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INTEGRA LIFESCIENCES HOLDINGS CORP

Form 10-Q

November 09, 2006

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2006

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

For the transition period from to

COMMISSION FILE NO. 0-26224

INTEGRA LIFESCIENCES HOLDINGS CORPORATION

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE

51-0317849

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

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

311 ENTERPRISE DRIVE  
PLAINSBORO, NEW JERSEY

08536

-----  
(ADDRESS OF PRINCIPAL  
EXECUTIVE OFFICES)

-----  
(ZIP CODE)

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

(Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

The number of shares of the registrant's Common Stock, \$.01 par value, outstanding as of November 6, 2006 was 27,771,327.

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## INTEGRA LIFESCIENCES HOLDINGS CORPORATION

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## PART I. FINANCIAL INFORMATION

### Item 1. Financial Statements

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(In thousands, except per share amounts)

	Three Months Ended 2006 ----	September 30, 2005 ----	Nine Months 2006 ----
Total Revenue.....	\$116,647	\$69,334	\$293,903
Costs and Expenses:			
Cost of product revenues.....	47,559	26,394	116,869
Research and development .....	10,991	3,110	20,518
Selling, general and administrative .....	43,431	22,653	111,770
Intangible asset amortization .....	2,852	1,085	6,150
	-----	-----	-----
Total costs and expenses .....	104,833	53,242	255,307
Operating income .....	11,814	16,092	38,596
Interest income .....	375	952	1,993
Interest expense .....	(4,362)	(1,345)	(8,117)
Other income (expense), net .....	(1,765)	(4)	(1,832)
	-----	-----	-----
Income before income taxes .....	6,062	15,695	30,640
Income tax expense .....	3,468	5,213	11,364
	-----	-----	-----
Net income.....	\$ 2,594	\$10,482	\$ 19,276
	=====	=====	=====
Basic net income per share .....	\$ 0.09	\$ 0.35	\$ 0.65
Diluted net income per share .....	\$ 0.09	\$ 0.33	\$ 0.64
Weighted average common shares outstanding :			
Basic .....	29,193	30,039	29,457
Diluted .....	29,867	34,297	30,162

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

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(In thousands)

September 30, 2006

## ASSETS

### Current Assets:

Cash and cash equivalents.....	\$ 24,322
Short-term investments .....	--
Accounts receivable, net of allowances of \$4,520 and \$3,508 .....	76,715
Inventories, net .....	93,773
Deferred tax assets.....	11,337
Prepaid expenses and other current assets .....	13,352
	-----

Total current assets ..... 219,499

Non-current investments.....	--
Property, plant, and equipment, net .....	40,659
Identifiable intangible assets, net .....	178,354
Goodwill.....	158,243
Other assets .....	7,705
	-----

Total assets ..... \$ 604,460  
=====

## LIABILITIES AND STOCKHOLDERS' EQUITY

### Current Liabilities:

Borrowings under senior credit facility.....	87,000
Convertible securities.....	115,205
Accounts payable, trade .....	16,255
Income taxes payable .....	--
Deferred revenue .....	4,986
Accrued expenses and other current liabilities .....	32,010
	-----

Total current liabilities ..... 255,456

Long-term debt .....	4,889
Deferred tax liabilities .....	33,094
Other liabilities.....	5,540
	-----

Total liabilities ..... 298,979

Commitments and contingencies (see Footnote 11) .....

--

### Stockholders' Equity:

Common stock; \$0.01 par value; 60,000 authorized shares; 31,190 and 29,823 issued at September 30, 2006 and December 31, 2005, respectively .....	312
Additional paid-in capital .....	353,415
Treasury stock, at cost; 3,226 and 2,368 shares at September 30, 2006 and December 31, 2005, respectively .....	(107,640)
Accumulated other comprehensive income (loss):	
Unrealized loss on available-for-sale securities, net of tax .	--
Foreign currency translation adjustment .....	5,010
Minimum pension liability adjustment, net of tax .....	(1,821)

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Retained earnings.....	56,205
	-----
Total stockholders' equity .....	305,481
	-----
Total liabilities and stockholders' equity .....	\$ 604,460
	=====

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

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

(In thousands)

	Nine Months Ended 2006 ----
<b>OPERATING ACTIVITIES:</b>	
Net income .....	\$ 19,276
Adjustments to reconcile net income to net cash provided by operating activities:	
Depreciation and amortization .....	13,181
Deferred income tax provision (benefit) .....	(7,821)
Amortization of discount/premium on investments .....	364
Loss of sale of assets/ investments .....	1,112
Amortization of bond issuance costs.....	1,910
Share-based compensation .....	10,499
Excess tax benefits from stock-based compensation arrangements	(730)
In-process research and development.....	5,600
Other, net .....	200
Changes in assets and liabilities, net of business acquisitions:..	
Accounts receivable .....	(18,373)
Inventories .....	(527)
Prepaid expenses and other current assets .....	(460)
Other non-current assets .....	(114)
Accounts payable accrued expenses and other liabilities.....	4,215
Income taxes payable .....	(316)
Deferred revenue .....	4,776
Other accrued expenses and current liabilities.....	7,781
Deferred tax liabilities.....	10,409
Other non-current liabilities.....	(214)
	-----
Net cash provided by operating activities .....	50,768
	-----
<b>INVESTING ACTIVITIES:</b>	
Cash used in business acquisition, net of cash acquired .....	(227,114)
Proceeds from sales/maturities of investments.....	109,872
Purchases of available-for-sale investments .....	(13,074)
Purchases of property and equipment .....	(7,236)

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Net cash used in investing activities .....	(137,552)
-----	
FINANCING ACTIVITIES:	
Borrowings under senior credit facility.....	140,000
Repayment of loans .....	(54,463)
Proceeds from exercised stock options.....	9,155
Excess tax benefits from stock-based compensation arrangements .....	730
Purchases of treasury stock .....	(31,825)
-----	
Net cash provided by (used in) financing activities .....	63,597
-----	
Effect of exchange rate changes on cash and cash equivalents.....	620
-----	
Net decrease in cash and cash equivalents .....	(22,567)
-----	
Cash and cash equivalents at beginning of period .....	46,889
-----	
Cash and cash equivalents at end of period .....	\$ 24,322
=====	

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

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INTEGRA LIFESCIENCES HOLDINGS CORPORATION  
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

General

In the opinion of management, the September 30, 2006 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, 2005 included in the Company's Annual Report on Form 10-K. The December 31, 2005 condensed consolidated balance sheet was derived from audited financial statements but does not include all disclosures required by accounting principles generally accepted in the United States. Operating results for the three- and nine-month periods ended September 30, 2006 are not necessarily indicative of the results to be expected for the entire year.

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amount of assets and liabilities, the disclosure of contingent liabilities, and the reported amounts of revenues and expenses. Significant estimates affecting

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amounts reported or disclosed in the consolidated financial statements include allowances for doubtful accounts receivable and sales returns, net realizable value of inventories, estimates of future cash flows associated with long-lived asset valuations, depreciation and amortization periods for long-lived assets, fair value estimates of stock-based compensation awards, valuation allowances recorded against deferred tax assets, estimates of amounts to be paid to employees and other exit costs to be incurred in connection with the restructuring of our operations and loss contingencies. These estimates are based on historical experience and on various other assumptions that are believed to be reasonable under the current circumstances. Actual results could differ from these estimates.

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

We revised our presentation of cost of product revenues in 2006 to include amortization of product technology-based intangible assets. Previously, this amortization was included in intangible asset amortization in the condensed consolidated statement of operations. We have revised prior period amounts to conform to the current year's presentation. This revision increased cost of product revenues by \$380,000 and \$1,138,000 for the three and nine-month periods ended September 30, 2005, respectively.

### Recently Adopted Accounting Standard

The Company adopted Statement of Financial Accounting Standards No. 123(R) "Share-Based Payment" on January 1, 2006 using the modified prospective method which requires companies (1) to record the unvested portion of previously issued awards that remain outstanding at the initial date of adoption and (2) to record compensation expense for any awards issued, modified or settled after the effective date of the statement. As a result of the adoption of Statement 123(R), the Company began expensing stock options in the 2006 first quarter using the fair value method prescribed by Statement 123(R). Stock-based compensation cost is measured at the grant date based on the fair value of an award and is recognized on a straight-line basis as an expense over the requisite service period, which is the vesting period. Certain of these costs are capitalized into inventory and will be recognized as an expense when the related inventory is sold. The Company's income before income taxes and net income for the nine months ended September 30, 2006 were \$10.3 million and \$3.3 million lower, respectively, than if it had continued to account for share-based compensation under APB No. 25.

The Company recognizes stock-based compensation expense in the consolidated statement of operations based on the awards that are expected to vest. Accordingly, the Company's recognized stock-based compensation expense is net of

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the impact of estimated forfeitures. Statement 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The Company estimates forfeitures based on historical experience.

Statement 123(R) supercedes the Company's previous accounting under Accounting Principals Boards Opinion No. 25 "Accounting for Stock Issued to Employees" for periods subsequent to December 31, 2005. In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107, which provides interpretive guidance in applying the provisions of Statement 123(R). The Company has applied the provisions of SAB 107 in its adoption of Statement 123(R). Had compensation cost for the Company's stock option plans been determined based on the fair value of the award at the grant date consistent

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with Statement 123, the Company's net income and basic and diluted net income per share for the three and nine months ended September 30, 2005 would have been as follows (in thousands, except per share amounts):

	Three Months Ended September 30, 2005 -----	Nine Mo Septemb -----
Net income, as reported.....	\$10,482	\$
Add back: Total stock-based employee compensation expense determined under the intrinsic value-based method for all awards, net of related tax effects.....	30	
Less: Total stock-based employee compensation expense determined under the fair value-based method for all awards, net of related tax effects.....	(1,897)	
	-----	
Pro forma .....	\$ 8,615 =====	\$ =
Net income per share:		
Basic:		
As reported .....	\$ 0.35	\$
Pro forma .....	\$ 0.29	\$
Diluted:		
As reported .....	\$ 0.33	\$
Pro forma .....	\$ 0.28	\$

Statement 123(R) did not change the accounting for stock-based awards granted to non-employees.

### Recently Issued Accounting Standards and Other Matters

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 158, Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans--an amendment of FASB Statements No. 87, 88, 106 and 132(R) .. SFAS No. 158 requires the Company to (a) recognize a plan's funded status in its statement of financial position, (b) measure a plan's assets and its obligations that determine its funded status as of the end of the employer's fiscal year, and (c) recognize changes in the funded status of a defined postretirement plan in the year in which the changes occur through other comprehensive income. The requirement to recognize the funded status of a benefit plan and the disclosure requirements are effective for the Company for the fiscal year ending December 31, 2006. The Company believes the implementation of this provision will not have a material impact on its financial position or results of operations.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. This Statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company is currently assessing the impact this provision may have on its financial position or results of operations.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in



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Current Year Financial Statements (SAB 108), to address diversity in practice in quantifying financial statement misstatements. SAB 108 requires the quantification of misstatements based on their impact to both the balance sheet and the income statement to determine materiality. The guidance provides for a one-time cumulative effect adjustment to correct for misstatements for errors that were not deemed material under a company's prior approach but are material under the SAB 108 approach. SAB 108 is effective for the fiscal year ending December 31, 2006. The Company believes the implementation of this provision will not have a material impact on its financial position or results of operations.

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In July 2006, the FASB issued FASB Interpretation 48, "Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109" (FIN 48). FIN 48 clarifies the accounting for uncertainty in income tax recognition in a company's financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes, by defining the criterion that an individual tax position must meet in order to be recognized in the financial statements. FIN 48 requires that the tax effects of a position be recognized only if it is "more-likely-than-not" to be sustained based solely on the technical merits as of the reporting date. FIN 48 further requires that interest that the tax law requires to be paid on the underpayment of taxes should be accrued on the difference between the amount claimed or expected to be claimed on the return and the tax benefit recognized in the financial statements. FIN 48 also requires additional disclosures of unrecognized tax benefits, including a reconciliation of the beginning and ending balance. The provisions of FIN 48 are effective January 1, 2007. The Company is currently assessing the impact that the adoption of FIN 48 will have on its financial position or results of operations.

### 2. BUSINESS ACQUISITIONS

#### Newdeal Technologies SAS

In January 2005, the Company acquired all of the outstanding capital stock of Newdeal Technologies SAS ("Newdeal Technologies") for \$51.9 million in cash paid at closing, a \$0.7 million working capital adjustment paid in January 2006, and \$0.8 million of acquisition related expenses. Additionally, the Company agreed to pay the sellers up to an additional 1.3 million Euros if the sellers were to continue their employment with the Company through January 3, 2006. This additional payment was accrued to selling, general and administrative expense on a straight-line basis in 2005 over the one-year employment requirement period and was paid in January 2006.

#### Radionics

On March 3, 2006, the Company acquired the assets of the Radionics Division of Tyco Healthcare Group, L.P. for approximately \$74.5 million in cash paid at closing, subject to certain adjustments, and \$3.2 million of acquisition-related expenses in a transaction treated as a business combination. Radionics, based in Burlington, Massachusetts, is a leader in the design, manufacture and sale of advanced minimally invasive medical instruments in the fields of neurosurgery and radiation therapy. Radionics' products include the CUSA EXcel(R) ultrasonic surgical aspiration system, the CRW(R) stereotactic system, the XKknife(R) stereotactic radiosurgery system, and the OmniSight(R) EXcel image-guided surgery system.

The following summarizes the fair value of the assets acquired and liabilities assumed:

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Inventory .....	\$ 8,201
Property, plant and equipment .....	1,365
Intangible assets:	
Tradename .....	18,100
Customer relationships .....	20,900
Technology .....	10,000
Goodwill .....	21,054
Other assets .....	72
	-----
Total assets acquired .....	79,692
	-----
Accrued expenses and other current liabilities .....	425
Deferred revenue .....	1,605
	-----
Total liabilities assumed .....	2,030
	-----
Net assets acquired .....	\$77,662
	=====

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Management determined the fair value of assets acquired with the assistance of a third-party valuation firm. Certain adjustments were finalized in the second quarter of 2006 relating to the Radionics valuation, which primarily resulted in an increase to intangible assets and a reduction in goodwill of \$4 million. The adjustment was related to the finalization of certain assumptions in the valuation of identifiable intangible assets. Additional direct costs of approximately \$450,000 were paid in the third quarter and have been added to goodwill. The goodwill recorded in connection with this acquisition is based on the benefits the Company expects to generate from the synergy between Radionics' ultrasonic aspirator product line and the Company's ultrasonic aspirator product lines. The goodwill acquired in the Radionics acquisition is expected to be deductible for tax purposes.

Miltex

On May 12, 2006, the Company acquired all of the outstanding capital stock of Miltex Holdings, Inc. ("Miltex") for \$102.7 million in cash paid at closing, subject to certain adjustments, and \$0.6 million of transaction-related costs. Miltex, based in York, Pennsylvania, is a leading provider of surgical and dental hand instruments to alternate site facilities, which includes physician and dental offices and ambulatory surgery care sectors. Miltex sells products under the Miltex(R), Meisterhand(R), Vantage(R), Moyco(R), Union Broach(R), and Thompson(R) trade names in over 65 countries, using a network of independent distributors. Miltex operates a manufacturing and distribution facility in York, Pennsylvania and also operates a leased facility in Tuttlingen, Germany, where Miltex's staff coordinates design, production and delivery of instruments.

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

Inventory .....	\$ 16,775
-----------------	-----------

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Other current assets .....	7,935
Property, plant and equipment .....	7,699
Intangible assets:	
Customer relationships .....	13,100
Tradename (Miltex).....	13,500
Tradename (Moyco, Union Branch, Thompson).....	300
Tradename (other product lines).....	600
Technology .....	1,100
Supplier relationships.....	29,300
Goodwill .....	40,431
Other assets .....	219
	-----
Total assets acquired .....	130,959
	-----
Accrued expenses and other current liabilities .....	5,066
Deferred tax liabilities .....	22,588
	-----
Total liabilities assumed .....	27,654
	-----
Net assets acquired .....	\$103,305
	=====

Management determined the preliminary fair value of assets acquired with the assistance of a third-party valuation firm. Certain adjustments were made in the third quarter of 2006 relating to the Miltex valuation. The most significant of which resulted in the recognition of a \$29.3 million supplier relationship intangible asset, a decrease of \$1.9 million in the customer relationship intangible asset, a decrease in goodwill of \$13.8 million and an increase in deferred tax liabilities of \$11.7 million. A portion of the goodwill acquired in the Miltex acquisition is expected to be deductible for tax purposes. Certain elements of the purchase price allocation are considered preliminary, particularly as they relate to the final valuation of certain identifiable intangible assets. Additional changes are not expected to be significant as the allocations are finalized.

Canada Microsurgical, Ltd.

On July 5, 2006, the Company acquired all of the outstanding capital stock of Canada Microsurgical, Ltd. ("CML") for \$5.8 million in cash paid at closing, subject to certain adjustments, and \$0.1 million of transaction-related costs. In addition, the Company may pay up to an additional 2.1 million Canadian dollars over the next three years, depending on the performance of the business. If and when such amounts are paid, then those payments will be added to goodwill. CML, a long-standing distributor for the Company, has eight sales representatives covering each province in Canada.

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

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Inventory .....	\$1,576
Other current assets .....	1,121
Intangible assets:	
Customer relationships .....	2,994
Tradename .....	2,140
Non-compete.....	90
Goodwill .....	610
Other assets .....	21
	-----
Total assets acquired .....	8,552
	-----
Accrued expenses and other current liabilities .....	686
Deferred tax liabilities .....	1,963
	-----
Total liabilities assumed .....	2,649
	-----
Net assets acquired .....	\$5,903
	=====

Management determined the preliminary fair value of assets acquired. Certain elements of the purchase price allocation are considered preliminary, particularly as they relate to the final valuation of certain identifiable intangible assets. Additional changes are not expected to be significant as the allocations are finalized.

Kinetikos Medical, Inc.

On July 31, 2006, the Company acquired all of the outstanding capital stock of Kinetikos Medical, Inc. ("KMI") for \$39.5 million in cash paid at closing, subject to certain adjustments, and \$1.1 million of transaction-related costs. In addition, the Company may pay up to an additional \$20 million over the next two years, depending on the performance of the business. If and when such amounts are paid, then those payments will be added to goodwill. Subsequent to closing, the Company implemented certain changes in the KMI business, including eliminating approximately one-half of the positions located in the Carlsbad, California facility. In addition, the Company plans to discontinue operating under the name of KMI before the end of this year and to exit the Carlsbad facility and move the remaining operations to its San Diego facility during 2007. A restructuring provision of \$360,000 has been set up on the opening balance sheet in connection with these plans as part of the purchase price allocation.

KMI, based in Carlsbad, California, was a leading developer and manufacturer of innovative orthopedic implants and surgical devices for small bone and joint procedures involving the foot, ankle, hand, wrist and elbow. KMI marketed products that addressed both the trauma and reconstructive segments of the extremities market. KMI's reconstructive products are largely focused on treating deformities and arthritis in small joints of the upper and lower extremity, while its trauma products are focused on the treatment of fractures of small bones most commonly found in the extremities. The Company has integrated the KMI product line into its U.S. direct sales force while

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maintaining seven former KMI independent sales agencies. The Company plans to increase sales of KMI products internationally through its well-established Newdeal infrastructure.

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

Inventory .....	\$ 2,208
Other current assets .....	2,451
Property, plant and equipment .....	1,646
Intangible assets:	
Customer relationships .....	6,100
Tradename (MBA, UNI2) .....	300
Developed technology patents.....	2,000
In-process research and development.....	5,600
Goodwill .....	23,624
Other assets .....	1,260
	-----
Total assets acquired .....	45,189
	-----
Accrued expenses and other liabilities .....	1,933
Deferred tax liabilities .....	2,684
	-----
Total liabilities assumed .....	4,617
	-----
Net assets acquired .....	\$40,572
	=====

Management determined the preliminary fair value of assets acquired with the assistance of a third-party valuation firm. The Company recorded an in-process research and development charge of \$5.6 million in the third quarter of 2006 in connection with this acquisition. Certain elements of the purchase price allocation are considered preliminary, particularly as they relate to the final valuation of certain identifiable intangible assets. Additional changes are not expected to be significant as the allocations are finalized.

The results of operations of each of the acquired businesses have been included in the condensed consolidated financial statements since their respective dates of acquisition.

The following unaudited pro forma financial information summarizes the results of operations for the three months and nine months ended September 30, 2006 and 2005 as if the acquisitions had been completed as of the beginning of 2005. The pro forma results are based upon certain assumptions and estimates, and they give effect to actual operating results prior to the acquisitions and adjustments to reflect increased interest expense, depreciation expense, intangible asset amortization, and income taxes at a rate consistent with the

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Company's statutory rate in each year. No effect has been given to cost reductions or operating synergies. As a result, these pro forma results do not necessarily represent results that would have occurred if the acquisitions had taken place on the basis assumed above, nor are they indicative of the results of future combined operations.

	Three Months Ended September 30,	Nine Months
(in thousands, except per share amounts)	2006 ----	2005 ---- 2006 ----
Total Revenue.....	\$117,768	\$103,357 \$337,692
Net income .....	7,777	12,286 22,568
Net income per share:		
Basic .....	\$0.27	\$0.41 \$0.77
Diluted .....	\$0.26	\$0.38 \$0.7

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### 3. INVENTORIES

Inventories, net consisted of the following (in thousands):

	September 30, 2006	December 31, 2005
Raw materials.....	\$15,138	\$13,175
Work-in process.....	14,331	9,801
Finished goods.....	64,304	44,500
	-----	-----
	\$93,773	\$67,476
	=====	=====

The Company capitalizes inventory costs associated with certain products prior to regulatory approval, based on management's judgment of probable future commercialization. The Company could be required to expense previously capitalized costs related to pre-approval inventory upon a change in such judgment, due to, among other potential factors, a denial or delay of approval by necessary regulatory bodies or a decision by management to discontinue the related development program.

In June 2006, the Company recorded a \$1.2 million charge to research and development related to pre-approval inventory associated with a project to develop an ultrasonic aspirator system. The Company discontinued this project in June 2006 following management's review of the Company's existing technology and the ultrasonic aspirator technology acquired in the Radionics acquisition. Management determined that there was no future, alternative use for the pre-approval inventory in any other development project.

### 4. GOODWILL AND OTHER INTANGIBLE ASSETS

Changes in the carrying amount of goodwill for the nine months ended September 30, 2006, were as follows:

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Balance at December 31, 2005 .....	
Radionics acquisition .....	
Newdeal working capital adjustment.....	
Miltex acquisition (based on preliminary allocation) .....	
Canada Microsurgical Ltd. acquisition (based on preliminary allocation) .....	
Kinetikos Medical, Inc. acquisition (based on preliminary allocation) .....	
Foreign currency translation .....	
Balance at September 30, 2006 .....	

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

		September 30, 2006	
	Weighted Average Life	Cost	Accumulated Amortization
Completed technology .....	12 years	\$ 32,816	\$ (7,669)
Customer relationships .....	12 years	66,085	(8,705)
Trademarks/brand names .....	Indefinite	31,600	--
Trademarks/brand names .....	34 years	34,726	(3,700)
Noncompetition agreements.....	5 years	7,109	(3,711)
Supplier relationships.....	30 years	29,300	(375)
All other .....	15 years	1,620	(742)
		-----	-----
		\$203,256	\$ (24,902)
Accumulated amortization .....		(24,902)	
		-----	
		\$178,354	
		=====	

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Annual amortization expense is expected to approximate \$11.7 million in 2006, \$14.3 million in 2007, \$14.0 million in 2008, \$12.5 million in 2009, and \$10.8 million in 2010. Identifiable intangible assets are initially recorded at fair market value at the time of acquisition generally using an income or cost approach.

### 5. RESTRUCTURING ACTIVITIES

In June 2005, management announced plans to restructure the Company's European operations. The restructuring plan included closing the Company's Integra ME production facility in Tuttlingen, Germany and reducing various positions in the Company's production facility located in Biot, France, both of which were substantially completed in December 2005. The Company transitioned the manufacturing operations of Integra ME to its production facility in Andover, UK. The Company also eliminated some duplicative sales and marketing positions, primarily in Europe. The Company terminated 68 individuals under the European

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restructuring plan.

During the nine months ended September 30, 2006, the Company terminated four employees in connection with the transfer of certain manufacturing packaging operations from its plant in Plainsboro, New Jersey to its plant in Anasco, Puerto Rico. The Company may terminate approximately ten additional employees over the next nine to twelve months in connection with this transfer; however no final decision has been made.

In connection with these restructuring activities, the Company has recorded the following charges during the three and nine months ended September 30, 2006 (in thousands):

	Cost of Sales	Research and Development	Sell Gener Admini
Involuntary employee termination costs:			
Three months ended September 30, 2006.....	\$ 63	--	
Nine months ended September 30, 2006.....	\$ 418	\$ 22	

Below is a reconciliation of the restructuring accrual activity recorded during 2006 (in thousands):

	Employee Terminatio Costs
Balance at December 31, 2005 .....	\$2,420
Additions.....	268
Change in estimate.....	(18)
Payments .....	(1,991)
Effects of Foreign Exchange .....	108
	-----
Balance at September 30, 2006 .....	\$ 787
	=====

The Company expects to pay all of the remaining costs by the end of 2007.

### 6. STOCK-BASED COMPENSATION

As of September 30, 2006, the Company had stock options, restricted stock awards, performance stock awards, contract stock awards and restricted stock unit awards outstanding under seven plans, the 1993 Incentive Stock Option and Non-Qualified Stock Option Plan (the 1993 Plan), the 1996 Incentive Stock Option and Non-Qualified Stock Option Plan (the 1996 Plan), the 1998 Stock Option Plan (the 1998 Plan), the 1999 Stock Option Plan (the 1999 Plan), the 2000 Equity Incentive Plan (the 2000 Plan), the 2001 Equity Incentive Plan (the 2001 Plan), and the 2003 Equity Incentive Plan (the 2003 Plan, and collectively, the Plans). No new awards may be granted under the 1993 Plan or the 1996 Plan.

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



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over specified periods, generally at three years after the date of grant.

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Prior to the adoption of Statement 123(R), the Company presented all tax benefits resulting from the exercise of stock options as operating cash flows (reflected in accrued taxes). Statement 123(R) requires the cash flows resulting from excess tax benefits (tax deductions realized in excess of the compensation costs recognized for the options exercised) from the date of adoption of Statement 123(R) to be classified as financing cash flows. Therefore, as of January 1, 2006, excess tax benefits for the nine months ended September 30, 2006, have been classified as financing cash flows.

At September 30, 2006, there were 6,697,371 shares authorized for issuance under the Plans, with 1,537,024 shares available for grant under the Plans.

Employee stock-based compensation expense recognized under FAS 123(R) was as follows (in thousands, except for per share data):

	Three Months Ended September 30, 2006
Research and development expense.....	\$ 168
Selling, general and administrative.....	3,529
Amortization of amounts previously capitalized to inventory.....	112
	-----
Total employee stock-based compensation expense.....	3,809
Tax benefit related to employee stock-based compensation expense.....	(1,212)
	-----
Net effect on net income.....	\$2,597
	=====
Effect on earnings per share:	
Basic.....	\$ .09
Diluted.....	\$ .09

As of September 30, 2006, \$111,000 of stock-based compensation costs remain capitalized in inventory based on the underlying employees receiving the awards.

Stock Options

The following is a summary of stock option activity for the nine-month period ended September 30, 2006 (shares in thousands):

	Stock Options	Wtd. Avg. Ex. Price
Outstanding, December 31, 2005.....	4,001	\$27.50
Granted .....	73	35.85
Exercised .....	(436)	21.31
Cancelled .....	(87)	33.30
	-----	-----
Outstanding, September 30, 2006.....	3,551	\$28.28
	=====	

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Options exercisable at September 30, 2006..... 2,146 \$25.06

The intrinsic value of options exercised during the nine-month periods ended September 30, 2006 and 2005 was \$7.7 million and \$8.7 million, respectively. The weighted-average per share fair value of stock options granted during the nine months ended September 30, 2006 and 2005 was \$15.35 and \$14.49, respectively.

As of September 30, 2006, there was approximately \$18.2 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 2.8 years.

The fair value of options granted prior to October 1, 2004 was calculated using the Black-Scholes model, while the fair value of options granted on or after October 1, 2004 was calculated using the binomial distribution model. Expected volatilities are based on historical volatility of the Company's stock price with forward-looking assumptions. The expected life of stock options is estimated based on historical data on exercises of stock options, post-vesting forfeitures and other factors to estimate the expected term of the stock options granted. The risk-free interest rates are derived from the U.S. Treasury yield

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curve in effect on the date of grant for instruments with a remaining term similar to the expected life of the options. In addition, the Company applies an expected forfeiture rate when amortizing stock-based compensation expenses. The estimate of the forfeiture rate is based primarily upon historical experience of employee turnover. As individual grant awards become fully vested, stock-based compensation expense is adjusted to recognize actual forfeitures. The Company used the following weighted-average assumptions to calculate the fair value for stock options granted during the following periods:

	Three Months Ended September 30,		Nine Months
	2006	2005	2006
	----	----	----
Dividend yield.....	0%	0%	0%
Expected volatility .....	43%	43%	43%
Risk free interest .....	4.3%	3.4%	3.4%
Expected life of option from grant date.....	5.4 years	5.4 years	5.4 years

The Company received proceeds of \$9.2 million and \$5.4 million from stock option exercises for the nine months ended September 30, 2006 and 2005, respectively.

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

The following is a summary of awards of restricted stock, performance stock and contract stock for the nine-month period ended September 30, 2006 (shares in thousands):

	Restricted Stock Awards	Performan	Contra
	Shares	Wtd. Avg. Fair Value Per Share	Shares

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Unvested, December 31, 2005.....	19	\$ 35.08	--
Grants .....	168	38.43	218
Vested .....	---	--	--
Cancellations.....	(6)	37.68	--
	---		---
Unvested, September 30, 2006.....	181	\$ 38.11	218
	===		===

Performance stock awards have performance features associated with them. Performance stock, restricted stock and contract stock awards generally have requisite service periods of three years. The fair value of these awards is being expensed on a straight-line basis over the vesting period. As of September 30, 2006, there was approximately \$11.2 million of total unrecognized compensation costs related to unvested awards. These costs are expected to be recognized over a weighted-average period of approximately 2.8 years. The Company granted 13,496 restricted stock awards with a weighted average fair value of \$34.08 during the nine months ended September 30, 2005.

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

The Company also maintains an Employee Stock Purchase Plan (the ESPP), which provides eligible employees of the Company with the opportunity to acquire shares of common stock at periodic intervals by means of accumulated payroll deductions. The ESPP was amended in 2005 to eliminate the look-back option and to reduce the discount available to participants to five percent. Accordingly, the ESPP is a non-compensatory plan under Statement 123(R).

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7. RETIREMENT BENEFIT PLANS

The Company maintains defined benefit pension plans that cover employees in its manufacturing plants located in Andover, United Kingdom and its former manufacturing plant in Tuttlingen, Germany. Net periodic benefit costs for the Company's defined benefit pension plans included the following amounts (in thousands):

	Three Months Ended September 30,	
	2006	2005
	----	----
Service cost .....	\$ 53	\$ 61
Interest cost .....	142	103
Expected return on plan assets .....	(124)	(85)
Recognized net actuarial loss.....	54	34
	-----	-----
Net periodic benefit cost .....	\$ 125	\$ 113
	=====	=====

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The Company made \$126,000 and \$167,000 of contributions to its defined benefit pension plans for the nine months ended September 30, 2006 and 2005 respectively.

### 8. COMPREHENSIVE INCOME

Comprehensive income was as follows (in thousands):

	Three Months Ended September 30,		Nin S
	2006 ----	2005 ----	200 ----
Net income .....	\$2,594	\$10,482	\$19,2
Foreign currency translation adjustment .....	1,312	(232)	7,3
Unrealized holding gains (losses) on available-for-sale securities, net of tax.....	522	--	7
Reclassification adjustment for losses included in net income, net of tax.....	(237)	--	
Minimum pension liability adjustment, net of tax.....	(55)	--	(1
Comprehensive income .....	<u>\$4,136</u>	<u>\$10,250</u>	<u>\$27,2</u>

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### 9. NET INCOME PER SHARE

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

	Three Months Ended September 30,		Nin S
	2006 ----	2005 ----	2006 ----
Basic net income per share:			
Net income.....	\$ 2,594	\$10,482	\$19,27
Weighted average common shares outstanding .....	29,193	30,039	29,45
Basic net income per share .....	\$ 0.09	\$ 0.35	\$ 0.6
Diluted net income per share:			
Net income .....	\$ 2,594	\$10,482	\$19,27
Add back: Interest expense and other income/(expense) related to convertible notes payable, net of tax .....	--	800	-
Net income applicable to common stock.....	<u>\$ 2,594</u>	<u>\$11,282</u>	<u>\$19,27</u>

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Weighted average common shares outstanding - Basic	29,193	30,039	29,45
Effect of dilutive securities:			
Stock options and restricted stock.....	674	744	70
Shares issuable upon conversion of notes payable	--	3,514	--
	-----	-----	-----
Weighted average common shares for diluted earnings per share.....	29,867	34,297	30,16
	=====	=====	=====
Diluted net income per share.....	\$ 0.09	\$ 0.33	\$ 0.6

Options outstanding at September 30, 2006 and 2005 to acquire approximately 1.8 million shares and 921,000 shares of common stock, respectively, were excluded from the computation of diluted net income per share for the three months ended September 30, 2006 and 2005, respectively, because their effects would be anti-dilutive. Options outstanding at September 30, 2006 and 2005 to acquire approximately 1.9 million shares and 624,000 shares of common stock, respectively, were excluded from the computation of diluted net income per share for the nine months ended September 30, 2006 and 2005, respectively, because their effects would be anti-dilutive. The Company excluded from the computation of diluted earnings per share for the three months and nine months ended September 30, 2006 approximately 3.5 million shares issuable upon conversion of its convertible notes payable because their effects would be anti-dilutive.

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10. SEGMENT AND GEOGRAPHIC INFORMATION

The Company's management reviews financial results and manages the business on an aggregate basis. Therefore, financial results are reported in a single operating segment, the development, manufacture and marketing of medical devices for use in neurosurgery, reconstructive surgery and general surgery.

In 2006, the Company revised the manner in which it presents its revenues. The Company now presents its revenues in two categories: Neurosurgical / Orthopedic Implants and Medical / Surgical Equipment. This change better aligns our product categories by functional product characteristic and intended use. The Company's revenues were as follows (in thousands):

	Three Months Ended September 30,		Nine Mo Septe
	2006	2005	2006
	----	----	----
Revenue:			
Neurosurgical and Orthopedic Implants .....	\$ 43,136	\$ 33,516	\$118,778
Medical Surgical Equipment.....	73,511	35,818	175,125
	-----	-----	-----
Total Revenue .....	\$116,647	\$ 69,334	\$293,903
	=====	=====	=====

Certain of the Company's products, including the DuraGen(R) and NeuraGen(TM) product families and the INTEGRA(R) Dermal Regeneration Template and wound-dressing products, contain material derived from bovine tissue. Products that contain materials derived from animal sources, including food as well as

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pharmaceuticals and medical devices, are increasingly subject to scrutiny from the press and regulatory authorities. These products constituted 23% and 32% of total revenues in each of the three-month periods ended September 30, 2006 and 2005, respectively, and 26% and 31% of total revenues in each of the nine-month periods ending September 30, 2006 and 2005, respectively. Accordingly, widespread public controversy concerning collagen products, new regulation, or a ban of the Company's products containing material derived from bovine tissue could have a material adverse effect on the Company's current business or its ability to expand its business.

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

	United States	Europe	Asia Pacific
Three months ended September 30, 2006.....	\$ 88,740	\$ 21,165	\$ 2,815
Three months ended September 30, 2005.....	53,504	10,443	2,662
Nine months ended September 30, 2006.....	\$220,393	\$ 56,884	\$ 8,809
Nine months ended September 30, 2005.....	152,623	36,187	8,443

### 11. COMMITMENTS AND CONTINGENCIES

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

Various lawsuits, claims and proceedings are pending or have been settled by the Company. The most significant of those are described below.

In May 2006, Codman & Shurtleff, Inc. ("Codman"), a division of Johnson & Johnson, commenced an action in the United States District Court for the District of New Jersey for declaratory judgment against Integra LifeSciences Corporation with respect to United States Patent No. 5,997,895 (the "'895 Patent") held by Integra. Integra's patent covers dural repair technology related to Integra's Duragen(R) family of duraplasty products.

The action seeks declaratory relief that Codman's DURAFORM(TM) product does not infringe Integra's patent and that Integra's patent is invalid and unenforceable. Codman does not seek either damages from Integra or injunctive

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relief to prevent Integra from selling the Duragen(R) Dural Graft Matrix. Integra has filed a counterclaim against Codman, alleging that Codman's DURAFORM(TM) product infringes the '895 Patent, seeking injunctive relief preventing the sale and use of DURAFORM(TM), and seeking damages, including treble damages, for past infringement.

In July 1996, the Company sued Merck KGaA, a German corporation, seeking damages for patent infringement. The patents in question are part of a group of patents granted to The Burnham Institute and licensed by Integra that are based on the interaction between a family of cell surface proteins called integrins and the arginine-glycine-aspartic acid ("RGD") peptide sequence found in many extracellular matrix proteins.

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The case has been tried, appealed and returned to the trial court. Most recently, in September 2004, the trial court ordered Merck KGaA to pay Integra \$6.4 million in damages. Merck KGaA filed a petition for a writ of certiorari with the United States Supreme Court seeking review of the Circuit Court's decision, and the Supreme Court granted the writ in January 2005.

On June 13, 2005, the Supreme Court vacated the June 2003 judgment of the Circuit Court. The Supreme Court held that the Circuit Court applied an erroneous interpretation of 35 U.S.C. ss.271(e)(1) when it rejected the challenge of Merck KGaA to the jury's finding that Merck KGaA failed to show that its activities were exempt from claims of patent infringement under that statute. On remand, the Circuit Court was to have reviewed the evidence under a reasonableness test that does not provide categorical exclusions of certain types of activities. The hearing before the Circuit Court occurred in June 2006, and a ruling is expected by the end of this year. Further enforcement of the trial court's order has been stayed. We have not recorded any gain in connection with this matter, pending final resolution and completion of the appeals process.

In addition to these matters, the Company is subject to various claims, lawsuits and proceedings in the ordinary course of its business, including claims by former employees, distributors and competitors and with respect to our products. In the opinion of management, such claims are either adequately covered by insurance or otherwise indemnified, or are not expected, individually or in the aggregate, to result in a material adverse effect on the Company's 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.

### 12. CONTINGENT CONVERTIBLE NOTES

On September 27, 2006, the Company exchanged of \$115.2 million (out of a total of \$120.0 million) of its 2 1/2% Contingent Convertible Subordinated Notes due 2008 (the "old notes") for the equivalent amount of 2 1/2% Contingent Convertible Subordinated Notes due 2008 (the "new notes"). The terms of the new notes are substantially similar to those of the old notes, except that the new notes have a net share settlement feature and include "takeover protection," whereby the Company will pay a premium to holders who convert their notes upon the occurrence of designated events, including a change in control. The net share settlement feature requires that, upon conversion of the new notes, the Company will pay holders in cash for up to the principal amount of the converted new notes, with any amounts in excess of this cash amount settled, at the election of the Company, in cash or shares of our common stock. Holders who exchanged their old notes in the exchange offer received an exchange fee of \$2.50 per \$1,000 principal amount of their old notes.

In addition, since the closing price of the Company's stock on the issuance date of the new notes was higher than the market price trigger of the new notes, the holders have the option to convert their notes into cash, and if applicable, shares of our common stock at any time. As a result, \$115.2 million of contingent convertible notes have been classified as current liabilities on the balance sheet. The Company recorded a \$1.2 million write-off of the unamortized debt issuance costs and \$0.3 million of fees associated with the old notes that were exchanged.

### 13. SUBSEQUENT EVENT

In October 2006, the Company exchanged an additional \$4.3 million of old notes in exchange for an equal amount of new notes under the same terms of the exchange offer which expired on September 27, 2006.

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, 2005 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. These forward-looking statements are subject to a number of risks, uncertainties and assumptions about the Company. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of many factors, including but not limited to those set forth above under the heading "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2005 and in subsequent Quarterly Reports on Form 10-Q.

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

GENERAL

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

Our distribution channels include two direct sales organizations (Integra NeuroSciences and Integra Reconstructive Surgery), two networks of manufacturer's representatives managed by a direct sales organization (JARIT Surgical Instruments and Miltex) and strategic alliances with market leaders such as Johnson & Johnson, Medtronic, Inc., Wyeth and Zimmer Holdings, Inc. We have direct sales forces in the United States, Canada, Germany, the United Kingdom, the Benelux (Belgium, Netherlands, Luxembourg) region and France. Elsewhere throughout the world, our products are distributed through a number of independent distributors. We invest substantial resources and management effort to develop our sales organizations, and we believe that we compete very effectively in this aspect of our business.

In 2006, we revised the manner in which we present our revenues. This change better aligns our product categories by functional product characteristic and intended use. We now present revenues in two categories: Neurosurgical and Orthopedic Implants and Medical Surgical Equipment. Our Neurosurgical and Orthopedic Implants product group includes dural grafts that are indicated for the repair of the dura matter, dermal regeneration and engineered wound dressings, implants used in small bone and joint fixation, repair of peripheral nerves, and hydrocephalus management, and implants used in bone regeneration and in guided tissue regeneration in periodontal surgery. Our Medical Surgical Equipment product group includes ultrasonic surgery systems for tissue ablation, cranial stabilization and brain retraction systems, instrumentation used in general, neurosurgical, spinal and plastic and reconstructive surgery and dental procedures, systems for the measurement of various brain parameters, and devices used to gain access to the cranial cavity and to drain excess cerebrospinal



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fluid from the ventricles of the brain.

We manage these product groups and distribution channels on a centralized basis. Accordingly, we report our financial results under a single operating segment - the development, manufacturing and distribution of medical devices.

We manufacture many of our products in various plants located in the United States, Puerto Rico, France, the United Kingdom and Germany. We also manufacture some of our ultrasonic surgical instruments and source most of our hand-held surgical instruments through specialized third-party vendors.

We believe that we have a particular advantage in the development, manufacture and sale of specialty tissue repair products derived from bovine collagen. We develop and manufacture these products primarily in our facilities in Plainsboro, New Jersey and Puerto Rico. Products that contain materials derived

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from animal sources, including food as well as pharmaceuticals and medical devices, are increasingly subject to scrutiny from the press and regulatory authorities. These products comprised 26% and 31% of total revenues in each of the nine-month periods ended September 30, 2006 and 2005, respectively. Accordingly, widespread public controversy concerning collagen products, new regulation, or a ban of the Company's products containing material derived from bovine tissue, could have a material adverse effect on the Company's current business or its ability to expand its business.

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

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

### ACQUISITIONS

Our strategy for growing our business includes the acquisition of complementary product lines and companies. Our recent acquisitions of businesses, assets and product lines may make our financial results for the nine months ended September 30, 2006 not directly comparable to those of the corresponding prior-year period. See Note 2 to the unaudited condensed consolidated financial statements for a further discussion. Since the beginning of 2005, we have acquired the following businesses:

In January 2005, we acquired all of the outstanding capital stock of Newdeal Technologies SAS ("Newdeal Technologies") for \$51.9 million in cash paid at closing, a \$0.7 million working capital adjustment paid in January 2006, and \$0.8 million of acquisition related expenses. Additionally, we agreed to pay the sellers up to an additional 1.3 million Euros if the sellers were to continue their employment with us through January 3, 2006. This additional payment was accrued to selling, general and administrative expense on a straight-line basis

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in 2005 over the one-year employment requirement period and was paid in January 2006.

Newdeal is a leading developer and marketer of specialty implants and instruments specifically designed for foot and ankle surgery. Newdeal's products include a wide range of products for the forefoot, the mid-foot and the hind foot, including the Bold(R) Screw, Hallu-Fix(R) plate system and the HINTEGRA(R) total ankle prosthesis. Newdeal's target physicians include orthopedic surgeons specializing in injuries of the foot, ankle and extremities, as well as podiatric surgeons.

On March 3, 2006, Integra acquired certain assets of the Radionics Division of Tyco Healthcare Group, L.P. for approximately \$74.5 million in cash paid at closing, subject to certain adjustments, and \$3.2 million of acquisition related expenses in a transaction treated as a business combination. Radionics, based in Burlington, Massachusetts, is a leader in the design, manufacture and sale of advanced minimally invasive medical instruments in the fields of neurosurgery and radiation therapy. Radionics' products include the CUSA EXcel(R) ultrasonic surgical aspiration system, the CRW(R) stereotactic system, the XKnife(R) stereotactic radiosurgery system, and the OmniSight(R) EXcel image guided surgery system.

Tyco Healthcare sold Radionics products in over 75 countries, using a network of independent distributors in the United States and both independent distributors and Tyco Healthcare affiliates internationally. We are using distributors in many of the markets in which Tyco Healthcare sold directly to customers. As a result, we expect that revenue and pre-tax income attributable to the acquired product lines will be less than the 2005 levels recognized by Tyco. In addition, because the CUSA Excel ultrasonic aspiration system competes with our existing line of ultrasonic surgery systems, our sales force may, in some situations, sell the CUSA system in lieu of our existing ultrasonic aspirator products.

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On May 12, 2006, we acquired all of the outstanding capital stock of Miltex Holdings, Inc. ("Miltex") for \$102.7 million in cash paid at closing, subject to certain adjustments, and \$0.6 million of transaction related costs. Miltex, based in York, Pennsylvania, is a leading provider of surgical and dental hand instruments to alternate site facilities, which includes physician and dental offices and ambulatory surgery care sectors. Miltex sells products under the Miltex(R), Meisterhand(R), Vantage(R), Moyco(R), Union Broach(R), and Thompson(R) trade names in over 65 countries, using a network of independent distributors. Miltex operates a manufacturing and distribution facility in York, Pennsylvania and also operates a leased facility in Tuttlingen, Germany, where Miltex's staff coordinates design, production and delivery of instruments.

On July 5, 2006, we acquired a direct sales force in Canada through the acquisition of our longstanding distributor, Canada Microsurgical Ltd. Canada Microsurgical has eight sales representatives covering each province in Canada. We paid \$5.8 million (6.4 million Canadian dollars) for Canada Microsurgical at closing and \$0.1 million of transaction related costs. In addition, we may pay up to an additional 2.1 million Canadian dollars over the next three years, depending on the performance of the business.

On July 31, 2006 we acquired the shares of Kinetikos Medical, Inc. ("KMI") for \$39.5 million in cash, subject to certain adjustments, including future payments based on the performance of the KMI business after the acquisition. KMI, based in Carlsbad, California, was a leading developer and manufacturer of innovative orthopedic implants and surgical devices for small bone and joint procedures involving the foot, ankle, hand, wrist and elbow. KMI marketed products that addressed both the trauma and reconstructive segments of the extremities market.

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KMI's reconstructive products are largely focused on treating deformities and arthritis in small joints of the upper and lower extremity, while its trauma products are focused on the treatment of fractures of small bones most commonly found in the extremities. The Company has integrated the KMI product line into its U.S. direct sales force while maintaining seven former KMI independent sales agencies. The Company plans to increase sales of KMI products internationally through our well-established Newdeal infrastructure.

### IMPACT OF RESTRUCTURING ACTIVITIES

In June 2005, we announced plans to restructure our European operations. The restructuring plan included closing our Integra ME production facility in Tuttlingen, Germany and reducing various positions in our production facility located in Biot, France, both of which were substantially completed in December 2005. We transitioned the manufacturing operations of Integra ME to our production facility in Andover, UK. We also eliminated some duplicative sales and marketing positions, primarily in Europe. The Company terminated 68 individuals under the European restructuring plan.

In 2005, we also completed the transfer of the Spinal Specialties assembly operations from our San Antonio, Texas plant to our San Diego, California plant and we continue to transfer certain assembly, processing and packaging operations to our San Diego and Puerto Rico facilities. During the nine months ended September 30, 2006, the Company terminated four employees in connection with the transfer of certain manufacturing packaging operations from its plant in Plainsboro, New Jersey to its plant in Anasco, Puerto Rico. The Company may terminate approximately ten additional employees over the next nine to twelve months in connection with this transfer; however no final decision has been made.

In connection with these restructuring activities, we recorded employee termination costs of \$63,000 and \$440,000, respectively, during the three and nine months ended September 30, 2006.

While we expect to achieve a positive impact from the restructuring and integration activities, such results remain uncertain. We have reinvested most of the savings from these restructuring and integration activities into further expanding our European sales, marketing and distribution organization, and integrating the Radionics and KMI businesses into our existing sales and distribution network.

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### RESULTS OF OPERATIONS

Net income for the three months ended September 30, 2006 was \$2.6 million, or \$0.09 per diluted share, as compared to net income of \$10.5 million, or \$0.33 per diluted share, for the three months ended September 30, 2005.

Net income for the nine months ended September 30, 2006 was \$19.3 million, or \$0.64 per diluted share, as compared to a net income of \$26.6 million, or \$0.82 per diluted share, for the nine months ended September 30, 2005.

These amounts include the following charges (in thousands):

Three Months Ended September 30,	
2006	2005
----	----

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### Acquisition-related charges:

Inventory fair market value purchase accounting adjustments .....	\$ 1,399	\$ --
Acquired in-process research and development.. .....	5,600	500
Charges associated with convertible debt exchange offer.....	1,792	--
Charges associated with termination of interest rate swap.....	1,425	--
Employee termination and related costs.....	63	666
Facility consolidation, acquisition integration, manufacturing transfer, enterprise business system integration and related costs.....	582	492
Impairment of inventory and fixed assets related to discontinued development project and product lines.....	--	--
	-----	-----
Total.....	\$10,861	\$1,658
	=====	=====

Of these amounts, \$5.4 million and \$1.8 million were charged to cost of product revenues in the nine-month periods ended September 30, 2006 and 2005, respectively, and \$7.2 million and \$1.0 million was charged to research and development in the nine months ended September 30, 2006. The remaining amounts were primarily charged to selling, general and administrative expenses.

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

Net income for the three and nine months ended September 30, 2006 also includes approximately \$2.6 million and \$7.0 million, respectively, net of tax, of stock-based compensation expense recorded in connection with the adoption of Statement of Financial Accounting Standards No 123(R) "Shared Based Payment".

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### Revenues and Gross Margin on Product Revenues

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

	Three Months Ended	
	September 30,	
	2006	2005
	----	----
Neurosurgical and Orthopedic Implants .....	\$43,136	\$33,516
Medical Surgical Equipment.....	73,511	35,818
	-----	-----
Total revenue .....	\$116,647	\$69,334
Cost of product revenues .....	47,559	26,394

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Gross margin on total revenues .....	69,088	42,940
Gross margin as a percentage of total revenues .....	59%	62%

THREE MONTHS ENDED SEPTEMBER 30, 2006 AS COMPARED TO THE THREE MONTHS ENDED SEPTEMBER 30, 2005

### Revenues and Gross Margin

For the quarter ended September 30, 2006, total revenues increased 68% over the prior-year period to \$116.6 million. Domestic revenues increased \$35.7 million to \$89.1 million, or 76% of total revenues, as compared to 77% of revenues in the three months ended September 30, 2005.

In the Neurosurgical and Orthopedic Implants category, sales of our reconstructive surgery implant products continued to grow strongly. Rapid growth in nerve and dermal repair products and sales of products for the hand, foot and ankle accounted for much of the increase in implant product revenues. INTEGRA(TM) dermal repair product revenues increased 32% over the third quarter of 2005, nerve repair product revenues increased by 44%, and our hand, foot and ankle products more than doubled. Revenues from bone graft and collagen dental products increased by 57% over the third quarter of 2005. KMI products contributed \$1.9 million of sales to the quarter.

In the Medical Surgical Equipment category, increased sales of our JARIT(R) surgical instrument lines and sales of the recently acquired Radionics and Miltex products provided the year-over-year growth in equipment product revenues for the third quarter. Radionics, Miltex and non-Integra distributed products sold through our former Canadian distributor (all acquired in 2006) contributed \$33.8 million of sales to the quarter.

We have generated our product revenue growth through acquisitions, new product launches and increased direct sales and marketing efforts both domestically and in Europe. We expect that our expanded domestic sales force, the recent conversion of JARIT domestic sales from a distributor billing model to a direct billing model, the continued implementation of our direct sales strategy in Europe and sales of internally developed and acquired products will drive our future revenue growth. We also intend to continue to acquire businesses that complement our existing businesses and products. Many of our recent acquisitions involve businesses or product lines that overlap in some way with our existing products. Our sales and marketing departments are integrating these acquisitions, and there has been, and we expect there will continue to be, some cannibalization of sales of our existing products that will affect our internal growth. Overall, we target our revenues to continue to grow internally and through acquisitions in the range of 20% to 30% per year.

In 2006, we revised our presentation of cost of product revenues to include amortization of product technology-based intangible assets. Previously, this amortization was included in intangible asset amortization in the condensed consolidated statement of operations. We have revised prior period amounts to conform to the current year's presentation. This revision increased cost of product revenues by \$673,000 and \$379,000 for the three-month period ended September 30, 2006 and 2005, respectively.

Gross margin on total revenues in the third quarter of 2006 was 59.2%. Strong sales growth in many higher gross margin products was offset by sales of the relatively lower-margin Radionics and Miltex products. We recognized \$1.4 million in inventory fair value purchase accounting adjustments from

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acquisitions as the products were sold, a \$1.3 million change in estimate related to consignment inventory and \$582,000 in restructuring and manufacturing transfer and systems integration costs. These charges reduced our gross margin in the third quarter of 2006 by approximately 2 percentage points.

We expect that sales of our higher gross margin products will continue to increase as a proportion of total product revenues, but be offset slightly by relatively lower gross margin generated from sales of Radionics and Miltex products. Also, we now invoice hospital customers directly for sales of JARIT instruments rather than distributors. This has resulted in increased product revenues as a result of higher selling prices, a higher gross margin, and also increased selling expenses from commissions paid to distributors.

### Other Operating Expenses

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

	Three Months Ended	
	September 30,	
	2006	2005
	----	----
Research and development .....	9%	4%
Selling, general and administrative .....	37%	33%
Intangible asset amortization .....	2%	2%
Total other operating expenses .....	49%	39%

Total other operating expenses, which consist of research and development expense, selling, general and administrative expense and amortization expense, increased \$30.4 million, or 113%, to \$57.3 million in the third quarter of 2006, compared to \$26.8 million in the third quarter of 2005. The increase is partially related to a \$5.6 million in-process research and development charge related to the acquisition of KMI, a \$3.7 million stock-based compensation expense associated with the adoption of Statement 123(R) (the majority of which is included in selling, general and administrative expense) and higher commission expenses associated with the JARIT direct bill initiative. Expenses also increased because of the continued expansion of our direct sales and marketing organizations in our direct selling platforms and increased corporate staff to support the recent growth in our business and to integrate acquired businesses. The recently acquired Radionics, Miltex, KMI and our former Canadian distributor businesses contributed approximately \$8.9 million in other operating expenses in the third quarter 2006.

Research and development expenses in the third quarter of 2006 increased by \$7.9 million compared to the prior-year period. Included in research and development costs were a \$5.6 million in-process research and development charge related to the KMI acquisition, a \$0.5 million charge related to an upfront payment pursuant to a new product development alliance and \$168,000 of stock-based compensation expenses associated with the adoption of Statement 123(R). In connection with our acquisition of Radionics and KMI, research and development expenses increased by \$1.1 million in the third quarter ended September 30, 2006. There was also an overall increase of \$1.5 million associated with product development initiatives compared to the prior-year period. Our research and development efforts in 2006 are expected to be focused on clinical activities directed towards expanding the indications for use of our absorbable implant technology products, including a multi-center clinical trial suitable to support an application to the FDA for approval of the DuraGen Plus(TM) Adhesion Barrier Matrix product, and development of a next-generation ultrasonic aspirator system.

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Selling, general and administrative expenses increased \$20.8 million, or 92%, as compared to the prior-year period to \$43.4 million. The increase in selling, general and administrative expenses includes \$3.5 million of stock-based compensation expense associated with the adoption of Statement 123(R) and higher commission expenses associated with the JARIT direct bill initiative. Selling, general and administrative costs also increased in the third quarter of 2006 in connection with the recently acquired Radionics, Miltex and KMI businesses. We also continued to expand our direct sales and marketing organizations in our direct selling platforms and increased corporate staff to support the recent growth in our business and to integrate acquired businesses. Additionally, we have incurred higher operating costs in connection with our recent investments in our infrastructure, including the continued implementation of an enterprise business system and the relocation and expansion of our domestic and international distribution capabilities through third-party service providers. We expect that we will continue to incur costs related to these activities during the remainder of 2006 and 2007 as we complete these ongoing activities.

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Amortization expense increased in the third quarter of 2006 as a result of amortization of intangible assets from acquisitions completed in 2006.

### Non-Operating Income and Expenses

Interest expense primarily relates to the \$120 million of 2 1/2% contingent convertible subordinated notes that we have outstanding and a related interest rate swap agreement, which was terminated on September 27, 2006 and interest on the used and unused portion of the \$200 million senior secured credit facility that we established in December 2005. The increase in interest expense in the third quarter of 2006 is primarily related to the write-off of unamortized debt issuance costs related to the old notes and interest associated with the credit facility that was established in December 2005. In the third quarter of 2006, we made net additional borrowings of \$23 million under our credit facility.

On September 27, 2006, the Company exchanged \$115.2 million (out of a total of \$120.0 million) of its old contingent convertible notes for the equivalent amount of new notes. See Note 12 to the unaudited condensed consolidated financial statements for a further discussion. In connection with the exchange of our convertible notes, the Company recorded a \$1.2 million write-off of the unamortized debt issuance costs and \$0.3 million of fees associated with the old contingent convertible notes that were exchanged. Our reported interest expense for the three-month period ended September 30, 2005 included \$204,000 of non-cash amortization of debt issuance costs.

We will pay additional interest on our convertible notes under certain conditions. The fair value of this contingent interest obligation is marked to its fair value at each balance sheet date, with changes in the fair value recorded to interest expense. In the third quarter of 2006, the change in the estimated fair value of the contingent interest obligation increased interest expense by \$104,000. In the third quarter of 2005, the fair value increased by \$300,000.

On September 27, 2006, we terminated an interest rate swap agreement with a \$50 million notional amount to hedge the risk of changes in fair value attributable to interest rate risk with respect to a portion of our fixed rate convertible notes. The interest rate swap agreement qualified as a fair value hedge under SFAS No. 133, as amended "Accounting for Derivative Instruments and Hedging Activities". The net amount to be paid or received under the interest rate swap agreement was recorded as a component of interest expense. Interest expense associated with the interest rate swap for the three months ended September 30,

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2006 and 2005 was \$345,000 and \$100,000, respectively.

The Company paid the counterparty approximately \$2.2 million in connection with the termination of the swap, consisting of a \$0.6 million payment of accrued interest and a \$1.6 million payment representing the fair market value of the interest rate swap on the termination date. The termination payment was already accrued by the Company. During the three months ended September 30, 2005, the net fair value of the interest rate swap increased \$500,000 to \$2.0 million, and the carrying value of our convertible notes decreased by \$512,000. The net difference between changes in the fair value of the interest rate swap and the contingent convertible notes represents the ineffective portion of the hedging relationship, and this amount is recorded in other income/(expense), net.

Our income tax expense was \$3.5 million and \$5.2 million for the three-month periods ended September 30, 2006 and 2005, respectively. The overall effective tax rate for the three months ended September 30, 2006 and 2005 was 57.2% and 33.2 %, respectively. The third quarter of 2006 included a \$5.6 million in-process research and development charge related to the KMI acquisition which is not deductible for tax purposes. The effective tax rate for the third quarter of 2006 would have been 29.7% without this charge. The decrease in the effective income tax rate in 2006 was primarily due to a continued favorable impact of various planning and reorganization initiatives, a change in the geographic mix of earnings and losses and our realization of additional deductions related to qualified production activities income provided for under the American Jobs Creation Act of 2004.

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In 2006, we have used all of our remaining unrestricted and current year allowable acquired net operating loss carryforwards to offset 2006 taxable income. At September 30, 2006, several of our subsidiaries had unused net operating loss carryforwards arising from periods prior to our ownership which expire through 2010. The Internal Revenue Code limits the timing and manner in which we may use any acquired net operating losses.

Our effective tax rate may vary from period to period depending on, among other factors, the geographic and business mix of taxable earnings and losses. We consider these factors and others, including our history of generating taxable earnings, in assessing our ability to realized deferred tax assets.

NINE MONTHS ENDED SEPTEMBER 30, 2006 AS COMPARED TO THE NINE MONTHS ENDED SEPTEMBER 30, 2005

### Revenues and Gross Margin

For the nine months ended September 30, 2006, total revenues increased 43% over the prior-year period to \$293.9 million. Domestic revenues increased \$67.8 million to \$220.4 million, or 75% of total revenues, as compared to 74% of revenues in the nine months ended September 30, 2005.

In the Neurosurgical and Orthopedic Implants category, sales of our Reconstructive Surgery implant products continued to grow strongly. Rapid growth in the NeuraGen(TM) Nerve Guide, the INTEGRA(TM) dermal repair products and sales of products for the hand, foot and ankle accounted for much of the increase in implant product revenues. INTEGRA(TM) dermal repair product revenues increased approximately 33% over the nine months of 2005, nerve repair product revenues increased by 40%, and our Newdeal(TM) foot and ankle products increased approximately 37%.

Sales of Reconstructive Surgery products continued their fast growth, while our



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Neurosurgery products, including the DuraGen(R) family of duraplasty products continued to grow modestly. Increased revenues of the Absorbable Collagen Sponge that we supply for use in Medtronic's INFUSE(TM) bone graft product and of the dental products we supply to Zimmer also contributed to the growth in implant revenues.

In the Medical Surgical Equipment category, increased sales of our JARIT(R) surgical instrument lines and sales of the recently acquired Radionics and Miltex products provided the year-over-year growth in equipment product revenues for the nine months. Sales of Radionics and Miltex products contributed \$59.5 million in the nine months ended September 2006.

In 2006, we revised our presentation of cost of product revenues to include amortization of product technology-based intangible assets. Previously, this amortization was included in intangible asset amortization in the condensed consolidated statement of operations. We have revised prior period amounts to conform to the current year's presentation. This revision increased cost of product revenues by \$1.8 million and \$1.1 million for the nine-month periods ended September 30, 2006 and 2005, respectively.

Gross margin on total revenues in the nine months of 2006 was 60.2%. Although we had strong sales growth in many higher gross margin products, we recognized \$4.0 million in inventory fair value purchase accounting adjustments from acquisitions as the products were sold and \$1.3 million in restructuring and manufacturing transfer and systems integration costs. These charges reduced our gross margin by approximately 2%. We recognized the impact of \$466,000 of inventory fair value purchase accounting adjustments in the nine months of 2005. Additionally, in the second quarter of 2006 we recorded a \$1.2 million impairment charge to cost of product revenues against a range of electrosurgical generators and accessories sold exclusively in Europe following a review of on-hand inventory quantities of those products in relation to expected demand for that product line.

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### Other Operating Expenses

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

	Nine Months Ended September 30,	
	2006	2005
	----	----
Research and development .....	7%	5%
Selling, general and administrative .....	38%	35%
Intangible asset amortization.....	2%	2%
Total other operating expenses.....	47%	42%

Total other operating expenses, which consist of research and development expense, selling, general and administrative expense and amortization expense, increased \$53.1 million, or 62%, to \$138.4 million in the nine months of 2006, compared to \$85.3 million in the nine months of 2005. The increase includes \$10.1 million of stock-based compensation expense associated with the adoption of Statement 123(R) (the majority of which is included in selling, general and administrative expense). Businesses we acquired in 2006 contributed approximately \$15.0 million of other operating expenses for the nine-month

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period ended September 30, 2006.

Research and development expenses increased \$11.3 million in the nine months of 2006 and included a \$5.6 million in-process research and charge associated with the KMI acquisition, \$452,000 of stock-based compensation expenses associated with the adoption of Statement 123(R), \$2.3 million of research and development activities from the recently acquired Radionics and KMI businesses, a \$1.6 million charge related to the discontinued ultrasonic aspirator development project and a \$0.5 million charge related to an upfront payment pursuant to a new product development alliance.

Selling, general and administrative expenses increased \$39.2 million, or 54%, as compared to the prior-year period to \$111.8 million. This increase is primarily related to a \$9.6 million stock-based compensation expense associated with the adoption of Statement 123(R), higher commission costs associated with the Jarit distributor network, and operating costs associated with the recently acquired Radionics and Miltex businesses. Additionally, we have incurred higher operating costs in connection with our recent investments in our infrastructure, including the continued implementation of an enterprise business system, the relocation and expansion of our domestic and international distribution capabilities through third-party service providers, the continued expansion of our direct sales and marketing organizations in our direct selling platforms and increased corporate staff to support the recent growth in our business and to integrate acquired businesses also contributed to the increase. We expect that we will continue to incur costs related to these activities during the remainder of 2006 and 2007 as we complete these ongoing activities.

Amortization expense increased by approximately \$2.7 million in the nine months of 2006 as a result of amortization of intangible assets from the acquisitions completed in 2006.

### Non-Operating Income and Expenses

The increase in interest expense in the nine months of 2006 is primarily related to an increase in the variable rate that we paid on our \$50 million interest rate swap, which was terminated on September 27, 2006, the write-off of unamortized debt issuance costs related to the old contingent convertible notes and interest on the used and unused portion of the \$200 million senior credit facility that was established in December 2005. In the nine months ended September 30, 2006, we made net borrowings of \$87 million under our credit facility.

On September 27, 2006, the Company exchanged \$115.2 million (out of a total of \$120.0 million) of its old contingent convertible notes for the equivalent amount of new notes. See Note 12 to the unaudited condensed consolidated financial statements for a further discussion. In connection with the exchange of our convertible notes, the Company recorded a \$1.2 million write-off of the unamortized debt issuance costs and \$0.3 million of fees associated with the old contingent convertible notes that were exchanged. Our reported interest expense for the nine-month periods ended September 30, 2006 and 2005 included \$599,000 and \$611,000, respectively, of non-cash amortization of debt issuance costs.

We will pay additional interest on our convertible notes under certain conditions. The fair value of this contingent interest obligation is marked to its fair value at each balance sheet date, with changes in the fair value recorded to interest expense. Changes in the estimated fair value of the contingent interest obligation increased interest expense by \$271,000 and \$78,000 for the nine months ended September 30, 2006 and 2005, respectively.

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On September 27, 2006, we terminated an interest rate swap agreement with a \$50 million notional amount to hedge the risk of changes in fair value attributable to interest rate risk with respect to a portion of our fixed rate convertible notes. The net amount to be paid or received under the interest rate swap agreement was recorded as a component of interest expense. Interest expense associated with the interest rate swap for the nine months ended September 30, 2006 was \$827,000. Interest expense for the nine months ended September 30, 2005 included an insignificant benefit associated with the interest rate swap.

The Company paid the counterparty approximately \$2.2 million in connection with the termination of the swap, consisting of a \$0.6 million payment of accrued interest and a \$1.6 million payment representing the fair market value of the interest rate swap on the termination date. The termination payment was already accrued by the Company. During the nine months ended September 30, 2005, the net fair value of the interest rate swap increased \$0.6 million to \$2.0 million, and this amount was included in other liabilities. The net difference between changes in the fair value of the interest rate swap and the contingent convertible notes represents the ineffective portion of the hedging relationship, and this amount is recorded in other income (expense), net.

Our income tax expense was \$11.4 million and \$13.7 million for the nine-month periods ended September 30, 2006 and 2005, respectively. The overall effective tax rate for the nine months ended September 30, 2006 and 2005 was 37.1% and 34.0%, respectively. The third quarter of 2006 included a \$5.6 million in-process research and development charge which is not deductible for tax purposes. The effective tax rate for the nine months of 2006 would have been 31.4% without this charge. The decrease in the effective income tax rate in 2006 was primarily due to a continued favorable impact of various planning and reorganization initiatives, a change in the geographic mix of earnings and losses and our realization of additional deductions related to qualified production activities income provided for under the American Jobs Creation Act of 2004.

### INTERNATIONAL PRODUCT REVENUES AND OPERATIONS

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

	United States -----	Europe -----	Asia Pacific -----
Three months ended September 30, 2006.....	\$ 88,740	\$ 21,165	\$ 2,815
Three months ended September 30, 2005.....	53,504	10,443	2,662
Nine months ended September 30, 2006.....	220,393	56,884	8,809
Nine months ended September 30, 2005.....	152,623	36,187	8,443

For the three months ended September 30, 2006, revenues from customers outside the United States totaled \$27.9 million, or 24% of total revenues, of which approximately 82% were to European customers. Revenues from customers outside the United States included \$22.3 million of revenues generated in foreign currencies.

In the three months ending September 30, 2005, revenues from customers outside the United States totaled \$15.8 million, or 23% of total revenues, of which approximately 66% were from European customers. Revenues from customers outside the United States included \$12.0 million of revenues generated in foreign currencies.

For the nine months ended September 30, 2006, revenues from customers outside the United States totaled \$73.5 million, or 25% of total revenues, of which approximately 77% were to European customers. Revenues from customers outside the United States included \$52.9 million of revenues generated in foreign currencies.

In the nine months ending September 30, 2005, revenues from customers outside the United States totaled \$52.3 million, or 26% of total revenues, of which approximately 69% were from European customers. Revenues from customers outside the United States included \$41.0 million of revenues generated in foreign currencies.

Because we have operations based in Europe and we generate revenues and incur operating expenses in Euros and British pounds, we experience currency exchange risk with respect to those foreign currency denominated revenues or expenses. We currently do not hedge our exposure to foreign currency risk. We will continue to assess the potential effects that changes in foreign currency exchange rates could have on our business. If we believe this potential impact presents a significant risk to our business, we may enter into derivative financial instruments to mitigate this risk.

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

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

Relationships with customers and effective terms of sale frequently vary by country, often with longer-term receivables than are typical in the United States.

#### LIQUIDITY AND CAPITAL RESOURCES

##### Cash and Marketable Securities

At September 30, 2006, we had cash and cash equivalents totaling approximately \$24.3 million. In the third quarter of 2006, we liquidated the remaining \$16.7 million of our current and non-current investments.

##### Cash Flows

Cash provided by operations has recently been and is expected to continue to be our primary means of funding existing operations and capital expenditures. We have generated positive operating cash flows on an annual basis, including \$56.8 million for the year ended December 31, 2005 and \$50.8 million for the nine months ended September 30, 2006. Operating cash flows for the nine months ended September 30, 2005 were \$41.9 million. Overall, operating cash flows in the nine months ended of 2006 were negatively affected by subsequent investments in working capital made in connection with the Radionics acquisition.

Our principal uses of funds during the nine-month period ended September 30, 2006 were \$227.1 million for acquisition consideration, \$31.8 million paid for

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the purchase of 857,650 shares of our common stock and \$7.2 million in capital expenditures. We received \$96.8 million in cash from sales and maturities of available for sale securities, net of purchases. In addition to the \$50.4 million in operating cash flows for the nine months ended September 30, 2006, we received \$9.2 million from the issuance of common stock through the exercise of stock options during the period and \$87.0 million from borrowings under our credit facility.

### Working Capital

At September 30, 2006 we have a negative working capital of \$36.3 million compared to a positive working capital on December 31, 2005 of \$234.7 million. The decrease in working capital is primarily related to the use of \$227.1 million for acquisition consideration in the first nine months of 2006. Also

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contributing to this decrease is the reclassification of \$115.2 million of contingent convertible notes to current liabilities. Such classification is made since the closing price of the Company's stock on the issuance date of the new notes was higher than the market price trigger of the new notes, the holders have the option to convert their notes into cash, and if applicable, shares of our common stock at any time.

### Convertible Debt and Related Hedging Activities

On September 27, 2006, we concluded an offer to exchange up to \$120 million principal amount of new notes with a "net share settlement" mechanism for our currently outstanding contingent convertible subordinated notes. As of that date, an aggregate principal amount of \$115,205,000 of old notes was tendered. See Note 12 to the unaudited condensed consolidated financial statements for a further discussion. Also on September 27, 2006, we terminated our interest rate swap agreement with a \$50 million notional amount to hedge the risk of changes in fair value attributable to interest rate risk with respect to a portion of the notes. See "Results of Operations - Non-Operating Income and Expenses" for a further discussion.

We pay interest on both our old and new contingent convertible subordinated notes at an annual rate of 2 1/2% each September 15 and March 15. We will also pay contingent interest on the notes if, at thirty days prior to maturity, our common stock price is equal to or greater than \$37.56. The contingent interest will be payable at maturity for each of the last three years the notes remain outstanding in an amount equal to the greater of (1) 0.50% of the face amount of the notes and (2) the amount of regular cash dividends paid during each such year on the number of shares of common stock into which each note is convertible. Holders of the old notes may convert the notes into shares of our common stock under certain circumstances, including when the market price of our common stock on the previous trading day is equal to or greater than \$37.56 per share, based on an initial conversion price of \$34.15 per share. Holders of the new notes may convert their notes into cash, and if applicable, shares of our common stock under certain circumstances, including when the market price of our common stock on the previous trading day is equal to or greater than \$37.56 per share. Between September 27 and September 30, 2006, our stock price exceeded \$37.56 and no convertible notes have been converted to cash or common stock.

The notes are general, unsecured obligations of the Company and are subordinate to any senior indebtedness. We cannot redeem the notes prior to their maturity, and the notes' holders may compel us to repurchase the notes upon a change of control. There are no financial covenants associated with the convertible notes.

### Share Repurchase Plan

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In February 2006, our Board of Directors authorized us to repurchase shares of our common stock for an aggregate purchase price not to exceed \$50 million through December 31, 2006 and terminated our prior repurchase program. Shares may be purchased either in the open market or in privately negotiated transactions.

The Company purchased 456,750 and 400,900 shares of our common stock for a total purchase price of approximately \$16.7 million and \$15.1 million during the three months ended September 30, 2006 and June 30, 2006, respectively under this repurchase program. No purchases were made under this program during the first quarter of 2006.

In October 2006, our Board of Directors terminated the repurchase program approved in February 2006 and adopted a new program that authorizes us to repurchase shares of our common stock for an aggregate purchase price not to exceed \$75 million through December 31, 2007. Shares may be repurchased either in the open market or in privately negotiated transactions.

### Dividend Policy

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

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### Requirements and Capital Resources

In December 2005, we established a \$200 million, five-year, senior secured revolving credit facility. The credit facility currently allows for revolving credit borrowings in a principal amount of up to \$200 million, which can be increased to \$250 million should additional financing be required in the future. We plan to utilize the credit facility for working capital, capital expenditures, share repurchases, acquisitions and other general corporate purposes. We have borrowed against this credit facility in 2006 for acquisition related purposes. As of September 30, 2006, we had \$87 million of outstanding borrowings under our credit facility, and the weighted average interest rate for this borrowing was 6.58% per annum.

The indebtedness under the credit facility is guaranteed by all but one of our domestic subsidiaries. The Company's obligations under the credit facility and the guarantees of the guarantors are secured by a first-priority security interest in all present and future capital stock of (or other ownership or profit interest in) each guarantor and substantially all of the Company's and the guarantors' other assets, other than real estate, intellectual property and capital stock of foreign subsidiaries.

Borrowings under the credit facility bear interest, at our option, at a rate equal to (i) the Eurodollar Rate in effect from time to time plus an applicable rate (ranging from 0.75% to 1.5%) or (ii) the higher of (x) the weighted average overnight Federal funds rate, as published by the Federal Reserve Bank of New York, plus 0.5%, and (y) the prime commercial lending rate of Bank of America, N.A. plus an applicable rate (ranging from 0% to 0.5%). The applicable rates are based on a financial ratio at the time of the applicable borrowing.

We will also pay an annual commitment fee (ranging from 0.15% to 0.25%) on the daily amount by which the commitments under the credit facility exceed the

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outstanding loans and letters of credit under the credit facility.

The credit facility requires us to maintain various financial covenants, including leverage ratios, a minimum fixed charge coverage ratio and a minimum liquidity ratio. The credit facility also contains customary affirmative and negative covenants, including those that limit the Company's and its subsidiaries' ability to incur additional debt, incur liens, make investments, enter into mergers and acquisitions, liquidate or dissolve, sell or dispose of assets, repurchase stock and pay dividends, engage in transactions with affiliates, engage in certain lines of business and enter into sale and leaseback transactions. As of September 30, 2006, we were in compliance with all of our debt covenants.

### Contractual Obligations and Commitments

Under certain agreements, we are required to make payments based on sales levels of certain products or if specific development milestones are achieved.

### 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, 2005 have not materially changed other than as set forth below.

#### Recently Adopted Accounting Standard

We adopted Statement of Financial Accounting Standards No. 123(R) "Share-Based Payment" on January 1, 2006 using the modified prospective method which requires companies (1) to record the unvested portion of previously issued awards that remain outstanding at the initial date of adoption and (2) to record compensation expense for any awards issued, modified or settled after the effective date of the statement. As a result of the adoption of Statement 123(R), we began expensing stock options in the first quarter of 2006 using the fair value method prescribed by Statement 123(R). Stock-based compensation cost is measured at the grant date based on the fair value of an award and is recognized on a straight-line basis as an expense over the requisite service

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period, which is the vesting period. Certain of these costs are capitalized into inventory and will be recognized as an expense when the related inventory is sold. Our income before income taxes and net income for the nine months ended September 30, 2006 were \$10.3 million and \$7.0 million lower, respectively, than if we had continued to account for share-based compensation under APB No. 25.

We recognize stock-based compensation expense in the consolidated statement of operations based on the awards that are expected to vest. Accordingly, we have adjusted stock-based compensation expense to reflect estimated forfeitures. Statement 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. We estimate forfeitures based on historical experience.

Statement 123(R) supercedes our previous accounting under Accounting Principals Boards Opinion No. 25 "Accounting for Stock Issued to Employees" for periods subsequent to December 31, 2005. In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107, which provides interpretive guidance in applying the provisions of Statement 123(R). We have applied the provisions of SAB 107 in our adoption of Statement 123(R).

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Our condensed consolidated statement of operations for the nine months ended September 30, 2006, includes compensation expense related to (i) stock-based awards granted prior to, but not fully vested as of, January 1, 2006, based on grant date fair values estimated in accordance with the pro forma provisions of Statement of Financial Accounting Standards Statement No 123 "Accounting for Stock-Based Compensation", and (ii) stock-based awards granted in 2006, based on grant-date fair values estimated in accordance with Statement 123(R).

We calculate the fair value of our restricted stock awards and restricted stock unit awards based on the closing market price of our common stock on the date of the grant. We calculated the fair value of options granted prior to October 1, 2004 using the Black-Scholes model, while we calculate the fair value of options granted on or after October 1, 2004 using the binomial distribution model. These models include assumptions regarding the expected term of our option awards, expected future volatility in the market price of our common stock, future risk-free interest rates, and future dividends, if any, on our common stock. We believe that the binomial distribution model is better than the Black-Scholes model because the binomial distribution model is a more flexible model that considers the impact of non-transferability, vesting and forfeiture provisions in the valuation of employee stock options.

The assumptions used in calculating the fair value of stock-based compensation awards involve inherent uncertainties and the application of management judgment. If factors were to change, and we used different assumptions, depending on the level of our future stock-based awards, our stock-based compensation expense in the future could be materially different from that reported for the nine months ended September 30, 2006 or pro forma amounts reported for periods prior to January 1, 2006. In addition, if our actual forfeiture rate varies significantly from our current estimate, the amount of stock-based compensation expense recognized in future periods will be affected.

### Recently Issued Accounting Standards

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 158, Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans--an amendment of FASB Statements No. 87, 88, 106 and 132(R) .. SFAS No. 158 requires the Company to (a) recognize a plan's funded status in its statement of financial position, (b) measure a plan's assets and its obligations that determine its funded status as of the end of the employer's fiscal year, and (c) recognize changes in the funded status of a defined postretirement plan in the year in which the changes occur through other comprehensive income. The requirement to recognize the funded status of a benefit plan and the disclosure requirements are effective for the Company for the fiscal year ending December 31, 2006. The Company does not believe the implementation of this provision will have a material impact on its financial position or results of operations.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. This Statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company is currently assessing the impact this provision may have on its financial position or results of operations.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements (SAB 108), to address diversity in practice in



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quantifying financial statement misstatements. SAB 108 requires the quantification of misstatements based on their impact to both the balance sheet and the income statement to determine materiality. The guidance provides for a one-time cumulative effect adjustment to correct for misstatements for errors that were not deemed material under a company's prior approach but are material under the SAB 108 approach. SAB 108 is effective for the fiscal year ending December 31, 2006. The Company does not believe the implementation of this provision will have a material impact on its financial position or results of operations.

In July 2006, the FASB issued FASB Interpretation 48, "Accounting for Uncertainty in Income Taxes - An Interpretation of FASB Statement No. 109" (FIN 48). FIN 48 clarifies the accounting for uncertainty in income tax recognition in a company's financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes, by defining the criterion that an individual tax position must meet in order to be recognized in the financial statements. FIN 48 requires that the tax effects of a position be recognized only if it is "more-likely-than-not" to be sustained based solely on the technical merits as of the reporting date. FIN 48 further requires that interest that the tax law requires to be paid on the underpayment of taxes should be accrued on the difference between the amount claimed or expected to be claimed on the return and the tax benefit recognized in the financial statements. FIN 48 also requires additional disclosures of unrecognized tax benefits, including a reconciliation of the beginning and ending balance. The provisions of FIN 48 are effective January 1, 2007. The Company is currently assessing the impact that the adoption of FIN 48 will have on its financial position or results of operations.

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

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

#### Foreign Currency Exchange Rate Risk

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

#### Interest Rate Risk - Marketable Securities

We are exposed to the risk of interest rate fluctuations on the fair value and interest income earned on our cash and cash equivalents and investments in available-for-sale marketable debt securities. A hypothetical 100 basis point movement in interest rates applicable to our cash and cash equivalents and investments in marketable debt securities outstanding at September 30, 2006 would increase or decrease interest income by approximately \$243,000 on an annual basis. We are not subject to material foreign currency exchange risk with respect to these investments.

#### Interest Rate Risk - Senior Secured Credit Facility

We are exposed to the risk of interest rate fluctuations on the interest paid under the terms of our senior secured credit facility. A hypothetical 100 basis

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point movement in interest rates applicable to this credit facility would increase or decrease interest expense by approximately \$870,000 on an annual basis.

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### ITEM 4. CONTROLS AND PROCEDURES

#### Evaluation of Disclosure Controls and Procedures

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

As required by Rule 13a-15(b) under the Exchange Act, 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 the end of the period covered by this report. Based on the foregoing, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

#### Changes in Internal Control over Financial Reporting

No changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the quarter ended September 30, 2006, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

On March 3, 2006 and May 12, 2006 the Company completed the purchases of Radionics and Miltex, respectively, and is in the process of integrating the operations and related controls of both businesses within the Company. On July 5, 2006 and July 31, 2006 the Company completed the purchases of Canada Microsurgical Ltd. And Kinetikos Medical, Inc., respectively, and is in the process of integrating the operations and related controls of these businesses within the Company. See Note 2, "Business Acquisitions", to the unaudited interim condensed consolidated financial statements included in this Quarterly Report on Form 10-Q for a discussion of the acquisitions and related financial data.

Internal control over financial reporting cannot provide absolute assurance of achieving financial reporting objectives because of its inherent limitations. Internal control over financial reporting is a process that involves human diligence and compliance and is subject to lapses in judgment and breakdowns resulting from human failures. Internal control over financial reporting also can be circumvented by collusion or improper management override. Because of such limitations, there is a risk that material misstatements may not be prevented or detected on a timely basis by internal control over financial

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reporting. However, these inherent limitations are known features of the financial reporting process. Therefore, it is possible to design into the process safeguards to reduce, though not eliminate, this risk.

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### PART II. OTHER INFORMATION

#### ITEM 1. LEGAL PROCEEDINGS

Various lawsuits, claims and proceedings are pending or have been settled by the Company. The most significant of those are described below.

In May 2006, Codman & Shurtleff, Inc., a division of Johnson & Johnson, commenced an action in the United States District Court for the District of New Jersey for declaratory judgment against Integra LifeSciences Corporation with respect to United States Patent No. 5,997,895 (the "'895 Patent") held by Integra. Integra's patent covers dural repair technology related to Integra's Duragen(R) family of duraplasty products.

The action seeks declaratory relief that Codman's DURAFORM(TM) product does not infringe Integra's patent and that Integra's patent is invalid and unenforceable. Codman does not seek either damages from Integra or injunctive relief to prevent Integra from selling the Duragen(R) Dural Graft Matrix. Integra has filed a counterclaim against Codman, alleging that Codman's DURAFORM(TM) product infringes the '895 Patent, seeking injunctive relief preventing the sale and use of DURAFORM(TM), and seeking damages, including treble damages, for past infringement.

In July 1996, the Company sued Merck KGaA, a German corporation, seeking damages for patent infringement. The patents in question are part of a group of patents granted to The Burnham Institute and licensed by Integra that are based on the interaction between a family of cell surface proteins called integrins and the arginine-glycine-aspartic acid ("RGD") peptide sequence found in many extracellular matrix proteins.

The case has been tried, appealed and returned to the trial court. Most recently, in September 2004, the trial court ordered Merck KGaA to pay Integra \$6.4 million in damages. Merck KGaA filed a petition for a writ of certiorari with the United States Supreme Court seeking review of the Circuit Court's decision, and the Supreme Court granted the writ in January 2005.

On June 13, 2005, the Supreme Court vacated the June 2003 judgment of the Circuit Court. The Supreme Court held that the Circuit Court applied an erroneous interpretation of 35 U.S.C. ss.271(e)(1) when it rejected the challenge of Merck KGaA to the jury's finding that Merck KGaA failed to show that its activities were exempt from claims of patent infringement under that statute. On remand, the Circuit Court was to have reviewed the evidence under a reasonableness test that does not provide categorical exclusions of certain types of activities. The hearing before the Circuit Court occurred in June 2006, and a ruling is expected this year. Further enforcement of the trial court's order has been stayed. We have not recorded any gain in connection with this matter, pending final resolution and completion of the appeals process.

In addition to these matters, we are subject to various claims, lawsuits and proceedings in the ordinary course of its business, including claims by former employees, distributors and competitors and with respect to our products. In the opinion of management, such claims are either adequately covered by insurance or otherwise indemnified, or are not expected, individually or in the aggregate, to

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result in a material adverse effect on our financial condition. However, it is possible that our results of operations, financial position and cash flows in a particular period could be materially affected by these contingencies.

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### ITEM 1A. RISK FACTORS

The Risk Factors included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005 (as modified by the subsequent Quarterly Report on Form 10-Q) have not materially changed other than the modifications to the risks factors as set forth below.

Certain Of Our Products Contain Materials Derived From Animal Sources And May Become Subject To Additional Regulation.

Certain of our products, including our dermal regeneration products, our duraplasty products and our nerve repair products, contain material derived from bovine tissue. Products that contain materials derived from animal sources, including food as well as pharmaceuticals and medical devices, are increasingly subject to scrutiny in the press and by regulatory authorities. Regulatory authorities are concerned about the potential for the transmission of disease from animals to humans via those materials. This public scrutiny has been particularly acute in Japan and Western Europe with respect to products derived from animal sources, because of concern that materials infected with the agent that causes bovine spongiform encephalopathy, otherwise known as BSE or mad cow disease, may, if ingested or implanted, cause a variant of the human Creutzfeldt-Jakob Disease, an ultimately fatal disease with no known cure. Recent cases of BSE in cattle discovered in Canada and the United States have increased awareness of the issue in North America.

We take great care to provide that our products are safe and free of agents that can cause disease. In particular, the collagen used in the products that Integra manufactures is derived only from the deep flexor tendon of cattle less than 24 months old from New Zealand, a country that has never had a case of BSE, or the United States. The collagen used in a product that we sell, but do not manufacture, is derived from bovine pericardium. We are also qualifying sources of collagen from other countries that are considered BSE-free. The World Health Organization classifies different types of cattle tissue for relative risk of BSE transmission. Deep flexor tendon and bovine pericardium are in the lowest risk categories for BSE transmission (the same category as milk, for example), and are therefore considered to have a negligible risk of containing the agent that causes BSE (an improperly folded protein known as a prion). Nevertheless, products that contain materials derived from animals, including our products, may become subject to additional regulation, or even be banned in certain countries, because of concern over the potential for prion transmission. Significant new regulation, or a ban of our products, could have a material adverse effect on our current business or our ability to expand our business.

In addition, we have been notified that Japan has issued new regulations regarding medical devices that contain tissue of animal origin. Among other regulations, Japan requires that the tendon used in the manufacture of medical devices sold in Japan originate in a country that has never had a case of BSE. Currently, we purchase our tendon from the United States and New Zealand. We received approval in Japan for the use of New Zealand sourced tendon in the manufacturing of our products sold in Japan. If we cannot continue to use or qualify a source of tendon from New Zealand or another country that has never had a case of BSE, we will not be permitted to sell our collagen hemostatic agents and products for oral surgery in Japan. We do not currently sell our dural or skin repair products in Japan.

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Lack Of Market Acceptance For Our Products Or Market Preference For Technologies That Compete With Our Products Could Reduce Our Revenues And Profitability.

We cannot be certain that our current products or any other products that we may develop or market will achieve or maintain market acceptance. Certain of the medical indications that can be treated by our devices can also be treated by other medical devices or by medical practices that do not include a device. The medical community widely accepts many alternative treatments, and certain of these other treatments have a long history of use. For example, the use of autograft tissue is a well-established means for repairing the dermis, and it competes for acceptance in the market with the INTEGRA(R) Dermal Regeneration Template. In addition, we face similar competition for acceptance of our Newdeal and Kinetikos Medical products, which previously were distributed by third parties.

We cannot be certain that our devices and procedures will be able to replace those established treatments or that either physicians or the medical community in general will accept and utilize our devices or any other medical products that we may develop.

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In addition, our future success depends, in part, on our ability to develop additional products. Even if we determine that a product candidate has medical benefits, the cost of commercializing that product candidate may be too high to justify development. Competitors may develop products that are more effective, achieve more favorable reimbursement status from third-party payors, cost less or are ready for commercial introduction before our products. If we are unable to develop additional commercially viable products, our future prospects could be adversely affected.

Market acceptance of our products depends on many factors, including our ability to convince prospective collaborators and customers that our technology is an attractive alternative to other technologies, to manufacture products in sufficient quantities and at acceptable costs, and to supply and service sufficient quantities of our products directly or through our distribution alliances. In addition, unfavorable reimbursement methodologies or determinations of third-party payors could harm acceptance or continued use of our products. The industry is subject to rapid and continuous change arising from, among other things, consolidation and technological improvements. One or more of these factors may vary unpredictably, which could have a material adverse effect on our competitive position. We may not be able to adjust our contemplated plan of development to meet changing market demands.

We Are Exposed To A Variety Of Risks Relating To Our International Sales And Operations, Including Fluctuations In Exchange Rates, Local Economic Conditions And Delays In Collection Of Accounts Receivable.

We generate significant revenues outside the United States in Euros, British pounds and in U.S. dollar-denominated transactions conducted with customers who generate revenue in currencies other than the U.S. dollar. For those foreign customers who purchase our products in U.S. dollars, currency fluctuations between the U.S. dollar and the currencies in which those customers do business may have an impact on the demand for our products in foreign countries where the U.S. dollar has increased in value compared to the local currency.

Because we have operations based in Europe and we generate revenues and incur operating expenses in Euros and British pounds, we experience currency exchange risk with respect to those foreign currency-denominated revenues and expenses. We also experience currency exchange risk with respect to the yen.

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Currently, we do not use derivative financial instruments to manage operating foreign currency risk. As the volume of our business transacted in foreign currencies increases, we expect to continue to assess the potential effects that changes in foreign currency exchange rates could have on our business. If we believe that this potential impact presents a significant risk to our business, we may enter into derivative financial instruments to mitigate this risk.

In general, we cannot predict the consolidated effects of exchange rate fluctuations upon our future operating results because of the number of currencies involved, the variability of currency exposure and the potential volatility of currency exchange rates.

Our international operations subject us to customs and import-export laws. These laws restrict, and in some cases prohibit, United States companies from directly or indirectly selling goods, technology or services to people or entities in certain countries. These laws also prohibit transactions with certain designated persons.

Our sales to foreign markets also may be affected by local economic conditions, legal, regulatory or political considerations, the effectiveness of our sales representatives and distributors, local competition and changes in local medical practice. Relationships with customers and effective terms of sale frequently vary by country, often with longer-term receivables than are typical in the United States.

Our Current Strategy Involves Growth Through Acquisitions, Which Requires Us To Incur Substantial Costs And Potential Liabilities For Which We May Never Realize The Anticipated Benefits.

In addition to internal growth, our current strategy involves growth through acquisitions. Since 1999, we have acquired 24 businesses or product lines at a total cost of approximately \$335 million.

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We may be unable to continue to implement our growth strategy, and our strategy ultimately may be unsuccessful. A significant portion of our growth in revenues has resulted from, and is expected to continue to result from, the acquisition of businesses complementary to our own. We engage in evaluations of potential acquisitions and are in various stages of discussion regarding possible acquisitions, certain of which, if consummated, could be significant to us. Any new acquisition can result in material transaction expenses, increased interest and amortization expense, increased depreciation expense and increased operating expense, any of which could have a material adverse effect on our operating results. Certain businesses that we acquire may not have adequate financial, regulatory or quality controls at the time we acquire them. As we grow by acquisition, we must integrate and manage the new businesses to bring them into our systems for financial, regulatory and quality control, realize economies of scale, and control costs. In addition, acquisitions involve other risks, including diversion of management resources otherwise available for ongoing development of our business and risks associated with entering new markets with which our marketing and sales force has limited experience or where experienced distribution alliances are not available. Our future profitability will depend in part upon our ability to develop further our resources to adapt to these new products or business areas and to identify and enter into satisfactory distribution networks. We may not be able to identify suitable acquisition candidates in the future, obtain acceptable financing or consummate any future acquisitions. If we cannot integrate acquired operations, manage the cost of providing our products or price our products appropriately, our profitability could suffer. In addition, as a result of our acquisitions of other healthcare

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businesses, we may be subject to the risk of unanticipated business uncertainties, regulatory matters or legal liabilities relating to those acquired businesses for which the sellers of the acquired businesses may not indemnify us.

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

In February 2006, our Board of Directors authorized us to repurchase shares of our common stock for an aggregate purchase price not to exceed \$50 million through December 31, 2006. Shares may be purchased either in the open market or in privately negotiated transactions.

The following table summarizes our repurchases of our common stock during the quarter ended September 30, 2006 under this program:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Share Purchased Part of Publicly Announce Program
-----	-----	-----	-----
July 1, 2006 - July 31, 2006	55,300	\$ 37.93	55,300
August 1, 2006 - August 31, 2006	401,450	36.26	401,450
September 1, 2006 - September 30, 2006	--	--	--
	-----		-----
Total	456,750	\$ 36.46	456,750
	=====		=====

In October 2006, our Board of Directors terminated the repurchase program approved in February 2006 and adopted a new program that authorizes us to repurchase shares of our common stock for an aggregate purchase price not to exceed \$75 million through December 31, 2007. Shares may be repurchased either in the open market or in privately negotiated transactions.

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### ITEM 6. EXHIBITS

- 4.1 Indenture, dated as of September 29, 2006, between Integra LifeSciences Holdings Corporation and Wells Fargo Bank, N.A. (Incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K filed on October 5, 2006)
  
- 4.2 Form of 2 1/2% Contingent Convertible Subordinated Note due 2008 (Incorporated by reference to Exhibit 4.2 to the Company's Current Report on Form 8-K filed on October 5, 2006)

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- 10.1 Integra LifeSciences Holdings Corporation Management Incentive Compensation Plan.
- 10.2 Fourth Amendment to Sublease, dated as of August 15, 2006, by and between Sorrento Montana, L.P. and Integra LifeSciences Corporation (Incorporated by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on August 17, 2006).
- 10.3 Lease Contract, dated April 1, 2005, between the Puerto Rico Industrial Development Company and Integra CI, Inc. (executed on September 15, 2006)
- 31.1 Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of Principal Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of Principal Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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SIGNATURES

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

INTEGRA LIFESCIENCES HOLDINGS CORPORATION

Date: November 9, 2006 /s/ Stuart M. Essig  
-----  
Stuart M. Essig  
President and Chief Executive Officer

Date: November 9, 2006 /s/ Maureen B. Bellantoni  
-----  
Maureen B. Bellantoni  
Executive Vice President and Chief  
Financial Officer

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Exhibits

- 4.1 Indenture, dated as of September 29, 2006, between Integra LifeSciences Holdings Corporation and Wells Fargo Bank, N.A. (Incorporated by reference to Exhibit 4.1 to the Company's Current



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Report on Form 8-K filed on October 5, 2006)

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