

INTEGRA LIFESCIENCES HOLDINGS CORP

Form 10-Q

November 04, 2009

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549  
FORM 10-Q**

(Mark One)

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

**For the quarterly period ended September 30, 2009**

**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  
(STATE OR OTHER JURISDICTION OF  
INCORPORATION OR ORGANIZATION)

51-0317849  
(I.R.S. EMPLOYER  
IDENTIFICATION NO.)

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

08536  
(ZIP CODE)

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

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

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

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

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

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

The number of shares of the registrant's Common Stock, \$.01 par value, outstanding as of October 30, 2009 was 28,480,778.



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## Item 1. Financial Statements

**INTEGRA LIFESCIENCES HOLDINGS CORPORATION**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(UNAUDITED)**

(In thousands, except per share amounts)

|   | Three Months Ended |             | Nine Months Ended |            |
|---|--------------------|-------------|-------------------|------------|
|   | September 30,      |             | September 30,     |            |
|   | 2009               | 2008        | 2009              | 2008       |
| Total Revenue   | \$ 172,286         | \$ 167,028  | \$ 498,961        | \$ 480,234 |
| Costs and Expenses:   |                    |             |                   |            |
| Cost of product revenues                                    | 63,021             | 64,317      | 180,974           | 184,688    |
| Research and development                                    | 11,525             | 34,718      | 32,470            | 50,309     |
| Selling, general and administrative                         | 69,915             | 87,660      | 204,618           | 213,624    |
| Intangible asset amortization                               | 4,005              | 3,224       | 10,922            | 9,170      |
| Total costs and expenses                                    | 148,466            | 189,919     | 428,984           | 457,791    |
| Operating income (loss)                                     | 23,820             | (22,891)    | 69,977            | 22,443     |
| Interest income   | 197                | 399         | 578               | 1,530      |
| Interest expense  | (5,493)            | (6,955)     | (18,351)          | (22,444)   |
| Other income (expense), net                                 | (380)              | (409)       | (1,729)           | 647        |
| Income (loss) before income taxes                           | 18,144             | (29,856)    | 50,475            | 2,176      |
| Income tax expense (benefit)                                | 3,712              | (13,001)    | 15,251            | (2,296)    |
| Net income (loss)   | \$ 14,432          | \$ (16,855) | \$ 35,224         | \$ 4,472   |
| Basic net income (loss) per share                           | \$ 0.49            | \$ (0.60)   | \$ 1.21           | \$ 0.16    |
| Diluted net income (loss) per share                         | \$ 0.49            | \$ (0.60)   | \$ 1.20           | \$ 0.16    |
| Weighted average common shares outstanding<br>(See Note 9): |                    |             |                   |            |
| Basic   | 29,049             | 28,123      | 28,999            | 27,558     |
| Diluted   | 29,400             | 28,123      | 29,232            | 28,158     |

The accompanying 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)

|  | <b>September<br/>30,<br/>2009</b> | <b>December 31,<br/>2008</b> |
|--|-----------------------------------|------------------------------|
| <b>ASSETS</b>  |                                   |                              |
| Current Assets:  |                                   |                              |
| Cash and cash equivalents  | \$ 106,747                        | \$ 183,546                   |
| Trade accounts receivable, net of allowances of \$13,027 and \$10,052  | 101,379                           | 112,417                      |
| Inventories, net   | 140,541                           | 146,103                      |
| Deferred tax assets  | 20,939                            | 24,135                       |
| Prepaid expenses and other current assets  | 26,189                            | 31,191                       |
| <br>   |                                   |                              |
| Total current assets   | 395,795                           | 497,392                      |
| Property, plant and equipment, net   | 70,834                            | 70,382                       |
| Intangible assets, net   | 214,432                           | 225,998                      |
| Goodwill   | 264,605                           | 212,094                      |
| Other assets   | 27,570                            | 20,148                       |
| <br>   |                                   |                              |
| Total assets   | \$ 973,236                        | \$ 1,026,014                 |
| <br>   |                                   |                              |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>   |                                   |                              |
| Current Liabilities:   |                                   |                              |
| Borrowings under senior credit facility  | \$                                | \$ 100,000                   |
| Convertible securities   | 94,233                            |                              |
| Accounts payable, trade  | 20,345                            | 22,964                       |
| Deferred revenue   | 4,083                             | 3,053                        |
| Accrued compensation   | 19,379                            | 16,030                       |
| Accrued expenses and other current liabilities   | 77,280                            | 32,704                       |
| <br>   |                                   |                              |
| Total current liabilities  | 215,320                           | 174,751                      |
| Long-term borrowings under senior credit facility  | 160,000                           | 160,000                      |
| Long-term convertible securities   | 147,220                           | 299,480                      |
| Other liabilities  | 20,274                            | 19,474                       |
| <br>   |                                   |                              |
| Total liabilities  | 542,814                           | 653,705                      |
| Commitments and contingencies  |                                   |                              |
| Stockholders' Equity:  |                                   |                              |
| Common stock; \$0.01 par value; 60,000 authorized shares; 34,808 and 34,352 issued at September 30, 2009 and December 31, 2008, respectively | 348                               | 344                          |
| Additional paid-in capital   | 512,385                           | 502,784                      |

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|  |            |              |
|--|------------|--------------|
| Treasury stock, at cost; 6,354 shares at September 30, 2009 and at December 31, 2008 | (252,380)  | (252,380)    |
| Accumulated other comprehensive income (loss):                                       |            |              |
| Foreign currency translation adjustment  | 19,700     | 6,314        |
| Pension liability adjustment, net of tax   | (1,061)    | (959)        |
| Retained earnings  | 151,430    | 116,206      |
| <br>   |            |              |
| Total stockholders' equity   | 430,422    | 372,309      |
| <br>   |            |              |
| Total liabilities and stockholders' equity   | \$ 973,236 | \$ 1,026,014 |

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

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

|   | Nine Months Ended<br>September 30, |           |
|---|------------------------------------|-----------|
|   | 2009                               | 2008      |
| <b>OPERATING ACTIVITIES:</b>  |                                    |           |
| Net income  | \$ 35,224                          | \$ 4,472  |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                    |           |
| Depreciation and amortization   | 27,116                             | 21,944    |
| In-process research and development   | 277                                | 25,240    |
| Deferred income tax benefit   | (4,438)                            | (14,528)  |
| Amortization of bond issuance costs   | 1,953                              | 1,826     |
| Non-cash interest expense   | 7,861                              | 9,719     |
| Payment of accreted interest  | (3,995)                            |           |
| Gain on bond repurchases  | (917)                              |           |
| Share-based compensation  | 11,521                             | 28,725    |
| Excess tax benefits from stock-based compensation arrangements                    | (14)                               | (1,362)   |
| Other, net  |                                    | 18        |
| Changes in assets and liabilities, net of business acquisitions:                  |                                    |           |
| Accounts receivable   | 11,664                             | (2,613)   |
| Inventories   | 6,755                              | (679)     |
| Prepaid expenses and other current assets   | 5,288                              | (30,817)  |
| Other non-current assets  | 2,738                              | 306       |
| Accounts payable, accrued expenses and other current liabilities                  | (5,168)                            | 1,088     |
| Deferred revenue  | 20                                 | 427       |
| Other non-current liabilities   | 306                                | 1,733     |
| Net cash provided by operating activities   | 96,191                             | 45,499    |
| <b>INVESTING ACTIVITIES:</b>  |                                    |           |
| Cash used in business acquisition, net of cash acquired                           | (4,786)                            | (77,844)  |
| Purchase of intangible assets   | (2,331)                            |           |
| Purchases of property and equipment   | (13,951)                           | (9,293)   |
| Net cash used in investing activities   | (21,068)                           | (87,137)  |
| <b>FINANCING ACTIVITIES:</b>  |                                    |           |
| Borrowings under senior credit facility   |                                    | 200,000   |
| Repayments under senior credit facility   | (100,000)                          |           |
| Repayment of loans  |                                    | (119,558) |
| Repurchase of liability component of convertible notes                            | (60,877)                           |           |
| Proceeds from exercised stock options   | 2,630                              | 9,193     |
| Excess tax benefits from stock-based compensation arrangements                    | 14                                 | 1,362     |



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|  |            |            |
|--|------------|------------|
| Net cash (used in) provided by financing activities          | (158,233)  | 90,997     |
| Effect of exchange rate changes on cash and cash equivalents | 6,311      | 2,641      |
| Net change in cash and cash equivalents                      | (76,799)   | 52,000     |
| Cash and cash equivalents at beginning of period             | 183,546    | 57,339     |
| Cash and cash equivalents at end of period                   | \$ 106,747 | \$ 109,339 |

The accompanying 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**

**1. BASIS OF PRESENTATION**

**General**

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

In the opinion of management, the September 30, 2009 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, 2008 included in the Company's Annual Report on Form 10-K. The December 31, 2008 condensed consolidated balance sheet was derived from audited financial statements but does not include all disclosures required by accounting principles generally accepted in the United States. Operating results for the nine-month period ended September 30, 2009 are not necessarily indicative of the results to be expected for the entire year.

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States 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, net realizable value of inventories, estimates of future cash flows associated with long-lived asset valuations, depreciation and amortization periods for long-lived assets, uncertain tax positions, fair value estimates of stock-based compensation awards, valuation allowances recorded against deferred tax assets, estimates of amounts to be paid to employees and other exit costs to be incurred in connection with the restructuring of our operations and loss contingencies. These estimates are based on historical experience and on various other assumptions that are believed to be reasonable under the current circumstances. Actual results could differ from these estimates.

Certain reclassifications have been made to the prior-year financial statements to conform to the current year presentation.

**New Accounting Pronouncements**

***Accounting Standards Codification***

In June 2009, the Financial Accounting Standards Board ( FASB ) issued SFAS 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles*, which is effective for interim and annual periods ending after September 15, 2009. This pronouncement made the FASB *Accounting Standards Codification* the single official source of authoritative, nongovernmental U.S. generally accepted accounting principles and supersedes all existing non-SEC standards. The references to accounting literature included in the footnotes herein have been updated to remove all references to superseded literature.

**Table of Contents****Debt**

Effective January 1, 2009, the Company adopted the authoritative guidance for accounting for convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement). The guidance requires that the liability and equity components of convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement) be separately accounted for in a manner that reflects an issuer's nonconvertible debt borrowing rate. The guidance is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. The guidance is effective for the \$330.0 million (of which \$261.6 million remains outstanding) aggregate principal amount of the senior convertible notes due June 2010 and June 2012 with an annual rate of 2.75% and 2.375%, respectively, (the 2010 Notes and the 2012 Notes, respectively), and the \$119.5 million exchanged portion of our contingent convertible subordinated notes that were due March 2008 with an annual rate of 2.5% (the 2008 Notes) and requires retrospective application for all periods presented. The guidance requires the issuer of convertible debt instruments with cash settlement features to separately account for the liability. As of the date of issuance for the 2010 Notes and the 2012 Notes, and the date of modification for the 2008 Notes (collectively, the Covered Notes), the result of the impact of the guidance for each of the Covered Notes is as follows (in millions):

|                               | <b>2008</b>  | <b>2010</b>  | <b>2012</b>  |
|-------------------------------|--------------|--------------|--------------|
|                               | <b>Notes</b> | <b>Notes</b> | <b>Notes</b> |
|                               | September    |              |              |
|                               | 2006         | June 2007    | June 2007    |
| Date impacted by the guidance |              |              |              |
| Total Amount                  | \$ 119.5     | \$ 165.0     | \$ 165.0     |
| Liability Component           | 103.0        | 142.2        | 122.5        |
| Equity Component              | 11.6         | 16.0         | 29.9         |
| Deferred Tax Component        | 4.9          | 6.8          | 12.6         |

The liability component was recognized at the present value of its cash flows discounted using discount rates of 9.70%, 6.47% and 6.81%, our borrowing rate at the date of exchange of the 2008 Notes and the dates of the issuance of the 2010 Notes and the 2012 Notes, respectively, for a similar debt instrument without the conversion feature. For additional information, see Note 5, Debt. The guidance also requires an accretion of the resultant debt discount over the expected life of the Covered Notes, which is March 2008 to June 2012.

The following table sets forth the effect of the retrospective application of the guidance on certain previously reported line items (in thousands, except per share amounts):

**Condensed Consolidated Statements of Operations:**

|                            | <b>Three Months Ended September 30,</b> |                    |                 | <b>Nine Months Ended September 30,</b> |                    |                 |
|----------------------------|---|--------------------|-----------------|--|--------------------|-----------------|
|                            | <b>2008</b>                             |                    |                 | <b>2008</b>                            |                    |                 |
|                            | <b>Originally</b>                       |                    | <b>As</b>       | <b>Originally</b>                      |                    | <b>As</b>       |
|                            | <b>Reported</b>                         | <b>Adjustments</b> | <b>Adjusted</b> | <b>Reported</b>                        | <b>Adjustments</b> | <b>Adjusted</b> |
| Interest expense           | \$ (4,249)                              | \$ (2,706)         | \$ (6,955)      | \$ (12,725)                            | \$ (9,719)         | \$ (22,444)     |
| Income tax expense         |   |                    |                 |  |                    |                 |
| (benefit)                  | (11,859)                                | (1,142)            | (13,001)        | 1,807                                  | (4,103)            | (2,296)         |
| Net income (loss)          | (15,291)                                | (1,564)            | (16,855)        | 10,088                                 | (5,616)            | 4,472           |
| Basic earnings per share   | \$ (0.54)                               |                    | \$ (0.60)       | \$ 0.37                                |                    | \$ 0.16         |
| Diluted earnings per share | \$ (0.54)                               |                    | \$ (0.60)       | \$ 0.35                                |                    | \$ 0.16         |

**Condensed Consolidated Balance Sheets:**

|  | <b>December 31, 2008</b> |           |
|--|--------------------------|-----------|
|  | <b>Originally</b>        | <b>As</b> |

|                                  | <b>Reported</b> | <b>Adjustments</b> | <b>Adjusted</b> |
|----------------------------------|-----------------|--------------------|-----------------|
| Other assets                     | \$ 28,565       | \$ (8,417)         | \$ 20,148       |
| Long-term convertible securities | 330,000         | (30,520)           | 299,480         |
| Additional paid-in capital       | 464,668         | 38,116             | 502,784         |
| Retained earnings                | 132,219         | (16,013)           | 116,206         |
| Total stockholders equity        | 350,206         | 22,103             | 372,309         |

**Table of Contents****Condensed Consolidated Statements of Cash Flows:**

|                               | <b>Nine Months Ended September 30, 2008</b> |                    |                        |
|-------------------------------|---|--------------------|------------------------|
|                               | <b>Originally<br/>Reported</b>              | <b>Adjustments</b> | <b>As<br/>Adjusted</b> |
| Net income                    | \$ 10,088                                   | \$ (5,616)         | 4,472                  |
| Deferred income tax (benefit) | (10,425)                                    | (4,103)            | (14,528)               |
| Non-cash interest expense     |   | 9,719              | 9,719                  |

For the three months ended September 30, 2009, the additional pre-tax non-cash interest expense recognized in the condensed consolidated income statement was \$2.3 million. Accumulated amortization related to the debt discount was \$20.1 million and \$11.5 million as of September 30, 2009 and December 31, 2008, respectively. The pre-tax increase in non-cash interest expense on our condensed consolidated statements of income to be recognized through 2012, the latest maturity date of the Covered Notes, is as follows (in millions):

|   | <b>2009</b> | <b>2010</b> | <b>2011</b> | <b>2012</b> |
|---|-------------|-------------|-------------|-------------|
| Pre-tax increase in non-cash interest expense | \$ 10.1     | \$ 7.5      | \$ 6.7      | \$ 2.9      |

**Other New Accounting Pronouncements**

Effective January 1, 2009, the Company adopted the authoritative guidance for determining whether instruments granted in share-based payment transactions are participating securities. The guidance states that unvested share-based payment awards that contain rights to receive nonforfeitable dividends or dividend equivalents (whether paid or unpaid) are participating securities, and thus, should be included in the two-class method of computing earnings per share (EPS) and requires retrospective application for all periods presented. The adoption of this standard did not have a material impact on the Company's disclosure of EPS. See Note 9, Net Income (Loss) Per Share for a further discussion.

Effective January 1, 2009, the Company adopted the revised authoritative guidance for business combinations. The new guidance changes the practice for accounting for business combinations, such as requiring that the Company (1) expense transaction costs as incurred, rather than capitalizing them as part of the purchase price; (2) record contingent consideration arrangements and pre-acquisition contingencies, such as legal issues, at fair value at the acquisition date, with subsequent changes in fair value recorded in the income statement; (3) capitalize the fair value of acquired research and development assets separately from goodwill, whereas the Company previously determined the acquisition-date fair value and then immediately charged the value to expense; and (4) limit the conditions under which restructuring expenses can be accrued in the opening balance sheet of a target to only those where the requirements would have been met at the acquisition date. Additionally, the new guidance provides that, upon initially obtaining control, an acquirer shall recognize 100 percent of the fair values of acquired assets, including goodwill, and assumed liabilities, with only limited exceptions, even if the acquirer has not acquired 100 percent of its target. The implementation of the new guidance could result in an increase or decrease in future selling, general and administrative and other operating expenses, depending upon the extent of the Company's acquisition related activities going forward. No business combination transactions occurred since the Company adopted the new guidance. The adoption of this guidance did not have a material impact on the Company's financial condition or results of operations. Effective January 1, 2009, the Company adopted the authoritative guidance for determination of the useful life of intangible assets. The new guidance amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset. The intent of the new guidance is to improve the consistency between the useful life of a recognized intangible asset under the new business combination rules and the period of expected cash flows used to measure the fair value of the asset, and other generally accepted accounting principles. The adoption of this guidance did not have a material impact on the Company's financial condition or results of operations.

Effective January 1, 2009, the Company adopted the authoritative guidance for the effective date of fair value measurements for all non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value on a recurring basis (at least annually). The adoption of this guidance did not have a material impact on the Company's financial condition or results of operations.

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Effective January 1, 2009, the Company adopted the new authoritative guidance for disclosures about derivative instruments and hedging activities. The new guidance requires enhanced disclosures about derivative instruments and hedging activities to allow for a better understanding of their effects on an entity's financial position, financial performance, and cash flows. Among other things, the new guidance requires disclosure of the fair values of derivative instruments and associated gains and losses in a tabular format. Since the new guidance requires only additional disclosures about our derivatives and hedging activities, the adoption of the new guidance does not affect our financial position or results of operations.

Effective January 1, 2009, the Company adopted the authoritative guidance for determining whether an instrument (or embedded feature) is indexed to an entity's own stock. The new guidance mandates a two-step process for evaluating whether an equity-linked financial instrument or embedded feature is indexed to the entity's own stock. Upon the adoption of the new guidance, equity instruments that a company issues that contain a strike price adjustment feature may no longer be considered indexed to the company's own stock. Accordingly, adoption of the new guidance may change the current classification (from equity to liability) and the related accounting for such equity instruments outstanding at that date. The adoption of this guidance did not change the classification of the Company's warrants issued in connection with the convertible debt.

In May 2009, the FASB issued and the Company adopted the new authoritative guidance for subsequent events. The new guidance establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before the financial statements are issued. The new guidance requires disclosure of the date through which an entity has evaluated subsequent events and the basis for that date. That is, whether the date represents the date the financial statements were issued or were available to be issued. The new guidance is effective in the first interim period ending after June 15, 2009. The adoption of this guidance did not have a material impact on the Company's financial condition or results of operations.

**2. BUSINESS ACQUISITIONS****Minnesota Scientific, Inc.**

In December 2008, the Company acquired Minnesota Scientific, Inc., doing business as Omni-Tract Surgical (Omni-Tract), for \$6.4 million in cash paid at closing, 310,000 unregistered shares of the Company's common stock valued at \$10.7 million (of which 135,000 shares were issued at closing, with the remainder issued in January 2009), working capital adjustments of \$0.1 million and \$0.3 million in transaction related costs, subject to certain adjustments. Omni-Tract is a global leader in the development and manufacture of table mounted retractors and is based in St. Paul, Minnesota. Omni-Tract markets and sells these retractor systems for use in vascular, bariatric, general, urologic, orthopedic, spine, pediatric, and laparoscopic surgery. The Company has integrated Omni-Tract's product lines into its combined offering of JARIT®, Padgett®, Redmond®, and Luxte® lines of surgical instruments and illumination systems sold by the Integra Medical Instruments sales organization.

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

|                               |    |        |            |
|-------------------------------|----|--------|------------|
| Cash                          | \$ | 1,501  |            |
| Accounts receivable           |    | 1,324  |            |
| Inventory                     |    | 544    |            |
| Other current assets          |    | 110    |            |
| Property, plant and equipment |    | 377    |            |
| Intangible assets:            |    |        | Wtd. Avg.  |
| Technology                    |    | 3,816  | Life       |
| Trade name                    |    | 13,084 | 15 years   |
| Goodwill                      |    | 3,098  | Indefinite |
| Total assets acquired         |    | 23,854 |            |

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|  |           |
|--|-----------|
| Accounts payable and other current liabilities | 335       |
| Deferred tax liabilities non current           | 6,030     |
| Total liabilities assumed                      | 6,365     |
| Net assets acquired                            | \$ 17,489 |



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Management determined the preliminary fair value of assets acquired during the fourth quarter of 2008. The purchase price was finalized in the second quarter of 2009 with only minor changes being recorded to goodwill resulting from the working capital adjustment. The goodwill recorded in connection with this acquisition is based on the benefits the Company expects to generate from Omni-Tract's future cash flows.

**Integra Neurosciences Pty Ltd.**

In October 2008, the Company acquired Integra Neurosciences Pty Ltd. in Australia and Integra Neurosciences Pty Ltd. in New Zealand for \$4.0 million (6.0 million Australian Dollars) in cash at closing, \$0.3 million in acquisition expenses and working capital adjustments, and up to \$2.1 million (3.1 million Australian Dollars) in future payments based on the performance of business in each of the three years after closing. With this acquisition of the Company's long-standing distributor, the Company now has a direct selling presence in Australia and New Zealand.

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

|  |    |       |                   |
|--|----|-------|-------------------|
| Cash   | \$ | 630   |                   |
| Inventory                                      |    | 1,234 |                   |
| Property, plant and equipment                  |    | 66    |                   |
| Intangible assets:                             |    |       | Wtd. Avg.<br>Life |
| Customer relationships                         |    | 4,367 | 15 years          |
| Trade name                                     |    | 90    | 1 year            |
| <br>   |    |       |                   |
| Total assets acquired                          |    | 6,387 |                   |
| <br>   |    |       |                   |
| Accounts payable and other current liabilities |    | 70    |                   |
| Deferred tax liabilities – non current         |    | 1,388 |                   |
| Other non-current liabilities                  |    | 628   |                   |
| <br>   |    |       |                   |
| Total liabilities assumed                      |    | 2,086 |                   |
| <br>   |    |       |                   |
| Net assets acquired                            | \$ | 4,301 |                   |

Management determined the preliminary fair value of assets acquired during the fourth quarter of 2008. The purchase price was finalized in the second quarter of 2009 with only minor changes being recorded for working capital adjustments.

**Theken**

In August 2008 the Company acquired Theken Spine, LLC, Theken Disc, LLC and Therics, LLC (collectively, Theken) for \$75.0 million in cash, acquisition expenses of \$2.4 million, working capital adjustments of \$4.0 million. In addition, the Company may pay up to an additional \$121.0 million in future payments based on the revenue performance of the business in each of the two years after closing, including the \$52.0 million accrued at September 30, 2009. Theken, based in Akron, Ohio, designs, develops and manufactures spinal fixation products, synthetic bone substitute products and spinal arthroplasty products.

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

|  |    |        |             |
|--|----|--------|-------------|
| Cash   | \$ | 167    |             |
| Inventory                                      |    | 15,130 |             |
| Accounts receivable                            |    | 5,969  |             |
| Other current assets                           |    | 699    |             |
| Property, plant and equipment                  |    | 8,244  |             |
| Other assets                                   |    | 1      |             |
|  |    |        | Wtd. Avg.   |
| Intangible assets:                             |    |        | Life        |
| Technology                                     |    | 13,470 | 11 years    |
| Customer relationships                         |    | 15,630 | 8 years     |
|  |    |        | Expensed    |
| In-process research and development            |    | 25,240 | immediately |
| Goodwill                                       |    | 6,533  |             |
|  |    |        |             |
| Total assets acquired                          |    | 91,083 |             |
| Accounts payable and other current liabilities |    | 9,716  |             |
|  |    |        |             |
| Net assets acquired                            | \$ | 81,367 |             |

Management determined the preliminary fair value of assets acquired during the third quarter of 2008. The in-process research and development had not yet reached technological feasibility and had no alternative future use at the date of acquisition. The Company recorded an in-process research and development charge of \$25.2 million in the third quarter of 2008 in connection with this acquisition, which was included in research and development expense. The goodwill recorded in connection with this acquisition is based on the benefits the Company expects to generate from Theken's future cash flows. The purchase price was finalized in the first quarter of 2009 with only minor changes being recorded to goodwill.

The fair value of the in-process research and development was determined by estimating the costs to develop the acquired technology into commercially viable products and estimating the net present value of the resulting net cash flows from these projects. These cash flows were based on our best estimates of revenue, cost of sales, research and development costs, selling, general and administrative costs and income taxes from the development projects. A summary of the estimates used to calculate the net cash flows for the projects is as follows:

| <b>Project</b>               | <b>Year net cash In-flows expected to begin</b> | <b>Discount rate including factor to account for uncertainty of success</b> | <b>Acquired In-Process Research and Development</b> |
|------------------------------|---|---|---|
| eDisc artificial lumbar disc | 2013  | 23%   | \$ 13.0 million                                     |

|                                |      |     |             |
|--------------------------------|------|-----|-------------|
| eDisc artificial cervical disc | 2016 | 23% | 7.2 million |
| Spinal fixation implants       | 2009 | 15% | 4.7 million |
| All other                      | 2009 | 15% | 0.3 million |

Pro Forma Results (unaudited)

The following unaudited pro forma financial information summarizes the results of operations for the three and nine months ended September 30, 2008 as if the acquisitions completed by the Company during 2008 had been completed as of the beginning of the period presented. The pro forma results are based upon certain assumptions and estimates, and they give effect to actual operating results prior to the acquisitions and adjustments to reflect increased interest expense, depreciation expense, intangible asset amortization, and income taxes at a rate consistent with the Company's statutory rate. No effect has been given to cost reductions or operating synergies. As a result, the pro forma results do not necessarily represent results that would have occurred if the acquisitions had taken place on the basis assumed above, nor are they indicative of the results of future combined operations.

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|                              | <b>Three Months<br/>Ended<br/>September 30,<br/>2008</b> | <b>Nine Months<br/>Ended<br/>September 30, 2008</b> |
|------------------------------|--|---|
|                              | <b>(in thousands, except per share amounts)</b>          |   |
| Total Revenue                | \$ 170,722   | \$ 503,327  |
| Net income                   | (19,543)   | (1,463)   |
| Net income per common share: |  |   |
| Basic                        | \$ (0.69)  | \$ (0.05)   |
| Diluted                      | \$ (0.69)  | \$ (0.05)   |

**Other**

In August 2009, the Company acquired certain assets and liabilities of Innovative Spinal Technologies, Inc. ( IST ) for approximately \$9.3 million in cash and \$0.2 million in acquisition expenses. IST had filed for Chapter 7 bankruptcy protection in May 2009 and the acquisition is the result of an auction process conducted by the bankruptcy trustee and approved by the U.S. Bankruptcy Judge for the District of Massachusetts. IST 's focus was on spinal implant products related to minimally invasive surgery and motion preservation techniques. The Company acquired three product lines, various product development assets for posterior dynamic stabilization, various patents and trademarks, inventory, and assumed certain of IST 's patent license agreements and related obligations.

The assets and liabilities acquired did not meet the definition of a business under the authoritative guidance for business combinations. Accordingly, the assets and liabilities have been recognized at fair value with no related goodwill.

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

|                                     |          |                      |
|-------------------------------------|----------|----------------------|
| Inventory                           | \$ 4,238 |                      |
| Property, plant and equipment       | 2,974    |                      |
| Intangible assets:                  |          | Wtd. Avg. Life       |
| Technology                          | 2,055    | 10 years             |
| In-process research and development | 277      | Expensed immediately |
| Total assets acquired               | 9,544    |                      |
| Accrued expenses                    | (20)     |                      |
| Net assets acquired                 | \$ 9,524 |                      |

**3. INVENTORIES**

Inventories, net consisted of the following:

|                | <b>September 30,<br/>2009</b> | <b>December 31,<br/>2008</b> |
|----------------|-------------------------------|------------------------------|
|                | <b>(in thousands)</b>         |                              |
| Finished goods | \$ 105,148                    | \$ 109,033                   |

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|                 |            |            |
|-----------------|------------|------------|
| Work-in process | 27,116     | 21,883     |
| Raw materials   | 36,710     | 38,688     |
| Less: reserves  | (28,433)   | (23,501)   |
|                 | \$ 140,541 | \$ 146,103 |

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

Changes in the carrying amount of goodwill for the nine months ended September 30, 2009 were as follows (in thousands):

|                                       |            |
|---------------------------------------|------------|
| Balance at December 31, 2008          | \$ 212,094 |
| Theken earn-out                       | 49,598     |
| Purchase price allocation adjustments | 524        |
| Foreign currency translation          | 2,389      |
| <br>                                  |            |
| Balance at September 30, 2009         | \$ 264,605 |

The Company's assessment of the recoverability of goodwill is based upon a comparison of the carrying value of goodwill with its estimated fair value, determined using a discounted cash flow methodology. This test was performed during the second quarter and resulted in no impairment for any of the periods presented.

During the third quarter of 2009, the Company recorded a \$0.9 million impairment charge related to a technology-based intangible asset as a component of its cost of product revenues. The impairment charge relates to decisions made by management to discontinue development of the related technology. The Company also recorded a \$0.6 million impairment charge related to a trade name in connection with the revised expected benefit from the related trade name.

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

|                              | Weighted<br>Average<br>Life | September 30, 2009 |                             |            | December 31, 2008 |                             |            |
|------------------------------|-----------------------------|--------------------|-----------------------------|------------|-------------------|-----------------------------|------------|
|                              |                             | Cost               | Accumulated<br>Amortization | Net        | Cost              | Accumulated<br>Amortization | Net        |
| Completed technology         | 12<br>years                 | \$ 69,750          | \$ (21,156)                 | \$ 48,594  | \$ 67,154         | \$ (15,658)                 | \$ 51,496  |
| Customer relationships       | 12<br>years                 | 96,470             | (34,123)                    | 62,347     | 94,487            | (26,104)                    | 68,383     |
| Trademarks/brand<br>names    | 35<br>years                 | 35,737             | (8,335)                     | 27,402     | 35,232            | (6,547)                     | 28,685     |
| Trademarks/brand<br>names    | Indefinite                  | 49,384             |                             | 49,384     | 49,384            |                             | 49,384     |
| Noncompetition<br>agreements | 5 years                     | 6,681              | (6,492)                     | 189        | 6,449             | (5,724)                     | 725        |
| Supplier relationships       | 30<br>years                 | 29,300             | (3,304)                     | 25,996     | 29,300            | (2,670)                     | 26,630     |
| All other                    | 15<br>years                 | 1,531              | (1,011)                     | 520        | 1,531             | (836)                       | 695        |
|                              |                             | \$ 288,853         | \$ (74,421)                 | \$ 214,432 | \$ 283,537        | \$ (57,539)                 | \$ 225,998 |

Annual amortization expense is expected to approximate \$20.3 million in 2009, \$17.0 million in 2010, \$16.7 million in 2011, \$16.5 million in 2012, \$13.8 million in 2013 and \$80.8 million thereafter. Identifiable intangible assets are initially recorded at fair market value at the time of acquisition generally using an income or cost approach.



**Table of Contents****5. DEBT***2010 and 2012 Senior Convertible Notes*

On June 11, 2007, the Company issued \$165 million aggregate principal amount of its 2010 Notes and \$165 million aggregate principal amount of its 2012 Notes (the 2010 Notes and the 2012 Notes, collectively the Notes). The 2010 Notes and the 2012 Notes bear interest at a rate of 2.75% per annum and 2.375% per annum, respectively, in each case payable semi-annually in arrears on December 1 and June 1 of each year. The fair value of the 2010 Notes and the 2012 Notes at September 30, 2009 was approximately \$95.1 million and \$150.0 million, respectively. The Notes are senior, unsecured obligations of the Company, and are convertible into cash and, if applicable, shares of its common stock based on an initial conversion rate, subject to adjustment, of 15.0917 shares per \$1,000 principal amount of notes for the 2010 Notes and 15.3935 shares per \$1,000 principal amount of notes for the 2012 Notes (which represents an initial conversion price of approximately \$66.26 per share and approximately \$64.96 per share for the 2010 Notes and the 2012 Notes, respectively.) The Company will satisfy any conversion of the Notes with cash up to the principal amount of the applicable series of Notes pursuant to the net share settlement mechanism set forth in the applicable indenture and, with respect to any excess conversion value, with shares of the Company's common stock. The Notes are convertible only in the following circumstances: (1) if the closing sale price of the Company's common stock exceeds 130% of the conversion price during a period as defined in the indenture; (2) if the average trading price per \$1,000 principal amount of the Notes is less than or equal to 97% of the average conversion value of the Notes during a period as defined in the indenture; (3) at any time on or after December 15, 2009 (in connection with the 2010 Notes) or anytime after December 15, 2011 (in connection with the 2012 Notes); or (4) if specified corporate transactions occur. The issue price of the Notes was equal to their face amount, which is also the amount holders are entitled to receive at maturity if the Notes are not converted. However, none of these conditions existed and, as a result, the 2012 Notes are classified as long-term. As of September 30, 2009, the 2010 Notes are classified as current due to their maturity date.

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

The Notes, under the terms of the private placement agreement, are guaranteed fully by Integra LifeSciences Corporation, a subsidiary of the Company. The 2010 Notes will rank equal in right of payment to the 2012 Notes. The Notes will be the Company's direct senior unsecured obligations and will rank equal in right of payment to all of the Company's existing and future unsecured and unsubordinated indebtedness.

In connection with the issuance of the Notes, the Company entered into call transactions and warrant transactions, primarily with affiliates of the initial purchasers of the Notes (the hedge participants), in connection with each series of Notes. The cost of the call transactions to the Company was approximately \$46.8 million. The Company received approximately \$21.7 million of proceeds from the warrant transactions. The call transactions involve the Company's purchasing call options from the hedge participants, and the warrant transactions involve the Company's selling call options to the hedge participants with a higher strike price than the purchased call options.

The initial strike price of the call transactions is (1) for the 2010 Notes, approximately \$66.26 per share of Common Stock, and (2) for the 2012 Notes, approximately \$64.96, in each case subject to anti-dilution adjustments substantially similar to those in the Notes. The initial strike price of the warrant transactions is (x) for the 2010 Notes, approximately \$77.96 per share of Common Stock and (y) for the 2012 Notes, approximately \$90.95, in each case subject to customary anti-dilution adjustments.

In March 2009, the Company repurchased \$32.1 million principal amount of the 2010 Notes and recognized a gain of \$1.2 million. Total cash paid for this repurchase was \$29.5 million of which \$28.0 million related to repayment of the liability component of the Notes and \$1.5 million for payment of accreted interest. In June 2009, the Company repurchased \$18.7 million principal amount of the 2010 Notes and recognized a loss of \$0.1 million. Total cash paid for this repurchase was \$18.0 million of which \$16.8 million related to repayment of the liability component of the Notes and \$1.2 million for payment of accreted interest. In September 2009, the Company repurchased \$17.7 million



principal amount of the 2010 Notes and recognized a loss of \$0.2 million. Total cash paid for this repurchase was \$17.3 million, of which \$16.8 million related to repayment of the liability component of the 2010 Notes and \$0.3 million for payment of accreted interest. For all of these transactions, the bond hedge contracts were terminated on a pro-rata basis and the number of options was adjusted to reflect the number of convertible securities outstanding that together have a total principal amount of \$96.6 million. In separate transactions, we amended the warrant transactions to reduce the number of warrants outstanding to reflect such number of convertible securities outstanding.

See Note 1, Basis of Presentation, for a discussion of the liability component associated with the Covered Notes and the retrospective accounting change resulting from the adoption of the authoritative guidance effective January 1, 2009.

**Table of Contents***Senior Secured Revolving Credit Facility*

As of September 30, 2009 the Company had \$160.0 million of outstanding borrowings under this credit facility at a weighted average interest rate of 1.27%. The fair value of the \$160.0 million outstanding borrowings on this credit facility at September 30, 2009 was approximately \$147.3 million. The Company used a portion of the borrowings to repay all of the remaining 2008 Notes totaling approximately \$119.4 million in the second quarter of 2008 and \$3.3 million of related accrued and contingent interest during March 2008. On July 28, 2008 and October 30, 2008, the Company borrowed \$80.0 million and \$60.0 million, respectively, to fund the acquisition of Theken and for other general corporate purposes. During June 2009 and August 2009, the Company repaid \$60.0 million and \$40.0 million, respectively, of its outstanding borrowings. The Company regularly borrows under the credit facility and makes payments each month with respect thereto and considers all such outstanding amounts to be long-term in nature based on its current intent and ability to repay the borrowing after the next twelve-month period. If additional borrowings are made in connection with, for instance, future acquisitions, such activities could impact the timing of when the Company intends to repay amounts under this credit facility, which expires in December 2011.

**6. STOCK-BASED COMPENSATION**

As of September 30, 2009, the Company had stock options, restricted stock awards, performance stock awards, contract stock awards and restricted stock unit awards outstanding under seven plans, 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 ), the 2000 Equity Incentive Plan (the 2000 Plan ), the 2001 Equity Incentive Plan (the 2001 Plan ), and the 2003 Equity Incentive Plan (the 2003 Plan, and collectively, the Plans ). No new awards may be granted under the 1993 Plan, the 1996 Plan or the 1998 Plan.

Stock options issued under the Plans become exercisable over specified periods, generally within four years from the date of grant for officers, employees and consultants, and generally expire six years from the grant date. The transfer and non-forfeiture provisions of restricted stock issued under the Plans lapse over specified periods, generally three years after the date of grant.

**Stock Options**

The Company granted 62,500 and 222,290 stock options during the nine months ended September 30, 2009 and September 30, 2008, respectively. As of September 30, 2009, there were approximately \$5.4 million of total unrecognized compensation costs related to unvested stock options. These costs were expected to be recognized over a weighted-average period of approximately 2.0 years. The Company received proceeds of \$2.6 million and \$9.2 million from stock option exercises for the nine months ended September 30, 2009 and 2008, respectively.

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

Performance stock awards have performance features associated with them. Performance stock, restricted stock and contract stock awards generally have requisite service periods of three years. The fair value of these awards is being expensed on a straight-line basis over the vesting period or requisite service period, whichever is shorter. As of September 30, 2009, there was approximately \$15.3 million of total unrecognized compensation costs related to unvested awards. These costs are expected to be recognized over a weighted-average period of approximately 2.0 years.

The Company has no formal policy related to the repurchase of shares for the purpose of satisfying stock-based compensation obligations. Independent of these programs, the Company does have a practice of repurchasing shares, from time to time, in the open market.

The Company also maintains an Employee Stock Purchase Plan (the ESPP ), which provides eligible employees of the Company 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.

**Table of Contents****7. RETIREMENT BENEFIT PLANS**

The Company maintains defined benefit pension plans that cover employees in its manufacturing plants located in Andover, United Kingdom (the UK Plan ) and Tuttlingen, Germany (the Germany Plan ). The Company had maintained a plan covering its employees located in York, Pennsylvania (the Miltex Plan ) which was terminated in the fourth quarter of 2008 with all distributions made to participants. The Miltex Plan was frozen and all future benefits were curtailed prior to the acquisition of Miltex by the Company. Accordingly, the Miltex Plan had no assets or liabilities remaining at December 31, 2008. The Company closed the Tuttlingen, Germany plant in December 2005. However, the Germany Plan was not terminated and the Company remains obligated for the accrued pension benefits related to this plan. The plans cover certain current and former employees. Net periodic benefit costs for the Company's defined benefit pension plans included the following amounts (in thousands):

|                                | Three Months Ended<br>September 30, |        | Nine Months Ended<br>September 30, |        |
|--------------------------------|-------------------------------------|--------|------------------------------------|--------|
|                                | 2009                                | 2008   | 2009                               | 2008   |
| Service cost                   | \$ 29                               | \$ 72  | \$ 85                              | \$ 215 |
| Interest cost                  | 150                                 | 362    | 435                                | 1,083  |
| Expected return on plan assets | (103)                               | (308)  | (298)                              | (920)  |
| Recognized net actuarial loss  | 114                                 | 6      | 331                                | 17     |
| Net period benefit cost        | \$ 190                              | \$ 132 | \$ 553                             | \$ 395 |

The Company made \$0.2 million and \$0.4 million of contributions to its defined benefit pension plans during the nine months ended September 30, 2009 and 2008, respectively.

**8. COMPREHENSIVE INCOME**

Comprehensive income was as follows (in thousands):

|   | Three Months Ended<br>September 30, |             | Nine Months Ended<br>September 30, |          |
|---|-------------------------------------|-------------|------------------------------------|----------|
|   | 2009                                | 2008        | 2009                               | 2008     |
| Net Income (Loss)                       | \$ 14,432                           | \$ (16,855) | \$ 35,224                          | \$ 4,472 |
| Foreign currency translation adjustment | 7,661                               | (15,343)    | 13,386                             | (3,104)  |
| Comprehensive (loss) income             | \$ 22,093                           | \$ (32,198) | \$ 48,610                          | \$ 1,368 |

**9. NET INCOME (LOSS) PER SHARE**

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

|   | Three Months Ended<br>September 30, |             | Nine Months Ended<br>September 30, |          |
|---|-------------------------------------|-------------|------------------------------------|----------|
|   | 2009                                | 2008        | 2009                               | 2008     |
| Basic net income (loss) per share:              |                                     |             |                                    |          |
| Net income (loss)                               | \$ 14,432                           | \$ (16,855) | \$ 35,224                          | \$ 4,472 |
| Percentage allocated to common shares           | 99.3%                               | 100.0%      | 99.3%                              | 98.1%    |
| Net income (loss) attributable to common shares | 14,330                              | (16,855)    | 34,977                             | 4,387    |
| Weighted average common shares outstanding      | 29,049                              | 28,123      | 28,999                             | 27,558   |
| Basic net income (loss) per common share        | \$ 0.49                             | \$ (0.60)   | \$ 1.21                            | \$ 0.16  |

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|   |    |        |             |           |          |
|---|----|--------|-------------|-----------|----------|
| Diluted net income (loss) per share:                              |    |        |             |           |          |
| Net income (loss) attributable to diluted shares                  | \$ | 14,330 | \$ (16,855) | \$ 34,977 | \$ 4,387 |
| Weighted average common shares outstanding                        |    |        |             |           |          |
| Basic   |    | 29,049 | 28,123      | 28,999    | 27,558   |
| Effect of dilutive securities:                                    |    |        |             |           |          |
| Stock options and restricted stock                                |    | 351    |             | 233       | 600      |
| Weighted average common shares for diluted earnings per share     |    |        |             |           |          |
|   |    | 29,400 | 28,123      | 29,232    | 28,158   |
| Diluted net income (loss) per common share                        | \$ | 0.49   | \$ (0.60)   | \$ 1.20   | \$ 0.16  |
| Weighted average common shares outstanding                        |    |        |             |           |          |
|   |    | 29,049 | 28,123      | 28,999    | 27,558   |
| Weighted average common shares and other participating securities |    |        |             |           |          |
|   |    | 29,400 | 28,123      | 29,232    | 28,158   |
| Common share percentage   |    | 99.3%  | 100.0%      | 99.3%     | 98.1%    |
| Diluted share percentage  |    | 99.3%  | 100.0%      | 99.3%     | 98.1%    |

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As described in Note 1, Basis of Presentation, the Company adopted the authoritative guidance to determine whether instruments issued in share-based payment transactions are participating securities on January 1, 2009. Certain of the Company's unvested restricted share units contain rights to receive nonforfeitable dividends, and thus, are participating securities requiring the two-class method of computing EPS. The calculation of earnings per share for common stock shown above excludes the income attributable to the unvested restricted share units from the numerator and excludes the dilutive impact of those units from the denominator.

At September 30, 2009 and 2008, the Company had 2.6 million and 2.7 million of outstanding stock options, respectively. The Company also has warrants outstanding relating to its 2010 Notes and 2012 Notes. Stock options and warrants are included in the diluted earnings per share calculation using the treasury stock method, unless the effect of including the stock options would be anti-dilutive. For the three months ended September 30, 2009 and 2008, 1.7 million and 0.6 million anti-dilutive stock options, respectively, were excluded from the diluted earnings per share calculation. As the strike price of the warrants exceeds the Company's average stock price for the period, the warrants are anti-dilutive and the entire number of warrants, the amount of which is based on the Company's average stock price, were also excluded from the diluted earnings per share calculation.

**10. SEGMENT AND GEOGRAPHIC INFORMATION**

The Company's management reviews financial results and manages the business on an aggregate basis. Therefore, financial results are reported in a single operating segment, the development, manufacture and marketing of medical devices for use in cranial and spinal procedures, peripheral nerve repair, small bone and joint injuries, and the repair and reconstruction of soft tissue.

The Company presents its revenues in three categories: Orthopedics, NeuroSciences and Medical Instruments. The Company's revenues were as follows (in thousands):

|                     | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|---------------------|-------------------------------------|------------|------------------------------------|------------|
|                     | 2009                                | 2008       | 2009                               | 2008       |
| Revenues:           |                                     |            |                                    |            |
| Orthopedics         | \$ 64,135                           | \$ 53,848  | \$ 193,665                         | \$ 155,996 |
| NeuroSciences       | 67,228                              | 68,014     | 188,407                            | 192,146    |
| Medical Instruments | 40,923                              | 45,166     | 116,889                            | 132,092    |
| <br>                |                                     |            |                                    |            |
| Total Revenues      | \$ 172,286                          | \$ 167,028 | \$ 498,961                         | \$ 480,234 |

Certain of the Company's products, including the DuraGen® and NeuraGen® product families and the INTEGRA® Dermal Regeneration Template and wound-dressing products, contain material derived from bovine tissue. Products that contain materials derived from animal sources, including food as well as pharmaceuticals and medical devices, are increasingly subject to scrutiny from the press and regulatory authorities. These products constituted 22.1% and 21.0% of total revenues in each of the three-month periods ended September 30, 2009 and 2008, respectively. Accordingly, widespread public controversy concerning collagen products, new regulation, or a ban of the Company's products containing material derived from bovine tissue could have a material adverse effect on the Company's current business or its ability to expand its business.

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

|               | Three months ended |                   | Nine months ended |                   |
|---------------|--------------------|-------------------|-------------------|-------------------|
|               | September 30,      |                   | September 30,     |                   |
|               | 2009               | 2008              | 2009              | 2008              |
| United States | \$ 132,143         | \$ 128,189        | \$ 381,814        | \$ 357,318        |
| Europe        | 23,484             | 23,605            | 69,913            | 76,204            |
| Asia Pacific  | 7,064              | 6,517             | 22,193            | 19,877            |
| Other Foreign | 9,595              | 8,717             | 25,041            | 26,835            |
| <b>Total</b>  | <b>\$ 172,286</b>  | <b>\$ 167,028</b> | <b>\$ 498,961</b> | <b>\$ 480,234</b> |

**11. COMMITMENTS AND CONTINGENCIES**

In consideration for certain technology, manufacturing, distribution and selling rights and licenses granted to the Company, the Company has agreed to pay royalties on 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 is described below.

In May 2006, Codman & Shurtleff, Inc., a subsidiary of Johnson & Johnson, commenced an action in the United States District Court for the District of New Jersey for declaratory judgment against the Company with respect to United States Patent No. 5,997,895 (the '895 Patent') held by the Company. The Company's '895 Patent describes dural repair technology related to the Company's DuraGen® family of duraplasty products.

The action sought declaratory relief that Codman's DURAFORM® product does not infringe the Company's '895 Patent and that the Company's '895 Patent is invalid and unenforceable. The Company filed a counterclaim seeking a judgment that Codman's DURAFORM® product infringes the '895 Patent.

In August 2009, the parties settled the litigation for an immaterial amount and entered into covenants not to sue and mutual releases.

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

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

**12. SUBSEQUENT EVENTS**

The Company has evaluated subsequent events through November 4, 2009, the date of issuance of the unaudited condensed consolidated financial statements. During this period, the Company did not have any material recognizable subsequent events.

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

The following discussion and analysis of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and the related notes thereto appearing elsewhere in this report and our consolidated financial statements for the year ended December 31, 2008 included in our Annual Report on Form 10-K.

We have made statements in this report which constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 (the Exchange Act). These forward-looking statements are subject to a number of risks, uncertainties and assumptions about the Company. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of many factors, including but not limited to those set forth above under the heading Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2008 (as modified by the subsequent Quarterly Reports on Form 10-Q for the quarterly periods ended March 31, 2009 and June 30, 2009). We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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

**GENERAL**

Integra is a market-leading, innovative medical device company focused on helping the medical professional enhance the standard of care for patients. Integra provides customers with clinically relevant, innovative and cost-effective products that improve the quality of life for patients. We focus on cranial and spinal procedures, small bone and joint injuries, the repair and reconstruction of soft tissue, and instruments for surgery.

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

We manage these product groups and distribution channels on a centralized basis. Accordingly, we report our financial results under a single operating segment—the development, manufacture and distribution of medical devices. We manufacture many of our products in plants located in the U.S., Puerto Rico, France, Germany, Ireland, the United Kingdom and Mexico. We also source most of our hand-held surgical instruments through specialized third-party vendors.

In the U.S., we have three sales channels. The largest sales channel, Integra Orthopedics, includes three sales organizations: Integra Extremity Reconstruction, which sells through a large direct sales organization, and Integra OrthoBiologics and Integra Spine, which each sell through specialty distributors focused on their respective surgical specialties. Integra NeuroSciences sells products through directly employed sales representatives. The Integra Medical Instruments market sales channel sells through two main sales organizations: Integra Surgical, which sells both directly and through distributors, and Miltex, which sells through distributors and wholesalers.

We also market certain products through strategic partners or original equipment manufacturer customers.

Our objective is to continue to build a customer-focused and profitable medical device company by developing or acquiring innovative medical devices and other products to sell through our sales channels. Our strategy therefore entails substantial growth in revenues through both internal means—through launching new and innovative products and selling existing products more intensively—and by acquiring existing businesses or already successful product lines.





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We aim to achieve this growth in revenues while maintaining strong financial results. While we pay attention to any meaningful trend in our financial results, we pay particular attention to measurements that are indicative of long-term profitable growth. These measurements include revenue growth (derived through acquisitions and products developed internally), gross margins on total revenues, operating margins (which we aim to continually expand on as we leverage our existing infrastructure), operating cash flows (which we aim to increase through improved working capital management), and earnings per diluted share of common stock.

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

*Developing metal implants for bone and joint repair, fixation and fusion.* Through acquisitions, particularly those of Theken in 2008 and Newdeal Technologies SAS in 2005, we have acquired significant expertise in developing metal implants for use in bone and joint repair, fixation and fusion and in successfully bringing those products to market.

*Developing, manufacturing and selling specialty regenerative technology products.* We have a broad technology platform for developing products that regenerate or repair soft tissue and bone. We believe that we have a particular advantage in developing, manufacturing and selling tissue repair products derived from bovine collagen. These products comprised 23% and 22% of revenues for the nine months ended September 30, 2009 and 2008, respectively. Products that contain materials derived from animal sources, including food, pharmaceuticals and medical devices, have been subject to scrutiny from the media and regulatory authorities. Accordingly, widespread public controversy concerning collagen products, new regulations, or a ban of our products containing material derived from bovine tissue, could have a material adverse effect on our current business and our ability to expand.

*Acquiring and integrating new product lines and complementary businesses.* Since 1999, we have acquired and integrated more than 30 product lines or businesses through an acquisition program that focuses on acquiring companies or product lines at reasonable valuations which complement our existing product lines or can be used to leverage our broad technology platform in tissue regeneration and metal implants. We also employ a team of seasoned managers and executives who have demonstrated their ability to successfully integrate the acquired product lines and businesses.

**ACQUISITIONS**

Our strategy for growing our business includes the acquisition of complementary product lines and companies. Our recent acquisitions of businesses, assets and product lines may make our financial results for the nine months ended September 30, 2009 not directly comparable to those of the corresponding prior-year period. See Note 2 to the unaudited condensed consolidated financial statements for a further discussion. Since the beginning of 2008, we have acquired the following businesses:

In August 2008, we acquired Theken Spine, LLC, Theken Disc, LLC and Therics, LLC (collectively, Theken ) for \$75.0 million in cash, acquisition expenses of \$2.4 million and working capital adjustments of \$4.0 million. In addition, the Company may pay up to an additional \$121.0 million in future payments based on the revenue performance of the business in each of the two years after closing, including the \$52.0 million that has been accrued at September 30, 2009. Theken, based in Akron, Ohio, designs, develops and manufactures spinal fixation products, synthetic bone substitute products and spinal arthroplasty products. With Theken, we acquired a unique and comprehensive portfolio of spinal implant products and a robust technology pipeline and demonstrated product development capacity, an established network of spinal hardware distributors with established access to the orthopedic spine market, and a strong management team with extensive experience in the orthopedic spine market. Theken does not currently sell its products outside of the U.S. Accordingly, we expect that the business will benefit from Integra's large international presence. The Theken products are now being marketed under the name Integra Spine .

In October 2008, we acquired Integra Neurosciences Pty Ltd. in Australia and Integra Neurosciences Pty Ltd. in New Zealand for \$4.0 million (6.0 million Australian Dollars) in cash at closing, \$0.3 million in acquisition expenses and working capital adjustments, and up to \$2.1 million (3.1 million Australian Dollars) in future payments based on the performance of business in the three years after closing. With this acquisition of the Company's long-standing distributor, we now have a direct selling presence in Australia and New Zealand.



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In December 2008, we acquired Minnesota Scientific, Inc., doing business as Omni-Tract Surgical ( Omni-Tract ), for \$6.4 million in cash paid at closing, 310,000 unregistered shares of our common stock valued at \$10.7 million (of which 135,000 shares were issued at closing, with the remainder issued in January 2009), working capital adjustments of \$0.1 million and \$0.3 million in transaction related costs, subject to certain adjustments. Omni-Tract is a global leader in the development and manufacture of table mounted retractors and is based in St. Paul, Minnesota. Omni-Tract markets and sells these retractor systems for use in vascular, bariatric, general, urologic, orthopedic, spine, pediatric, and laparoscopic surgery. We have integrated Omni-Tract's product lines into our combined offering of JARIT®, Padgett, Redmond, and Luxe lines of surgical instruments and illumination systems sold by the Integra Medical Instruments sales organization.

In August 2009, we acquired certain assets and liabilities of Innovative Spinal Technologies, Inc. ( IST ) for approximately \$9.3 million in cash and \$0.2 million in acquisition expenses. IST had filed for Chapter 7 bankruptcy protection in May 2009 and the acquisition was the result of an auction process conducted by the bankruptcy trustee and approved by the U.S. Bankruptcy Judge for the District of Massachusetts. IST's focus was on spinal implant products related to minimally invasive surgery and motion preservation techniques. We acquired three product lines, various product development assets for posterior dynamic stabilization, various patents and trademarks, inventory, and assumed certain of IST's patent license agreements and related obligations. These assets and liabilities acquired did not meet the definition of a business under the authoritative guidance for business combinations. Accordingly, the assets and liabilities have been recognized at fair value with no related goodwill.

**RESULTS OF OPERATIONS**

Net income for the three months ended September 30, 2009 was \$14.4 million, or \$0.49 per diluted share, as compared with net loss of \$(16.9) million, or \$(0.60) per diluted share, for the three months ended September 30, 2008.

Net income for the nine months ended September 30, 2009 was \$35.2 million, or \$1.20 per diluted share, as compared with net income of \$4.5 million, or \$0.16 per diluted share, for the nine months ended September 30, 2008.

**Executive Summary**

The increase in net income for the three months ended September 30, 2009 over the prior-year period resulted primarily from decreases in operating expenses stemming from two significant charges recorded in the third quarter of 2008 in the pre-tax amounts of \$25.2 million for in-process research and development related to the Theken acquisition, and a non-cash charge of \$18.0 million in connection with the chief executive officer's stock-based compensation. In addition, net income improved as our revenues increased by 3% in the period and our gross margin percentage increased from 61% in the 2008 period to 63% in 2009. Offsetting this somewhat was the impact of income taxes in the third quarter of 2009.

The increase in net income for the nine months ended September 30, 2009 over the prior-year period resulted primarily from decreases in operating expenses related to the significant third quarter 2008 charges described above and from a 4% increase in revenue, and an improvement in gross margin percentage from 62% in the 2008 period to 64% in 2009.

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

|  | Three Months Ended |                  | Nine Months Ended |                  |
|--|--------------------|------------------|-------------------|------------------|
|  | September 30,      |                  | September 30,     |                  |
|  | 2009               | 2008             | 2009              | 2008             |
| Acquisition-related charges  | \$ 1,035           | \$ 26,131        | \$ 4,966          | \$ 26,584        |
| Employee termination and related costs   |                    |                  | 646               |                  |
| Inventory fair market value purchase accounting adjustments  |                    | 453              |                   | 3,661            |
| Facility consolidation, acquisition integration, manufacturing and distribution transfer, and system integration charges   | 96                 | 238              | 488               | 802              |
| Discontinued product lines   |                    | 1,207            | 246               | 1,207            |
| Incremental professional and bank fees related to (a) the delayed filing of financial statements and (b) waivers or possibility of obtaining waivers under our revolving credit facility |                    |                  | 350               | 1,041            |
| (Gain)/loss related to early extinguishment of convertible note  | 207                |                  | (916)             |                  |
| Non-cash interest expense related to the application of FSP APB 14-1   | 2,335              |                  | 7,862             |                  |
| Stock-based compensation and other related charges   |                    | 18,356           |                   | 18,356           |
| Impairment of long-lived assets  | 1,519              |                  | 1,519             |                  |
| Litigation settlement  | (253)              |                  | (253)             |                  |
| Foreign exchange loss on intercompany loan (1)   |                    |                  | 1,876             |                  |
| <b>Total</b>   | <b>\$ 4,939</b>    | <b>\$ 46,385</b> | <b>\$ 16,784</b>  | <b>\$ 51,651</b> |

(1) This foreign exchange loss is associated with our intercompany loan set up in connection with the restructuring of a German subsidiary in the fourth quarter of 2008. Net income for the nine months ended September 30, 2009 and prior periods include

foreign  
exchange gains  
and losses  
associated with  
intercompany  
loans not related  
to any  
restructuring.

Of these amounts, \$6.1 million and \$6.5 million were charged to cost of product revenues in the nine-month periods ended September 30, 2009 and 2008, respectively. The remaining amounts, except for intangible asset amortization and interest expense, were charged to selling, general and administrative expenses.

We believe that, given our strategy of seeking new acquisitions and integrating recent acquisitions, our current focus on rationalizing our existing manufacturing and distribution infrastructure, our recent review of various product lines in relation to our current business strategy, and a renewed focus on enterprise business systems integrations, charges similar to those discussed above could recur with similar materiality in the future. We believe that the delineation of these costs provides useful information to measure the comparative performance of our business operations across reporting periods.

**Table of Contents****Revenues and Gross Margin on Product Revenues**

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

|  | Three Months Ended<br>September 30, |            | Nine Months Ended<br>September 30, |            |
|--|-------------------------------------|------------|------------------------------------|------------|
|  | 2009                                | 2008       | 2009                               | 2008       |
| Orthopedics                                    | \$ 64,135                           | \$ 53,848  | \$ 193,665                         | \$ 155,996 |
| NeuroSciences                                  | 67,228                              | 68,014     | 188,407                            | 192,146    |
| Medical Instruments                            | 40,923                              | 45,166     | 116,889                            | 132,092    |
| <br>   |                                     |            |                                    |            |
| Total revenue                                  | 172,286                             | 167,028    | 498,961                            | 480,234    |
| Cost of product revenues                       | 63,021                              | 64,317     | 180,974                            | 184,688    |
| <br>   |                                     |            |                                    |            |
| Gross margin on total revenues                 | \$ 109,265                          | \$ 102,711 | \$ 317,987                         | \$ 295,546 |
| <br>   |                                     |            |                                    |            |
| Gross margin as a percentage of total revenues | 63%                                 | 61%        | 64%                                | 62%        |

**THREE MONTHS ENDED SEPTEMBER 30, 2009 AS COMPARED TO THREE MONTHS ENDED SEPTEMBER 30, 2008****Revenues and Gross Margin**

For the three months ended September 30, 2009, total revenues increased by \$5.3 million, or 3.2%, to \$172.3 million from \$167.0 million for the same period during 2008. Domestic revenues increased by \$3.9 million to \$132.1 million, or 77% of total revenues, for the three months ended September 30, 2009 from \$128.2 million, or 77% of total revenues, for the three months ended September 30, 2008. International revenues increased to \$40.1 million from \$38.8 million in the prior-year period, an increase of 3.4%.

Orthopedics revenues were \$64.1 million, an increase of 19.1% over the prior-year period. Most of the increase came from sales of metal spine implants because we owned the Theken spine business for only two months during the 2008 period. Sales of metal implants for the mid- and hindfoot, engineered collagen products for skin and wound repair, and Integra Mozaik collagen/ceramic bone void filler also grew significantly.

NeuroSciences revenues were \$67.2 million, down 1.2% from the prior-year period. Sales of implants, including the DuraGen® family of products, grew year-over-year, but were offset by declines in sales of hospital capital equipment, particularly in our critical care monitoring systems, Radionics® image guided surgery, and stereotactic radio surgery systems. We are uncertain when hospitals will begin to increase spending on capital equipment relative to the prior year; however, we expect that revenues from implants, particularly our DuraGen® family of products, will continue to grow.

Revenues in the Medical Instruments category were \$40.9 million, down 9.4% from the prior year but up sequentially for the second quarter in a row. Sales decreased due to eliminated distributed product lines, the discontinuation of our Original Equipment Manufacturing ( OEM ) surgical lighting line of products, and declines in hospital-based instruments and pain management sales.

Foreign exchange fluctuations, primarily due to the weakening of the euro, British pound and Canadian dollar versus the U.S. dollar, accounted for a \$1.7 million decrease in third quarter of 2009 revenues as compared to the same period last year.

We expect that the following factors will continue to temper sales growth in the short term: reduced spending by hospitals on capital equipment, the occurrence of fewer elective surgical procedures in the current global recessionary economic environment, our recent elimination of many of the product lines we distributed for third parties, and the discontinuation of our OEM surgical lighting line of products. However, we do expect these factors to produce a

benefit in our gross margin as a percentage of revenue, as most of our capital equipment products and products distributed for third parties tend to generate lower gross margins as compared to our other products.

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While most of our products are not used in elective surgical procedures, approximately 10% of our revenues in the three-month period ended September 30, 2009 consisted of sales of capital equipment. Given the current economic conditions, lower hospital spending on capital equipment could continue for the rest of 2009 and potentially beyond then. We expect to drive future revenue growth by continuing to launch new products and acquire businesses and products that can be sold through our existing sales organizations, and by gaining additional market share through the expansion of our Integra Extremity Reconstruction and Integra Spine sales organizations in the U.S. and leveraging the distribution channels in our Integra Spine, Integra NeuroSciences, and Integra OrthoBiologics sales organizations to broaden each organization's access to spine surgeons. We believe that the biggest opportunities for revenue growth exist in the extremity reconstruction and spine markets.

Gross margin increased by \$6.6 million to \$109.3 million for the three-month period ended September 30, 2009, from \$102.7 million for the same period last year. Gross margin as a percentage of total revenue was 63% for the third quarter 2009 compared to 61% for the same period last year. This increase results from a higher portion of product sales coming from higher margin implants, particularly spine and extremity reconstruction, in combination with reduced sales of lower margin instrument, distributed and capital products, partially offset by an impairment of technology assets of \$0.9 million and increased reserves. In addition, the 2009 period contains less inventory purchase accounting adjustments, where charges of \$0.6 million related to Theken in the third quarter of 2009 compared to \$1.3 million related to this acquisition in the third quarter of 2008. The 2008 period also contained charges related to discontinued product lines totaling \$1.2 million.

We expect our consolidated gross margin to improve for the rest of 2009 as sales of our higher gross margin implant products, particularly those from the spine business, are expected to continue to increase as a proportion of total revenues. Although we continuously identify and implement programs to reduce costs at our manufacturing plants and to manage our inventory more efficiently, gross margin improvements in our business are expected to continue to result primarily from changes in sales mix to a larger proportion of sales of our higher gross margin implant products.

**Other Operating Expenses**

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

|                                     | Three Months Ended September |      |
|-------------------------------------|------------------------------|------|
|                                     | 2009                         | 2008 |
| Research and development            | 7%                           | 21%  |
| Selling, general and administrative | 41%                          | 52%  |
| Intangible asset amortization       | 2%                           | 2%   |
| Total other operating expenses      | 50%                          | 75%  |

Total other operating expenses, which consist of research and development expenses, selling, general and administrative expenses, and amortization expenses, decreased \$40.2 million, or 32%, to \$85.4 million in the third quarter of 2009 compared to \$125.6 million in the third quarter of 2008.

Research and development expenses in the third quarter of 2009 decreased by \$23.2 million to \$11.5 million, compared to \$34.7 million in the same period last year. This decrease is due to a \$25.2 million charge for In Process Research and Development (IPRD) associated with the Theken acquisition in 2008, partially offset by a \$0.3 million IPRD charge in the third quarter of 2009. Excluding the IPRD charges, spending increased \$1.7 million to \$11.5 million, and most of the increase in spending is attributable to our spine business and our clinical trial to support FDA approval of expanded claims for our INTEGRA® Dermal Regeneration Template product.

We target 2009 spending on research and development to be between 6% and 7% of total revenues. Most of this planned spending for 2009 is concentrated on product development efforts for our spine, neurosurgery and extremity reconstruction product lines.





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Selling, general and administrative expenses in the third quarter of 2009 decreased by \$17.8 million to \$69.9 million, compared to \$87.7 million in the same period last year, largely due to the 2008 non-cash charge of \$18.0 million in connection with the chief executive officer's stock-based compensation. Selling expenses increased by \$1.5 million primarily due to the increase in revenues and the corresponding commission costs, particularly in connection with our spine product revenues, which generate relatively higher distributor commission costs. In addition to spine, selling expenses also increased in the third quarter of 2009 compared to the same period last year in connection with the acquisitions of the Integra Neurosciences Pty Ltd. in Australia and New Zealand and Omni-Tract businesses. Excluding the stock-based compensation charge in 2008, general and administrative costs decreased \$1.2 million primarily due to lower legal fees driven by the settlement of our Codman litigation, lower consulting and professional fees related to our financial operations, which offset increases related to the acquisitions of the Theken, Integra Neurosciences Pty Ltd. in Australia and New Zealand, and Omni-Tract businesses. We will continue to expand our direct sales organizations in our direct selling platforms where business opportunities are most attractive, including extremity reconstruction, and increase corporate staff to support our information systems infrastructure to facilitate future growth.

Amortization expense in the third quarter of 2009 was \$4.0 million, compared to \$3.2 million in the same period last year. Increases related to the acquisitions of the Theken, Integra Neurosciences Pty Ltd. in Australia and New Zealand, and Omni-Tract businesses, and \$0.6 million due to the impairment of a trade name, which were partially offset by reductions from fully amortized intangible assets.

**Non-Operating Income and Expenses**

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

|                        | <b>Three Months Ended</b> |             |
|------------------------|---------------------------|-------------|
|                        | <b>September 30</b>       |             |
|                        | <b>2009</b>               | <b>2008</b> |
| Interest income        | \$ 197                    | \$ 399      |
| Interest expense       | \$ (5,493)                | \$ (6,955)  |
| Other income (expense) | \$ (380)                  | \$ (409)    |

**Interest Income**

Interest income decreased in the three months ended September 30, 2009 compared to the same period last year, primarily as a result of lower interest rates of return coupled with the overall lower cash balances due to the use of \$17.3 million for the repurchase of debt and \$40.0 million of repayments under the senior credit facility during the period.

**Interest Expense**

Interest expense for the three months ended September 30, 2009 and 2008 included the impact of the additional interest expense from the adoption of the authoritative guidance for convertible debt instruments that may be settled in cash upon conversion (see Note 1). Interest expense decreased in the three-month period ended September 30, 2009, compared to the same period last year, primarily due to reductions in the 2010 Notes and credit facility amounts outstanding resulting from our debt repayments. Our reported interest expense for the three-month periods ended September 30, 2009 and 2008, respectively, includes \$2.4 million and \$3.6 million of cash interest expense. The remainder of the expense represents non-cash interest expense related to the adoption of the authoritative guidance and the amortization of debt issuance costs.

**Income Taxes**

|                                   | <b>Three Months Ended</b> |             |
|-----------------------------------|---------------------------|-------------|
|                                   | <b>September 30,</b>      |             |
|                                   | <b>2009</b>               | <b>2008</b> |
|                                   | <b>(in thousands)</b>     |             |
| Income (loss) before income taxes | \$ 18,144                 | \$ (29,856) |
| Income tax expense (benefit)      | 3,712                     | (13,001)    |

|                    |    |        |    |          |
|--------------------|----|--------|----|----------|
| Net income (loss)  | \$ | 14,432 | \$ | (16,855) |
| Effective tax rate |    | 20.5%  |    | (43.5%)  |

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Our effective income tax rate for the three months ended September 30, 2009 and 2008 was 20.5% and 43.5% (benefit), respectively. Income tax expense for the three months ended September 30, 2009 included the reversal of accruals for uncertain tax positions and the year-to-date adjustment to reflect our current view of the full year estimated tax rate.

Our effective tax rate may vary from period to period depending on, among other factors, the geographic and business mix of taxable earnings and losses. We consider these factors and others, including our history of generating taxable earnings, in assessing our ability to realize deferred tax assets. We expect our effective income tax rate for the full year to be approximately 31%. The main contributor to the reduction in the rate for the period was a geographical shift of income from the U.S. to the foreign jurisdictions.

**NINE MONTHS ENDED SEPTEMBER 30, 2009 AS COMPARED TO NINE MONTHS ENDED SEPTEMBER 30, 2008****Revenues and Gross Margin**

For the nine-month period ended September 30, 2009, total revenues increased by \$18.8 million or 3.9%, to \$499.0 million from \$480.2 million during the prior-year period. Domestic revenues increased by \$24.5 million to \$381.8 million and were 77% of total revenues, as compared to 74% of revenues in the nine months ended September 30, 2008. International revenues decreased \$5.8 million to \$117.1 million, a decrease of 4.7% compared to the same period in 2008.

Orthopedics revenues were \$193.7 million, an increase of 24.1% over the prior-year period. Most of the increase came from sales of metal spine implants because we owned the Theken spine business for only two months during the 2008 period. Sales of metal implants for the mid- and hindfoot, engineered collagen products for skin and wound repair, and Integra Mozaik collagen/ceramic bone void filler also grew significantly. Sales of our private-label orthopedics products declined significantly as our customers reduced inventory in their distribution chains.

NeuroSciences revenues were \$188.4 million, down 1.9% from the prior-year period. Sales of implants, including the DuraGen® family of products, grew year-over-year, but were offset by declines in sales of hospital capital equipment, particularly in our critical care monitoring systems, Radionics® image guided surgery, and stereotactic radio surgery systems. We are uncertain when hospitals will begin to increase spending on capital equipment relative to the prior year; however, we expect that revenues from implants, particularly our DuraGen® family of products, will continue to grow.

Revenues in the Medical Instruments category were \$116.9 million, down 11.5% from the prior year but up sequentially for the second quarter in a row. Sales decreased due to eliminated distributed product lines, the discontinuation of our Original Equipment Manufacturing ( OEM ) surgical lighting line of products, and declines in hospital-based instruments and pain management sales.

Foreign exchange fluctuations, primarily due to the weakening of the euro, British pound, and Canadian dollar versus the U.S. dollar, accounted for an \$11.6 million decrease in the nine-month period ended September 30, 2009 revenues as compared to the same period last year.

Gross margin increased by \$22.5 million to \$318.0 million for the nine-month period ended September 30, 2009, from \$295.5 million for the same period last year. Gross margin as a percentage of total revenue was 64% for the first three quarters of 2009, compared to 62% for this same period during 2008. This increase results from a higher portion of product sales coming from higher margin implants, particularly spine and extremity reconstruction, in combination with reduced sales of lower margin instrument, distributed and capital products. Inventory purchase accounting adjustment charges totaled \$4.6 million in the nine-month period ended September 30, 2009 related to our Theken and Integra Neurosciences Pty Ltd. in Australia and New Zealand acquisitions, versus \$4.7 million of charges in the same period during 2008 related to our IsoTis and Theken acquisitions.

**Table of Contents****Other Operating Expenses**

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

|                                     | <b>Nine Months Ended<br/>September 30,</b> |             |
|-------------------------------------|--|-------------|
|                                     | <b>2009</b>                                | <b>2008</b> |
| Research and development            | 7%   | 10%         |
| Selling, general and administrative | 41%  | 44%         |
| Intangible asset amortization       | 2%   | 2%          |
| <br>Total other operating expenses  | <br>50%                                    | <br>56%     |

Total other operating expenses, which consist of research and development expenses, selling, general and administrative expenses and amortization expenses, decreased \$25.1 million, or 9%, to \$248.0 million in the first nine months of 2009, compared to \$273.1 million in the same period last year.

Research and development expenses in the first nine months of 2009 decreased by \$17.8 million to \$32.5 million, compared to \$50.3 million in the same period last year. This decrease resulted from a \$25.2 million charge for IPRD associated with our Theken acquisition in 2008, partially offset by a \$0.3 million IPRD charge in the third quarter of 2009. Excluding the IPRD charges, the increase resulted largely from the acquisition of Theken in August 2008 and to increased spending in our multi-center clinical trial being conducted under a FDA Investigational Device Exemption initiated in 2006 to support FDA approval of our DuraGen Plus® Adhesion Barrier Matrix product in the United States.

Selling, general and administrative expenses in the first nine months of 2009 decreased by \$9.0 million to \$204.6 million, compared to \$213.6 million in the same period last year, largely due to the 2008 non-cash charge of \$18.0 million in connection with the chief executive officer's stock-based compensation. Selling expenses increased by \$11.2 million primarily due to the increase in revenues and the corresponding commission costs, particularly in connection with our spine product revenues, which generate relatively higher distributor commission costs. In addition to spine, selling expenses also increased in the first nine months of 2009 compared to the same period last year in connection with the acquisitions of the Integra Neurosciences Pty Ltd. in Australia and New Zealand and Omni-Tract businesses. General and administrative costs, excluding the stock-based compensation charge in 2008, decreased \$2.2 million from the prior period primarily due to decreases in cash bonus accruals, lower professional and consulting fees related to financial operations, and lower legal fees resulting from the settlement of our Codman litigation, which were partially offset by increases in connection with the acquisitions of the Theken, Integra Neurosciences Pty Ltd. in Australia and New Zealand, and Omni-Tract businesses.

Amortization expense in the first nine months of 2009 increased by \$1.7 million to \$10.9 million, compared to \$9.2 million in the same period last year. The increase was primarily related to the acquisitions of the Theken, Integra Neurosciences Pty Ltd. in Australia and New Zealand, and Omni-Tract businesses, and \$0.6 million due to impairment of a trade name.

**Non-Operating Income and Expenses**

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

|                        | <b>Nine Months Ended<br/>September 30,</b> |             |
|------------------------|--|-------------|
|                        | <b>2009</b>                                | <b>2008</b> |
| Interest income        | \$ 578                                     | \$ 1,530    |
| Interest expense       | (18,351)                                   | (22,444)    |
| Other income (expense) | (1,729)                                    | 647         |
| <b>Interest Income</b> |  |             |

Interest income decreased in the nine-month period ended September 30, 2009, compared to the same period last year, primarily as a result of lower interest rates of return coupled with the overall lower cash balances due to the use of \$64.9 million for the repurchase of debt and \$100.0 million of repayments under the senior credit facility during the year.

**Table of Contents****Interest Expense**

Interest expense for the nine months ended September 30, 2009 and 2008 included the impact of the additional interest expense from the adoption of the authoritative guidance for convertible debt instruments that may be settled in cash upon conversion (see Note 1). Interest expense decreased in the nine-month period ended September 30, 2009, compared to the same period last year, primarily due to the settlement of our 2008 Notes, which were fully repaid in April 2008, waiver fees paid in 2008, and reductions in the 2010 Notes and credit facility amounts outstanding resulting from our debt repayments.

Our reported interest expense for the nine-month periods ended September 30, 2009 and 2008 include \$8.6 million and \$10.3 million of cash interest expense, respectively. The remainder of the expense represents non-cash interest expense related to the adoption of the authoritative guidance and the amortization of debt issuance costs.

On March 17, 2008, our 2008 Notes matured and we paid \$1.8 million of contingent interest because our common stock price was greater than \$37.56 at thirty days prior to the maturity date. The value of this contingent interest obligation was marked to its fair value at each balance sheet date, with changes in the fair value recorded to interest expense. In accordance with the terms of the 2008 Notes we paid approximately \$0.2 million and \$119.4 million and issued 12,000 and 756,000 shares of our common stock in March and April 2008, respectively. We borrowed \$120.0 million under our credit facility in March 2008 in order to repay the 2008 Notes, which were entirely repaid in April 2008. The changes in the estimated fair value of the contingent interest obligation increased interest expense by \$25,000 for the nine months ended September 30, 2008.

**Other Income (Expense)**

Other income (expense) decreased in the nine months ended September 30, 2009, compared to the same period last year, primarily as a result of foreign exchange losses of \$3.5 million in the nine months ended September 30, 2009, compared to foreign exchange gains of \$0.4 million in the nine months ended September 30, 2008. Offsetting this loss in 2009 was \$0.9 million of net gains related to the March, June and September 2009 repurchases of our 2010 Notes totaling \$68.4 million.

**Income Taxes**

|                              | <b>Nine Months Ended<br/>September 30,</b> |             |
|------------------------------|--|-------------|
|                              | <b>2009</b>                                | <b>2008</b> |
|                              | <b>(in thousands)</b>                      |             |
| Income before income taxes   | \$ 50,475                                  | \$ 2,176    |
| Income tax expense (benefit) | 15,251                                     | (2,296)     |
| Net income                   | \$ 35,224                                  | \$ 4,472    |
| Effective tax rate           | 30.2%                                      | (105.5)%    |

Our effective income tax rate for the nine months ended September 30, 2009 and 2008 was 30.2% and 105.5% (benefit), respectively. Income tax expense for the nine months ended September 30, 2009 included the reversal of accruals for uncertain tax positions and the year-to-date adjustment to reflect our current view of the full year estimated tax rate.

Our effective tax rate may vary from period to period depending on, among other factors, the geographic and business mix of taxable earnings and losses. We consider these factors and others, including our history of generating taxable earnings, in assessing our ability to realize deferred tax assets. The main contributor to the reduction in the rate for the period was a geographical shift of income from the U.S. to the foreign jurisdictions.

**Table of Contents****GEOGRAPHIC PRODUCT REVENUES AND OPERATIONS**

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

|                                       | <b>United<br/>States</b> | <b>Europe</b> | <b>Asia<br/>Pacific</b> | <b>Other<br/>Foreign</b> | <b>Total</b> |
|---------------------------------------|--------------------------|---------------|-------------------------|--------------------------|--------------|
| Three months ended September 30, 2009 | \$ 132,143               | \$ 23,484     | \$ 7,064                | \$ 9,595                 | \$ 172,286   |
| Three months ended September 30, 2008 | 128,189                  | 23,605        | 6,517                   | 8,717                    | 167,028      |
| Nine months ended September 30, 2009  | 381,814                  | 69,913        | 22,193                  | 25,041                   | 498,961      |
| Nine months ended September 30, 2008  | 357,318                  | 76,204        | 19,877                  | 26,835                   | 480,234      |

For the nine months ended September 30, 2009, revenues from customers outside the United States totaled \$117.1 million, or 23.5% of total revenues, of which approximately 59.7% were from European customers. Revenues from customers outside the United States included \$89.3 million of revenues generated in foreign currencies. For the nine months ended September 30, 2008, revenues from customers outside the United States totaled \$122.9 million, or 25.6% of total revenues, of which approximately 62.0% were from European customers. Revenues from customers outside the United States included \$66.3 million of revenues generated in foreign currencies. Because we have operations based in Europe and we generate revenues and incur operating expenses in euros, British pounds, and other currencies, we experience currency exchange risk with respect to those foreign currency denominated revenues or expenses. We currently do not hedge our exposure to foreign currency risk. Accordingly, fluctuations of the dollar against these other currencies could negatively affect future gross margins and operating margins. We will continue to assess the potential effects that changes in foreign currency exchange rates could have on our business. If we believe this potential impact presents a significant risk to our business, we may enter into derivative financial instruments to mitigate this risk.

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

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

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

We had cash and cash equivalents totaling approximately \$106.7 million and \$183.5 million at September 30, 2009 and December 31, 2008, respectively.

**Cash Flows**

|  | <b>Nine Months Ended<br/>September 30,<br/>2009                  2008<br/>(in thousands)</b> |               |
|--|--|---------------|
| Net cash provided by operating activities                | \$ 96,191  | \$ 45,499     |
| Net cash used in investing activities                    | (21,068)   | (87,137)      |
| Net cash (used in) provided by financing activities      | (158,233)  | 90,997        |
| Effect of exchange rate fluctuations on cash             | 6,311  | 2,641         |
| <br>Net (decrease) increase in cash and cash equivalents | <br>\$ (76,799)  | <br>\$ 52,000 |





**Table of Contents****Cash Flows Provided by Operating Activities**

We have generated positive operating cash flows on an annual basis, including \$72.6 million for the year ended December 31, 2008 and \$96.2 million for the nine months ended September 30, 2009, resulting from net income and non-cash add-backs, partially offset by deferred tax benefit and changes in working capital items.

Cash provided by operations has recently been, and is expected to continue to be our primary means of funding existing operations and capital expenditures. Operating cash flows increased in 2009 as a result of increased net income, improved collections of accounts receivable, usage of prepaid expenses (particularly prepaid income taxes) and reductions in inventory and other working capital adjustments, partially offset by cash used in the purchase of inventory from IST of approximately \$4.2 million.

**Cash Flows Provided by Investing and Financing Activities**

Our principal use of funds during the nine months ended September 30, 2009 was \$60.9 million used to repurchase the liability component of the 2010 Notes and repayment of \$100.0 million of our senior credit facility. These Notes had a face value amount of \$68.4 million, and their purchase will result in overall reduced net interest costs. Other uses in the period included \$14.0 million in capital expenditures (including \$3.0 million purchased from IST), \$2.3 million of intangible assets purchased from IST and \$4.8 million of payments related to previous business acquisitions.

**Working Capital**

At September 30, 2009 and December 31, 2008, working capital was \$180.5 million and \$322.6 million, respectively. The decrease in working capital is primarily related to the inclusion of our 2010 Notes in current liabilities due to their maturity date and the \$52.0 million accrued as the first earnout payment related to the Theken acquisition.

**Convertible Debt and Senior Secured Revolving Credit Facility**

We pay interest each June 1 and December 1 on our \$114.2 million senior convertible notes due June 2010 ( 2010 Notes ) at an annual rate of 2.75% and on our \$165 million senior convertible notes due June 2012 ( 2012 Notes ) and, collectively with the 2010 Notes , the Notes ) at an annual rate of 2.375%.

The Notes are senior, unsecured obligations of Integra, and are convertible into cash and, if applicable, shares of our common stock based on an initial conversion rate, subject to adjustment, of 15.0917 shares per \$1,000 principal amount of notes for the 2010 Notes and 15.3935 shares per \$1,000 principal amount of notes for the 2012 Notes (which represents an initial conversion price of approximately \$66.26 per share and approximately \$64.96 per share for the 2010 Notes and the 2012 Notes, respectively.) We expect to satisfy any conversion of the Notes with cash up to the principal amount of the applicable series of Notes pursuant to the net share settlement mechanism set forth in the applicable indenture and, with respect to any excess conversion value, with shares of our common stock. The Notes are convertible only in the following circumstances: (1) if the closing sale price of our common stock exceeds 130% of the conversion price during a period as defined in the indenture; (2) if the average trading price per \$1,000 principal amount of the Notes is less than or equal to 97% of the average conversion value of the Notes during a period as defined in the indenture; (3) at any time on or after December 15, 2009 (in connection with the 2010 Notes) or anytime after December 15, 2011 (in connection with the 2012 Notes); or (4) if specified corporate transactions occur. The issue price of the Notes was equal to their face amount, which is also the amount holders are entitled to receive at maturity if the Notes are not converted. As of September 30, 2009, the 2010 Notes are classified as current due to their maturity date. However, none of these conditions existed and, as a result, the entire balance of the 2012 Notes is classified as long-term.

The Notes, under the terms of the private placement agreement, are guaranteed fully by Integra LifeSciences Corporation, a subsidiary of Integra. The 2010 Notes will rank equal in right of payment to the 2012 Notes. The Notes are Integra's direct senior unsecured obligations and will rank equal in right of payment to all of our existing and future unsecured and unsubordinated indebtedness.

In connection with the issuance of the Notes, we entered into call transactions and warrant transactions, primarily with affiliates of the initial purchasers of the Notes (the hedge participants ), in connection with each series of Notes. The cost of the call transactions to us was approximately \$46.8 million. We received approximately \$21.7 million of proceeds from the warrant transactions. The call transactions involved our purchasing call options from the hedge participants, and the warrant transactions involved us selling call options to the hedge participants with a higher strike price than the purchased call options.



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The initial strike price of the call transactions is (1) for the 2010 Notes, approximately \$66.26 per share of Common Stock, and (2) for the 2012 Notes, approximately \$64.96, in each case subject to anti-dilution adjustments substantially similar to those in the Notes. The initial strike price of the warrant transactions is (i) for the 2010 Notes, approximately \$77.96 per share of Common Stock and (ii) for the 2012 Notes, approximately \$90.95, in each case subject to customary anti-dilution adjustments.

In March 2009, we repurchased \$32.1 million principal amount of the 2010 Notes and recognized a gain of \$1.2 million. Total cash paid for this repurchase was \$29.5 million of which \$28.0 million related to repayment of the liability component of the Notes and \$1.5 million for payment of accreted interest. In June 2009, we repurchased \$18.7 million principal amount of the 2010 Notes and recognized a loss of \$0.1 million. Total cash paid for this repurchase was \$18.0 million of which \$16.8 million related to repayment of the liability component of the Notes and \$1.2 million for payment of accreted interest. In September 2009, we repurchased \$17.7 million principal amount of the 2010 Notes and recognized a loss of \$0.2 million. Total cash paid was \$17.3 million of which \$16.0 million related to repayment of the liability component of the Notes and \$1.3 million for payment of accreted interest. For all of these transactions the bond hedge contracts were terminated on a pro-rata basis and the number of options was adjusted to reflect the number of convertible securities outstanding that together have a total principal amount of \$96.6 million. In separate transactions, we amended the warrant transactions to reduce the number of warrants outstanding to reflect such number of convertible securities outstanding.

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

As of September 30, 2009 we had \$160 million of outstanding borrowings under our credit facility at a weighted average rate of 1.27%. We used a portion of the borrowings to repay all of the remaining 2008 Notes totaling approximately \$119.4 million in the second quarter of 2008 and \$3.3 million of related accrued and contingent interest during March 2008. On July 28, 2008 and October 30, 2008, we borrowed \$80.0 million and \$60.0 million, respectively, to fund the acquisition of Theken and for other general corporate purposes. During June 2009 and August 2009, we repaid \$60.0 million and \$40.0 million, respectively, of our outstanding borrowings. We consider all such outstanding amounts to be long-term in nature based on our current intent and ability to repay this borrowing after the next twelve-month period. If additional borrowings are made in connection with, for instance, future acquisitions, such activities could impact the timing of when we intend to repay amounts under this credit facility, which expires in December, 2011. We believe that our cash and available borrowings under the senior secured revolving credit facility are sufficient to finance our operations, capital expenditures and potential acquisition-related earn-out payments in the near term.

### **Share Repurchase Plan**

In October 2007, our Board of Directors adopted a program that authorized us to repurchase shares of our common stock for an aggregate purchase price not to exceed \$75.0 million through December 31, 2008. On October 30, 2008, our Board of Directors terminated the repurchase authorization it adopted in October 2007 and authorized us to repurchase shares of our common stock for an aggregate purchase price not to exceed \$75.0 million through December 31, 2010. Shares may be purchased either in the open market or in privately negotiated transactions. We did not repurchase any shares of our common stock in 2008 or during the first nine months of 2009 under either of these programs.

### **Dividend Policy**

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



**Table of Contents****Capital Resources**

We believe that our cash and available borrowings under the senior secured revolving credit facility are sufficient to finance our operations and capital expenditures, and potential acquisition-related earn-out payments in the near term based on our current intent. We regularly borrow under the credit facility and make payments with respect thereto and consider all such outstanding amounts to be long-term in nature. See **Convertible Debt and Senior Secured Revolving Credit Facility** for a description of the material terms of our credit facility.

**Contractual Obligations and Commitments**

As of September 30, 2009, we were obligated to pay the following amounts under various agreements (in millions):

|                                    | <b>Total</b>    | <b>Less than<br/>1 Year</b> | <b>1-3<br/>Years<br/>(in millions)</b> | <b>3-5<br/>Years</b> | <b>More<br/>than<br/>5 years</b> |
|------------------------------------|-----------------|-----------------------------|--|----------------------|----------------------------------|
| Convertible Securities             | \$ 261.6        | \$ 96.6                     | \$ 165.0                               | \$                   | \$                               |
| Revolving Credit Facility (1)      | 160.0           |                             | 160.0                                  |                      |                                  |
| Interest on Convertible Securities | 14.9            | 3.5                         | 11.4                                   |                      |                                  |
| Employment Agreements (2)          | 5.5             | 3.1                         | 2.4                                    |                      |                                  |
| Operating Leases                   | 32.1            | 7.3                         | 8.1                                    | 6.5                  | 10.2                             |
| Acquisition Obligations (3)        | 52.0            | 52.0                        |  |                      |                                  |
| Purchase Obligations               | 9.8             | 8.9                         | 0.9                                    |                      |                                  |
| Pension Contributions              | 0.4             | 0.4                         |  |                      |                                  |
| <b>Total</b>                       | <b>\$ 536.3</b> | <b>\$ 171.8</b>             | <b>\$ 347.8</b>                        | <b>\$ 6.5</b>        | <b>\$ 10.2</b>                   |

(1) We regularly borrow and make payment each month against the credit facility and consider all such outstanding amounts to be long-term in nature based on our current intent and ability to repay this borrowing. If additional borrowings are made in connection with, for instance, future acquisitions, this could impact the

timing of when we intend to repay amounts under this credit facility which expires in December 2011.

(2) Amounts shown under Employment Agreements do not include executive compensation or compensation resulting from a change in control relating to our executive officers.

(3) The terms of the purchase agreements executed in connection with certain acquisitions we closed in the last several years require us to make payments to the sellers of those businesses based on the performance of such businesses after the acquisition. The purchase adjustments could require payments up to a total of approximately \$121.0 million in 2009 and 2010, the actual amounts to depend primarily

on the revenues attributable to the Theken Spine, LLC acquisition. Approximately \$52.0 million of this amount has been accrued at September 30, 2009 relating to the Theken Spine, LLC acquisition.

Excluded from the contractual obligations table is the liability for unrecognized tax benefits totaling \$13.9 million. This liability for unrecognized tax benefits has been excluded because we cannot make a reliable estimate of the period in which the unrecognized tax benefits will be realized.

#### **OTHER MATTERS**

##### **Critical Accounting Estimates**

The critical accounting estimates included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2008 have not materially changed. Certain of these estimates, such as the valuation of identifiable intangible assets, have been affected by lower revenues and profitability than had been originally anticipated. Such valuations have accordingly become more sensitive to factors such as prevailing interest rates and assumptions about market royalty rates.



**Table of Contents****Recently Adopted Accounting Standards****Accounting Standards Codification**

In June 2009, the Financial Accounting Standards Board ( FASB ) issued SFAS 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles*, which is effective for interim and annual periods ending after September 15, 2009. This pronouncement made the FASB *Accounting Standards Codification* the single official source of authoritative, nongovernmental U.S. generally accepted accounting principles and supersedes all existing non-SEC standards. The references to accounting literature included in the discussion herein have been updated to remove all references to superseded literature.

**Debt**

Effective January 1, 2009, we adopted the authoritative guidance for accounting for convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement). The guidance requires that the liability and equity components of convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement) be separately accounted for in a manner that reflects an issuer's nonconvertible debt borrowing rate. The guidance is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. The guidance is effective for our \$330.0 million (of which \$261.6 million remains outstanding) aggregate principal amount of our senior convertible notes due June 2010 and June 2012 with an annual rate of 2.75% and 2.375%, respectively, (the 2010 Notes and the 2012 Notes, respectively), and the \$119.5 million exchanged portion of our contingent convertible subordinated notes due March 2008 with an annual rate of 2.5% (the 2008 Notes ) and requires retrospective application for all periods presented. The guidance requires the issuer of convertible debt instruments with cash settlement features to separately account for the liability. As of the date of issuance for the 2010 Notes and the 2012 Notes, and the date of modification for the 2008 Notes (collectively, the Covered Notes ), the result of the impact of the guidance for each of the Covered Notes is as follows (in millions):

|                                    | <b>2008</b><br><b>Notes</b><br>September<br>2006 | <b>2010</b><br><b>Notes</b><br>June 2007 | <b>2012</b><br><b>Notes</b><br>June 2007 |
|------------------------------------|--|--|--|
| Date debt impacted by the guidance |  |  |  |
| Total Amount                       | \$ 119.5   | \$ 165.0                                 | \$ 165.0                                 |
| Liability Component                | 103.0  | 142.2                                    | 122.5                                    |
| Equity Component                   | 11.6   | 16.0                                     | 29.9                                     |
| Deferred Tax Component             | 4.9  | 6.8                                      | 12.6                                     |

The liability component was recognized at the present value of its cash flows discounted using discount rates of 9.70%, 6.47% and 6.81%, our borrowing rate at the date of exchange of the 2008 Notes and the dates of the issuance of the 2010 Notes and the 2012 Notes, respectively, for a similar debt instrument without the conversion feature. For additional information, see Note 5, Debt.

The guidance also requires an accretion of the resultant debt discount over the expected life of the Covered Notes, which is March, 2008 to June, 2012.

For the three months ended September 30, 2009, the additional pre-tax non-cash interest expense recognized in the condensed consolidated income statement was \$2.3 million. Accumulated amortization related to the debt discount was \$20.1 million and \$11.5 million as of September 30, 2009 and December 31, 2008, respectively. The pre-tax increase in non-cash interest expense on our condensed consolidated statements of income to be recognized through 2012, the latest maturity date of the Notes, is as follows (in millions):

|   | <b>2009</b> | <b>2010</b> | <b>2011</b> | <b>2012</b> |
|---|-------------|-------------|-------------|-------------|
| Pre-tax increase in non-cash interest expense | \$ 10.1     | \$ 7.5      | \$ 6.7      | \$ 2.9      |



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***Other Recently Adopted Accounting Standards***

Effective January 1, 2009, we adopted the authoritative guidance for determining whether instruments granted in share-based payment transactions are participating securities. In the guidance, unvested share-based payment awards that contain rights to receive nonforfeitable dividends or dividend equivalents (whether paid or unpaid) are participating securities, and thus, should be included in the two-class method of computing earnings per share (EPS). The adoption of this guidance did not have a material impact on our disclosure of EPS. See Note 9, Net Income Per Share.

Effective January 1, 2009, we adopted the revised authoritative guidance for business combinations. This guidance changes the practice for accounting for business combinations, such as requiring that we (1) expense transaction costs as incurred, rather than capitalizing them as part of the purchase price; (2) record contingent consideration arrangements and pre-acquisition contingencies, such as legal issues, at fair value at the acquisition date, with subsequent changes in fair value recorded in the income statement; (3) capitalize the fair value of acquired research and development assets separately from goodwill, whereas we previously determined the acquisition-date fair value and then immediately charged the value to expense; and (4) limit the conditions under which restructuring expenses can be accrued in the opening balance sheet of a target. Additionally, this guidance provides that, upon initially obtaining control, an acquirer shall recognize 100 percent of the fair values of acquired assets, including goodwill, and assumed liabilities, with only limited exceptions, even if the acquirer has not acquired 100 percent of its target. The implementation of this guidance could result in an increase or decrease in future selling, general and administrative and other operating expenses, depending upon the extent of our acquisition related activities going forward. No business combination transactions occurred during the three months ended September 30, 2009. The adoption of this guidance did not have a material impact on our financial condition and results of operations.

Effective January 1, 2009, we adopted the authoritative guidance for determination of the useful life of intangible assets. This guidance amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset. The intent of this guidance is to improve the consistency between the useful life of a recognized intangible asset and the period of expected cash flows used to measure the fair value of the asset under the new business combination rule and other generally accepted accounting principles. The adoption of this guidance did not have a material impact on our financial condition and results of operations.

Effective January 1, 2009, we adopted the authoritative guidance for the effective date of fair value measurements for all non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value on a recurring basis (at least annually). The adoption of this guidance did not have a material impact on our financial condition and results of operations.

Effective January 1, 2009, we adopted the authoritative guidance for disclosures about derivative instruments and hedging activities. This guidance requires enhanced disclosures about derivative instruments and hedging activities to allow for a better understanding of their effects on an entity's financial position, financial performance, and cash flows. Among other things, this guidance requires disclosure of the fair values of derivative instruments and associated gains and losses in a tabular format. Since this guidance requires only additional disclosures about our derivatives and hedging activities, the adoption of this guidance does not affect our financial position or results of operations. The adoption of this guidance did not have a material impact on our financial condition and results of operations.

Effective January 1, 2009, we adopted the authoritative guidance for determining whether an instrument (or embedded feature) is indexed to an entity's own stock. This guidance mandates a two-step process for evaluating whether an equity-linked financial instrument or embedded feature is indexed to the entity's own stock. Equity instruments that a company issues that contain a strike price adjustment feature, upon the adoption of this guidance, may no longer be considered indexed to the company's own stock. Accordingly, adoption of this guidance may change the current classification (from equity to liability) and the related accounting for such equity instruments outstanding at that date. The adoption of this guidance did not have a material impact on our financial condition and results of operations.

In May 2009, the FASB issued and we adopted the authoritative guidance for subsequent events. This guidance establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before the financial statements are issued. This guidance requires disclosure of the date through which an entity has

evaluated subsequent events and the basis for that date. That is, whether the date represents the date the financial statements were issued or were available to be issued. The adoption of this guidance did not have a material impact on our financial condition and results of operations.

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

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

**Foreign Currency Exchange Rate Risk**

A discussion of foreign currency exchange risks is provided under the caption Geographic Product Revenues and Operations under Management's Discussion and Analysis of Financial Condition and Results of Operations.

**Interest Rate Risk Senior Secured Credit Facility**

We are exposed to the risk of interest rate fluctuations on the interest paid under the terms of our senior secured credit facility. Based on our outstanding borrowings as of September 30, 2009, a hypothetical 100 basis point movement in interest rates applicable to this credit facility would increase or decrease interest expense by approximately \$1.6 million on an annual basis.

**ITEM 4. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures**

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

As required by Exchange Act Rule 13a-15(b), we have carried out an evaluation, under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of September 30, 2009. Based upon this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective as of September 30, 2009 to provide such reasonable assurance.

**Changes in Internal Control Over Financial Reporting**

There were no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) that occurred during the quarter ended September 30, 2009 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II. OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

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

In May 2006, Codman & Shurtleff, Inc., a subsidiary of Johnson & Johnson, commenced an action in the United States District Court for the District of New Jersey for declaratory judgment against the Company with respect to United States Patent No. 5,997,895 (the '895 Patent') held by the Company. The Company's '895 Patent describes dural repair technology related to the Company's DuraGen® family of duraplasty products.

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The action sought declaratory relief that Codman's DURAFORM<sup>®</sup> product does not infringe the Company's 895 Patent and that the Company's 895 Patent is invalid and unenforceable. The Company filed a counterclaim seeking a judgment that Codman's DURAFORM<sup>®</sup> product infringes the 895 Patent.

In August 2009, the parties settled the litigation for an immaterial amount and entered into covenants not to sue and mutual releases.

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

**ITEM 1A. RISK FACTORS**

The Risk Factors included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2008 (as modified by the subsequent Quarterly Reports on Form 10-Q for the quarterly periods ended March 31, 2009 and June 30, 2009) have not materially changed other than the modifications to the risk factors as set forth below.

***Changes in the healthcare industry may require us to decrease the selling price for our products, may reduce the size of the market for our products, or may eliminate a market, any of which could have a negative impact on our financial performance.***

Trends toward managed care, healthcare cost containment and other changes in government and private sector initiatives in the U.S. and other countries in which we do business are placing increased emphasis on the delivery of more cost-effective medical therapies that could adversely affect the sale and/or the prices of our products. For example:

- major third-party payors of hospital services and hospital outpatient services, including Medicare, Medicaid and private healthcare insurers, annually revise their payment methodologies, which can result in stricter standards for reimbursement of hospital charges for certain medical procedures or the elimination of reimbursement;

- Medicare, Medicaid and private healthcare insurer cutbacks could create downward price pressure on our products;

- recently effected local Medicare coverage determinations will eliminate reimbursement for certain of our matrix wound dressing products in most regions, negatively affecting our market for these products, and future determinations could eliminate reimbursement for these products in other regions and could eliminate reimbursement for other products;

- potential legislative proposals have been considered that would result in major reforms in the U.S. healthcare system, that could have an adverse effect on our business, including a proposed excise tax on U.S. sales of medical devices, which, if enacted in accordance with certain proposals in pending legislation, could have a material adverse effect on our earnings;

- there has been a consolidation among healthcare facilities and purchasers of medical devices in the U.S. who prefer to limit the number of suppliers from whom they purchase medical products, and these entities may decide to stop purchasing our products or demand discounts on our prices;

- we are party to contracts with group purchasing organizations, which negotiate pricing for many member hospitals, that require us to discount our prices for certain of our products and limit our ability to raise prices for certain of our products, particularly surgical instruments;

- there is economic pressure to contain healthcare costs in domestic and international markets;

there are proposed and existing laws, regulations and industry policies in domestic and international markets regulating the sales and marketing practices and the pricing and profitability of companies in the healthcare industry;

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proposed laws or regulations that will permit hospitals to provide financial incentives to doctors for reducing hospital costs (known as gainsharing) and to award physician efficiency (known as physician profiling) could reduce prices; and

there have been initiatives by third-party payors to challenge the prices charged for medical products that could affect our ability to sell products on a competitive basis.

Both the pressures to reduce prices for our products in response to or despite these trends and the decrease in the size of the market as a result of these trends could adversely affect our levels of revenues and profitability of sales.

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

In October 2008, our Board of Directors adopted a new program that authorizes us to repurchase shares of our common stock for an aggregate purchase price not to exceed \$75 million through December 31, 2010. Shares may be repurchased either in the open market or in privately negotiated transactions.

There were no such repurchases of our common stock during the quarter ended September 30, 2009 under this program.

**ITEM 6. EXHIBITS**

3.2 Amended and Restated Bylaws of the Company (Incorporated by reference to Exhibit 3.2 to the Company's Current Report on Form 8-K filed on November 3, 2009)

\*31.1 Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

\*31.2 Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

\*32.1 Certification of Principal Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

\*32.2 Certification of Principal Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

\* Filed herewith



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**SIGNATURES**

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

**INTEGRA LIFESCIENCES HOLDINGS  
CORPORATION**

Date: November 4, 2009

*/s/ Stuart M. Essig*

*Stuart M. Essig  
President and Chief Executive Officer*

Date: November 4, 2009

*/s/ John B. Henneman, III*

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

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