

INTEGRA LIFESCIENCES HOLDINGS CORP  
Form 10-Q  
July 26, 2017  
UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2017

or

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

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

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

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

311 ENTERPRISE DRIVE	08536
PLAINSBORO, NEW JERSEY	
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)	(ZIP CODE)
REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (609) 275-0500	

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past

90 days. Yes ☒ No ☐

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

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

Large accelerated filer ☒ Accelerated filer ☐

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

Emerging growth company ☐

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

The number of shares of the registrant's Common Stock, \$0.01 par value, outstanding as of July 24, 2017 was 78,078,309.

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2017	2016	2017	2016
Total revenue, net	\$282,164	\$249,309	\$540,801	\$486,079
Costs and expenses:				
Cost of goods sold	98,998	89,565	185,583	174,338
Research and development	15,747	14,679	31,241	29,130
Selling, general and administrative	145,015	119,217	287,512	231,192
Intangible asset amortization	5,419	3,471	9,520	6,943
Total costs and expenses	265,179	226,932	513,856	441,603
Operating income	16,985	22,377	26,945	44,476
Interest income	64	6	71	12
Interest expense	(6,181)	(6,588)	(11,312)	(12,961)
Other expense, net	(2,866)	(852)	(2,956)	(1,590)
Income before income taxes	8,002	14,943	12,748	29,937
Income tax (benefit) expense	(2,833)	2,188	(4,482)	3,764
Net income	\$10,835	\$12,755	\$17,230	\$26,173
Net income per share				
Basic	\$0.14	\$0.17	\$0.23	\$0.35
Diluted	\$0.14	\$0.16	\$0.22	\$0.34
Weighted average common shares outstanding (See Note 10):				
Basic	76,213	74,392	75,487	74,074
Diluted	78,963	78,710	78,703	77,542
Comprehensive income (See Note 11)	\$28,131	\$5,844	\$40,226	\$30,499

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

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INTEGRA LIFESCIENCES HOLDINGS CORPORATION  
 CONDENSED CONSOLIDATED BALANCE SHEETS  
 (UNAUDITED)

(In thousands, except per share amount)

	June 30, 2017	December 31, 2016
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 154,600	\$ 102,055
Trade accounts receivable, net of allowances of \$7,530 and \$6,319	171,323	148,186
Inventories, net	234,680	217,263
Prepaid expenses and other current assets	55,563	27,666
Total current assets	616,166	495,170
Property, plant and equipment, net	232,074	222,369
Intangible assets, net	648,744	561,175
Goodwill	585,410	510,571
Deferred tax assets	6,214	6,935
Other assets	12,523	11,734
Total assets	\$2,101,131	\$ 1,807,954
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Short-term portion of borrowings under senior credit facility	\$ 12,500	\$ —
Accounts payable, trade	42,193	29,057
Deferred revenue	8,424	6,812
Accrued compensation	47,380	52,762
Accrued expenses and other current liabilities	67,380	34,970
Total current liabilities	177,877	123,601
Long-term borrowings under senior credit facility	867,500	665,000
Deferred tax liabilities	131,255	148,941
Other liabilities	29,944	30,745
Total liabilities	1,206,576	968,287
Commitments and contingencies		
Stockholders' equity:		
Preferred stock; no par value; 15,000 authorized shares; none outstanding	—	—
Common stock; \$0.01 par value; 240,000 authorized shares; 80,363 and 77,666 issued at June 30, 2017 and December 31, 2016, respectively	804	777
Additional paid-in capital	812,250	798,652
Treasury stock, at cost; 2,921 shares and 2,946 shares at June 30, 2017 and December 31, 2016, respectively	(122,014 )	(123,051 )
Accumulated other comprehensive loss	(34,158 )	(57,154 )
Retained earnings	237,673	220,443
Total stockholders' equity	894,555	839,667
Total liabilities and stockholders' equity	\$2,101,131	\$ 1,807,954

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

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

	Six Months Ended June 30,	
	2017	2016
<b>OPERATING ACTIVITIES:</b>		
Net income	\$ 17,230	\$ 26,173
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	41,312	36,267
Deferred income tax	(1,138)	(642)
Amortization of debt issuance costs	784	1,236
Non-cash interest expense	—	4,168
Realized loss on sale of short-term investment	2,287	—
Loss on disposal of property and equipment	452	1,184
Change in fair value of contingent consideration and other	(1,995)	251
Share-based compensation	11,050	7,897
Changes in assets and liabilities, net of business acquisitions:		
Accounts receivable	(11,303)	(13,525)
Inventories	(5,464)	(7,362)
Prepaid expenses and other current assets	(9,236)	4,362
Other non-current assets	(1,811)	(571)
Accounts payable, accrued expenses and other current liabilities	20,287	2,237
Deferred revenue	2,083	2,510
Other non-current liabilities	(6,785)	(1,076)
Net cash provided by operating activities	57,753	63,109
<b>INVESTING ACTIVITIES:</b>		
Purchases of property and equipment	(22,010)	(19,162)
Proceeds from sale of property and equipment	143	—
Cash used in business acquisition, net of cash acquired	(225,744)	—
Cash received from business acquisition purchase price adjustment	—	224
Change in restricted cash	—	4,165
Proceeds from sale of short-term investments	16,951	—
Net cash used in investing activities	(230,660)	(14,773)
<b>FINANCING ACTIVITIES:</b>		
Borrowings under senior credit facility	245,000	15,000
Repayments under senior credit facility	(30,000)	(28,750)
Net cash received for contingent consideration	87	—
Principal payments under capital lease obligations	—	(323)
Proceeds from exercised stock options	9,774	9,260
Cash taxes paid in net equity settlement	(6,498)	(4,269)
Net cash provided by (used in) financing activities	218,363	(9,082)
Effect of exchange rate changes on cash and cash equivalents	7,089	(583)
Net increase in cash and cash equivalents	52,545	38,671
Cash and cash equivalents at beginning of period	102,055	48,132
Cash and cash equivalents at end of period	\$ 154,600	\$ 86,803

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



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INTEGRA LIFESCIENCES HOLDINGS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. BASIS OF PRESENTATION

General

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

In the opinion of management, the June 30, 2017 unaudited condensed consolidated financial statements contain all adjustments (consisting only of normal recurring adjustments) necessary for a fair statement of the financial position, results of operations and cash flows of the Company. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted in accordance with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. These unaudited condensed consolidated financial statements should be read in conjunction with the Company’s consolidated financial statements for the year ended December 31, 2016 included in the Company’s Annual Report on Form 10-K. The December 31, 2016 consolidated balance sheet was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States. Operating results for the three- and six-month periods ended June 30, 2017 are not necessarily indicative of the results to be expected for the entire year.

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

Amendment to the Certificate of Incorporation and Stock Split

On October 25, 2016, the Board of Directors recommended, subject to stockholder approval, an Amendment to the Company’s Certificate of Incorporation (the “Amendment”) to increase the number of authorized shares of common stock from 60.0 million shares to 240.0 million shares with \$0.01 per share par value, for the purpose of, among other things, effecting a two-for-one stock split. The stockholders approved the amendment at its special meeting of stockholders on December 21, 2016, and the Company subsequently filed a certificate of amendment to its Amended and Restated Certificate of Incorporation to effect the increase in the number of authorized shares of common stock and the two-for-one-stock split. Stockholders of record, as of the close of market on December 21, 2016, became entitled to receive one additional share of common stock for each share held. The shares were distributed on January 3, 2017. No fractional shares of common stock were issued as a result of the stock split. The adjusted stock price was reflected on the NASDAQ stock market beginning on January 4, 2017.

The shares of common stock retain a par value of \$0.01 per share. Accordingly, the stockholders' equity reflects the stock split by reclassifying from "additional paid-in capital" to "common stock" an amount equal to the par value of the increased shares resulting from the stock split. All share and per share amounts of common stock contained in the Company's financial statements have been restated for all periods to give retroactive effect to the stock split.

Johnson & Johnson's Codman Neurosurgery Business

On February 14, 2017, the Company entered into a binding offer letter (the “Offer Letter”) with DePuy Synthes, Inc., a Delaware corporation (“DePuy Synthes”), a wholly-owned subsidiary of Johnson & Johnson, pursuant to which Integra

made a binding offer to acquire certain assets, and assume certain liabilities, of Johnson & Johnson's Codman neurosurgery business (the "Codman Neurosurgery Transaction"). The assets and liabilities subject to the proposed Codman Neurosurgery Transaction relate to the research, development, manufacture, marketing, distribution and sale of certain products used in connection with neurosurgery procedures (the "Codman Neurosurgery Business"). The purchase price for the Codman Neurosurgery Transaction is \$1.045 billion, subject to adjustments set forth in the Purchase Agreement (as defined below) relating to the book value of inventory transferred to the Company at the closing of the Codman Neurosurgery Transaction, the book value of certain inventory retained by DePuy Synthes and the amount of certain prepaid taxes.

## INTEGRA LIFESCIENCES HOLDINGS CORPORATION

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

(continued)

Pursuant to the terms of the Offer Letter, following the conclusion of certain statutory information or consultation processes in connection with the Codman Neurosurgery Transaction by the employees of DePuy Synthes and its affiliates in France, Switzerland, and Germany, on May 11, 2017, DePuy Synthes accepted the Company's offer and countersigned the Asset Purchase Agreement (the "Purchase Agreement") with respect to the Codman Neurosurgery Transaction, previously executed by the Company. Completion of the Codman Neurosurgery Transaction remains subject to the satisfaction or waiver of customary closing conditions, including, among other things, (i) the expiration of the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended (the "HSR Act"), (ii) obtaining antitrust approvals in Spain, the United Kingdom and India, (iii) the transfer of certain product registrations required for the operation of the Codman Neurosurgery Business, (iv) the receipt of certain audited and unaudited financial statements of the Codman Neurosurgery Business, (v) the absence of a material adverse effect regarding the Codman Neurosurgery Business, and (vi) customary conditions regarding the accuracy of the representations and warranties and material compliance by the parties with their respective obligations under the Purchase Agreement. The parties have received antitrust clearance in India, the United Kingdom and Spain, and the Company is in discussions with the Federal Trade Commission for antitrust clearance under the HSR Act.

**Assets and Liabilities Held for Sale**

The Company considers assets and liabilities to be held for sale when management approves and commits to a formal plan to actively market the assets and liabilities for sale, the assets and liabilities are available for immediate sale in its present condition, an active program to locate a buyer and other actions required to complete the sale have been initiated, the sale of the assets and liabilities are expected to be completed within one year, the assets and liabilities are being actively marketed for sale at a price that is reasonable in relation to its current fair value and it is unlikely that significant changes will be made to the plan. Upon designation of the assets and liabilities as held for sale, the Company records the assets at the lower of its carrying value or its estimated fair value, less estimated costs to sell. Assets held for sale are not depreciated. Any loss resulting from this measurement is recognized in the period in which the held for sale criteria are met and gains are not recognized until the date of sale. The Company assesses the fair value of assets held for sale less any costs to sell each reporting period it remains classified as held for sale and reports any reduction in fair value as an adjustment to the carrying value of the assets held for sale.

To facilitate the Company's planned acquisition of the Codman Neurosurgery Business, the Company has identified certain assets within its Specialty Surgical Solutions segment as Assets Held for Sale as of June 30, 2017 when all of the criteria above were met. The assets are expected to be disposed of by sale in the next twelve months.

Assets and liabilities held for sale consisted of the following as of June 30, 2017 (amounts in thousands):

Inventories	\$7,674
Property, plant and equipment, net	399
Goodwill	2,911
Total assets held for sale	\$10,984

Deferred revenue	\$792
Accrued compensation	184
Total liabilities held for sale	\$976

Goodwill was allocated to the assets and liabilities held for sale using the relative fair value method. Assets and liabilities held for sale were included in prepaid expenses and other current assets and accrued expenses and other current liabilities in the consolidated balance sheet. The Company recognized no losses in its consolidated statement of operations for the three and six months ended June 30, 2017.

**Recently Issued Accounting Standards**

In May 2014, the FASB issued Update No. 2014-09, Revenue from Contracts with Customers (Topic 606). The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or

services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve that core principle, an entity should 1) identify the contract(s) with a customer, 2) identify the performance obligations in the contract, 3) determine the transaction price, 4) allocate the transaction price to the performance obligations in the contract, and 5) recognize revenue when (or as) the entity satisfies a performance obligation. This update will become effective for all annual periods and interim reporting periods beginning after December 15, 2017.

The Company will adopt this standard on January 1, 2018. The Company expects to apply the full retrospective method of adoption. The Company is progressing with the implementation and continues to evaluate the impact of the standard's revenue recognition

INTEGRA LIFESCIENCES HOLDINGS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

(continued)

model on business processes, accounting systems, controls and financial statement disclosures. The Company has reviewed significant contracts with customers and does not expect the adoption of ASU 2014-09 to have a material impact on the amount or timing of revenues recognized. However, the Company's initial conclusion may change as the implementation is finalized.

In July 2015, the FASB issued Update No. 2015-11, Simplifying the Measurement of Inventory. The amendment requires an entity to measure inventory that is within the scope of this amendment at the lower of cost and net realizable value. Existing impairment models will continue to be used for inventories that are accounted for using the last-in first-out ("LIFO") method. The ASU requires prospective adoption for inventory measurements for fiscal years beginning after December 15, 2016 and interim periods within those fiscal years for public business entities. Early adoption was permitted. The Company adopted ASU 2015-11 as of January 1, 2017 on a prospective basis, and there was no significant impact of this guidance on its consolidated financial statements.

In February 2016, the FASB issued Update No. 2016-02, Leases (Topic 842). Under current accounting guidance an entity is not required to report operating leases on the balance sheet. The amendment requires that lessees recognize virtually all of their leases on the balance sheet by recording a right-of-use asset and lease liability (other than leases that meet the definition of a "short-term lease"). This update will become effective for all annual periods and interim reporting periods beginning after December 15, 2018. The new standard must be adopted using a modified retrospective transition. Early adoption is permitted. The Company is in the process of evaluating the impact of this standard on its financial statements.

In August 2016, the FASB issued Update No. 2016-15, Classification of Certain Cash Receipts and Cash Payments. The guidance addresses the classification of cash flows related to debt repayment or extinguishment costs, settlement of zero-coupon debt instruments or debt instruments with coupon rates that are insignificant in relation to the effective interest rate of the borrowing, contingent consideration payments made after business combination, proceeds from the settlement of insurance claims and corporate-owned life insurance, distribution received from equity method investees and beneficial interest in securitization transaction. This update will become effective for all annual periods and interim reporting periods beginning after December 15, 2017. Early adoption is permitted. The Company is in the process of evaluating the impact of this standard on its financial statements.

In October 2016, the FASB issued Update No. 2016-16, Intra-Entity Transfers of Assets Other Than Inventory. The guidance requires the income tax consequences of intra-entity transfers of assets other than inventory to be recognized as current period income tax expense or benefit and removes the requirement to defer and amortize the consolidated tax consequences of intra-entity transfers. The new standard will be effective for all annual periods beginning after December 15, 2017. Early adoption is permitted. The Company is in the process of evaluating the impact of this standard on its financial statements.

In January 2017, the FASB issued Update No. 2017-01, Business Combinations. The standard provides guidance for evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. The guidance provides a screen to determine when an integrated set of assets and activities (a "set") does not qualify to be a business. The screen requires that when substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in an identifiable asset or a group of similar identifiable assets, the set of assets and activities is not a business. If the screen is not met, the guidance requires a set of assets and activities to be considered a business and to include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create outputs and removes the evaluation as to whether a market participant could replace the missing elements. The new standard will be effective for all annual periods beginning after December 15, 2017. Early adoption is permitted. The Company elected to early adopt ASU 2017-01 effective January 1, 2017. The implementation of the amended guidance did not have any material impact on the Company's consolidated financial statements.

In January 2017, the FASB issued Update 2017-04, Simplifying the Test for Goodwill Impairment. The standard eliminates the second step in the goodwill impairment test, which requires an entity to determine the implied fair value of the reporting unit's goodwill. Instead, an entity should recognize an impairment loss if the carrying value of the net assets assigned to the reporting unit exceeds the fair value of the reporting unit, with the impairment loss not to exceed

the amount of goodwill allocated to the reporting unit. The standard is effective for annual and interim goodwill impairment tests conducted in fiscal years beginning after December 15, 2019. Early adoption is permitted. The Company elected to early adopt ASU 2017-04 effective January 1, 2017 and will apply the new guidance in its annual assessment in the third quarter of 2017.

In May 2017, the FASB issued ASU 2017-09, Compensation-Stock Compensation (Topic 718): Scope of Modification Accounting. The update to provide clarity and reduce both (1) diversity in practice and (2) cost and complexity when applying the guidance in Topic 718, Compensation-Stock Compensation, to a change to the terms or conditions of a share-based payment award. The new standard will be effective for all annual periods beginning after December 15, 2017. Early adoption is permitted. The Company is in the process of evaluating the impact of this standard on its financial statements.

There are no other recently issued accounting pronouncements that are expected to have a material effect on the Company's financial position, results of operations or cash flows.

## INTEGRA LIFESCIENCES HOLDINGS CORPORATION

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

(continued)

## 2. BUSINESS ACQUISITION

## TGX Medical

On April 4, 2017, the Company entered into a Membership Interest Purchase Agreement (the "Purchase Agreement"), by and among the Company, MCF I LP THX Medical System LLC Holdings, Inc., Terragraphix, Inc. and TGX Medical Systems, LLC (collectively, "TGX Medical"). Pursuant to the Purchase Agreement, the Company purchased all issued and outstanding membership interests in TGX Medical for \$5.3 million, subject to adjustment based on actual working capital as defined in the Purchase Agreement at the date of closing.

TGX Medical designs, develops and markets software solutions that track surgical instruments from the operating room, sterilization, to storage, which helps ensure that the instruments have been properly cleaned, assembled and maintained. TGX Medical's customers are located in the U.S. and Canada.

The Company recorded revenue for TGX Medical of approximately \$0.2 million in the condensed consolidated statements of operations and comprehensive income for three months ended June 30, 2017. The net income or loss attributable to this acquisition cannot be identified on a stand-alone basis because it is in the process of being integrated into the Company's operations.

The following summarizes the preliminary allocation of the purchase price as of June 30, 2017 based on the fair value of the assets acquired and liabilities assumed:

	Preliminary Purchase Price Allocation (Dollars in thousands)	
Cash and cash equivalents	\$ 49	
Accounts receivables	279	
Property, plant and equipment	3	
Intangible assets:		Wtd. Avg. Life:
Completed technology	4,707	13 Years
Goodwill	541	
Total assets acquired	5,579	
Accounts payable	13	
Accrued expenses and other current liabilities	65	
Other liabilities	234	
Net assets acquired	\$ 5,267	

Goodwill was allocated to the Special Surgical Solutions segment. Goodwill is the excess of the consideration transferred over the net assets recognized and represents the expected revenue and cost synergies of the combined company and assembled workforce. Goodwill recognized as a result of the acquisition is not deductible for income tax purposes.

## Derma Sciences

On February 24, 2017, the Company executed the Agreement and Plan of Merger (the "Merger Agreement") under which the Company acquired all of the outstanding shares of Derma Sciences, Inc., a Delaware corporation ("Derma Sciences") for an aggregate purchase price of approximately \$210.8 million, including payment of certain of Derma Sciences' closing expenses and settlement of stock-based compensation plans of \$4.8 million and \$4.3 million, respectively. The purchase price consisted of a cash payment to the former shareholders of Derma Sciences of approximately \$201.7 million upon the closing of the transaction.

Derma Sciences is a tissue regeneration company focused on advanced wound and burn care that offers products to help manage chronic and hard-to-heal wounds, especially those resulting from diabetes and poor vascular functioning. The Company recorded revenue for Derma Sciences of approximately \$23.8 million and \$34.3 million in the condensed consolidated statements of operations and comprehensive income for the three and six months ended June 30, 2017, respectively. The net income or loss attributable to this acquisition cannot be identified on a stand-alone basis because it is in the process of being integrated into the Company's operations.



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

The following summarizes the preliminary allocation of the purchase price as of June 30, 2017 based on the fair value of the assets acquired and liabilities assumed:

	Preliminary Purchase Price Allocation (Dollars in thousands)	
Cash and cash equivalents	\$ 16,512	
Short-term investments	19,238	
Accounts receivable	8,949	
Inventory	17,977	
Prepaid expenses and other current assets	4,369	
Property, plant and equipment	4,311	
Intangible assets:		Wtd. Avg. Life:
Customer relationship	78,300	14 years
Trademarks/brand names	13,500	15 years
Completed technology	11,600	14 years
Non-compete agreement	280	1 year
Goodwill	70,700	
Deferred tax assets	17,820	
Other assets	101	
Total assets acquired	263,657	
Accounts payable	4,560	
Accrued expenses and other current liabilities	7,347	
Contingent liability	37,174	
Other liabilities	3,805	
Net assets acquired	\$ 210,771	

Goodwill was allocated to the Orthopedics and Tissue Technologies segment. Goodwill is the excess of the consideration transferred over the net assets recognized and represents the expected revenue and cost synergies of the combined company and assembled workforce. Goodwill recognized as a result of the acquisition is not deductible for income tax purposes.

The Company adjusted its preliminary purchase price allocation of other liabilities by \$1.7 million because of additional liabilities for sales and use tax, employment tax and unclaimed property.

#### Short-term Investments

Short-term investments recognized at acquisition date of Derma Sciences are investments in equity and debt securities including certificates of deposit purchased with an original maturity greater than three months which are deposited in various U.S. financial institutions and are fully insured by the Federal Deposit Insurance Corporation. The Company considers securities with original maturities of greater than 90 days to be available for sale securities. Securities under this classification are recorded at fair value and unrealized gains and losses are recorded within accumulated other comprehensive income. The estimated fair value of the available for sale securities is determined based on quoted market prices. The Company evaluates securities with unrealized losses to determine whether such losses, if any, are other than temporary. Short-term investments are classified as Level 1 in fair value hierarchy. Fair values of short-term investments are determined using the unadjusted quoted prices in active markets for identical assets or liabilities that the Company has the ability to access at the balance sheet date.

During the six months ended June 30, 2017, the Company sold the acquired short-term investments and recognized a realized loss of \$2.3 million included in other expense, net in the consolidated statement of operations.

INTEGRA LIFESCIENCES HOLDINGS CORPORATION

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

(continued)

Deferred Taxes

The acquired deferred taxes of \$17.8 million include a deferred tax asset of \$39.7 million related to a federal net operating loss which the Company expects to utilize against income in future periods, a deferred tax asset of \$15.8 million related to intangibles acquired by Derma Sciences in previous periods, and a deferred tax asset of \$0.6 million related to various deferred items, offset by a deferred tax liability of \$38.3 million for new intangibles for which the Company will not receive a tax benefit. In second quarter of 2017, the Company increased the preliminary estimated fair value of deferred tax liability by \$1.5 million to reflect the adjustments to preliminary estimated fair values of assets and liabilities acquired.

United States Food and Drug Administration ("FDA") Untitled Letter

On June 22, 2015, the FDA issued an Untitled Letter (the "Untitled Letter") alleging that BioD LLC's ("BioD") morselized amniotic membrane based products do not meet the criteria for regulation as human cellular tissue-based products ("HCT/Ps") solely under Section 361 of the Public Health Service Act and that, as a result, BioD would need a biologics license to lawfully market those morselized products (BioD is a wholly owned subsidiary of Derma Sciences). Since the issuance of the Untitled Letter, BioD and now the Company have been in discussions with the FDA to communicate its disagreement with the FDA's assertion that certain products are more than minimally manipulated and therefore do not meet the requirements for HCT/Ps. To date, the FDA has not changed its position that certain of the acquired morselized products are not eligible for marketing solely under Section 361 of the Public Health Service Act, but discussions are continuing. The Company continues to market these products.

On December 22, 2014, the FDA issued for comment "Draft Guidance for Industry and FDA Staff: Minimal Manipulation of Human Cells, Tissues, and Cellular and Tissue-Based Products." On October 28, 2015, the FDA issued for comment, "Draft Guidance for Industry and FDA Staff: Homologous Use of Human Cells, Tissues, and Cellular and Tissue-Based Products." The FDA held a public hearing on September 12 and 13, 2016 to obtain input on the Homologous Use draft guidance and the Minimal Manipulation draft guidance, as well as other recently issued guidance documents on HCT/Ps.

If the FDA does allow us to continue to market its morselized products without a 510(k) or biologics license either prior to or after finalization of the draft guidance documents, it may impose conditions on marketing, such as labeling restrictions and compliance with current Good Manufacturing Practices. Compliance with these conditions would require significant additional time and cost investments from us. It also is possible that the FDA will not allow us to market any form of a morselized product without a biologics license even prior to finalization of the draft guidance documents and could require us to recall our morselized products. We continue to market these products. The Company continues to monitor the FDA's position on these products. Any potential action of the FDA could have a financial impact on the sales of BioD's morselized amniotic tissue-based products. Revenues from BioD morselized amniotic membrane based products for the three and six months ended June 30, 2017 were less than 1.0% of consolidated revenues.

Contingent Consideration

The Company assumed contingent liabilities incurred by Derma Sciences related to its acquisitions of BioD and the intellectual property related to the Medihoney product. The Company accounted for the contingent liabilities by recording their fair value on the date of the acquisition based on a discounted cash-flow model. The contingent liabilities recognized as part of the Derma Sciences acquisition relate to the following:

- i. contractual incentive payments that could be made to former equity owners of BioD if net sales of BioD products exceed a certain amount for the twelve-month periods ending June 30, 2017 and 2018 ("BioD Earnout Payment");
- ii.

a contractual incentive payment that could be made to the former equity owners if there has been no specific enforcement action or notice by the FDA against the specific BioD products as a result of the Untitled Letter for a certain period after closing as defined by the agreement ("Product Payment"); and

- iii. contractual incentive payments that could be made to the former owner of the intellectual property relating to the Medihoney product line, if net sales of Medihoney products exceed certain amounts defined in the agreement between Derma Sciences and the former owner of the intellectual property of Medihoney for any twelve-month period ("Medihoney Earnout Payment").

At the date of the acquisition, net sales used in estimating the BioD Earnout Payment is based on the weighted average of different possible scenarios using revenue volatility of 13.5%. The BioD Earnout Payment was valued using a discount rate of 3.0%. The maximum payout related to the BioD Earnout Payment is \$26.5 million. The estimated fair value as of February 24, 2017 was \$9.1 million. As of June 30, 2017, the estimated fair value of the BioD Earnout Payment is \$7.0 million.

## INTEGRA LIFESCIENCES HOLDINGS CORPORATION

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

(continued)

At the date of acquisition, the Company estimates that the probability of the Product Payment was 98.0% and valued it at a discount rate of 2.5%. The maximum payout related to the Product Payment is \$29.7 million. The estimated fair value as of February 24, 2017 was \$26.8 million. In second quarter of 2017, the Company adjusted the preliminary estimated fair value to increase the Product Payment by \$0.9 million related to additional products that should have been included in the preliminary estimate based on the Merger Agreement. On May 25, 2017, the Company made full payment for the Product Payment of \$26.6 million. The payment was included in cash used in business acquisition, net of cash acquired within investing activities in the condensed consolidated statements of cash flows since the payment was made shortly after the acquisition.

At the date of the acquisition, net sales used in estimating the Medihoney Earnout Payment is based on the weighted average of different possible scenarios using revenue volatility of 27.5%. The Medihoney Earnout Payment was valued using a discount rate of 4.5%. The maximum payout related to the Medihoney Earnout Payment is \$5.0 million. The estimated fair value as of February 24, 2017 and June 30, 2017 was \$1.3 million.

These fair value measurements were based on significant inputs not observed in the market and thus represented a Level 3 measurement. The contingent considerations are re-measured to fair value at each reporting date until the contingency is resolved, and those changes in fair value are recognized in earnings. Depending on the expected timing of the estimated payments, the acquisition date fair values and subsequent remeasurement could be different.

## Pro Forma Results

The following unaudited pro forma financial information summarizes the results of operations for the three months ended June 30, 2016 and six months ended June 30, 2017 and 2016 as if the acquisitions had been completed as of the beginning of the prior year. The pro forma results are based upon certain assumptions and estimates, and they give effect to actual operating results prior to the acquisition and adjustments to reflect (i) the change in interest expense and intangible asset amortization, (ii) certain external expenses related to the acquisition as if they were incurred on January 1 of the year prior to the acquisition that will not be recurring in the post-acquisition periods, which includes \$2.9 million incurred by Derma Sciences prior to acquisition and \$10.2 million incurred by Integra, and (iii) income taxes on the aforementioned adjustments at the Company's statutory rate. No effect has been given to other cost reductions or operating synergies. As a result, these pro forma results do not necessarily represent results that would have occurred if the acquisition had taken place on the basis assumed above, nor are they indicative of the results of future combined operations.

	Three Months Ended June 30, 2016	Six Months Ended June 30, 2017	2016
	(In thousands, except per share amounts)		
Total revenue	\$271,737	\$553,625	\$528,750
Net income	\$12,733	\$19,878	\$15,218
Basic income per share	\$0.17	\$0.26	\$0.20

The results of operations of TGX Medical from April 1, 2017 through April 3, 2017 were immaterial.

## 3. INVENTORIES

Inventories, net consisted of the following:

	June 30, 2017	December 31, 2016
	(In thousands)	
Finished goods	\$ 141,832	\$ 127,973
Work in process	49,690	50,043

Raw materials	43,158	39,247
	\$234,680	\$ 217,263

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

#### 4. GOODWILL AND OTHER INTANGIBLE ASSETS

Changes in the carrying amount of goodwill for the six-month period ended June 30, 2017 were as follows:

	Specialty Surgical Solutions	Orthopedics and Tissue Technologies	Total
(In thousands)			
Goodwill at December 31, 2016	\$284,358	\$ 226,213	\$510,571
Derma Sciences acquisition	—	70,700	70,700
TGX Medical acquisition	541	—	541
Transfer to assets held for sale	(2,911 )	—	(2,911 )
Foreign currency translation	3,103	3,406	6,509
Balance, June 30, 2017	\$285,091	\$ 300,319	\$585,410

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

	June 30, 2017			
	Weighted Average Life	Cost	Accumulated Amortization	Net
(Dollars in thousands)				
Completed technology	17 years	\$497,079	\$ (109,454 )	\$387,625
Customer relationships	13 years	232,961	(84,592 )	148,369
Trademarks/brand names	28 years	105,147	(21,200 )	83,947
Supplier relationships	27 years	34,721	(14,378 )	20,343
All other <sup>(1)</sup>	5 years	11,498	(3,038 )	8,460
		\$881,406	\$ (232,662 )	\$648,744

	December 31, 2016			
	Weighted Average Life	Cost	Accumulated Amortization	Net
(Dollars in thousands)				
Completed technology	17 years	\$479,964	\$ (94,991 )	\$384,973
Customer relationships	12 years	152,335	(77,005 )	75,330
Trademarks/brand names	30 years	90,507	(19,158 )	71,349
Supplier relationships	27 years	34,721	(13,664 )	21,057
All other <sup>(1)</sup>	5 years	10,806	(2,340 )	8,466
		\$768,333	\$ (207,158 )	\$561,175

(1) At June 30, 2017 and December 31, 2016, all other included in-process research and development ("IPR&D") of \$1.0 million in both periods, which was indefinite-lived.

Based on quarter-end exchange rates, annual amortization expense (including amounts reported in cost of product revenues, but excluding any possible future amortization associated with acquired in-process research and development) is expected to be approximately \$48.4 million in 2017, \$49.3 million in 2018, \$49.2 million in 2019, \$49.1 million in 2020, \$48.1 million in 2021 and \$44.6 million in 2022. Identifiable intangible assets are initially recorded at fair market value at the time of acquisition using an income or cost approach.





## INTEGRA LIFESCIENCES HOLDINGS CORPORATION

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

(continued)

## 5. DEBT

## Amended and Restated Senior Credit Agreement

On March 31, 2017, the Company entered into an amendment ("March 2017 Amendment") to its fourth amended and restated Senior Credit Facility with a syndicate of lending banks and Bank of America, N.A., as Administrative Agent. The March 2017 Amendment increased the aggregate principal amount from \$1.5 billion to \$2.2 billion available to the Company through the following facilities:

## i. a \$500.0 million Term Loan A facility;

a \$700.0 million Term Loan A-1, which will be available in a single drawing on a delayed basis at the time of closing of the Asset Purchase Agreement dated February 14, 2017 between the Company and DuPuy Synthes, Inc., a wholly owned subsidiary of Johnson & Johnson to acquire certain assets, and assume certain liabilities of Johnson & Johnson's Codman neurosurgery business (see Note 1 - Basis of Presentation); and

iii. a \$1.0 billion revolving credit facility, which includes a \$60.0 million sublimit for the issuance of standby letters of credit and a \$60.0 million sublimit for swingline loans.

In connection with the March 2017 Amendment, the Company's maximum consolidated total leverage ratio in the financial covenants was increased to the following:

Fiscal Quarter	Maximum Consolidated Total Leverage Ratio
December 31, 2016 through before the first fiscal quarter after the delayed draw date of Term Loan A-1	4.50 : 1.00
First fiscal quarter ended after the delayed draw date of Term Loan A-1 through September 30, 2018	5.50 : 1.00
October 1, 2018 through September 30, 2019	5.00 : 1.00
October 1, 2019 through September 30, 2020	4.50 : 1.00
October 1, 2020 and thereafter	4.00 : 1.00

There was no change in the maturity date, which remains December 7, 2021.

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

i. the Eurodollar Rate (as defined in the amendment and restatement) in effect from time to time plus the applicable rate (ranging from 1.00% to 2.00%), or

ii. the highest of:

1. the weighted average overnight Federal funds rate, as published by the Federal Reserve Bank of New York, plus 0.50%,

2. the prime lending rate of Bank of America, N.A., or

3. the one-month Eurodollar Rate plus 1.00%.

The applicable rates are based on the Company's consolidated total leverage ratio (defined as the ratio of (a) consolidated funded indebtedness less cash in excess of \$40.0 million that is not subject to any restriction on the use or investment thereof to (b) consolidated EBITDA) at the time of the applicable borrowing.

The Company will pay an annual commitment fee ranging from 0.15% to 0.35%, based on the Company's consolidated total leverage ratio on the daily amount by which the revolving credit facility exceeds the outstanding loans and letters of credit under the credit facility.

The Senior Credit Facility is collateralized by substantially all of the assets of the Company's U.S. subsidiaries, excluding intangible assets. The Senior Credit Facility is subject to various financial and negative covenants, and, as of June 30, 2017, the Company was in compliance with all such covenants. The Company capitalized \$0.5 million of incremental financing costs in 2017 in connection with the modifications to the Senior Credit Facility.

At June 30, 2017 and December 31, 2016, there were \$380.0 million and \$165.0 million outstanding, respectively, under the revolving credit component of the Senior Credit Facility at a weighted average interest rate of 2.6% and 2.2%, respectively. At

## INTEGRA LIFESCIENCES HOLDINGS CORPORATION

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

(continued)

June 30, 2017 and December 31, 2016, there was \$500.0 million outstanding under the Term Loan A component of the Senior Credit Facility at a weighted average interest rate of 2.6% and 2.2%, respectively. At June 30, 2017, there was no outstanding balance under Term Loan A-1 component of Senior Credit Facility. At June 30, 2017, there was approximately \$1.3 billion available for borrowing under the Senior Credit Facility, including the \$700.0 million available under the Term Loan A-1 component.

The fair value of outstanding borrowings of the Senior Credit Facility's revolving credit facility and Term Loan A components at June 30, 2017 was approximately \$371.0 million and \$487.9 million, respectively. These fair values were determined by using a discounted cash flow model based on current market interest rates available to the Company. These inputs are corroborated by observable market data for similar liabilities and therefore classified within Level 2 of the fair value hierarchy. Level 2 inputs represent inputs that are observable for the asset or liability, either directly or indirectly and are other than active market observable inputs that reflect unadjusted quoted prices for identical assets or liabilities. The Company considers the balance of the revolving credit component of the Senior Credit Facility to be long-term in nature based on its current intent and ability to repay the borrowing outside the next twelve-month period.

Letters of credit outstanding as of June 30, 2017 and December 31, 2016 totaled \$0.5 million. There were no amounts drawn as of June 30, 2017.

The Company used interest rate derivative instruments to manage earnings and cash flow exposure to changes in interest rates of the Term Loan A component of the Senior Credit Facility. At June 30, 2017 and December 31, 2016, the notional amounts related to the Company's interest rate swaps were \$400.0 million and \$150.0 million, respectively.

Contractual repayments of the Term Loan A will begin March 31, 2018 and are due as follows:

Year Ended December 31,	Principal Repayment (In thousands)
2017	—
2018	25,000
2019	25,000
2020	37,500
2021	412,500
	\$ 500,000

The outstanding balance of revolving credit component of the Senior Credit Facility is due on December 7, 2021.

## 2016 Convertible Senior Notes

On December 15, 2016, the Company extinguished its 1.625% Convertible Senior Notes due in 2016 (the "2016 Convertible Notes") by paying the principal amount of \$227.1 million and issued 2.9 million shares of common stock with a fair value of \$122.0 million related to excess conversion value. No gain or loss on extinguishment was recognized as a result of the conversion. The Company also received 2.9 million shares of common stock from the exercise of call options with hedge participants with a fair value of \$123.1 million at the date of the exercise. The shares of common stock received from the exercise of the call options were held as treasury stock as of December 31, 2016 at a weighted average price of \$41.78 for a total of \$123.1 million.

The 2016 Convertible Notes were issued on June 15, 2011 with the aggregate principal of \$230.0 million and a maturity date of December 15, 2016. The 2016 Convertible Notes bore interest at a rate of 1.625% per annum payable semi-annually in arrears on December 15 and June 15 of each year. The 2016 Convertible Notes were senior, unsecured obligations and were convertible into cash and, if applicable, shares of its common stock based on a conversion rate defined within the note agreement.

In connection with the issuance of the 2016 Convertible Notes, the Company entered into call transactions and warrant transactions, primarily with affiliates of the initial purchasers of such notes (the “hedge participants”). The initial strike price of the call transaction was approximately \$28.72 per share, subject to customary anti-dilution adjustments. The initial strike price of the warrant transaction was approximately \$35.03 per share, subject to customary anti-dilution adjustments. The strike price of the call transactions and warrant transactions has been adjusted similar to the 2016 Convertible Notes as a result of the spin-off of the Company's spine business in July 2015 to \$26.42 per share and \$32.22 per share, respectively. The warrants expire on a series of expiration dates from March 2017 to August 2017. For the three and six months ended June 30, 2017, the hedge participants exercised 5,485,510 and 6,617,400 warrants, respectively and, as a result, the Company issued 1,681,707 and 1,893,420 shares of common stock for the three and six months ended June 30, 2017, respectively. The Company has 2,089,802 warrants outstanding as of June 30, 2017.

## INTEGRA LIFESCIENCES HOLDINGS CORPORATION

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

(continued)

## Convertible Note Interest

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

	Three Months Ended June 30, 2016	Six Months Ended June 30, 2016
	(In thousands)	

## 2016 Notes:

Amortization of the discount on the liability component (1)	\$ 2,104	\$ 4,168
Cash interest related to the contractual interest coupon (2)	892	1,780
Total	\$ 2,996	\$ 5,948

(1)The amortization of the discount on the liability component of the 2016 Notes is presented net of capitalized interest of \$0.1 million and \$0.2 million for the three and six months ended June 30, 2016, respectively.

(2)The cash interest related to the contractual interest coupon on the 2016 Notes is presented net of capitalized interest of none and \$0.1 million for the three and six months ended June 30, 2016. The Company capitalized a minimal amount of interest for the three months ended June 30, 2016.

## 6. DERIVATIVE INSTRUMENTS

## Interest Rate Hedging

The Company's interest rate risk relates to U.S. dollar denominated variable interest rate borrowings. The Company uses interest rate swap derivative instruments to manage earnings and cash flow exposure resulting from changes in interest rates. These interest rate swaps apply a fixed interest rate on a portion of our expected LIBOR-indexed floating-rate borrowings. The Company held the following interest rate swaps as of June 30, 2017 (amounts in thousands):

Hedged Item	Current Notional Amount	Designation Date	Effective Date	Termination Date	Fixed Interest Rate	Floating Rate	Estimated Fair Value  Assets (Liabilities)
Term Loan A	\$50,000	June 22, 2016	December 31, 2016	June 30, 2019	1.062 %	3-month BBA LIBOR	\$ 520
Term Loan A	50,000	June 22, 2016	December 31, 2016	June 30, 2019	1.062 %	3-month BBA LIBOR	517
Term Loan A	50,000	July 12, 2016	December 31, 2016	June 30, 2019	0.825 %	1-month USD LIBOR	682
Term Loan A	50,000	February 6, 2017	June 30, 2017	June 30, 2020	1.834 %	3-month USD LIBOR	(187 )
Term Loan A	100,000	February 6, 2017	June 30, 2017	June 30, 2020	1.652 %	1-month USD	(35 )

Term Loan A	100,000	March 27, 2017	December 31, 2017	June 30, 2021	1.971 %	LIBOR 1-month USD LIBOR	(562 )
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Total interested rate

derivatives designated as cash flow hedge \$400,000 \$ 935

cash flow hedge

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

#### Foreign Currency Hedging

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

## INTEGRA LIFESCIENCES HOLDINGS CORPORATION

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

(continued)

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

**Counterparty Credit Risk**

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

**Fair Value of Derivative Instruments**

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

The following table summarizes the fair value and presentation for derivatives designated as hedging instruments in the condensed consolidated balance sheets as of June 30, 2017 and December 31, 2016:

Location on Balance Sheet <sup>(1)</sup> :	Fair Value as of	
	June 30, 2017	December 31, 2016
	(In thousands)	
Derivatives designated as hedges — Assets:		
Interest rate swap — Prepaid expenses and other current assets <sup>(2)</sup>	\$660	\$ 242
Interest rate swap — Other assets <sup>(2)</sup>	\$1,293	1,629
	\$1,953	\$ 1,871
Derivatives designated as hedges — Liabilities:		
Interest rate swap — Accrued expenses and other current liabilities <sup>(2)</sup>	\$618	\$ —
Interest rate swap — Other liabilities <sup>(2)</sup>	400	—
Total Derivatives designated as hedges — Liabilities	\$1,018	\$ —

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

At June 30, 2017 and December 31, 2016, the notional amounts related to the Company's interest rate swaps were

<sup>(2)</sup> \$400.0 million and \$150.0 million, respectively. There is no expected reduction in this notional amount in the next twelve months.

## INTEGRA LIFESCIENCES HOLDINGS CORPORATION

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

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The following presents the effect of derivative instruments designated as cash flow hedges on the accompanying condensed consolidated statement of operations during the three and six months ended June 30, 2017 and 2016:

	Balance in AOCI Beginning of Quarter	Amount of Loss Recognized in AOCI- Effective Portion	Amount of Gain Reclassified from AOCI into Earnings-Effective Portion	Balance in AOCI End of Quarter	Location in Statements of Operations
(In thousands)					
Three Months Ended June 30, 2017					
Interest rate swap	\$2,479	\$ (1,500 )	\$ 44	\$ 935	Interest (expense)
	\$2,479	\$ (1,500 )	\$ 44	\$ 935	
Three Months Ended June 30, 2016					
Interest rate swap	\$—	\$ (602 )	\$ —	\$ (602 )	Interest (expense)
	\$—	\$ (602 )	\$ —	\$ (602 )	
	Balance in AOCI Beginning of Year	Amount of Loss Recognized in AOCI- Effective Portion	Amount of Gain Reclassified from AOCI into Earnings-Effective Portion	Balance in AOCI End of Quarter	Location in Statements of Operations
(In thousands)					
Six Months Ended June 30, 2017					
Interest rate swap	\$1,871	\$ (914 )	\$ 22	\$ 935	Interest (expense)
	\$1,871	\$ (914 )	\$ 22	\$ 935	
Six Months Ended June 30, 2016					
Interest rate swap	\$—	\$ (602 )	\$ —	\$ (602 )	Interest (expense)
	\$—	\$ (602 )	\$ —	\$ (602 )	

The Company recognized no gains or losses resulting from ineffectiveness of cash flow hedges during the three and six months ended June 30, 2017 and 2016. The Company expects a minimal amount of pre-tax income recorded in AOCI related to interest rate hedges to be reclassified to earnings in the next twelve months.

## 7. STOCK-BASED COMPENSATION

As of June 30, 2017, the Company had stock options, restricted stock awards, performance stock units, contract stock awards and restricted stock unit awards outstanding under two plans, the 2001 Equity Incentive Plan (the “2001 Plan”) and the 2003 Equity Incentive Plan (the “2003 Plan,” and collectively, the “Plans”).

Stock options issued under the Plans become exercisable over specified periods, generally within three to four years from the date of grant for officers and employees, and within a year from date of grant for directors and generally expire eight years from the grant date for employees, and from eight to ten years for directors and certain executive officers. Restricted stock issued under the Plans vests over specified periods, generally three years after the date of grant. The vesting of performance stock issued under the Plans is subject to service and performance conditions.

## Stock Options



As of June 30, 2017, there were approximately \$5.3 million of total unrecognized compensation costs related to unvested stock options. These costs are expected to be recognized over a weighted-average period of approximately three years. There were 186,853 stock options granted during the six months ended June 30, 2017.

## INTEGRA LIFESCIENCES HOLDINGS CORPORATION

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

(continued)

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

Performance stock, restricted stock and contract stock awards generally have requisite service periods of three years. Performance stock units are subject to graded vesting conditions, and the Company expenses their fair value over the requisite service period. The Company expenses the fair value of restricted stock and contract stock awards on a straight-line basis over the vesting period or requisite service period, whichever is shorter. As of June 30, 2017, there were approximately \$27.8 million of total unrecognized compensation costs related to these unvested awards. The Company expects to recognize these costs over a weighted-average period of approximately two years. The Company granted 340,078 restricted stock awards and 133,333 performance shares during the six months ended June 30, 2017. The Company has no formal policy related to the repurchase of shares for the purpose of satisfying stock-based compensation obligations.

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

## 8. TREASURY STOCK

On October 25, 2016, the Board of Directors terminated its October 2014 authorization for the repurchase of its outstanding common stock and authorized management to repurchase up to \$150.0 million of its outstanding common stock through December 2018. Shares may be repurchased either in the open market or in privately negotiated transactions. As of June 30, 2017 there remained \$150.0 million available for repurchase under this authorization.

As part of the conversion of the 2016 Convertible Notes, the Company received 2.9 million shares of common stock from the exercise of call options with hedge participants. The shares of common stock received from exercise of the call options are held as treasury stock, there were 2.9 million treasury stock outstanding as of June 30, 2017 and December 31, 2016, with cost of \$122.0 million and \$123.1 million, respectively, at a weighted average of \$41.78 per share.

There were no cash treasury stock repurchases during the six months ended June 30, 2017 or 2016.

## 9. INCOME TAXES

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

	Three Months		Six Months	
	Ended June 30,		Ended June 30,	
	2017	2016	2017	2016
Reported tax rate	(35.4)%	14.6%	(35.2)%	12.6%

The Company's effective income tax rates for the three months ended June 30, 2017 and 2016 were (35.4)% and 14.6%, respectively. For the three months ended June 30, 2017, the primary drivers of the lower tax rate are lower income before income taxes compared to the same period in 2016, the jurisdictional mix of income before tax in U.S.-based operations relative to foreign operations, and an increase of \$3.1 million in excess tax benefits from stock-based compensation for the three months ended June 30, 2017 compared to the same period in 2016. The change in jurisdictional mix of income primarily results from significant 2017 acquisition and integration costs incurred in the U.S. The tax rate for the three months ended June 30, 2016 included a benefit of \$0.2 million related to the release of uncertain tax positions.

The Company's effective income tax rates for the six months ended June 30, 2017 and 2016 were (35.2)% and 12.6%, respectively. For the six months ended June 30, 2017, the primary drivers of the lower tax rate are lower income before income taxes compared to the same period in 2016, the jurisdictional mix of income before tax in U.S.-based operations relative to foreign operations, and an increase of \$4.0 million in excess tax benefits from stock-based compensation for the six months ended June 30, 2017 compared to the same period in 2016, offset by an expense adjustment of \$0.2 million related to filing of foreign income tax returns. The change in jurisdictional mix of income primarily results from significant 2017 acquisition and integration costs incurred in the U.S.

The Company expects its effective income tax rate for the full year to be approximately 8.3%, resulting largely from excess tax benefits from stock-based compensation, federal research credit benefits and the jurisdictional mix of income before tax in U.S.-

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

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based operations relative to foreign operations. This estimate could be revised in the future as additional information is presented to the Company.

## 10. NET INCOME PER SHARE

Basic and diluted net income per share was as follows:

	Three Months Ended June 30, 2017		Six Months Ended June 30, 2017	
	2016		2016	
	(In thousands, except per share amounts)			
Basic net income per share:				
Net income	\$10,835	\$12,755	\$17,230	\$26,173
Weighted average common shares outstanding	76,213	74,392	75,487	74,074
Basic net income per common share	\$0.14	\$0.17	\$0.23	\$0.35
Diluted net income per share:				
Net income	\$10,835	\$12,755	\$17,230	\$26,173
Weighted average common shares outstanding — Basic	76,213	74,392	75,487	74,074
Effect of dilutive securities:				
2016 Convertible notes	—	2,285	—	1,796
Warrants	1,589	911	1,864	454
Stock options and restricted stock	1,161	1,122	1,352	1,218
Weighted average common shares for diluted earnings per share	78,963	78,710	78,703	77,542