

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2017

or

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

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

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

DELAWARE  
(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) (ZIP CODE)

08536

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

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

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

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

Large accelerated filer  Accelerated filer

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

Emerging growth company

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

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

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

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

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

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

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INTEGRA LIFESCIENCES HOLDINGS CORPORATION  
 CONDENSED CONSOLIDATED BALANCE SHEETS  
 (UNAUDITED)

(In thousands, except per share amount)

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

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

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

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

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

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

1. BASIS OF PRESENTATION

General

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

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

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

Amendment to the Certificate of Incorporation and Stock Split

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

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

Johnson & Johnson's Codman Neurosurgery Business

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

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

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

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

#### Assets and Liabilities Held for Sale

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

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

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

|                                    |          |
|------------------------------------|----------|
| Inventories                        | \$7,674  |
| Property, plant and equipment, net | 399      |
| Goodwill                           | 2,911    |
| Total assets held for sale         | \$10,984 |
| Deferred revenue                   | \$792    |
| Accrued compensation               | 184      |
| Total liabilities held for sale    | \$976    |

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

#### Recently Issued Accounting Standards

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

## 2. BUSINESS ACQUISITION

### TGX Medical

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

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

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

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

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

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

### Derma Sciences

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

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



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

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

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

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

#### Short-term Investments

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

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

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#### Deferred Taxes

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

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

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

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

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

#### Contingent Consideration

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

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

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

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

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

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

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

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

#### Pro Forma Results

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

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

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

### 3. INVENTORIES

Inventories, net consisted of the following:

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

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

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4. GOODWILL AND OTHER INTANGIBLE ASSETS

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

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

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

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

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

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

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





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## 5. DEBT

### Amended and Restated Senior Credit Agreement

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

- i. a \$500.0 million Term Loan A facility;
  - a \$700.0 million Term Loan A-1, which will be available in a single drawing on a delayed basis at the time of closing of the Asset Purchase Agreement dated February 14, 2017 between the Company and DuPuy Synthes, Inc.,
- ii. a wholly owned subsidiary of Johnson & Johnson to acquire certain assets, and assume certain liabilities of Johnson & Johnson's Codman neurosurgery business (see Note 1 - Basis of Presentation); and
- iii. a \$1.0 billion revolving credit facility, which includes a \$60.0 million sublimit for the issuance of standby letters of credit and a \$60.0 million sublimit for swingline loans.

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

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

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

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

- i. the Eurodollar Rate (as defined in the amendment and restatement) in effect from time to time plus the applicable rate (ranging from 1.00% to 2.00%), or
- ii. the highest of:
  - 1. the weighted average overnight Federal funds rate, as published by the Federal Reserve Bank of New York, plus 0.50%,
  - 2. the prime lending rate of Bank of America, N.A., or
  - 3. the one-month Eurodollar Rate plus 1.00%.

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

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

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

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

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

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

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

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

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

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

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

#### 2016 Convertible Senior Notes

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

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

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

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Convertible Note Interest

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

|  | Three<br>Months<br>Ended<br>June 30,<br>2016 | Six<br>Months<br>Ended<br>June 30,<br>2016 |
|--|--|--|
|  | (In thousands)                               |  |

2016 Notes:

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

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

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

## 6. DERIVATIVE INSTRUMENTS

### Interest Rate Hedging

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

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

|   |           |                   |                      |               |         |                                  |        |
|---|-----------|-------------------|----------------------|---------------|---------|----------------------------------|--------|
| Term Loan A   | 100,000   | March 27,<br>2017 | December 31,<br>2017 | June 30, 2021 | 1.971 % | LIBOR<br>1-month<br>USD<br>LIBOR | (562 ) |
| Total interested rate<br>derivatives designated as<br>cash flow hedge | \$400,000 |                   |                      |               |         |                                  | \$ 935 |

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

#### Foreign Currency Hedging

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

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

#### Counterparty Credit Risk

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

#### Fair Value of Derivative Instruments

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

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

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

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

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

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

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

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

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

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

## 7. STOCK-BASED COMPENSATION

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

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

### Stock Options



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

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

Awards of Restricted Stock, Performance Stock and Contract Stock

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

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

## 8. TREASURY STOCK

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

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

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

## 9. INCOME TAXES

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

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

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

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

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

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

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

#### 10. NET INCOME PER SHARE

Basic and diluted net income per share was as follows:

|   | Three Months<br>Ended June 30,           |          | Six Months<br>Ended June 30, |          |
|---|--|----------|------------------------------|----------|
|   | 2017                                     | 2016     | 2017                         | 2016     |
|   | (In thousands, except per share amounts) |          |                              |          |
| Basic net income per share:                                   |  |          |                              |          |
| Net income  | \$10,835                                 | \$12,755 | \$17,230                     | \$26,173 |
| Weighted average common shares outstanding                    | 76,213                                   | 74,392   | 75,487                       | 74,074   |
| Basic net income per common share                             | \$0.14                                   | \$0.17   | \$0.23                       | \$0.35   |
| Diluted net income per share:                                 |  |          |                              |          |
| Net income  | \$10,835                                 | \$12,755 | \$17,230                     | \$26,173 |
| Weighted average common shares outstanding — Basic            | 76,213                                   | 74,392   | 75,487                       | 74,074   |
| Effect of dilutive securities:                                |  |          |                              |          |
| 2016 Convertible notes  | —  | 2,285    | —                            | 1,796    |
| Warrants  | 1,589                                    | 911      | 1,864                        | 454      |
| Stock options and restricted stock                            | 1,161                                    | 1,122    | 1,352                        | 1,218    |
| Weighted average common shares for diluted earnings per share | 78,963                                   | 78,710   | 78,703                       | 77,542   |
| Diluted net income per common share                           | \$0.14                                   | \$0.16   | \$0.22                       | \$0.34   |

Shares of common stock of approximately 0.2 million and 0.4 million at June 30, 2017 and 2016, respectively, that are issuable through the exercise of dilutive securities were not included in the computation of diluted net income per share because their effect would have been antidilutive.

For the three and six months ended June 30, 2017 and 2016 the potential excess conversion value on warrants was included in the Company's dilutive share calculation because the average stock price for the three and six months ended June 30, 2017 and 2016 exceeded the conversion price.

For the three and six months ended June 30, 2016 the potential excess conversion value on the 2016 Notes were included in the Company's dilutive share calculation because the average stock price for the three and six months ended June 30, 2016 exceeded the conversion price.

Restricted and performance units that entitle the holders to approximately 0.5 million shares of common stock are included in the basic and diluted weighted average shares outstanding calculation because no further consideration is due related to the issuance of the underlying common shares.

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

COMPREHENSIVE INCOME

Comprehensive income was as follows:

|  | Three Months   |          | Six Months Ended |          |
|--|----------------|----------|------------------|----------|
|  | Ended June 30, |          | June 30,         |          |
|  | 2017           | 2016     | 2017             | 2016     |
|  | (In thousands) |          |                  |          |
| Net income   | \$10,835       | \$12,755 | \$17,230         | \$26,173 |
| Foreign currency translation adjustment              | 19,484         | (6,569 ) | 23,548           | 4,675    |
| Change in unrealized gain on derivatives, net of tax | (884 )         | (345 )   | (537 )           | (345 )   |
| Unrealized gain on short-term investments            | (1,291 )       | —        | —                | —        |
| Pension liability adjustment, net of tax             | (13 )          | 3        | (15 )            | (4 )     |
| Comprehensive income, net                            | \$28,131       | \$5,844  | \$40,226         | \$30,499 |

Changes in Accumulated Other Comprehensive Income by component between December 31, 2016 and June 30, 2017 are presented in the table below, net of tax:

|  | Cash<br>Flow<br>Hedges | Defined<br>Benefit<br>Pension<br>Items | Foreign<br>Currency<br>Items | Short-term<br>Investment | Total      |
|--|------------------------|--|------------------------------|--------------------------|------------|
|  | (In thousands)         |  |                              |                          |            |
| Beginning balance  | \$1,071                | \$ (36 )                               | \$(58,189)                   | —                        | \$(57,154) |
| Other comprehensive (loss) income                                | (559 )                 | (15 )                                  | 23,548                       | (3,019)                  | 19,955     |
| Amounts reclassified from accumulated other comprehensive income | 22                     | —                                      | —                            | 3,019                    | 3,041      |
| Net current-period other comprehensive (loss) income             | (537 )                 | (15 )                                  | 23,548                       | —                        | 22,996     |
| Ending balance   | \$534                  | \$ (51 )                               | \$(34,641)                   | \$ —                     | \$(34,158) |

12. SEGMENT AND GEOGRAPHIC INFORMATION

The Company internally manages two global reportable segments and reports the results of its businesses to its chief operating decision maker. The two reportable segments and their activities are described below.

The Specialty Surgical Solutions segment includes (i) the Neurosurgery business, which sells a full line of products for neurosurgery and neuro critical care such as tissue ablation equipment, dural repair products, cerebral spinal fluid management devices, intracranial monitoring equipment, and cranial stabilization equipment and (ii) the precision tools and instruments business, which sells more than 60,000 instrument patterns and surgical and lighting products to hospitals, surgery centers, and dental, podiatry, and veterinary offices.

The Orthopedics and Tissue Technologies segment includes such offerings as skin repair, advanced wound care, amniotic tissue, bone and joint fixation implants in the upper and lower extremities, bone grafts and nerve and tendon repair.

The Corporate and other category includes (i) various legal, finance, information systems, executive, and human resource functions, (ii) brand management, and (iii) share-based compensation costs.



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

The operating results of the various reportable segments as presented are not comparable to one another because (i) certain operating segments are more dependent than others on corporate functions for unallocated general and administrative and/or operational manufacturing functions, and (ii) the Company does not allocate certain manufacturing costs and general and administrative costs to the operating segment results. Net sales and profit by reportable segment for the three and six months ended June 30, 2017 and 2016 are as follows:

|                                     | Three Months Ended |            | Six Months Ended |            |
|-------------------------------------|--------------------|------------|------------------|------------|
|                                     | June 30,           |            | June 30,         |            |
|                                     | 2017               | 2016       | 2017             | 2016       |
|                                     | (In thousands)     |            |                  |            |
| Segment Net Sales                   |                    |            |                  |            |
| Specialty Surgical Solutions        | \$ 159,857         | \$ 158,163 | \$ 316,147       | \$ 309,338 |
| Orthopedics and Tissue Technologies | 122,307            | 91,146     | 224,654          | 176,741    |
| Total revenues                      | \$ 282,164         | \$ 249,309 | \$ 540,801       | \$ 486,079 |
| Segment Profit                      |                    |            |                  |            |
| Specialty Surgical Solutions        | \$ 67,250          | \$ 63,397  | \$ 129,953       | \$ 120,978 |
| Orthopedics and Tissue Technologies | 31,010             | 26,025     | 58,089           | 46,300     |
| Segment profit                      | 98,260             | 89,422     | 188,042          | 167,278    |
| Amortization                        | (5,419 )           | (3,471)    | (9,520)          | (6,943)    |
| Corporate and other                 | (75,856 )          | (63,574 )  | (151,577)        | (115,859 ) |
| Operating income                    | \$ 16,985          | \$ 22,377  | \$ 26,945        | \$ 44,476  |

The Company does not allocate any assets to the reportable segments. No asset information is reported to the chief operating decision maker and disclosed in the financial information for each segment.

The Company attributes revenues to geographic areas based on the location of the customer. Total revenue by major geographic area consisted of the following:

|                | Three Months   |            | Six Months Ended |            |
|----------------|----------------|------------|------------------|------------|
|                | Ended June 30, |            | June 30,         |            |
|                | 2017           | 2016       | 2017             | 2016       |
|                | (In thousands) |            |                  |            |
| United States  | \$ 219,266     | \$ 191,872 | \$ 420,363       | \$ 373,101 |
| Europe         | 32,499         | 31,663     | 61,315           | 61,098     |
| Rest of World  | 30,399         | 25,774     | 59,123           | 51,880     |
| Total Revenues | \$ 282,164     | \$ 249,309 | \$ 540,801       | \$ 486,079 |

### 13. COMMITMENTS AND CONTINGENCIES

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

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

TEI, acquired by Integra on July 17, 2015, manufactures a bovine-derived surgical mesh product for Boston Scientific Corporation ("BSC") and has been named as a defendant in lawsuits under a broad range of products liability theories, many of which have not been served on TEI. Currently, there are approximately fifty active cases against TEI.

Pursuant to an indemnification agreement with BSC (i) BSC is managing the litigation; and (ii) TEI has in place a product liability insurance policy, of which it must exhaust \$3.0 million before BSC's indemnity begins to cover relevant claims (and of which only a small portion has been utilized to date and against which the insurer has reserved the entire \$3.0 million). Because the thrust of products liability litigation focuses on



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

synthetic surgical mesh products, counsel is filing motions to dismiss on behalf of TEI in many cases. In addition, Integra has certain protections in the merger agreements with TEI which would indemnify it for approximately \$30.0 million for the first fifteen months after closing and between \$20.0 and \$30.0 million for the remainder of the three-year period after closing for losses relating to a variety of matters, including half of certain products liability claims (including those related to the product it manufactures for BSC) not covered by insurance. As of July 26, 2017, no indemnification payments were received nor owed in relation to the lawsuits.

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.

#### Contingent Consideration

The Company determined the fair value of contingent consideration during the six-month period ended June 30, 2017 to reflect the change in estimate and the time value of money during the period. A reconciliation of the opening balances to the closing balances of these Level 3 measurements is as follows (in thousands):

|   | Contingent Considerations Liabilities Related to Acquisition of Derma Sciences (See Note 2) |           | Contingent Consideration Liability Related to Acquisition of Confluent Surgical, Inc. |           | Location in Financial Statements    |
|---|---|-----------|---|-----------|-------------------------------------|
|   | Short-term  | Long-term | Short-term  | Long-term |                                     |
| Balance as of January 1, 2017   | \$—   | \$—       | \$—   | \$ 22,036 |                                     |
| Additions from acquisition of Derma Sciences                                  | 33,707  | 3,467     | —   | —         |                                     |
| Transfers from long-term to current portion                                   | —   | —         | 4,662   | (4,662)   |                                     |
| Payments  | (26,598)  | —         | —   | —         |                                     |
| (Gain) loss from change in fair value of contingent consideration liabilities | (2,359)   | 82        | —   | 148       | Selling, general and administrative |
| Balance as of June 30, 2017   | \$4,750   | \$ 3,549  | \$4,662   | \$ 17,522 |                                     |

On January 15, 2014, the Company acquired all outstanding shares of Confluent Surgical, Inc., ("Confluent Surgical"). The purchase price includes contingent consideration. The potential maximum undiscounted contingent consideration of \$30.0 million consists of \$25.0 million upon obtaining certain U.S. governmental approvals and \$5.0 million upon obtaining certain European governmental approvals, both related to the completion of the transition of the Confluent Surgical business. The fair values of contingent consideration related to the acquisition of Confluent Surgical were estimated using a discounted cash flow model using discount rate of 2.2%.

The Company assesses these assumptions on an ongoing basis as additional information affecting the assumptions is obtained. The contingent consideration balance was included in accrued expenses and other current liabilities and other liabilities at June 30, 2017 and in other liabilities at December 31, 2016.

#### Supply Agreement Liability and Above Market Supply Agreement Liability

On January 15, 2014, the Company entered into a transitional supply agreement with Covidien Group S.a.r.l ("Covidien"). This agreement contains financial incentives to Covidien for the timely supply of products each fiscal quarter through the third anniversary of the agreement. The prices paid under the supply agreement are essentially flat through the third anniversary of the agreement, and then increase significantly in each of the following three years.



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

The Company determined the fair value of its supply agreement liability and above market supply agreement liability with Covidien during the six-month period ended June 30, 2017 to reflect the payments, change in estimate and the time value of money during the period. A reconciliation of the opening balances to the closing balances of these Level 3 measurements is as follows (in thousands):

|  | Supply<br>Agreement<br>Liability -<br>Short-term | Above<br>Market<br>Supply<br>Agreement<br>Liability -<br>Short-term | Above<br>Market<br>Supply<br>Agreement<br>Liability -<br>Long-term | Location in Financial Statements    |
|--|--|---|--|-------------------------------------|
| Balance as of January 1, 2017              | \$ 166   | \$ —  | \$ 2,648   |                                     |
| Payments                                   | (166 )   |   | (273 )   |                                     |
| Transfer from long-term to current portion | —  | 2,101   | (2,101 )   |                                     |
| Loss from increase in fair value           | —  | 274   | 579  | Selling, general and administrative |
| Balance as of June 30, 2017                | \$ —   | \$ 2,375  | \$ 853   |                                     |

The fair values of supply agreement liability and above market supply agreement liability were estimated using a discounted cash flow model using discount rate of 12.0%. The Company assesses these assumptions on an ongoing basis as additional information impacting the assumptions is obtained. The supply agreement liability-current was included in accrued expenses and other current liabilities and the supply agreement-long term and above market supply agreement liability were included in other liabilities at June 30, 2017 and December 31, 2016.

There are no transfers between level 1, 2 or 3 during the six months ended June 30, 2017 and 2016. If the Company's estimate regarding the fair value of its contingent consideration liabilities, supply agreement liability and above market supply agreement liability are inaccurate, a future adjustment to these estimated fair values may be required which could change significantly.

#### BioD

On April 7, 2017, the Company's indirect wholly-owned subsidiary, BioD filed an action in the Superior Court of New Jersey, Chancery Division, Middlesex County seeking a declaration that the resignation of Russell Olsen, the former CEO of BioD, was "for Good Reason" (as defined in Olsen's employment agreement); a finding that Olsen breached the implied covenant of good faith and fair dealing, committed legal fraud, equitable fraud and negligent misrepresentation; and an award of damages for such actions, including a return of severance fees paid to Olsen. BioD was acquired in August 2016 by Derma Sciences, which Integra subsequently acquired in February 2017. After receiving a job offer from Integra that Olsen believed materially diminished his title and authority, on February 24, 2017 Olsen indicated his intention to terminate his position with BioD for Good Reason, as otherwise permitted by his employment agreement with BioD. Shortly thereafter, Cynthia Weatherly (as representative of the former equity owners of BioD) claimed in a letter to Derma Sciences that Olsen's resignation was a "termination Without Cause" (as also defined in Olsen's employment agreement), which would arguably trigger an acceleration of the earn out under a merger agreement between Derma Sciences, BioD and other parties (the "BioD Merger Agreement"), which was entered into in July 2016, and require as a result of the acceleration the payment of \$26.5 million by BioD. As previously disclosed and described in Note 2 - Business Acquisition, to the Company's consolidated financial statements for the three and six months ended June 30, 2017, Integra assumed this contingent liability in connection with its acquisition of Derma Sciences. The action for a declaratory judgment was filed to clarify that Olsen's termination was for Good Reason and not Without Cause. If the employment agreement was terminated for Good Reason, then the Company believes that the earn out provision under the BioD Merger Agreement should not be accelerated and the likelihood of loss is remote.

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, 2016 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 could differ materially from those anticipated in these forward-looking statements as a result of many factors, including but not limited to those set forth under the heading "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2016,

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Quarterly Report on Form 10-Q for quarterly the period ended March 31, 2017, and in this report. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

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

### GENERAL

Integra is a worldwide leader in medical technology focused on limiting uncertainty for surgeons so that they can concentrate on providing the best patient care. Integra provides customers with clinically relevant, innovative and cost-effective products that improve the quality of life for patients. We focus on cranial procedures, small bone and joint reconstruction, the repair and reconstruction of soft tissue, and instruments for surgery.

We manufacture and sell our products in two reportable business segments — Specialty Surgical Solutions and Orthopedics and Tissue Technologies. Our Specialty Surgical Solutions products offer specialty surgical implants and instrumentation for a broad range of specialties. This product category includes products and solutions for dural repair, precision tools and instruments, tissue ablation, and neuro critical care including market-leading product portfolios used in neurosurgery operating suites and critical care units. Our Orthopedics and Tissue Technologies products offer a unique combination of differentiated regenerative technology products for soft tissue repair and tissue regeneration products, alongside small bone fixation and joint replacement hardware products for both upper extremities and lower extremities. This product category also includes private-label sales of a broad set of our regenerative medicine technologies.

We manufacture many of our products in plants located in the United States, Puerto Rico, France, Germany, Ireland, Canada, China and Mexico. We also source most of our handheld surgical instruments and specialty metal and pyrocarbon implants, and dural sealant products through specialized third-party vendors.

We have several sales channels in the United States. Specialty Surgical Solutions products are sold through a combination of directly employed sales representatives, distributors and wholesalers, depending on the customer call point. Orthopedics and Tissue Technologies products are sold through directly employed sales representatives and specialty distributors focused on their respective surgical specialties. We sell in the international markets through a combination of direct sales organizations and distributors.

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

Our objective is to become a multi-billion dollar diversified global medical technology company that helps patients by limiting uncertainty for medical professionals and is a high-quality investment for shareholders. We will achieve these goals by delivering on our brand promises to our customers so they can concentrate on providing the best care for their patients and by becoming a company recognized as a leader by our customers worldwide in specialty surgical applications, regenerative technologies and extremities orthopedics. Our strategy is built around three pillars - execute, optimize, and accelerate growth. These three pillars support our strategic initiatives to deliver on our commitments through improved planning and communication, optimizing our infrastructure, and growing by introducing new products to the market through internal development, geographic expansion, and strategic acquisitions.

We aim to achieve growth in our revenues while maintaining strong financial results. While we pay attention to any meaningful trend in our financial results, we pay particular attention to measurements that are indicative of long-term profitable growth. These measurements include (1) revenue growth (including organic growth and acquisitions), (2) gross margins on total revenues, (3) operating margins (which we aim to expand as we leverage our existing infrastructure), (4) earnings before interest, taxes, depreciation, and amortization, (5) earnings per diluted share of common stock, and (6) operating cash flows.

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

• **Regenerative Technology Platform.** We have developed numerous product lines through our proprietary collagen and polyethylene glycol technologies that are sold through all of our sales channels.

• **Diversification and Platform Synergies.** The selling platforms of Specialty Surgical Solutions and Orthopedics and Tissue Technologies each contribute a different strength to our core business. Specialty Surgical Solutions provides us with a strong presence in the hospital, with market-leading products and comprehensive solutions for surgical

specialties, such as neurosurgery, as well as a strong capacity to generate cash flows. Orthopedics and Tissue Technologies enables us to grow our top line by continuing to introduce new, differentiated products in fast-growing markets, such as small joint replacement and advanced wound care, as well as to increase gross margins. We have unique synergies between these platforms, such as our regenerative technology, instrument sourcing capabilities, and enterprise contract management.

Specialized Sales Footprint. Our medical technology investment and manufacturing strategy provide us with a specialized set of customer call-points and synergies. We have market-leading products across our portfolio providing both scale and

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depth in solutions for a broad set of clinical needs across many departments in healthcare systems. We also have clinical expertise across all our channels in the United States, and an opportunity to expand and leverage this expertise in markets worldwide. In response to our customers' needs for clinical and technical solutions across multiple departments and clinical areas, we have developed and deployed our enterprise selling team to bring unique clinical solutions for the most difficult healthcare issues in our key accounts across multiple clinical sites and multi-hospital integrated delivery networks.

**Ability to Change and Adapt.** Our corporate culture is what enables us to adapt and evolve. We have demonstrated that we can quickly and profitably integrate new products and businesses. This core strength has made it possible for us to grow over the years, and is key to our ability to grow into a multi-billion-dollar company.

### Acquisitions

#### Derma Sciences

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

Derma Sciences is a tissue regeneration company focused on advanced wound and burn care that offers products to help manage chronic and hard-to-heal wounds, especially those resulting from diabetes and poor vascular functioning.

#### TGX Medical

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

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

#### Johnson & Johnson's Codman Neurosurgery Business

On February 14, 2017, the Company entered into a binding offer letter (the "Offer Letter") with DePuy Synthes, Inc., a Delaware corporation ("DePuy Synthes") and wholly-owned subsidiary of Johnson & Johnson, pursuant to which we made a binding offer to acquire certain assets, and assume certain liabilities, of Johnson & Johnson's Codman neurosurgery business (the "Codman Neurosurgery Transaction"). The assets and liabilities subject to the proposed Codman Neurosurgery Transaction relate to the research, development, manufacturing, marketing, distribution and sale of certain products used in connection with neurosurgery procedures (the "Codman Neurosurgery Business"). The purchase price for the Codman Neurosurgery Transaction is \$1.045 billion, subject to adjustments set forth in the Purchase Agreement (as defined below) relating to the book value of inventory transferred to us at the closing of the Codman Neurosurgery Transaction, the book value of certain inventory retained by DePuy Synthes and the amount of certain prepaid taxes.

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

regarding the Codman Neurosurgery Business, and (vi) customary conditions regarding the accuracy of the representations and warranties and material compliance by the parties with their respective obligations under the Purchase Agreement. The parties have received antitrust clearance in India, the United Kingdom and Spain, and the Company is in discussions with the Federal Trade Commission for antitrust clearance under the HSR Act. We obtained sufficient capacity from our Senior Credit Facility to pay the purchase price and fees and expenses to be incurred in connection with the Transaction.



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### Clinical and Product Development Activities

After finalizing our multi-center clinical trial evaluating the safety and effectiveness of the INTEGRA Dermal Regeneration Template for the treatment of diabetic foot ulcers ("DFU") in 2015, we filed the resulting data with the FDA and received PMA approval on January 7, 2016. The Company started commercializing the resulting DFU product, Omnigraft, late in 2016. Additionally, we finalized patient follow-up in a post-approval study for our DuraSeal Exact Spine Sealant System, and submitted the study results to the FDA in October 2016. The study showed the continued safety and effectiveness of this approved medical device, and we expect that this study will satisfy the post-approval commitment related to this product. We continue to invest in additional clinical studies to support market access and promotion of existing products, and to pursue new product indications, such as breast reconstruction. The Company continues to invest in product development such as long-term research programs to evaluate products as well as next generation nerve product.

### FDA Untitled Letter

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

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

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

## RESULTS OF OPERATIONS

### Executive Summary

Net income for the three months ended June 30, 2017 was \$10.8 million, or \$0.14 per diluted share, as compared to \$12.8 million or \$0.16 per diluted share for the three months ended June 30, 2016.

Net income for the six months ended June 30, 2017 was \$17.2 million, or \$0.22 per diluted share, as compared to \$26.2 million or \$0.34 per diluted share for the six months ended June 30, 2016.

Net income for the six months ended June 30, 2017 decreased from the same period last year, primarily resulting from higher acquisition-related expenses of \$17.7 million, and offset by growth in both of our Orthopedics and Tissue Technologies and Specialty Surgical Solutions segments. The results also reflect strong growth in our regenerative technology franchise.

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Income before taxes includes the following special charges:

|                                    | Three Months   |          | Six Months     |          |
|------------------------------------|----------------|----------|----------------|----------|
|                                    | Ended June 30, |          | Ended June 30, |          |
|                                    | 2017           | 2016     | 2017           | 2016     |
|                                    | (In thousands) |          |                |          |
| Global ERP implementation charges  | \$834          | \$5,696  | \$3,261        | \$9,020  |
| Structural optimization charges    | 1,806          | 1,838    | 3,392          | 3,547    |
| Certain employee severance charges | —              | 617      | 125            | 1,267    |
| Discontinued product lines charges | —              | —        | 1,025          | —        |
| Acquisition-related charges        | 23,698         | 6,020    | 44,015         | 12,061   |
| Convertible debt non-cash interest | —              | 2,104    | —              | 4,168    |
| Total                              | \$26,338       | \$16,275 | \$51,818       | \$30,063 |

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

|                                     | Three Months   |          | Six Months     |          |
|-------------------------------------|----------------|----------|----------------|----------|
|                                     | Ended June 30, |          | Ended June 30, |          |
|                                     | 2017           | 2016     | 2017           | 2016     |
|                                     | (In thousands) |          |                |          |
| Cost of goods sold                  | \$2,861        | \$5,969  | \$5,426        | \$10,817 |
| Selling, general and administrative | 21,214         | 8,202    | 44,129         | 15,078   |
| Interest expense                    | —              | 2,104    | —              | 4,168    |
| Other expense                       | 2,263          | —        | 2,263          | —        |
| Total from continuing operations    | \$26,338       | \$16,275 | \$51,818       | \$30,063 |

We typically define special charges as items for which the amounts and/or timing of such expenses may vary significantly from period to period, depending upon our acquisition, integration and restructuring activities, and for which the amounts are non-cash in nature, or for which the amounts are not expected to recur at the same magnitude. We believe that given our ongoing strategy of seeking acquisitions, our continuing focus on rationalizing our existing manufacturing and distribution infrastructure and our continuing review of various product lines in relation to our current business strategy, some of the special charges discussed above could recur with similar materiality in the future. In 2010, we began investing significant resources in the global implementation of a single enterprise resource planning ("ERP") system. We began capitalizing certain costs for the project starting in 2011 and continued to do so during 2017. We expect the additional capital and integration expenses associated with our current ERP system to decrease in 2017 as the project is substantially complete. However, we expect additional capital and integration expenses in 2017 associated with the integration of Derma Sciences.

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

#### Update on Remediation Activities

We have an outstanding FDA warning letter related to TEI, acquired by Integra on July 17, 2015. TEI received a Warning Letter from the FDA dated May 29, 2015 for promoting the product SurgiMend for breast surgery applications that were not cleared in the 510(k) process and do not have a PMA approval for the indication. The FDA requested that TEI immediately cease all activities that resulted in misbranding or adulteration of the product in commercial distribution. The FDA also required TEI to cease all violations regarding promotion of the product for an indication that was not cleared or approved. TEI responded to the FDA with a corrective action plan and took action to

address the issues prior to the completion of the acquisition. We will continue to monitor this activity and address all corrective actions submitted to the FDA. The FDA might not accept our corrective action plan or it might choose to scrutinize other promotional claims on products and require additional corrective actions. We do not expect to incur material operating expenses to complete the corrective action plan.

There were no material remediation expenses incurred in the three and six months ended June 30, 2017.

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## Revenues and Gross Margin on Product Revenues

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

|  | Three Months Ended<br>June 30, |            | Six Months Ended June<br>30, |            |
|--|--------------------------------|------------|------------------------------|------------|
|  | 2017                           | 2016       | 2017                         | 2016       |
| Segment Net Sales                              | (Dollars in thousands)         |            |                              |            |
| Specialty Surgical Solutions                   | \$ 159,857                     | \$ 158,163 | \$ 316,147                   | \$ 309,338 |
| Orthopedics & Tissue Technologies              | 122,307                        | 91,146     | 224,654                      | 176,741    |
| Total revenue                                  | 282,164                        | 249,309    | 540,801                      | 486,079    |
| Cost of goods sold                             | 98,998                         | 89,565     | 185,583                      | 174,338    |
| Gross margin on total revenues                 | \$ 183,166                     | \$ 159,744 | \$ 355,218                   | \$ 311,741 |
| Gross margin as a percentage of total revenues | 64.9                           | % 64.1     | % 65.7                       | % 64.1     |

## Three Months Ended June 30, 2017 as Compared to Three Months Ended June 30, 2016

## Revenues and Gross Margin

For the three months ended June 30, 2017, total revenues increased by \$32.9 million to \$282.2 million from \$249.3 million for the same period in 2016.

Specialty Surgical Solutions revenues were \$159.9 million, an increase of 1.1% from the prior-year period. The increase resulted from the growth of our dural repair products and precision tools and instruments, both of which increased in the low single digits for the quarter, offset by flat sales in tissue ablation and neuro critical care. Our dural repair franchise did not grow at the high single digit rate as expected because of the impact of increased competition for our dural sealant product.

Orthopedics and Tissue Technologies revenues were \$122.3 million, an increase of 34.2% from the prior-year period. Revenue from the Derma Sciences acquisition was \$23.8 million for the three months ended June 30, 2017. Revenues from our artificial skin products grew during the quarter, resulting from strong demand from both domestic and international markets, particularly for Integra Skin and PriMatrix. Our private label, upper and lower extremities grew contributing to the growth of the segment.

Gross margin increased to \$183.2 million for the three-month period ended June 30, 2017, up from \$159.7 million for the same period last year. Gross margin as a percentage of total revenue increased to 64.9% for the second quarter of 2017 from 64.1% for the same period last year. The increase in gross margin percentage resulted from an increase in sales of higher margin products such as dural repair, skin and wound products, offset by sales in Derma Sciences with lower margins than the company average.

We expect our consolidated gross margin percentage for the full year 2017 to be approximately 65.0% to 66.0%. We expect no significant change in gross margin percentage in 2017 compared to 2016, as gross margins from products acquired in the Derma Sciences transaction are expected to offset the margins from the growth in our regenerative business.

## Operating Expenses

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

|                                     | Three<br>Months<br>Ended June<br>30, |        |
|-------------------------------------|--------------------------------------|--------|
|                                     | 2017                                 | 2016   |
| Research and development            | 5.6 %                                | 5.9 %  |
| Selling, general and administrative | 51.4 %                               | 47.8 % |
| Intangible asset amortization       | 1.9 %                                | 1.4 %  |
| Total operating expenses            | 58.9 %                               | 55.1 % |

Total operating expenses, which consist of research and development expenses, selling, general and administrative expenses, and amortization expense, increased \$28.8 million, or 21.0%, to \$166.2 million in the three months ended June 30, 2017, compared to \$137.4 million in the same period last year.

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Research and development expenses in the second quarter of 2017 increased by \$1.1 million to \$15.7 million compared to \$14.7 million in the same period last year. This increase primarily resulted from an increase in headcount to support clinical studies. We expect full-year 2017 spending on research and development to be approximately 6.0% of total revenues.

Selling, general and administrative expenses in the second quarter of 2017 increased by \$25.8 million to \$145.0 million compared to \$119.2 million in the same period last year. Selling and marketing expenses increased by \$12.2 million compared to last year resulting primarily from selling and marketing expenses of Derma Sciences of approximately \$10.5 million and additional investments in adding direct sales representatives and distributors. General and administrative costs increased by \$13.6 million, resulting from the increase in acquisition-related expenses of \$17.7 million, offset by lower ERP implementation costs. We expect full-year selling, general and administrative expenses to be approximately 51.0% to 52.0% of revenue in 2017, resulting from acquisition and integration-related costs and as we make additional investments in our commercial channels.

Amortization expense as a percentage of revenues in the second quarter of 2017 increased compared to the same period last year. This increase was primarily related to the increase in intangibles from the Derma Sciences acquisition in the first quarter of 2017.

## Non-Operating Income and Expenses

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

|                    | Three<br>Months<br>Ended June<br>30,<br>2017 2016<br>(In<br>thousands) |         |
|--------------------|--|---------|
| Interest income    | \$ 64  | \$ 6    |
| Interest expense   | (6,181)  | (6,588) |
| Other expense, net | (2,866)  | (852)   |

## Interest Income and Interest Expense

Interest expense in the three months ended June 30, 2017 decreased by \$0.4 million, primarily due to the settlement of our 2016 Convertible Notes in December 2016 and offset by a higher outstanding balance on our Senior Credit Facility for the period compared to the same period in 2016. Our reported interest expense for the three-month period ended June 30, 2016 included non-cash interest related to the accounting for convertible securities of \$2.1 million. Interest income was negligible for the three months ended June 30, 2017 and 2016.

## Other Expense, net

Other expense, net for the three months ended June 30, 2017, includes \$2.3 million loss on a sale of short term investments. Other expense, net for the three months ended June 30, 2017 and 2016 includes the impact of transactional foreign exchange gains and losses. Other expense, net for the three months ended June 30, 2016 includes a \$1.1 million loss on disposal of property and equipment.

## Income Taxes

|                              | Three Months Ended<br>June 30,<br>2017 2016<br>(In thousands) |           |
|------------------------------|---|-----------|
| Income before income taxes   | \$ 8,002  | \$ 14,943 |
| Income tax (benefit) expense | (2,833 )  | 2,188     |
| Effective tax rate           | (35.4 )%  | 14.6 %    |

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



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The Company expects its effective income tax rate for the full year to be approximately 8.3%, resulting largely from excess tax benefits from stock-based compensation, Federal research credit benefits and the jurisdictional mix of pretax income in U.S.-based operations relative to foreign operations. This estimate could be revised in the future as additional information is presented to the Company.

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

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

On March 29, 2017, the United Kingdom ("UK") provided formal notice of its intention to leave the European Union ("EU"). This notice begins the two-year negotiation process for the UK's exit. Existing tax exemptions and tax relief between the UK and EU member states will most likely cease. The Company has entities domiciled in the UK and conducts transactions with entities within the EU. New tax legislation or renegotiated exemptions and tax relief may result in additional tax liabilities. The Company will monitor the ongoing negotiations and will assess the impact on its tax expense.

### Six Months Ended June 30, 2017 as Compared to Six Months Ended June 30, 2016

#### Revenues and Gross Margin

For the six months ended June 30, 2017, total revenues increased by \$54.7 million to \$540.8 million from \$486.1 million during the prior-year period.

Specialty Surgical Solutions revenues were \$316.1 million, an increase of 2.2% from the prior-year period. The increase resulted from mid-single digit growth in our dural repair and precision tools and instrument products. Together, our tissue ablation and neuro critical care revenues were relatively flat. Our DuraGen, DuraSeal, next generation Mayfield 2 cranial stabilization device and MicroFrance products contributed to the increase. Our dural repair franchise did not grow at the rate as expected because of the impact of increased competition for our dural sealant product.

Orthopedics and Tissue Technologies revenues were \$224.7 million, an increase of 27.1% from the prior-year period. Revenue from Derma Sciences acquisition was \$34.3 million for the six months ended June 30, 2017. Sales from our regenerative technologies products grew double-digits, including strength in skin products as a result of strong demand from both domestic and international markets. Our upper extremities products grew high-single digits, driven by strength in our shoulder products. The increases were offset by declining sales in both lower extremities and SurgiMend.

Gross margin increased to \$355.2 million for the six-month period ended June 30, 2017, up from \$311.7 million for the same period last year. Gross margin as a percentage of total revenue increased to 65.7% for the year to date period from 64.1% for the same period last year. The increase in gross margin percentage resulted from an increase in sales of higher margin products such as dural repair, skin and wound products, and lower effect of purchase price adjustments from acquisitions, offset by sales in Derma Sciences with lower margins than the company average.

#### Operating Expenses

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

|                                     | Six Months |        |
|-------------------------------------|------------|--------|
|                                     | Ended June |        |
|                                     | 30,        |        |
|                                     | 2017       | 2016   |
| Research and development            | 5.8 %      | 6.0 %  |
| Selling, general and administrative | 53.2 %     | 47.6 % |
| Intangible asset amortization       | 1.8 %      | 1.4 %  |
| Total operating expenses            | 60.8 %     | 55.0 % |

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Total operating expenses, which consist of research and development expenses, selling, general and administrative expenses, and amortization expense, increased \$61.0 million, or 22.8%, to \$328.3 million for the first six months of 2017, compared to \$267.3 million in the same period last year.

Research and development expenses in the first six months of 2017 increased approximately \$2.1 million and decreased as a percentage of sales from 6.0% to 5.8%. This increase in spending resulted from additional spending on new product development and clinical studies.

Selling, general and administrative expenses in the first six months of 2017 increased by \$56.3 million to \$287.5 million compared to \$231.2 million in the same period last year. Selling and marketing expenses increased by \$21.6 million, resulting primarily from selling and marketing expenses of Derma Sciences of approximately \$14.4 million and additional spending on new product launches and the addition of new sales representatives. General and administrative costs increased by \$34.7 million resulting from the increase in acquisition-related expenses of \$35.5 million offset by lower ERP implementation costs.

Amortization expense in the first six months of 2017 increased by \$2.6 million to \$9.5 million, compared to \$6.9 million in the same period last year. Amortization expense in the first six months of 2017 reflects the increase in intangibles due to the two acquisitions in in first half of 2017.

**Non-Operating Income and Expenses**

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

|                    | Six Months<br>Ended June<br>30,<br>2017 2016<br>(In<br>thousands) |          |
|--------------------|---|----------|
| Interest income    | \$71  | \$12     |
| Interest expense   | (11,310)  | (12,961) |
| Other expense, net | (2,956)   | (1,590)  |

**Interest Income and Interest Expense**

Interest expense in the six-month period ended June 30, 2017 decreased by \$1.6 million primarily resulting from the settlement of 2016 Convertible Notes in December 2016 offset by increased borrowings and higher effective borrowing rates on our Senior Credit facility compared to the prior year. Our reported interest expense for the six-month period ended June 30, 2016 includes non-cash interest related to the accounting for convertible securities of \$4.2 million.

Interest income was negligible for the six months ended June 30, 2017 and 2016.

**Other Expense, net**

Other expense, net for the six months ended June 30, 2017 includes a \$2.3 million loss on sale of short term investments. Other income for the six months ended June 30, 2017 and 2016 includes the impact of transactional foreign exchange gains and losses. Other expense, net for the six months ended June 30, 2016 includes a \$1.2 million loss on disposal of property and equipment.

**Income Taxes**

|                              | Six Months Ended<br>June 30,<br>2017 2016<br>(In thousands) |          |   |
|------------------------------|---|----------|---|
| Income before income taxes   | \$12,748  | \$29,937 |   |
| Income tax (benefit) expense | (4,482 )  | 3,764    |   |
| Effective tax rate           | (35.2 )%  | 12.6     | % |

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

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change in jurisdictional mix of income primarily results from significant 2017 acquisition and integration costs incurred in the U.S.

The Company expects its effective income tax rate for the full year to be approximately 8.3%, resulting largely from excess tax benefits, the Federal research credit benefit, and jurisdictional mix of pretax income in U.S.-based operations relative to foreign operations.

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

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

**GEOGRAPHIC PRODUCT REVENUES AND OPERATIONS**

We attribute revenues to geographic areas based on the location of the customer. Total revenue by major geographic area consisted of the following:

|                | Three Months<br>Ended June 30, |           | Six Months Ended<br>June 30, |           |
|----------------|--------------------------------|-----------|------------------------------|-----------|
|                | 2017                           | 2016      | 2017                         | 2016      |
|                | (In thousands)                 |           |                              |           |
| United States  | \$219,266                      | \$191,872 | \$420,363                    | \$373,101 |
| Europe         | 32,499                         | 31,663    | 61,315                       | 61,098    |
| Rest of World  | 30,399                         | 25,774    | 59,123                       | 51,880    |
| Total Revenues | \$282,164                      | \$249,309 | \$540,801                    | \$486,079 |

We generate significant revenues outside the United States, a portion of which are U.S. dollar-denominated transactions conducted with customers who generate revenue in currencies other than the U.S. dollar. As a result, currency fluctuations between the U.S. dollar and the currencies in which those customers do business could have an impact on the demand for our products in foreign countries. Local economic conditions, regulatory compliance or political considerations, the effectiveness of our sales representatives and distributors, local competition and changes in local medical practice all may combine to affect our sales into markets outside the United States.

Domestic revenues increased to \$219.3 million, or 77.7% of total revenues, for the three months ended June 30, 2017 from \$191.9 million, or 77.0% of total revenues, for the three months ended June 30, 2016. The Derma Sciences acquisition accounted for \$19.4 million of the increase for the three months ended June 30, 2017. International revenues increased to \$62.9 million from \$57.4 million in the prior-year period. The Derma Sciences acquisition accounted for \$4.4 million of the increase for the three months ended June 30, 2017. Foreign exchange fluctuations had a negative impact of \$1.2 million on revenues for the three months ended June 30, 2017 compared to the same period in 2016.

Domestic revenues increased to \$420.4 million, or 77.7% of total revenues, for the six months ended June 30, 2017 from \$373.1 million, or 76.8% of total revenues, for the six months ended June 30, 2016. The Derma Sciences acquisition accounted for \$27.7 million of the increase for the six months ended June 30, 2017. International revenues increased to \$120.4 million from \$113.0 million in the prior-year period. The Derma Sciences acquisition accounted for \$6.6 million of the increase for the six months ended June 30, 2017.

## LIQUIDITY AND CAPITAL RESOURCES

### Cash and Marketable Securities

We had cash and cash equivalents totaling approximately \$154.6 million and \$102.1 million at June 30, 2017 and December 31, 2016, respectively, which are valued based on Level 1 measurements in the fair value hierarchy. At June 30, 2017, our non-U.S. subsidiaries held approximately \$111.7 million of cash and cash equivalents that are available for use outside the United States.

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If cash and cash equivalents held by our non-U.S. subsidiaries were repatriated to the United States, or used for operations, certain amounts could be subject to tax in the United States for the incremental amount in excess of the foreign tax paid.

## Cash Flows

|   | Six Months Ended<br>June 30, |           |
|---|------------------------------|-----------|
|   | 2017                         | 2016      |
|   | (In thousands)               |           |
| Net cash provided by operating activities           | \$57,753                     | \$63,109  |
| Net cash used in investing activities               | (230,660)                    | (14,773 ) |
| Net cash provided by (used in) financing activities | 218,363                      | (9,082 )  |
| Effect of exchange rate fluctuations on cash        | 7,089                        | (583 )    |

In 2017, we anticipate that our principal uses of cash will include approximately \$50.0 to \$55.0 million of capital expenditures primarily for support and maintenance in our existing plants, facility automation, our enterprise resource planning system implementation, and additions to our instrument kits used in sales of orthopedic products. We also expect to spend approximately \$1.045 billion to complete the acquisition of the Codman Neurosurgery Business, which is expected to be completed in the fourth quarter of 2017. The Company will fund the acquisition through the Term Loan A-1 and revolving credit components of our Senior Credit Facility.

## Cash Flows Provided by Operating Activities

We generated operating cash flows of \$57.8 million and \$63.1 million for the six months ended June 30, 2017 and 2016, respectively.

Operating cash flows for the six months ended June 30, 2017 decreased compared to the same period in 2016. Net income decreased compared to the same period of the prior year. Changes in non-cash adjustments included in net income decreased cash flows for the six months ended June 30, 2017 by approximately \$2.4 million compared to the same period in 2016, which resulted primarily from the increase in depreciation and amortization, share-based compensation expenses and realized loss on sale of short-term investments offset by non-cash interest expense from convertible debt, which was settled in December 2016. Changes in working capital decreased cash flows for the six months ended June 30, 2017 by approximately \$3.6 million. Among the changes in working capital, accounts receivable used \$11.3 million of cash, inventory used \$5.5 million of cash, prepaid expenses and other current assets used \$9.2 million of cash and accounts payable, and accrued expenses and other current liabilities provided \$20.3 million of cash. Increases in accounts receivables and inventories are consistent with the increase in revenue. Operating cash flow for the six months ended June 30, 2016 decreased compared to the same period in 2015. Net income increased compared to the same period of the prior year. Changes in non-cash adjustments included in net income increased cash flows for the six months ended June 30, 2016 by approximately \$13.9 million compared to the same period in 2015, which resulted primarily from the increase in depreciation and amortization. Changes in working capital decreased cash flows for the six months ended June 30, 2016 by approximately \$11.8 million. Among the changes in working capital, accounts receivable used \$13.5 million of cash, inventory used \$7.4 million of cash, prepaid expenses and other current assets provided \$4.4 million of cash and accounts payable, and accrued expenses and other current liabilities provided \$2.2 million of cash. Increases in accounts receivables and inventories are consistent with increase in revenue.

## Cash Flows Used in Investing Activities

During the six months ended June 30, 2017, we paid \$22.0 million for capital expenditures, most of which were directed to the expansion of a manufacturing facility and commercial expansion. We also used \$225.7 million for the acquisition of Derma Sciences and TGX Medical, net of cash acquired. The payment for Derma Sciences includes \$210.8 million initial payment plus \$26.6 million payment for BioD Product Payment in May 2017. We received \$17.0 million from sale of short-term investments acquired from Derma Sciences.

During the six months ended June 30, 2016, we paid \$19.2 million for capital expenditures, most of which was directed to the implementation of our global enterprise system implementation and commercial expansion. We also

released \$4.2 million from a restricted cash account that supported our European cash pool activities.

Cash Flows Provided by (Used in) Financing Activities

Our principal source of cash from financing activities in the six months ended June 30, 2017 was \$245.0 million in borrowings under our Senior Credit Facility used to acquire Derma Sciences and proceeds that we received from the exercise of stock options of \$9.8 million, offset by repayments of \$30.0 million on the revolving portion of our Senior Credit Facility and \$6.5 million cash taxes paid in net equity settlement.



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Our principal source of cash from financing activities in the six months ended June 30, 2016 was a \$15.0 million borrowing under our Senior Credit Facility for general operating purposes and proceeds that we received from stock option exercises of \$9.3 million, offset by repayments of \$28.8 million on the revolving portion of our Senior Credit Facility and \$4.3 million cash taxes paid in net equity settlement.

### Upcoming Debt Maturities

The first quarterly installment of the Company's Term Loan A component of its Senior Credit Facility is due on March 31, 2018. We recorded the \$12.5 million portion of the Senior Credit Facility as a current liability in the Company's consolidated balance sheets. There are no other upcoming debt maturities in the next twelve months.

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

See Note 5 - Debt to the current period's condensed consolidated financial statements for a discussion of our (i) amended and restated Senior Credit Agreement, and (ii) convertible debt and related hedging activities.

### Share Repurchase Plan

On October 25, 2016, our Board of Directors terminated the share repurchase authorization dated October 28, 2014, which authorized management to purchase up to \$75.0 million of outstanding common stock prior to the end of 2016, and authorized new repurchases of up to \$150.0 million of outstanding common stock through December 2018. Shares may be repurchased either in the open market or in privately negotiated transactions.

The Company has not repurchased any shares of common stock under these authorizations through June 30, 2017.

### Dividend Policy

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

### Capital Resources

We believe that our cash and available borrowings under the Senior Credit Facility are sufficient to finance our operations and capital expenditures. The Company considers the portion of the Senior Credit Facility payable within the next twelve-month period of \$12.5 million as a current liability.

### Off-Balance Sheet Arrangements

There were no off-balance sheet arrangements during the six months ended June 30, 2017 that have or are reasonably likely to have, a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that are material to our interests.

## OTHER MATTERS

### Critical Accounting Estimates

The critical accounting estimates included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2016, have not materially changed.

### Recently Issued Accounting Standards

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

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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 and Other Rate Risks**

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

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

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

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

**Interest Rate Risk**

**Cash and Cash Equivalents** - We are exposed to the risk of interest rate fluctuations on the interest income earned on our cash and cash equivalents. A hypothetical 100 basis point movement in interest rates applicable to our cash and cash equivalents outstanding at June 30, 2017 would increase interest income by approximately \$1.5 million on an annual basis. No significant decrease in interest income would be expected as our cash balances are earning interest at rates of approximately one basis point. We are subject to foreign currency exchange risk with respect to cash balances maintained in foreign currencies.

**Senior Credit Facility** - Our interest rate risk relates primarily to U.S. dollar LIBOR-indexed borrowings. We have used an interest rate derivative instrument to manage our earnings and cash flow exposure to changes in interest rates. This interest rate swap fixes the interest rate on a portion of our expected LIBOR-indexed floating-rate borrowings beginning various dates starting on December 31, 2016.

Based on our outstanding borrowings at June 30, 2017, a one-percentage point increase in interest rates would affect interest expense on the debt by \$4.8 million on an annualized basis. A one-percentage point decrease in interest rates would affect interest expense on the debt by \$4.8 million on an annualized basis.

**ITEM 4. CONTROLS AND PROCEDURES**

**Evaluation of Disclosure Controls and Procedures**

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

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

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As required by Exchange Act Rule 13a-15(b), we have carried out an evaluation, under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of June 30, 2017. Based upon this evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective as of June 30, 2017 to provide such reasonable assurance.

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

### 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 June 30, 2017 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 of which are described below.

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

#### TEI

TEI, acquired by Integra on July 17, 2015, manufactures a bovine-derived surgical mesh product for Boston Scientific Corporation ("BSC") and has been named as a defendant in lawsuits under a broad range of products liability theories, many of which have not been served on TEI. Currently, there are approximately fifty active cases against TEI. Pursuant to an indemnification agreement with BSC (i) BSC is managing the litigation; (ii) TEI has in place a products liability insurance policy, of which it must exhaust \$3.0 million before BSC's indemnity begins to cover relevant claims (and of which only a small portion has been utilized to date and against which the insurer has reserved the entire \$3.0 million). Because the thrust of products liability litigation focuses on synthetic surgical mesh products, counsel is filing motions to dismiss on behalf of TEI in many cases. In addition, Integra has certain protections in the merger agreements with TEI which would indemnify it for approximately \$30.0 million for the first fifteen months after closing and between \$20.0 and \$30.0 million for the remainder of the three-year period after closing for losses relating to a variety of matters, including half of certain products liability claims (including those related to the product it manufactures for BSC) not covered by insurance. As of July 26, 2017, no indemnification payments were received nor owed in relation to the lawsuits for the initial indemnification time period, which covered the first fifteen months after closing.

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.

## BioD

On April 7, 2017, the Company's indirect wholly-owned subsidiary, BioD filed an action in the Superior Court of New Jersey, Chancery Division, Middlesex County seeking a declaration that the resignation of Russell Olsen, the former CEO of BioD, was “for Good Reason” (as defined in Olsen’s employment agreement); a finding that Olsen breached the implied covenant of good faith and fair dealing, committed legal fraud, equitable fraud and negligent misrepresentation; and an award of damages for such actions, including a return of severance fees paid to Olsen. BioD was acquired in August 2016 by Derma Sciences, which Integra subsequently acquired in February 2017. After receiving a job offer from Integra that Olsen believed materially diminished his title and authority, on February 24, 2017 Olsen indicated his intention to terminate his position with BioD for Good Reason, as otherwise permitted by his employment agreement with BioD. Shortly thereafter, Cynthia Weatherly (as representative of the former equity owners of BioD) claimed in a letter to Derma Sciences that Olsen’s resignation was a “termination Without Cause” (as

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also defined in Olsen's employment agreement), which would arguably trigger an acceleration of the earn out under a merger agreement between Derma Sciences, BioD and other parties (the "BioD Merger Agreement"), which was entered into in July 2016, and require as a result of the acceleration the payment of \$26.5 million by BioD. As previously disclosed and described in Note 2 - Business Acquisition, to the Company's consolidated financial statements for the three and six months ended June 30, 2017, Integra assumed this contingent liability in connection with its acquisition of Derma Sciences. The action for a declaratory judgment was filed to clarify that Olsen's termination was for Good Reason and not Without Cause. If the employment agreement was terminated for Good Reason, then the Company believes that the earn out provision under the BioD Merger Agreement should not be accelerated.

ITEM 1A. RISK FACTORS

The Risk Factors included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2016 and Quarterly Report on Form 10-Q for the quarterly period ended March 31, 2017 have not materially changed except the following:

The adoption of healthcare reform in the United States and initiatives sponsored by other governments may adversely affect our business, results of operations and/or financial condition.

Our operations may be substantially affected by potential fundamental changes in the global political, economic and regulatory landscape of the healthcare industry. Government and private sector initiatives to limit the growth of healthcare costs are continuing in the U.S., and in many other countries where we do business, causing the marketplace to put increased emphasis on the delivery of more cost-effective treatments. These initiatives include price regulation, competitive pricing, coverage and payment policies, comparative effectiveness of therapies, technology assessments and managed-care arrangements.

In March 2010, significant reforms to the U.S. healthcare system were adopted in the form of the Patient Protection and Affordable Care Act (the "Affordable Care Act"). The Affordable Care Act includes provisions that, among other things, reduce and/or limit Medicare reimbursement, require all individuals to have health insurance (with limited exceptions) and impose new and/or increased taxes. Specifically, the law requires the medical device industry to subsidize healthcare reform by implementing a 2.3% excise tax, commencing on January 1, 2013, on the sale of certain medical devices by a manufacturer, producer or importer of such devices in the United States. Because the substantial majority of our revenues is generated in the United States, the Affordable Care Act affected our financial results since it came into effect after December 31, 2012. In December 2015, President Obama signed into law The Consolidated Appropriations Act, which included a two-year moratorium on the 2.3% medical device excise tax, with the effect such that medical device revenues earned in 2016 and 2017 will be exempt from such tax. Unless there is further legislative action during that two-year period, the 2.3% medical device excise tax automatically will be reinstated for sales of medical devices on or after January 1, 2018. While this two-year moratorium on the 2.3% medical device excise tax could provide a short-term benefit to the Company in terms of providing additional monies available to spend on various projects in 2016 and 2017, we are unable to predict what the long-term impact will have on our financial statements and financial performance.

In addition, the Affordable Care Act also requires detailed disclosure of gifts and other remuneration made to healthcare professionals, which could have a negative impact on our relationships with customers and ability to seek input on product design or involvement in research.

Other provisions of the Affordable Care Act could meaningfully change the way healthcare is developed and delivered in the United States, and may adversely affect our business and results of operations.

There are many programs and requirements for which the details have not yet been fully established or consequences not fully understood, and it is unclear what the full impact of the legislation will be. We cannot predict what healthcare programs and regulations will ultimately be implemented at the U.S. federal or state level, or the effect of any future legislation or regulation in the United States or elsewhere. That said, any changes that lower reimbursements for our products or reduce medical procedure volumes could have a material adverse effect on our business, financial condition and results of operations. We continue to monitor the implementation of such legislation and, to the extent new market or industry trends or new governmental programs evolve, we will have implemented or will consider implementing programs to respond.

Initiatives sponsored by government agencies, legislative bodies and the private sector to limit the growth of healthcare costs, including price regulation and competitive pricing, are ongoing in other markets where we do business.

Further, the Affordable Care Act encourages hospitals and physicians to work collaboratively through shared savings programs, such as accountable care organizations, as well as other bundled payment initiatives, which may ultimately result in the reduction of medical device purchases and the consolidation of medical device suppliers used by hospitals.

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Since the adoption of the Affordable Care Act in 2010, the law has been challenged before the U.S. Supreme Court, and several bills have been and continue to be introduced in Congress to delay, defund or repeal implementation of or amend significant provisions of the Affordable Care Act. In addition, there continues to be ongoing litigation over the interpretation and implementation of certain provisions of the law. Furthermore, on January 20, 2017, an executive order was issued that, among other things, stated the intention of the administration to repeal the Affordable Care Act and, pending that repeal, instructed the executive branch of the Federal government to defer or delay the implementation of any provision or requirement of the Affordable Care Act that would impose a fiscal burden on any state or a cost, fee, tax or penalty on any individual, family, health care provider, health insurer, or manufacturer of pharmaceuticals or medical devices. We cannot predict whether the Affordable Care Act will be repealed, replaced, or modified or what impact the President's executive order will have on the implementation and enforcement of the provisions of the Affordable Care Act. In addition, if the Affordable Care Act is replaced or modified, we cannot predict what the replacement plan or modifications would be, when the replacement plan or modifications would become effective, or whether any of the existing provisions of the Affordable Care Act would remain in place. As a result, while we are unable to predict the effect on our business, financial condition or results of operations, changes to this law, or a new law that replaces it, could materially and adversely affect our business and results of operations.

In addition to the Affordable Care Act, the Medicare Access and CHIP Reauthorization Act of 2015 (MACRA) replaces the Sustainable Growth Rate (SGR) formula for payment of physicians performing procedures on people covered by Medicare with the Quality Payment Program ("QPP"). The Centers for Medicare and Medicaid Services (CMS) released final rules for the QPP in October 2016. The QPP, which impacts more than 600,000 physicians and other practice-based clinicians, represents a fundamental change in physician reimbursement from a system that solely rewards volume of care to one that also rewards quality and value of care. While the full impact of performance-based payment adjustments on physicians' practices and product selection decisions will not be fully seen until 2019 when payment adjustments go into effect, 2017 represents the first performance measurement year. The increased emphasis on quality and cost of care may encourage physicians to move from smaller practices to larger physician groups or hospital employment, leading to a consolidation of a portion of our customer base, which could negatively impact the rate of adoption and utilization of the Company's new and existing products. Although we believe that we are positioned to capitalize on this consolidation trend, our inability to successfully accomplish this could materially and adversely affect our business and results of operations.

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

There were no repurchases of our common stock under the repurchase program during the three and six months ended June 30, 2017.

**ITEM 4. MINE SAFETY DISCLOSURES**

Not applicable.

**ITEM 5. OTHER INFORMATION**

None

**ITEM 6. EXHIBITS**

Exhibits

- 2.7(a) Asset Purchase Agreement accepted and countersigned by DePuy Synthes, dated May 11, 2017  
(Incorporated by reference to Exhibit 2.1 to the Company's Current Report on Form 8-K filed on May 15, 2017)



- 10.1(d) Lease Modification #4 entered into as of April 20, 2017, by and between Plainsboro Associates and Integra LifeSciences Corporation (Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on April 25, 2017)
- #10.10(e) Fourth Amended and Restated 2003 Equity Incentive Plan, effective May 23, 2017 (Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on May 25, 2017)
- #10.35(b) 2018 Performance Incentive Compensation Plan, effective January 1, 2018 (Incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K filed on May 25, 2017)
- \*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
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- \*32.2 Certification of Principal Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- \*†101.INS XBRL Instance Document
- \*†101.SCHXBRL Taxonomy Extension Schema Document
- \*†101.CALXBRL Taxonomy Extension Calculation Linkbase Document
- \*†101.DEF XBRL Definition Linkbase Document
- \*†101.LABXBRL Taxonomy Extension Labels Linkbase Document
- \*†101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

\* Filed herewith

# Indicates a management contract or compensatory plan or arrangement.

† The financial information of Integra LifeSciences Holdings Corporation Quarterly Report on Form 10-Q for the quarter ended June 30, 2017 filed on July 26, 2017 formatted in XBRL (Extensible Business Reporting Language): (i) the Condensed Consolidated Statements of Operations and Comprehensive Income, (ii) the Condensed Consolidated Balance Sheets, (iii) Parenthetical Data to the Condensed Consolidated Balance Sheets, (iv) the Condensed Consolidated Statements of Cash Flows, and (v) Notes to Condensed Consolidated Financial Statements, is furnished electronically herewith.

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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: July 26, 2017 /s/ Peter J. Arduini

Peter J. Arduini

President and Chief Executive Officer

Date: July 26, 2017 /s/ Glenn G. Coleman

Glenn G. Coleman

Corporate Vice President and Chief Financial Officer

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