first quarter of 2000 to defer a portion of an up-front licensing fee received and recorded in other revenue in 1998. The cumulative effect of this accounting change was measured as of January 1, 2000. As a result of this accounting change, other revenue in each of the first three quarterly periods in the year ended December 31, 2000 has been restated to reflect an additional $28,000 of amortization related to this licensing fee. As the result of the adoption of EITF 00-10 Accounting for Shipping and Handling Fees and Costs, we have reclassified shipping and handling fees billed to customers into products sales and the related expenses in cost of product sales for all quarterly periods presented. The adoption of this accounting policy did not affect operating results or net income (loss). 18. SUBSEQUENT EVENTS On March 16, 2001, the Company signed an agreement to acquire all of the stock of GMSmbH ("GMS"), the German manufacturer of the LICOX(R) Brain Tissue Oxygen Monitoring System (the "LICOX system"), for approximately $1.2 million in cash and approximately $1.3 million in assumed debt. The LICOX system allows for continuous qualitative regional monitoring of dissolved oxygen in body fluids and tissues. Prior to the acquisition of GMS, the Integra NeuroSciences division served as the distributor of the LICOX system in the United States and the United Kingdom. The acquisition is expected to close in the second quarter of 2001. F-37 3,750,000 SHARES INTEGRA LIFESCIENCES HOLDINGS CORPORATION COMMON STOCK ---------- PROSPECTUS ---------- U.S. BANCORP PIPER JAFFRAY ABN AMRO ROTHSCHILD LLC CIBC WORLD MARKETS ADAMS, HARKNESS & HILL, INC. , 2001 PART II INFORMATION NOT REQUIRED IN PROSPECTUS ITEM 14. OTHER EXPENSES OF ISSUANCE AND DISTRIBUTION OF INTEGRA The following table sets forth the various expenses in connection with the sale and distribution of the securities being registered, other than the underwriting discounts and commissions. All amounts shown are estimates except for the SEC registration fee and the NASD filing fee. All of these fees are being paid by Integra. Registration fee .... $ 24,581 NASD Filing Fee .... $ 10,400 Blue Sky Fees and Expenses .... 5,000 Legal fees and expenses .... 250,000 Accounting fees and expenses .... 75,000 Printing and engraving expenses .... 110,000 Miscellaneous .... 125,019 Total .... $600,000 ITEM 15. INDEMNIFICATION OF OFFICERS AND DIRECTORS Officers and directors of Integra are covered by certain provisions of the DGCL, the charter, the bylaws and insurance policies which serve to limit, and, in certain instances, to indemnify them against, certain liabilities which they may incur in such capacities. These various provisions are described below. ELIMINATION OF LIABILITY IN CERTAIN CIRCUMSTANCES. In June 1986, Delaware enacted legislation which authorizes corporations to limit or eliminate the personal liability of directors to corporations and their stockholders for monetary damages for breach of directors' fiduciary duty of care. This duty of care requires that, when acting on behalf of the corporation, directors must exercise an informed business judgment based on all significant information reasonably available to them. Absent the limitations now authorized by such legislation, directors are accountable to corporations and their stockholders for monetary damages for conduct constituting negligence or gross negligence in the exercise of their duty of care. Although the statute does not change directors' duty of care, it enables corporations to limit available relief to equitable remedies such as injunction or rescission. The charter limits the liability of directors to Integra or its stockholders (in their capacity as directors but not in their capacity as officers) to the fullest extent permitted by such legislation. Specifically, the directors of

Integra will not be personally liable for monetary damages for breach of a director's fiduciary duty as director, except for liability: (1) for any breach of the director's duty of loyalty to Integra or its stockholders; (2) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; (3) for unlawful payments of dividends or unlawful share repurchases or redemptions as provided in Section 174 of the DGCL; or (4) for any transaction from which the director derived an improper personal benefit. INDEMNIFICATION AND INSURANCE. As a Delaware corporation, Integra has the power, under specified circumstances generally requiring the director or officer to act in good faith and in a manner he reasonably believes to be in or not opposed to Integra's best interests, to indemnify its directors and officers in connection with actions, suits or proceedings brought against them by a third party or in the name of Integra, by reason of the fact that they were or are such directors or officers, against expenses, judgments, fines and amounts paid in settlement in connection with any such action, suit or proceeding. The bylaws generally provide for mandatory indemnification of Integra's directors and officers to the full extent provided by Delaware corporate law. In addition, Integra has entered into indemnification agreements with its directors and officers which generally provide for mandatory indemnification under circumstances for which indemnification would otherwise be discretionary under Delaware law. II-1 Integra intends to purchase and maintain insurance on behalf of any person who is or was a director or officer of Integra, or is or was a director or officer of Integra serving at the request of Integra as a director, officer, employee or agent of another corporation, partnership, joint venture, trust, employee benefit plan or other enterprise against any liability asserted against him and incurred by him in any such capacity, or arising out of his status as such, whether or not Integra would have the power or obligation to indemnify him against such liability under the provisions of the bylaws. ITEM 16. EXHIBITS EXHIBIT NUMBER DESCRIPTION ---------- --- 1.1+ Form of Underwriting Agreement. 2.1(1) Asset Purchase Agreement, dated as of January 14, 2000, by and among Clinical Neuro Systems, Inc., Surgical Sales Corporation (trading as CONNELL NEUROSURGICAL) and George J. Connell. 2.2(2) Purchase Agreement, dated January 5, 1999, among Integra LifeSciences Corporation, Rystan Company, Inc., and Healthpoint, Ltd.** 2.3(3) Asset Purchase Agreement, dated as of March 29, 1999, by and among Heyer-Schulte Neurocare, L.P., Neuro Navigational, L.L.C., Integra Neurocare LLC and Redmond Neurocare LLC**. 2.4(6) Purchase Agreement, dated March 20, 2000, by and among NMT Medical, Inc., NMT Neurosciences (US), Inc., NMT Neurosciences Holdings (UK) Ltd., NMT Neurosciences (UK) Ltd., Spembly Medical Ltd., Spembly Cryosurgery Ltd., Swedemed AB, Integra NeuroSciences Holdings (UK) Ltd. and Integra Selector Corporation. 2.5(6) Asset Purchase Agreement, dated March 20, 2000, by and among NMT Neurosciences (US), Inc., NMT Medical, Inc. and Integra Selector Corporation. 4.1(4) Certificate of Designation, Preferences and Rights of Series A Convertible Preferred Stock as filed with the Delaware Secretary of State on April 14, 1998. 4.2(5) Certificate of Designation, Preferences and Rights of Series B Convertible Preferred Stock as filed with the Delaware Secretary of State on March 12, 1999. 4.3(3) Warrant to Purchase 60,000 shares of Common Stock of Integra LifeSciences Corporation issued to SFM Domestic Investments LLC. 4.4(3) Warrant to Purchase 180,000 shares of Common Stock of Integra LifeSciences Corporation issued to Quantum Industrial Partners LDC. 4.5(7) Certificate of Designation, Rights and Preferences of Series C Convertible Preferred Stock of Integra LifeSciences Holdings Corporation dated March 21, 2000. 4.6(7) Certificate of Amendment of Certificate of Designation, Rights and Preferences of Series B Convertible Preferred Stock of Integra LifeSciences Holdings Corporation dated March 21, 2000. 4.7(7) Warrant to Purchase 270,550 Shares of Common Stock of Integra LifeSciences Holdings Corporation issued to Quantum Industrial Partners LDC. 4.8(7) Warrant to Purchase 29,450 Shares of Common Stock of Integra LifeSciences Holdings Corporation issued to SFM Domestic Investments LLC. 4.9(8) Stock Option Grant and Agreement dated December 22, 2000 between Integra LifeSciences Holdings Corporation and Stuart M. Essig. 4.10(8)Stock Option Grant and Agreement dated December 22, 2000 between Integra LifeSciences Holdings Corporation and Stuart M. Essig. 4.11(8)Restricted Units Agreement dated December 22, 2000 between Integra LifeSciences Holdings Corporation and Stuart M. Essig. 4.12(9)Second Amendment to Certificate of Rights, Designations and Preferences of Series B Convertible Preferred Stock. 4.13(9)First Amendment to Certificate of Rights, Designations and Preferences of Series C Convertible Preferred Stock. II-2 ITEM 16. EXHIBITS (CONTINUED) EXHIBIT NUMBER DESCRIPTION --------- --- 5.1+ Opinion of Latham & Watkins regarding legality of securities being registered hereunder. 12.1* Statement of the Calculation of Ratio of Earnings to Fixed Charges and Statement of the Calculation of Ratio of Earnings to Combined Fixed Charges and Preferred Stock Dividends. 21.1* Subsidiaries of the Company 23.1 Consent of Latham & Watkins (contained in their opinion filed as Exhibit 5.1) 23.2 Consent of PricewaterhouseCoopers LLP, independent accountants 24.1* Power of Attorney (included in signature page) ------------- * Previously filed with the original filing of this Registration Statement on Form S-3 (Registration No. 333-62176) on June 1, 2001. + Previously filed with Amendment No. 3 to this Registration Statement on Form S-3 (Registration No. 333-62176) on August 3, 2001. ** Schedules and other attachments to the indicated exhibit were omitted. We agree to furnish supplementally to the SEC upon request a copy of any omitted schedules or attachments. (1) Filed as an exhibit to Integra's Current Report on Form 8-K dated January 14, 2000, and incorporated herein by reference. (2) Filed as an exhibit to Integra's Current Report on Form 8-K dated January 5, 1999, and incorporated herein by reference. (3) Filed as an exhibit to Integra's Current Report on Form 8-K dated March 29, 1999, and incorporated herein by reference. (4) Filed as an exhibit to Integra's Quarterly Report on Form 10-Q for the quarter ended March 31, 1998, as filed with the SEC on May 15, 1998, and incorporated by reference herein. (5) Filed as an exhibit to Integra's Annual Report on Form 10-K for the fiscal year ended December 31, 1998, as filed with the , and incorporated herein by reference. (6) Filed as an exhibit to Integra's Current Report on Form 8-K dated March 20, 2000, and incorporated herein by reference. (7) Filed as an exhibit to Integra's Current Report on Form 8-K dated March 29, 2000, and incorporated herein by reference. (8) Filed as an exhibit to Integra's Current Report on Form 8-K dated December 22, 2000, and incorporated herein by reference. (9) Filed as an exhibit to Integra's Current Report on Form 8-K dated May 15, 2001, and incorporated herein by reference. ITEM 17. UNDERTAKINGS. (a) The undersigned Registrant hereby undertakes that, for purposes of determining any liability under the Securities Act of 1933, each filing of the Registrant's annual report pursuant to Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934 (and, where applicable, each filing of an employee benefit plan's annual report pursuant to Section 15(d) of the Securities Exchange Act of 1934) that is incorporated by reference in the registration statement shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof. (b) Insofar as indemnification for liabilities arising under the Securities Act of 1933 may be permitted to directors, officers and controlling persons of the registrant under provisions described in Item 15 or otherwise, the registrant has been advised that in the opinion of the Securities and Exchange Commission such indemnification is against public policy as expressed in the Securities Act of 1933 and is, therefore, unenforceable. If a claim for indemnification against such liabilities (other than the payment by the registrant of expenses incurred or paid by a director, officer or controlling person of the registrant in the successful defense of any action, suit or proceeding) is asserted by such director, officer or controlling person in connection with the securities being registered, the registrant will, unless in the opinion of its counsel the matter has been settled by controlling precedent, submit to a court of appropriate jurisdiction the question whether such indemnification by it is against public policy as expressed in the Securities Act of 1933 and will be governed by the final adjudication of such issue. (c) The undersigned Registrant hereby undertakes that: (1) For purposes of determining any liability under the Securities Act of 1933, the information omitted from the form of prospectus filed as a part of this Registration II-3 Statement in reliance upon Rule 430A and contained in the form of prospectus filed by the Registrant pursuant to Rule 424(b)(1) or (4) or 497(h) under the Securities Act of 1933 shall be deemed part of this Registration Statement as of the time it was declared effective. (2) For the purpose of determining any liability under the Securities Act of 1933, each post-effective amendment that contains a form of prospectus shall be deemed to be a new Registration Statement relating to the securities offered therein, and the offering of such securities at such time shall be deemed to be the initial bona fide offering thereof. II-4 SIGNATURES Under the requirements of the Securities Act of 1933, as amended, the Registrant certifies that it has reasonable grounds to believe that it meets all of the requirements for filing on Form S-3, and has duly caused this Amendment No. 4 to this Registration Statement on Form S-3 to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Plainsboro, State of New Jersey, on August 6, 2001. INTEGRA LIFESCIENCES HOLDINGS CORPORATION By: /s/ JOHN B. HENNEMAN, III ------------------------------- John B. Henneman, III Senior Vice President, Chief Administrative Officer Under the requirements of the Securities Act of 1933, as amended, this Amendment No. 4 to this Registration Statement has been signed by the following persons in the capacities and on the dates indicated. SIGNATURE TITLE DATE ----------------------------- --------------------------- ------------- President, Chief Executive August 6, 2001 * Officer and Director ----------------------------- Stuart M. Essig Executive Vice President, August 6, 2001 Chief Operating Officer * and Director ----------------------------- George W. McKinney, III, Ph.D. * Senior Vice President, August 6, 2001 Finance ----------------------------- David B. Holtz * Chairman and Director August 6, 2001 ----------------------------- Richard E. Caruso, Ph.D * Director August 6, 2001 ----------------------------- James M. Sullivan * Director August 6, 2001 ----------------------------- Keith Bradley, Ph.D. * Director August 6, 2001 ----------------------------- Neal Moszkowski /s/ JOHN B. HENNEMAN, III ----------------------------- *By: John. B. Henneman, III ATTORNEY-IN-FACT II-5