

Edgar Filing: GREATBATCH, INC. - Form 10-Q/A

GREATBATCH, INC.
Form 10-Q/A
December 16, 2005

U.S. SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q/A

(Amendment No. 1)

QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934
For the Quarter ended July 1, 2005

Commission File Number 1-16137

GREATBATCH, INC.
(Exact name of Registrant as specified in its charter)

Delaware
(State of incorporation)

16-1531026
(I.R.S. employer identification no.)

9645 Wehrle Drive
Clarence, New York
14031
(Address of principal executive offices)

(716) 759-5600
(Registrant's telephone number, including area code)

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 [X] No []

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes [X] No []

The number of shares outstanding of the Company's common stock, \$.001 par value per share, as of August 5, 2005 was: 21,613,552 shares.

EXPLANATORY NOTE

Greatbatch, Inc. (the "Company") is filing this Amendment No. 1 on Form 10-Q/A to amend its Form 10-Q for the three months ended June 30, 2005 as filed with the Securities and Exchange Commission on August 10, 2005 (the "Original Filing") to (i) revise Part I, Item 1, Item 2, and Item 4, and Part II, Item 6 to reflect the restatement of its condensed consolidated balance sheet and condensed consolidated statement of cash flows to correct the classification of auction rate securities which were previously classified as cash and cash equivalents, to restate its consolidated statements of cash flows for the impact

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of changes in accounts payable related to the acquisition of property, plant and equipment, and to account for a deferred tax asset related to net operating losses acquired in the Company's acquisition of NanoGram Devices Corporation in 2004, and (ii) present revised exhibits 31.1, 31.2 and 32.1.

Except for the amendments set forth in this Amendment No. 1, the Original Filing is not being modified or amended in any way, and the disclosures contained in the Original Filing are not being updated herein.

GREATBATCH, INC.
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AS OF AND FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2005

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PART I - FINANCIAL INFORMATION
ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

GREATBATCH, INC.
CONDENSED CONSOLIDATED BALANCE SHEET - Unaudited
(IN THOUSANDS)

| | June 30, 2005 (1) | December 31, 2004 (1) |
|---------------------------|----------------------|--------------------------|
| ----- | | |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 25,721 | \$ 34,795 |

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| | | |
|--|------------|------------|
| Short-term investments | 62,422 | 57,437 |
| Accounts receivable, net | 35,515 | 24,288 |
| Inventories | 33,672 | 34,027 |
| Refundable income taxes | 3,783 | 3,673 |
| Deferred income taxes | 3,622 | 3,622 |
| Prepaid expenses and other current assets | 6,094 | 4,637 |
| | ----- | ----- |
| Total current assets | 170,829 | 162,479 |
| Property, plant, and equipment, net | 100,901 | 92,210 |
| Intangible assets, net | 62,058 | 63,984 |
| Goodwill | 155,039 | 155,039 |
| Other assets | 4,496 | 4,493 |
| | ----- | ----- |
| Total assets | \$ 493,323 | \$ 478,205 |
| | ===== | ===== |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | 7,850 | 8,971 |
| Accrued expenses and other current liabilities | 18,703 | 18,109 |
| Current portion of long-term debt | 1,001 | 1,000 |
| | ----- | ----- |
| Total current liabilities | 27,554 | 28,080 |
| Long-term debt, net of current portion | 58 | 652 |
| Convertible subordinated notes | 170,000 | 170,000 |
| Deferred income taxes | 27,222 | 23,296 |
| | ----- | ----- |
| Total liabilities | 224,834 | 222,028 |
| | ----- | ----- |
| Stockholders' equity: | | |
| Preferred stock | - | - |
| Common stock | 21 | 21 |
| Additional paid-in capital | 215,912 | 212,131 |
| Deferred stock-based compensation | (1,579) | (833) |
| Treasury stock, at cost | - | (95) |
| Retained earnings | 54,254 | 44,971 |
| Accumulated other comprehensive loss | (119) | (18) |
| | ----- | ----- |
| Total stockholders' equity | 268,489 | 256,177 |
| | ----- | ----- |
| Total liabilities and stockholders' equity | \$ 493,323 | \$ 478,205 |
| | ===== | ===== |

(1) As restated, see Note 2.

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

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(IN THOUSANDS EXCEPT PER SHARE AMOUNTS)

| | Three months ended | | Six months ended | |
|---|--------------------|-----------|------------------|------------|
| | June 30, | | June 30, | |
| | 2005 | 2004 | 2005 | 2004 |
| Sales | \$ 63,524 | \$ 52,942 | \$ 119,882 | \$ 100,000 |
| Cost of sales | 38,405 | 29,124 | 73,976 | 60,000 |
| Gross profit | 25,119 | 23,818 | 45,906 | 40,000 |
| Selling, general and administrative expenses | 8,481 | 6,389 | 15,247 | 10,000 |
| Research, development and engineering costs, net | 3,657 | 5,688 | 8,058 | 10,000 |
| Amortization of intangible assets | 958 | 1,076 | 1,916 | 0 |
| Other operating expense, net | 4,001 | 2,957 | 6,389 | 0 |
| Operating income | 8,022 | 7,708 | 14,296 | 10,000 |
| Interest expense | 1,191 | 1,144 | 2,322 | 0 |
| Interest income | (652) | (245) | (1,227) | 0 |
| Other expense, net | (60) | (2) | (60) | 0 |
| Income before provision for income taxes | 7,543 | 6,811 | 13,261 | 10,000 |
| Provision for income taxes | 2,263 | 2,078 | 3,978 | 0 |
| Net income | \$ 5,280 | \$ 4,733 | \$ 9,283 | \$ 10,000 |
| Earnings per share: | | | | |
| Basic | \$ 0.24 | \$ 0.22 | \$ 0.43 | \$ 0.40 |
| Diluted | \$ 0.23 | \$ 0.21 | \$ 0.42 | \$ 0.40 |
| Weighted average shares outstanding: | | | | |
| Basic | 21,581 | 21,366 | 21,527 | 20,000 |
| Diluted | 26,061 | 25,715 | 25,862 | 20,000 |
| Comprehensive income: | | | | |
| Net income | \$ 5,280 | \$ 4,733 | \$ 9,283 | \$ 10,000 |
| Net unrealized loss on available for sale securities, net of deferred income tax benefits of \$21 and \$44 in the three and six month periods in 2005, respectively | (61) | - | (101) | 0 |
| Comprehensive income | \$ 5,219 | \$ 4,733 | \$ 9,182 | \$ 10,000 |

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

GREATBATCH, INC.
 CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS - Unaudited
 (IN THOUSANDS)

Six months ended
 June 30,
 2005 (1) 2004 (1)

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| | | |
|---|-----------|-----------|
| Cash flows from operating activities: | | |
| Net income | \$ 9,283 | \$ 11,352 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 8,744 | 7,253 |
| Stock-based compensation | 1,448 | 1,511 |
| Deferred income taxes | 3,926 | 3,540 |
| Loss on disposal of assets | 1,489 | 115 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (11,227) | (5,628) |
| Inventories | 355 | (4,391) |
| Prepaid expenses and other current assets | (2,007) | 1,164 |
| Accounts payable | 115 | 725 |
| Accrued expenses and other current liabilities | 1,945 | (2,915) |
| Income taxes | (88) | (1,502) |
| | ----- | ----- |
| Net cash provided by operating activities | 13,983 | 11,224 |
| | ----- | ----- |
| Cash flows from investing activities: | | |
| Short-term investments | | |
| Purchases | (38,990) | (67,875) |
| Proceeds from dispositions | 34,005 | 110,584 |
| Acquisition of property, plant and equipment | (17,281) | (14,475) |
| Proceeds from sale of assets | 23 | 64 |
| (Increase) decrease in other assets | (256) | 37 |
| Acquisition of subsidiary, net | - | (45,604) |
| | ----- | ----- |
| Net cash used in investing activities | (22,499) | (17,269) |
| | ----- | ----- |
| Cash flows from financing activities: | | |
| Principal payments of long-term debt | (593) | (663) |
| Payment of debt issue costs | (213) | - |
| Issuance of common stock | 248 | 1,114 |
| Issuance of treasury stock | - | 179 |
| | ----- | ----- |
| Net cash (used in) provided by financing activities | (558) | 630 |
| | ----- | ----- |
| Net decrease in cash and cash equivalents | (9,074) | (5,415) |
| Cash and cash equivalents, beginning of year | 34,795 | 23,960 |
| | ----- | ----- |
| Cash and cash equivalents, end of period | \$ 25,721 | \$ 18,545 |
| | ===== | ===== |

(1) As restated, see Note 2.

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

GREATBATCH, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Unaudited

1. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted

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in the United States of America for interim financial information (APB 28, Interim Financial Reporting) and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information necessary for a fair presentation of financial position, results of operations, and cash flows in conformity with accounting principles generally accepted in the United States of America. Operating results for interim periods are not necessarily indicative of results that may be expected for the fiscal year as a whole. In the opinion of management, the condensed consolidated financial statements reflect all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of the results of Greatbatch, Inc. (the "Company") for the periods presented. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, sales, expenses, and related disclosures at the date of the financial statements and during the reporting period. Actual results could differ from these estimates. For further information, refer to the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K/A for the year ended December 31, 2004.

The Company officially changed its name to Greatbatch, Inc. from Wilson Greatbatch Technologies, Inc. during the second quarter.

The Company utilizes a fifty-two, fifty-three week fiscal year ending on the Friday nearest December 31st. For 52-week years, each quarter contains 13 weeks. For clarity of presentation, the Company describes all periods as if each quarter end is March 31st, June 30th and September 30th and as if the year-end is December 31st. The second quarter of 2005 and 2004 each contained 13 weeks.

2. RESTATEMENTS

Subsequent to the original filing of the Company's Form 10-Q for the three and six months ended June 30, 2005, the Company concluded that its condensed consolidated financial statements should be restated to change the classification of auction rate securities from cash and cash equivalents to short-term investments. Auction rate securities are securities that have stated maturities beyond three months, but are priced and traded as short-term investments due to the liquidity provided through the auction mechanism that generally resets interest rates every 7 to 35 days. Although management had determined the risk of failure of an auction process to be remote, the definition of a cash equivalent in Statement of Financial Accounting Standards (SFAS) No. 95, Statement of Cash Flows, requires reclassification to short-term investments. The condensed consolidated balance sheets as of June 30, 2005 and December 31, 2004, and condensed consolidated statements of cash flows for the three and six months ended June 30, 2005 and 2004, have been restated in order to conform to this change in classification. Due to the short-term nature of the interest rate resets, the fair market value of the auction rate securities approximates their recorded value.

The Company has also restated its condensed consolidated statement of cash flows for the periods ended June 30, 2005 and 2004 to reflect the impact of changes in accounts payable related to the acquisition of property, plant and equipment as a non-cash activity as required under SFAS No. 95.

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In addition, the Company determined that it had not accounted for a deferred tax asset in purchase accounting related to net operating losses acquired in the Company's acquisition of NanoGram in 2004. The recording of this deferred tax asset decreased long-term deferred income tax liabilities and correspondingly decreased goodwill.

The restatements have been made to the Condensed Consolidated Balance Sheet and Condensed Consolidated Statement of Cash Flows as follows:

Condensed Consolidated Balance Sheet as of

June 30, 2005

| | As previously | | |
|---|-------------------|-------------------|-------------------|
| | reported | Adjustment | As restated |
| Current assets: | | | |
| Cash and cash equivalents | \$ 83,036 | \$ (57,315) | \$ 25,721 |
| Short-term investments | \$ 5,107 | \$ 57,315 | \$ 62,422 |
| Goodwill | \$ 156,772 | \$ (1,733) | \$ 155,039 |
| Total assets | \$ 495,056 | \$ (1,733) | \$ 493,323 |
| Long term liabilities | | | |
| Deferred income taxes | \$ 28,955 | \$ (1,733) | \$ 27,222 |
| Total liabilities | \$ 226,567 | \$ (1,733) | \$ 224,834 |
| Total liabilities and stockholders' equity | \$ 495,056 | \$ (1,733) | \$ 493,323 |

Condensed Consolidated Balance Sheet as of

December 31, 2004

| | As previously | | |
|---|-------------------|-------------------|-------------------|
| | reported | Adjustment | As restated |
| Current assets: | | | |
| Cash and cash equivalents | \$ 89,473 | \$ (54,678) | \$ 34,795 |
| Short-term investments | \$ 2,759 | \$ 54,678 | \$ 57,437 |
| Goodwill | \$ 156,772 | \$ (1,733) | \$ 155,039 |
| Total assets | \$ 479,938 | \$ (1,733) | \$ 478,205 |
| Long term liabilities | | | |
| Deferred income taxes | \$ 25,029 | \$ (1,733) | \$ 23,296 |
| Total liabilities | \$ 223,761 | \$ (1,733) | \$ 222,028 |
| Total liabilities and stockholders' equity | \$ 479,938 | \$ (1,733) | \$ 478,205 |

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Condensed Consolidated Statement of Cash Flows for the three months ended

June 30, 2005

| | As previously | | |
|--|---------------|------------|-------------|
| | reported | Adjustment | As restated |
| Cash flows from operating activities: | | | |
| Net cash provided by operating activities | \$ 12,747 | \$ 1,236 | \$ 13,983 |
| Cash flows from investing activities: | | | |

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| | | | |
|--|-------------|-------------|-------------|
| Net cash used in investing activities | \$ (18,626) | \$ (3,873) | \$ (22,499) |
| Net decrease in cash and cash equivalents | \$ (6,437) | \$ (2,637) | \$ (9,074) |
| Cash and cash equivalents, beginning of year | \$ 89,473 | \$ (54,678) | \$ 34,795 |
| Cash and cash equivalents, end of period | \$ 83,036 | \$ (57,315) | \$ 25,721 |

Condensed Consolidated Statement of Cash Flows for the three months ended

June 30, 2004

| | As previously reported | Adjustment | As restated |
|--|---------------------------|-------------|-------------|
| Cash flows from operating activities: | | | |
| Net cash provided by operating activities | \$ 11,932 | \$ (708) | \$ 11,224 |
| Cash flows from investing activities: | | | |
| Net cash used in investing activities | \$ (52,197) | \$ 34,928 | \$ (17,269) |
| Net decrease in cash and cash equivalents | \$ (39,635) | \$ 34,220 | \$ (5,415) |
| Cash and cash equivalents, beginning of year | \$ 119,486 | \$ (95,526) | \$ 23,960 |
| Cash and cash equivalents, end of period | \$ 79,851 | \$ (61,306) | \$ 18,545 |

3. STOCK-BASED COMPENSATION

The Company accounts for stock-based compensation in accordance with Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation ("SFAS No. 123"). As permitted in SFAS No. 123, the Company has chosen to account for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board No. 25, Accounting for Stock Issued to Employees, and related interpretations.

The Company has determined the pro forma information as if the Company had accounted for stock options granted under the fair value method of SFAS No. 123. The Black-Scholes option-pricing model was used with the following weighted average assumptions.

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These pro forma calculations assume the common stock is freely tradable for all periods presented and, as such, the impact is not necessarily indicative of the effects on reported net income of future periods.

| | Three months ended June 30, 2005 | | Six months ended June 30, 2004 | |
|--------------------------|---|-------|---|-------|
| Risk-free interest rate | 3.83% | 3.93% | 4.03% | 3.80% |
| Expected volatility | 52% | 50% | 52% | 50% |
| Expected life (in years) | 5 | 5 | 5 | 5 |
| Expected dividend yield | 0% | 0% | 0% | 0% |

The Company's net income and earnings per share as if the fair value based method had been applied to all outstanding and unvested awards in each period is as follows (in thousands except per share data):

| | Three months ended June 30, 2005 | | Six months ended June 30, 2004 | |
|--|---|--|---|--|
| | | | | |

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| | | | | |
|---|----------|----------|----------|-----------|
| Net income as reported | \$ 5,280 | \$ 4,733 | \$ 9,283 | \$ 11,352 |
| Stock-based employee compensation cost included in net income as reported, net of related tax effects | \$ 457 | \$ 438 | \$ 1,014 | \$ 1,050 |
| Stock-based employee compensation cost determined using the fair value based method, net of related tax effects | \$ 976 | \$ 968 | \$ 2,019 | \$ 2,104 |
| Pro forma net income | \$ 4,761 | \$ 4,203 | \$ 8,278 | \$ 10,298 |
| Earnings per share: | | | | |
| Basic - as reported | \$ 0.24 | \$ 0.22 | \$ 0.43 | \$ 0.53 |
| Basic - pro forma | \$ 0.22 | \$ 0.20 | \$ 0.38 | \$ 0.48 |
| Diluted - as reported | \$ 0.23 | \$ 0.21 | \$ 0.42 | \$ 0.52 |
| Diluted - pro forma | \$ 0.21 | \$ 0.19 | \$ 0.38 | \$ 0.48 |

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4. SUPPLEMENTAL CASH FLOW INFORMATION (in thousands):

| | Six months ended June 30, | |
|--|------------------------------|----------|
| | 2005 | 2004 |
| Noncash investing and financing activities: | | |
| Acquisition of property utilizing capital leases | \$ - | \$ 1,007 |
| Common stock contributed to 401(k) Plan | \$ 2,729 | \$ 2,723 |
| Property, plant and equipment purchases included in accounts payable | \$ 994 | \$ 1,232 |

5. SHORT-TERM INVESTMENTS

Short-term investments at June 30, 2005 and December 31, 2004 consisted of the following (in thousands):

| | As of June 30, 2005 | | | |
|-------------------------------------|---------------------|------------------------|-------------------------|----------------------|
| | Cost | Gross unrealized gains | Gross unrealized losses | Estimated fair value |
| Available-for-sale: | | | | |
| Equity Securities | \$ 276 | \$ - | \$ (81) | \$ 195 |
| Auction Rate Securities | 55,546 | - | - | 55,546 |
| Total available for sale securities | 55,822 | - | (81) | 55,741 |
| Held-to-maturity: | | | | |
| Municipal Bonds (1) | 6,681 | - | (13) | 6,668 |
| Short-term investments | \$ 62,503 | \$ - | \$ (94) | \$ 62,409 |

(1) The municipal bonds have maturity dates ranging from July 2005 to November 2005.

As of December 31, 2004

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| | Cost | Gross unrealized gains | Gross unrealized losses | Estimated fair value |
|-------------------------------------|-----------|------------------------|-------------------------|----------------------|
| Available-for-sale: | | | | |
| Equity Securities | \$ 276 | \$ - | \$ (18) | \$ 258 |
| Auction Rate Securities | 54,678 | - | - | 54,678 |
| | ----- | ----- | ----- | ----- |
| Total available for sale securities | 54,954 | - | (18) | 54,936 |
| Held-to-maturity: | | | | |
| Municipal Bonds | 2,501 | 1 | - | 2,502 |
| | ----- | ----- | ----- | ----- |
| Short-term investments | \$ 57,455 | \$ 1 | \$ (18) | \$ 57,438 |
| | ===== | ===== | ===== | ===== |

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6. INVENTORIES

Inventories comprised the following (in thousands):

| | June 30, 2005 | December 31, 2004 |
|-----------------|------------------|----------------------|
| Raw materials | \$ 16,527 | \$ 14,053 |
| Work-in-process | 10,328 | 11,275 |
| Finished goods | 6,817 | 8,699 |
| | ----- | ----- |
| Total | \$ 33,672 | \$ 34,027 |
| | ===== | ===== |

7. INTANGIBLE ASSETS

Intangible assets comprised the following (in thousands):

| | As of June 30, 2005 | | |
|-----------------------------------|-------------------------|--------------------------|---------------------|
| | Gross carrying amount | Accumulated amortization | Net carrying amount |
| Amortizing intangible assets: | | | |
| Patented technology | \$ 21,462 | \$ (10,938) | \$ 10,524 |
| Unpatented technology | 30,886 | (7,638) | 23,248 |
| Other | 1,340 | (1,306) | 34 |
| | ----- | ----- | ----- |
| | 53,688 | (19,882) | 33,806 |
| Non-amortizing intangible assets: | | | |
| Trademark and names | 31,420 | (3,168) | 28,252 |
| | ----- | ----- | ----- |
| Total intangible assets | \$ 85,108 | \$ (23,050) | \$ 62,058 |
| | ===== | ===== | ===== |
| | As of December 31, 2004 | | |
| | Gross carrying amount | Accumulated amortization | Net carrying amount |
| Amortizing intangible assets: | | | |
| Patented technology | \$ 21,462 | \$ (10,137) | \$ 11,325 |
| Unpatented technology | 30,886 | (6,525) | 24,361 |

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| | | | |
|-----------------------------------|-----------|-------------|-----------|
| Other | 1,340 | (1,294) | 46 |
| | ----- | ----- | ----- |
| | 53,688 | (17,956) | 35,732 |
| Non-amortizing intangible assets: | | | |
| Trademark and names | 31,420 | (3,168) | 28,252 |
| | ----- | ----- | ----- |
| Total intangible assets | \$ 85,108 | \$ (21,124) | \$ 63,984 |
| | ===== | ===== | ===== |

Aggregate amortization expense for second quarter 2005 and 2004 was \$1.0 million and \$1.1 million, respectively. Aggregate amortization expense for the six months ended June 30, 2005 and 2004 was \$1.9 million. Annual amortization expense is estimated to be \$1.9 million for the remainder of 2005, \$3.8 million for 2006 to 2008, \$3.2 million for 2009, and \$2.7 million for 2010.

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8. DEBT

Long-term debt comprised the following (in thousands):

| | June 30, 2005 | December 31, 2004 |
|--|------------------|----------------------|
| 2.25% convertible subordinated notes, due 2013 | \$ 170,000 | \$ 170,000 |
| Capital lease obligations | 1,059 | 1,652 |
| | ----- | ----- |
| | 171,059 | 171,652 |
| Less current portion | (1,001) | (1,000) |
| | ----- | ----- |
| Total long-term debt | \$ 170,058 | \$ 170,652 |
| | ===== | ===== |

Revolving Line of Credit

On May 31, 2005, the Company amended its Senior Secured Credit Facility, which included changes to the underlying covenants. The amended three-year facility replaced the old \$20.0 million revolving credit facility with a new \$50.0 million Revolving Credit Facility ("new revolver"), which contains a \$10.0 million sub-limit for the issuance of commercial or standby letters of credit. The new revolver is secured by the Company's non-realty assets including cash, accounts and notes receivable, and inventories. The new revolver requires the Company to comply with two quarterly financial covenants, as defined. The first relates to the ratio of consolidated net earnings or loss before interest, taxes, depreciation, and amortization ("EBITDA") to Fixed Charges. The second is a Leverage ratio, which is calculated based on the ratio of Consolidated Funded Debt less Cash, Cash Equivalent Investments and Short-Term Investments to Consolidated EBITDA. Interest rates under the new Facility vary with the Company's leverage. The Company is required to pay a commitment fee of between .125% and .250% per annum on the unused portion of the revolving line of credit based on the Company's leverage. As of June 30, 2005, the Company had no balance outstanding on its \$50.0 million committed revolving line of credit.

Debt issue expenses for the new revolver totaled \$0.2 million and are being amortized using the straight-line method over a three-year term. The revolver refinancing transaction resulted in the write-off of \$0.1 million

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of existing deferred financing fees associated with the prior revolving line of credit.

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9. EARNINGS PER SHARE

The following table reflects the calculation of basic and diluted earnings per share (in thousands, except per share amounts):

| | Three months ended June 30, 2005 | | Six months ended June 30, 2004 | |
|---|--|----------|--------------------------------------|-----------|
| Numerator for basic earnings per share: | | | | |
| Income from continuing operations | \$ 5,280 | \$ 4,733 | \$ 9,283 | \$ 11,352 |
| Effect of dilutive securities: | | | | |
| Interest expense on convertible notes and related deferred financing fees, net of tax | 783 | 769 | 1,565 | 1,537 |
| Numerator for diluted earnings per share | \$ 6,063 | \$ 5,502 | \$ 10,848 | \$ 12,889 |
| Denominator for basic earnings per share: | | | | |
| Weighted average shares outstanding | 21,581 | 21,366 | 21,527 | 21,323 |
| Effect of dilutive securities: | | | | |
| Convertible notes | 4,219 | 4,219 | 4,219 | 4,219 |
| Stock options and unvested restricted stock | 261 | 130 | 116 | 239 |
| Dilutive potential common shares | 4,480 | 4,349 | 4,335 | 4,458 |
| Denominator for diluted earnings per share | 26,061 | 25,715 | 25,862 | 25,781 |
| Basic earnings per share | \$ 0.24 | \$ 0.22 | \$ 0.43 | \$ 0.53 |
| Diluted earnings per share | \$ 0.23 | \$ 0.21 | \$ 0.42 | \$ 0.50 |

10. COMPREHENSIVE INCOME

For the second quarter and six months ended June 30, 2004, the Company's only component of comprehensive income is its net income. For the second quarter and six months ended June 30, 2005, the Company's comprehensive income includes net income and a net unrealized loss on available-for-sale securities.

11. COMMITMENTS AND CONTINGENCIES

Litigation - During 2002, a former non-medical customer commenced an action alleging that the Company had used proprietary information of the customer to develop certain products. We have meritorious defenses and are vigorously defending the case. No accrual for an adverse judgment has been made as such outcome is not deemed probable, the potential risk of loss is between \$0.0 and \$1.75 million.

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As reported in the Company's 2005 first quarter Form 10-Q, on May 2, 2005, a complaint was filed against the Company by a developer of an implantable drug delivery device in the United States Federal District Court for the Central District of California. On May 20, 2005, the parties entered into a settlement agreement under which the Company undertook certain obligations including the performance of certain additional development tasks for a limited period of time. On June 2, 2005, the Court ordered the complaint dismissed without prejudice.

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Product Warranties - The change in aggregate product warranty liability for the quarter ended June 30, 2005, is as follows (in thousands):

| | |
|-------------------------------|----------|
| Beginning balance | \$ 948 |
| Additions to warranty reserve | 374 |
| Warranty claims paid | (57) |
| | ----- |
| Ending balance | \$ 1,265 |
| | ===== |

Capital Expenditures - During 2004, the Company commenced the build out of its medical battery and capacitor manufacturing facility in Alden, NY and its value-add manufacturing facility in Tijuana, Mexico. These facilities will enable the Company to further consolidate its operations and implement state of the art manufacturing capabilities at both locations. The total contractual obligation for construction of these facilities at June 30, 2005 is \$4.4 million and will be financed by existing or internally generated cash.

12. BUSINESS SEGMENT INFORMATION

The Company operates its business in two reportable segments: Implantable Medical Components ("IMC") and Electrochem Commercial Power ("ECP"), (formerly "Electrochem Power Solutions"). The IMC segment designs and manufactures critical components used in implantable medical devices. The principal components are batteries, capacitors, filtered feedthroughs, coated components, enclosures and machined and molded precision components. The principal medical devices are pacemakers, defibrillators and neurostimulators. The ECP segment designs and manufactures high performance cells and battery packs; principal markets for these products are for oil and gas exploration, oceanographic equipment, and aerospace.

The Company defines segment income from operations as gross profit less costs and expenses attributable to segment-specific selling, general and administrative, research, development and engineering expenses, intangible amortization and other operating expenses. Segment income also includes a portion of non-segment specific selling, general and administrative, and research, development and engineering expenses based on allocations appropriate to the expense categories. The remaining unallocated operating expenses along with other income and expense are not allocated to reportable segments. Transactions between the two segments are not significant. The accounting policies of the segments are the same as those described and referenced in Note 1.

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An analysis and reconciliation of the Company's business segment information to the respective information in the condensed consolidated financial statements is as follows (in thousands):

| | Three months ended June 30, | | Six months ended June 30, | |
|--|--------------------------------|-----------|------------------------------|------------|
| Sales: | 2005 | 2004 | 2005 | 2004 |
| IMC | | | | |
| ICD batteries | \$ 12,608 | \$ 10,119 | \$ 23,234 | \$ 19,539 |
| Pacemaker and other batteries | 6,315 | 5,361 | 11,695 | 11,050 |
| ICD Capacitors | 5,954 | 6,239 | 10,251 | 14,647 |
| Feedthroughs | 15,859 | 12,261 | 29,541 | 26,016 |
| Enclosures | 6,019 | 5,142 | 12,566 | 10,539 |
| Other | 8,031 | 7,077 | 15,363 | 12,686 |
| | ----- | ----- | ----- | ----- |
| Total IMC | 54,786 | 46,199 | 102,650 | 94,477 |
| ECP | 8,738 | 6,743 | 17,232 | 13,990 |
| | ----- | ----- | ----- | ----- |
| Total sales | \$ 63,524 | \$ 52,942 | \$ 119,882 | \$ 108,467 |
| | ===== | ===== | ===== | ===== |
| Segment income from operations: | | | | |
| IMC | \$ 9,481 | \$ 8,396 | \$ 17,361 | \$ 19,218 |
| ECP | 2,430 | 1,608 | 4,308 | 3,903 |
| | ----- | ----- | ----- | ----- |
| Total segment income from operations | 11,911 | 10,004 | 21,669 | 23,121 |
| Unallocated operating expenses | (3,889) | (2,296) | (7,373) | (5,040) |
| | ----- | ----- | ----- | ----- |
| Operating income as reported | 8,022 | 7,708 | 14,296 | 18,081 |
| Unallocated other income and expense | (479) | (897) | (1,035) | (1,746) |
| | ----- | ----- | ----- | ----- |
| Income before income taxes as reported | \$ 7,543 | \$ 6,811 | \$ 13,261 | \$ 16,335 |
| | ===== | ===== | ===== | ===== |

The carrying amount of goodwill at December 31, 2004 and June 30, 2005 is as follows (in thousands):

| IMC | ECP | Total |
|------------|----------|------------|
| \$ 152,473 | \$ 2,566 | \$ 155,039 |
| ===== | ===== | ===== |

13. OTHER OPERATING EXPENSE

During the second quarter and six months ended June 30, 2005, the following non-recurring charges were recorded in other operating expense in the Company's Condensed Consolidated Statement of Operations.

Costs to exit development agreement. There was a \$1.15 million charge recorded in other operating expenses for the IMC segment during the second quarter for charges associated with the discontinuation of a drug pump development agreement.

Severance charges. During the first quarter, the Company implemented a 4% workforce reduction as a continuation of cost containment efforts initiated mid-year 2004, which resulted in a severance charge of \$1.5 million.

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Accrued liabilities at June 30, 2005 related to the severance charges comprised the following (in thousands):

| | IMC | ECP | CORPORATE | TOTAL |
|------------------------|--------|--------|-----------|----------|
| Severance charges | \$ 860 | \$ 210 | \$ 430 | \$ 1,500 |
| Cash payments | (794) | (128) | (367) | (1,289) |
| | ----- | ----- | ----- | ----- |
| Balance, June 30, 2005 | \$ 66 | \$ 82 | \$ 63 | \$ 211 |

The severance charges related to corporate employees are included in unallocated operating expenses. It is expected that the remaining accrued severance as of June 30, 2005, will be paid within the next three months.

Alden Facility Consolidation - On February 23, 2005, the Company announced its intent to consolidate the medical capacitor manufacturing operations, currently in Cheektowaga, NY, and the implantable medical battery manufacturing operations, currently in Clarence, NY, into the advanced power source manufacturing facility in Alden, NY ("Alden Facility"). The Company is also consolidating the capacitor research, development and engineering operations from the Cheektowaga, NY, facility into the existing implantable medical battery research, development, and engineering operations in Clarence, NY.

The total cost estimated for these consolidation efforts is anticipated to be between \$3.5 and \$4.0 million. The Company expects to incur the balance of this additional expense over the next two fiscal quarters. The expenses for the Alden Facility consolidation are included in the IMC business segment. The major categories of costs, which will primarily be cash expenditures, include the following:

- o Production inefficiencies and revalidation - \$1.5 to \$1.7 million;
- o Training - \$0.6 to \$0.7 million;
- o Moving and facility closures - \$0.9 million to \$1.0 million; and
- o Infrastructure - \$0.5 to \$0.6 million.

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Accrued liabilities at June 30, 2005 related to the Alden Facility consolidation comprised the following (in thousands):

| | Production Inefficiencies and Revalidation | Training | Moving and Facility Closures | Infrastr |
|------------------------|--|----------|---------------------------------|----------|
| | ----- | ----- | ----- | ----- |
| Restructuring charges | \$ 135 | \$ 15 | \$ 517 | \$ 1 |
| Cash payments | (120) | (15) | (130) | (1 |
| Write-offs | -- | -- | (167) | |
| | ----- | ----- | ----- | ----- |
| Balance, June 30, 2005 | \$ 15 | \$ -- | \$ 220 | \$ |
| | ===== | ===== | ===== | ===== |

Carson City Facility shutdown and Tijuana Facility consolidation - On March 7, 2005, the Company announced its intent to close the Carson City, NV facility ("Carson City Facility") and consolidate the work performed at the Carson City Facility into the Tijuana, Mexico facility ("Tijuana

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Facility").

The total estimated cost for this facility consolidation plan is anticipated to be between \$4.5 million and \$5.4 million. The Company expects to incur the remaining cost over the next four fiscal quarters. The major categories of costs include the following:

- o Costs related to the shutdown of the Carson City Facility:
 - a. Severance and retention - \$1.4 to \$1.6 million;
 - b. Accelerated depreciation - \$0.5 to \$0.6 million; and
 - c. Other - \$0.6 to \$0.7 million.

- o Costs related to the Tijuana Facility consolidation:
 - a. Production inefficiencies and revalidation - \$0.4 to \$0.5 million;
 - b. Relocation and moving - \$0.3 to \$0.5 million;
 - c. Personnel (including travel, training and duplicate wages) - \$1.0 to \$1.1 million; and
 - d. Other - \$0.3 to \$0.4 million.

All categories of costs are considered to be cash expenditures, except accelerated depreciation. The expenses for the Carson City facility shutdown and the Tijuana Facility consolidation are included in the IMC business segment.

Accrued liabilities at June 30, 2005 related to the Carson City Facility shutdown comprised the following (in thousands):

| | Severance and retention ----- | Accelerated Depreciation ----- | Other ----- | Total ----- |
|------------------------|-------------------------------------|--------------------------------------|----------------|----------------|
| Restructuring charges | \$ 620 | \$ 200 | \$ 12 | \$ 832 |
| Cash payments | -- | -- | (12) | (12) |
| Write-offs | -- | (200) | -- | (200) |
| | ----- | ----- | ----- | ----- |
| Balance, June 30, 2005 | \$ 620 | \$ -- | \$ -- | \$ 620 |
| | ===== | ===== | ===== | ===== |

Accrued liabilities at June 30, 2005 related to the Tijuana Facility consolidation comprised the following (in thousands):

| | Production inefficiencies and revalidation ----- | Relocation and moving ----- | Personnel ----- | Other ----- | Total ----- |
|-----------------------|---|-----------------------------------|--------------------|----------------|----------------|
| Restructuring charges | \$ -- | \$ -- | \$ 40 | | \$ 40 |
| Cash payments | -- | -- | (40) | -- | (40) |
| | ----- | ----- | ----- | ----- | ----- |

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| | | | | | |
|------------------------|-------|-------|-------|-------|-------|
| Balance, June 30, 2005 | \$ -- | \$ -- | \$ -- | \$ -- | \$ -- |
| | ===== | ===== | ===== | ===== | ===== |

14. IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS

In July 2005, the Financial Accounting Standards Board ("FASB") published an Exposure Draft of a proposed Interpretation, Accounting for Uncertain Tax Positions. The Exposure Draft seeks to reduce the significant diversity in practice associated with recognition and measurement in the accounting for income taxes. It would apply to all tax positions accounted for in accordance with SFAS 109, Accounting for Income Taxes. The Exposure Draft requires that a tax position meet a "probable recognition threshold" for the benefit of the uncertain tax position to be recognized in the financial statements. This threshold is to be met assuming that the tax authorities will examine the uncertain tax position. The Exposure Draft contains guidance with respect to the measurement of the benefit that is recognized for an uncertain tax position, when that benefit should be derecognized, and other matters. This proposed Interpretation would clarify the accounting for uncertain tax positions in accordance with SFAS 109. This Interpretation, once approved, is expected to be effective as of the end of the first fiscal year ending after December 15, 2005. The Company outlined its critical accounting policies related to income taxes in its Annual Report on Form 10-K for the year ended December 31, 2004. Certain tax accounting and reporting guidelines may change as a result of new accounting guidance. The Company's accounting and reporting treatment will be determined at the time of issuance of a final standard.

In June 2005 the issued Statement of Financial Accounting Standards ("SFAS") No. 154, Accounting Changes and Error Corrections, ("SFAS 154") a replacement of APB Opinion No. 20, Accounting Changes, and Statement No. 3, Reporting Accounting Changes in Interim Financial Statements. SFAS 154 changes the requirements for the accounting for and the reporting of a change in accounting principle. Previously, most voluntary changes in accounting principles required recognition by recording a cumulative effect adjustment within net income in the period of change. SFAS 154 requires retrospective application to prior periods' financial statements, unless it is impracticable to determine either the specific period effects or the cumulative effect of the change. SFAS 154 is effective for accounting changes made in fiscal years beginning after December 15, 2005. The Company does not expect that adoption of SFAS No. 154 will have a material effect on its consolidated financial position, consolidated results of operations, or liquidity.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), Share-Based Payment ("SFAS No. 123(R)"). This statement is a revision of SFAS No. 123, Accounting for Stock-Based Compensation, and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. This standard requires the Company to measure the cost of employee services received in exchange for equity awards based on the grant date fair value of the awards. The cost will be recognized as compensation expense over the vesting period of the awards.

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The Company anticipates adopting the provisions of SFAS No. 123(R) on January 1, 2006 using the modified prospective application. Accordingly, compensation expense will be recognized for all newly granted awards and awards modified, repurchased, or cancelled after January 1, 2006. Compensation cost for the unvested portion of awards that are outstanding

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as of January 1, 2006 will be recognized ratably over the remaining vesting period. The compensation cost for the unvested portion of awards will be based on the fair value at date of grant as calculated for the Company's pro forma disclosure under SFAS 123.

The Company estimates that the effect on net income and earnings per share in the periods following adoption of SFAS 123(R) will be consistent with the Company's pro forma disclosure under SFAS No. 123, except that estimated forfeitures will be considered in the calculation of compensation expense under SFAS 123(R). Additionally, the actual effect on net income and earnings per share will vary depending upon the number of options granted in subsequent periods compared to prior years.

In November 2004, the FASB issued SFAS No. 151, Inventory Costs, an amendment of ARB No. 43, Chapter 4 ("SFAS No. 151"). SFAS No. 151 amends the guidance in ARB No. 43, Chapter 4, "Inventory Pricing," to clarify the accounting for abnormal amounts of idle facility expense, handling costs and wasted material (spoilage). Among other provisions, the new rule requires that such items be recognized as current-period charges, regardless of whether they meet the criterion of "so abnormal" as stated in ARB No. 43. SFAS No. 151 is effective for fiscal years beginning after June 15, 2005. The company does not expect that adoption of SFAS No. 151 will have a material effect on its consolidated financial position, consolidated results of operations, or liquidity.

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

The condensed consolidated financial statements in Item 1 have been restated as described in Note 2. -Restatements and the following discussion, analysis and financial information herein have been revised to reflect the effects of the restatements.

Introduction

We are a leading developer and manufacturer of batteries, capacitors, feedthroughs, enclosures, and other components used in implantable medical devices ("IMDs") through our Implantable Medical Components ("IMC") business. We offer technologically advanced, highly reliable and long lasting products for IMDs and enable our customers to introduce IMDs that are progressively smaller, longer lasting, more efficient and more functional. We also leverage our core competencies in technology and manufacturing through our Electrochem Commercial Power ("ECP") business (formerly "Electrochem Power Solutions") to develop and produce cells and battery packs for commercial applications that demand high performance and reliability, including oil and gas exploration, oceanographic equipment and aerospace.

Most of the IMC products that we sell are utilized by customers in cardiac rhythm management ("CRM") devices. The CRM market comprises devices utilizing high-rate batteries and capacitors such as implantable cardioverter defibrillators ("ICDs") and cardiac resynchronization therapy ("CRT") with backup defibrillation devices ("CRT-D") and devices utilizing low or medium rate batteries but no capacitors (pacemakers and CRTs). All CRM devices utilize other components such as enclosures and feedthroughs, and certain CRM devices utilize electromagnetic interference ("EMI") filtering technology.

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We utilize a fifty-two, fifty-three week fiscal year ending on the Friday nearest December 31st. For 52-week years, each quarter contains 13 weeks. For clarity of presentation, we describe all periods as if each quarter end is March 31st, June 30th and September 30th and as if the year-end is December 31st. The second quarter of 2005 and 2004 each contained 13 weeks.

The commentary that follows should be read in conjunction with our condensed consolidated financial statements and related notes and with the Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our Form 10-K/A for the fiscal year ended December 31, 2004.

Overview

During and subsequent to the second quarter 2005, there were several developments affecting our business:

- o We reported all-time record sales results of \$63.5 million, led by strong sales of implantable medical components and commercial power sources.
- o We changed the name of the Company to Greatbatch, Inc., from the former name of Wilson Greatbatch Technologies, Inc.

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- o We celebrated the grand opening of the world-class manufacturing facility in Tijuana, Mexico.
- o We appointed Thomas J. Hook as President and Chief Operating Officer.
- o The installation of the remaining assembly equipment at the Tijuana Facility continued to proceed as planned; completion is expected in the fourth quarter of 2005. The consolidation plan was finalized for the move of the Carson City plant into the Tijuana Facility. The move is expected to be completed by first quarter 2006.
- o The move of the medical battery manufacturing equipment to Alden, NY, was substantially completed in accordance with plan. The movement of the manufacturing equipment from the existing capacitor plant was initiated and is expected to be complete by the end of the fourth quarter 2005.
- o We amended our Senior Secured Credit Facility to replace our existing \$20.0 million revolving credit with a new three-year, \$50 million revolving credit facility.

Product Development

As mentioned in our annual report (which is available on our website, www.greatbatch.com), our near term focus for growth in the medical battery market is the introduction of our Q-Series batteries. Initially they will be available in two configurations - QHR (High Rate) and QMR (Medium Rate). These batteries hold the promise of unparalleled performance in a wide range of implantable device and neurostimulation applications and allow our customers to incorporate advanced power-hungry features into these devices. While companies typically announce new products that have modest improvements in form and/or function regularly, we believe the Q-Series firmly establishes a new industry standard. It delivers advanced performance criteria to an industry that historically embraces new products. We believe the Q-Series will represent a major breakthrough by combining a smaller size with greater energy density (more power).

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Based on our limited test results to date, batteries incorporating nanotechnology may demonstrate the potential for generating even further improvements. While nanotechnology is showing some limited benefits in current battery designs, we do not anticipate realizing its full potential until it can be tested in the Q-Series design. As the word implies, "nano" unlocks the promise of smaller size and offers potential for enhanced product performance and manufacturability. Additionally, nano applications are not limited to batteries. The same technology may well be the enabling force behind other new products now in development such as significantly smaller higher voltage capacitors, novel form batteries and capacitors that will be used in new, far less intrusive cardiac therapy applications that represent an entirely new approach to CRM treatment.

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Cost savings and consolidation efforts

During second quarter 2005, we recorded non-recurring charges in other operating expense related to our ongoing cost savings and consolidation efforts.

Severance charges. The Company implemented a 4% workforce reduction during the first quarter, which resulted in a severance charge of \$1.5 million. Of that amount, \$0.8 million and \$0.5 million was paid in cash during the first and second quarters, respectively. The remaining \$0.2 million balance is anticipated to be paid in cash within the next three months.

Alden Facility Consolidation. On February 23, 2005, we announced our intent to consolidate the medical capacitor manufacturing operations, currently in Cheektowaga, NY, and the implantable medical battery manufacturing operations, currently in Clarence, NY, into the advanced power source manufacturing facility in Alden, NY ("Alden Facility"). We are also consolidating the capacitor research, development and engineering operations from the Cheektowaga, NY, facility into the existing implantable medical battery research, development, and engineering operations in Clarence, NY.

The total cost estimated for these consolidation efforts is anticipated to be between \$3.5 and \$4.0 million. Expenses of \$0.9 million have been incurred through the second quarter. Of these, \$0.4 million were paid in cash, \$0.2 million were for written-off assets, and \$0.3 million remain to be paid. We expect to incur the remaining expense over the next two fiscal quarters.

Carson City Facility shutdown and Tijuana Facility consolidation. On March 7, 2005, we announced our intent to close the Carson City, NV facility ("Carson City Facility") and consolidate the work performed at the Carson City Facility into the Tijuana, Mexico facility ("Tijuana Facility").

The total estimated cost for this facility consolidation plan is anticipated to be between \$4.5 million and \$5.4 million, comprised of between \$2.5 million to \$2.9 million for the Carson City Facility shutdown and \$2.0 to \$2.5 million for the Tijuana Facility consolidation. We expect to incur the remaining costs over the next three fiscal quarters. All categories of costs are considered to be cash expenditures, except accelerated depreciation.

Carson City Facility shutdown expenses of \$0.8 million have been accrued year to date, of which \$0.2 million have been recorded as accelerated depreciation and \$0.6 million remain to be paid. Tijuana Facility consolidation expenses of \$0.04 million have been incurred and paid year to date.

Results of Operation and Financial Condition

| In thousands, except per share data | Three months ended June 30, | | \$ Change | % Change | Six mo ended J |
|--|--------------------------------|-----------|--------------|-------------|-------------------|
| | 2005 | 2004 | | | |
| IMC | | | | | |
| ICD batteries | \$12,608 | \$ 10,119 | 2,489 | 25% | \$ 23,234 |
| Pacemaker and other batteries | 6,315 | 5,361 | 954 | 18% | 11,695 |
| ICD Capacitors | 5,954 | 6,239 | (285) | -5% | 10,251 |
| Feedthroughs | 15,859 | 12,261 | 3,598 | 29% | 29,541 |
| Enclosures | 6,019 | 5,142 | 877 | 17% | 12,566 |
| Other | 8,031 | 7,077 | 954 | 13% | 15,363 |
| Total IMC | 54,786 | 46,199 | 8,587 | 19% | 102,650 |
| ECP | 8,738 | 6,743 | 1,995 | 30% | 17,232 |
| Total sales | 63,524 | 52,942 | 10,582 | 20% | 119,882 |
| Cost of sales | 38,405 | 29,124 | 9,281 | 32% | 73,976 |
| Gross profit | 25,119 | 23,818 | 1,301 | 5% | 45,906 |
| Gross margin | 39.5% | 45.0% | | -5.5% | 38.3% |
| Selling, general, and administrative expenses (SG&A) | 8,481 | 6,389 | 2,092 | 33% | 15,247 |
| SG&A as a % of sales | 13.4% | 12.1% | | 1.3% | 12.7% |
| Research, development and engineering costs, net (RD&E) | 3,657 | 5,688 | (2,031) | -36% | 8,058 |
| RD&E as a % of sales | 5.8% | 10.7% | | -4.9% | 6.7% |
| Intangible amortization | 958 | 1,076 | (118) | -11% | 1,916 |
| Other operating expense, net | 4,001 | 2,957 | 1,044 | 35% | 6,389 |
| Operating income | 8,022 | 7,708 | 314 | 4% | 14,296 |
| Operating margin | 12.6% | 14.6% | | -2.0% | 11.9% |
| Interest expense | 1,191 | 1,144 | 47 | 4% | 2,322 |
| Interest income | (652) | (245) | (407) | 166% | (1,227) |
| Other expense (income), net | (60) | (2) | (58) | 2900% | (60) |
| Provision for income taxes | 2,263 | 2,078 | 185 | 9% | 3,978 |
| Effective tax rate | 30.0% | 30.5% | | -0.5% | 30.0% |
| Net income | \$ 5,280 | \$ 4,733 | \$ 547 | 12% | \$ 9,283 |
| Net margin | 8.3% | 8.9% | | -0.6% | 7.7% |
| Diluted earnings per share | \$ 0.23 | \$ 0.21 | \$ 0.02 | 10% | \$ 0.42 |

Sales

IMC. The nature and extent of our selling relationship with each CRM customer is

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different in terms of component products purchased, selling prices, product volumes, ordering patterns and inventory management. We have pricing arrangements with our customers that at times do not specify minimum order quantities. Our visibility to customer ordering patterns is over a relatively short period of time. Our customers may have inventory management programs and alternate supply arrangements of which we are unaware. Additionally, the relative market share among the CRM device manufacturers changes periodically. Consequently, these and other factors can significantly impact our sales in any given period.

The results for the quarter did receive benefit from the field issues surrounding ICD products. However, it is extremely difficult to identify how much benefit we did receive during the second quarter. We did see a quarterly sequential increase in CRM related sales in the range of \$5 million. We do not have granularity into the nature of the orders and can only assume that some percentage of the increase relates to the ICD field actions in the marketplace. It is very conceivable that the impact on our sales will continue to be favorably affected by these field issues into the second half of the year.

There are a number of factors, both short-term and long-term related to these field actions that may impact our results. In the short-term, if product has to be replaced, or customer inventory levels have to be restored, this will result in increased component demand. Also, changing customer order patterns due to market share shifts or accelerated device replacements may also have a positive impact on our sales results in the near-term. These same factors may have longer-term implications as well. Customer inventory levels may ultimately have to be rebalanced to match demand. These dynamics should become clearer in early 2006 and will have to be carefully considered when we provide our 2006 outlook.

Moving beyond the field actions, the increase in demand is not isolated to any one customer. We are seeing strength across all of our products and our entire customer base. We believe that the market continues to exhibit strong underlying growth fundamentals and that we are well positioned to participate in this market growth.

The increase in IMC sales of 19% during the second quarter and 9% year to date were primarily due to increased demand for ICD batteries, filtered feedthroughs, coated components and medical enclosures offset by an average 2% reduction in selling prices. Sales of assembly products manufactured in our Tijuana Facility added incremental sales of \$0.8 million to the quarter and year to date.

ECP. Similar to IMC customers, we have pricing arrangements with our customers that many times do not specify minimum quantities. Our visibility to customer ordering patterns is over a relatively short period of time.

We recorded our second consecutive record sales performance in our commercial business segment. The ECP sales increases of 30% in the second quarter and 23% year to date have been driven by volume increases due to a number of factors.

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First and foremost, we have expanded our commercial sales force. We are aggressively pursuing new business opportunities and have been successful on many of these fronts.

Second, we have significantly reduced our manufacturing lead times at our Canton facility, which has allowed us to increase shipments in the current year. We will continue to expand on these efforts from various lean manufacturing initiatives that are underway in our Canton facility and throughout the Company.

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The third factor that has contributed to our positive commercial results has been favorable market dynamics. The oil and gas exploration market remains robust due to the increased demand for products used in pipeline inspections, pressure monitoring and measurement while drilling applications. In addition, we have seen an increase in demand for power sources used in wave monitoring and seismic recording, due to increased Tsunami related concerns, mainly in the international markets.

Gross profit

The basis point decreases in gross margin for the quarter and year to date were primarily due to the following factors:

| | Basis point impact | |
|--|--------------------|--------------|
| | Quarter | Year to Date |
| Excess capacity at wet tantalum capacitor and Tijuana facilities | 290 | 230 |
| Lower IMC selling prices | 130 | 170 |
| Profit sharing accruals and incentive compensation | 60 | 30 |
| Higher platinum costs & other items | 70 | 70 |
| | --- | --- |
| | 550 | 500 |
| | === | === |

SG&A expenses

Expenses for the quarter and year to date increased primarily as a result of \$2.0 million of increased incentive compensation accruals recorded during the second quarter.

RD&E expenses

RD&E expenses, net of development costs reimbursed, decreased by 36% for the quarter and 24% for the year to date compared to last year. Gross RD&E spending declined by 12% for the quarter and 8% for the year to date versus last year. The majority of this decrease is due to the QHR battery product line moving from the development stage into production. We expect that RD&E costs will increase in the second half, due to increased investment in future development programs and the timing of achievement of reimbursement milestones.

In terms of the development costs billed, reimbursements for development projects were 360% higher in the current quarter, and 101% higher for the year to date compared to the same period last year. The reimbursements for achieving certain development milestones are netted against gross spending. The timing of the achievement of these milestones was the primary reason for the decline in net RD&E expenses.

Amortization expense

Amortization expense for the quarter declined as the result of the completion of amortization of a noncompete/employment agreement during 2004. The result is a \$0.1 million reduction in amortization expense per quarter in 2005.

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Amortization expense for the year to date reflects an incremental \$0.3 million of intangible amortization resulting from the NanoGram acquisition in March 2004 offset by the \$0.2 million reduction of expense due to the completion of the amortization of the noncompete/employment agreement during 2004.

Other operating expense

Other operating expense for the quarter and year to date is comprised of the following costs (in millions):

| | Quarter | Year to Date |
|-------------------------------------|---------|--------------|
| Costs to exit development agreement | \$ 1.2 | \$ 1.2 |
| Alden facility consolidation * | 0.9 | 0.9 |
| Severance * | - | 1.5 |
| Asset dispositions | 1.0 | 1.5 |
| Carson City facility shutdown * | 0.6 | 0.8 |
| Tijuana start-up * | 0.3 | 0.5 |
| | \$ 4.0 | \$ 6.4 |
| | ===== | ===== |

The \$1.2 million charge for "costs to exit a development agreement" were recorded in other operating expenses during the second quarter for charges associated with the discontinuation of a drug pump development agreement.

Refer to "Cost savings and consolidation efforts" discussion for disclosure related to the timing and level of remaining expenditures for items marked with "**".

Interest expense and interest income

Interest expense increased during the quarter and year to date due to the incremental deferred financing fees amortization related to the new revolver.

Interest income increased during the quarter and year to date due to higher interest rates as well as the movement of investments in mid-2004 from tax deferred to taxable securities, which bear higher rates of return.

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Provision for income taxes

The effective tax rate declined due to various state tax planning initiatives realized in mid-2004. We anticipate the full year effective tax rate will not exceed 30.0%.

Our effective tax rate is below the United States statutory rate primarily as a result of federal and state tax credits and the allowable Extraterritorial Income Exclusion ("ETI") for 2005.

Liquidity and Capital Resources

Revolving Line of Credit

On May 31, 2005, we amended our Senior Secured Credit Facility, which included changes to the underlying covenants. The amended three-year facility replaced the old \$20.0 million revolving credit facility with a new \$50.0 million

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Revolving Credit Facility ("new revolver"), which contains a \$10.0 million sub-limit for the issuance of commercial or standby letters of credit. The new revolver is secured by our non-realty assets including cash, accounts and notes receivable, and inventories. The new revolver requires us to comply with two quarterly financial covenants, as defined. The first relates to the ratio of consolidated net earnings or loss before interest, taxes, depreciation, and amortization ("EBITDA") to Fixed Charges. The second is a Leverage ratio, which is calculated based on the ratio of Consolidated Funded Debt less Cash, Cash Equivalent Investments and Short-Term Investments to Consolidated EBITDA. Interest rates under the new Facility vary with our leverage. We are required to pay a commitment fee of between .125% and .250% per annum on the unused portion of the revolving line of credit based on our leverage. As of June 30, 2005, we had no balance outstanding on our \$50.0 million committed revolving line of credit.

Our principal sources of liquidity are our operating cash flow combined with our working capital of \$143.3 million at June 30, 2005 and availability under our line of credit. Historically we have generated cash from operations sufficient to meet our capital expenditure and debt service needs, other than for acquisitions. At June 30, 2005, our current ratio was 6.2:1.

The Company regularly engages in discussions relating to potential acquisitions and may announce an acquisition transaction at any time.

Operating activities

Positive cash flows from operating activities were achieved in both periods presented. During the second quarter and year to date, increased accounts receivable utilized approximately \$6.9 million and \$11.2 million dollars of the cash provided from operating activities, respectively.

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Investing activities

The majority of the current year increase in capital spending was for the following:

- a. New medical power manufacturing plant in Alden, NY - \$5.6 million; and
- b. New assembly plant in Tijuana, Mexico - \$6.7 million.

In March 2004, we purchased NanoGram for approximately \$45.7 million. The most significant elements of the purchase price allocation were to patented and unpatented technology and goodwill. The costs allocated to patented and unpatented technology are being amortized over the remaining estimated useful life of 11.5 years. The residual amount of the allocation of \$33.4 million went to goodwill, which is not amortized but rather subject to periodic testing for impairment. NanoGram is now referred to as our Advanced Research Laboratory. Since the primary function of this operation is research and development, all costs are appropriately classified in that category.

Approximately \$9.5 million of short-term investments were purchased during the quarter, net of dispositions. On a year to date basis, short-term investments of \$5.0 million have been purchased, net of dispositions.

Financing activities

Payments on capital lease obligations and non-qualified stock option exercises are the primary financing activities for both periods presented.

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Capital Structure

At June 30, 2005, our capital structure consisted primarily of \$170.0 million of convertible subordinated notes and our 21.6 million shares of common stock outstanding. We have in excess of \$88.0 million in cash, cash equivalents and short-term investments and are in a position to facilitate future acquisitions if necessary. We are also authorized to issue 100 million shares of common stock and 100 million shares of preferred stock. The market value of our outstanding common stock since our IPO has exceeded our book value; accordingly, we believe that if needed we can access public markets to sell additional common or preferred stock assuming conditions are appropriate.

Our capital structure allows us to support our internal growth and provides liquidity for corporate development initiatives. The current expectation for 2005 is that capital spending is expected to be in the range of \$30.0 million to \$35.0 million, primarily due to the build-out of the Alden Facility (\$11.0 million), the Tijuana Facility (\$10.0 million), and normal maintenance capital expenditures.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements within the meaning of Item 303(a)(4) of Regulation S-K.

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Inflation

We do not believe that inflation has had a significant effect on our operations.

Impact of Recently Issued Accounting Standards

In July 2005, the Financial Accounting Standards Board ("FASB") published an Exposure Draft of a proposed Interpretation, Accounting for Uncertain Tax Positions. The Exposure Draft seeks to reduce the significant diversity in practice associated with recognition and measurement in the accounting for income taxes. It would apply to all tax positions accounted for in accordance with SFAS 109, Accounting for Income Taxes. The Exposure Draft requires that a tax position meet a "probable recognition threshold" for the benefit of the uncertain tax position to be recognized in the financial statements. This threshold is to be met assuming that the tax authorities will examine the uncertain tax position. The Exposure Draft contains guidance with respect to the measurement of the benefit that is recognized for an uncertain tax position, when that benefit should be derecognized, and other matters. This proposed Interpretation would clarify the accounting for uncertain tax positions in accordance with SFAS 109. This Interpretation, once approved, is expected to be effective as of the end of the first fiscal year ending after December 15, 2005. We outlined our critical accounting policies related to income taxes in our Annual Report on Form 10-K for the year ended December 31, 2004. Certain tax accounting and reporting guidelines may change as a result of new accounting guidance. Our accounting and reporting treatment will be determined at the time of issuance of a final standard.

In June 2005 the issued Statement of Financial Accounting Standards ("SFAS") No. 154, Accounting Changes and Error Corrections, ("SFAS 154") a replacement of APB Opinion No. 20, Accounting Changes, and Statement No. 3, Reporting Accounting Changes in Interim Financial Statements. SFAS 154 changes the requirements for the accounting for and the reporting of a change in accounting principle. Previously, most voluntary changes in accounting principles required recognition by recording a cumulative effect adjustment within net income in the period of

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change. SFAS 154 requires retrospective application to prior periods' financial statements, unless it is impracticable to determine either the specific period effects or the cumulative effect of the change. SFAS 154 is effective for accounting changes made in fiscal years beginning after December 15, 2005. We do not expect that adoption of SFAS No. 154 will have a material effect on our consolidated financial position, consolidated results of operations, or liquidity.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), Share-Based Payment ("SFAS No. 123(R)"). This statement is a revision of SFAS No. 123, Accounting for Stock-Based Compensation, and supercedes APB Opinion No. 25, Accounting for Stock Issued to Employees. This standard requires the Company to measure the cost of employee services received in exchange for equity awards based on the grant date fair value of the awards. The cost will be recognized as compensation expense over the vesting period of the awards.

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We anticipate adopting the provisions of SFAS No. 123(R) on January 1, 2006 using the modified prospective application. Accordingly, compensation expense will be recognized for all newly granted awards and awards modified, repurchased, or cancelled after January 1, 2006. Compensation cost for the unvested portion of awards that are outstanding as of January 1, 2006 will be recognized ratably over the remaining vesting period. The compensation cost for the unvested portion of awards will be based on the fair value at date of grant as calculated for our pro forma disclosure under SFAS 123.

We estimate that the effect on net income and earnings per share in the periods following adoption of SFAS 123(R) will be consistent with the our pro forma disclosure under SFAS No. 123, except that estimated forfeitures will be considered in the calculation of compensation expense under SFAS 123(R). Additionally, the actual effect on net income and earnings per share will vary depending upon the number of options granted in subsequent periods compared to prior years.

In November 2004, the FASB issued SFAS No. 151, Inventory Costs, an amendment of ARB No. 43, Chapter 4 ("SFAS No. 151"). SFAS No. 151 amends the guidance in ARB No. 43, Chapter 4, "Inventory Pricing," to clarify the accounting for abnormal amounts of idle facility expense, handling costs and wasted material (spoilage). Among other provisions, the new rule requires that such items be recognized as current-period charges, regardless of whether they meet the criterion of "so abnormal" as stated in ARB No. 43. SFAS No. 151 is effective for fiscal years beginning after June 15, 2005. We do not expect that adoption of SFAS No. 151 will have a material effect on our consolidated financial position, consolidated results of operations, or liquidity.

Application of Critical Accounting Estimates

Our unaudited condensed consolidated financial statements are based on the selection of accounting policies and the application of significant accounting estimates, some of which require management to make significant assumptions. We believe that some of the more critical estimates and related assumptions that affect our financial condition and results of operations are in the areas of inventories, goodwill and other indefinite lived intangible assets, long-lived assets and income taxes.

During the three months ended June 30, 2005, we did not change or adopt new accounting policies that had a material effect on our consolidated financial condition and results of operations.

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Contractual Obligations

During 2004, we commenced the build out of our Alden Facility and our Tijuana Facility. These facilities will enable the Company to further consolidate its operations and implement state of the art manufacturing capabilities at both locations. The contractual obligations for construction of these facilities is \$4.4 million and will be financed by existing, or internally generated cash.

Litigation

During 2002, a former non-medical customer commenced an action alleging that we used proprietary information of the customer to develop certain products. We have meritorious defenses and are vigorously defending the case. No accrual for an adverse judgment has been made as such outcome is not deemed probable, the potential risk of loss is between \$0.0 and \$1.75 million.

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As reported in our 2005 first quarter Form 10-Q, on May 2, 2005, a complaint was filed against us by a developer of an implantable drug delivery device in the United States Federal District Court for the Central District of California. On May 20, 2005, the parties entered into a settlement agreement under which the Company undertook certain obligations including the performance of certain additional development tasks for a limited period of time. On June 2, 2005, the Court ordered the complaint dismissed without prejudice.

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Forward-Looking Statements

Some of the statements contained in this Quarterly Report on Form 10-Q/A and other written and oral statements made from time to time by us and our representatives, are not statements of historical or current fact. As such, they are "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. We have based these forward-looking statements on our current expectations, which are subject to known and unknown risks, uncertainties and assumptions. They include statements relating to:

- o future sales, expenses and profitability;
- o the future development and expected growth of our business and the implantable medical device industry;
- o our ability to successfully execute our business model and our business strategy;
- o our ability to identify trends within the for implantable medical devices, medical components, and commercial power sources industries and to offer products and services that meet the changing needs of those markets;
- o projected capital expenditures; and
- o trends in government regulation.

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You can identify forward-looking statements by terminology such as "may," "will," "should," "could," "expects," "intends," "plans," "anticipates," "believes," "estimates," "predicts," "potential" or "continue" or the negative of these terms or other comparable terminology. These statements are only predictions. Actual events or results may differ materially from those suggested by these forward-looking statements. In evaluating these statements and our prospects generally, you should carefully consider the factors set forth below. All forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by these cautionary factors and to others contained throughout this report. We are under no duty to update any of the forward-looking statements after the date of this report or to conform these statements to actual results.

Although it is not possible to create a comprehensive list of all factors that may cause actual results to differ from the results expressed or implied by our forward-looking statements or that may affect our future results, some of these factors include the following: dependence upon a limited number of customers, product obsolescence, inability to market current or future products, pricing pressure from customers, reliance on third party suppliers for raw materials, products and subcomponents, fluctuating operating results, inability to maintain high quality standards for our products, challenges to our intellectual property rights, product liability claims, inability to successfully consummate and integrate acquisitions, unsuccessful expansion into new markets, competition, inability to obtain licenses to key technology, regulatory changes or consolidation in the healthcare industry, and other risks and uncertainties that arise from time to time as described in the Company's Annual Report on Form 10-K and other periodic filings with the Securities and Exchange Commission.

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ITEM 4. Controls and Procedures.

- a. Evaluation of Disclosure Controls and Procedures. During the second quarter of 2005, our management, including the principal executive officer and principal financial officer, evaluated our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) related to the recording, processing, summarization and reporting of information in our reports that we file with the SEC. These disclosure controls and procedures have been designed to ensure that material information relating to us, including our subsidiaries, is made known to our management, including these officers, by other of our employees, and that this information is recorded, processed, summarized, evaluated and reported, as applicable, within the time periods specified in the SEC's rules and forms. Due to the inherent limitations of control systems, not all misstatements may be detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. Our controls and procedures can only provide reasonable, not absolute, assurance that the above objectives have been met.

As a result of the restatement of the Company's consolidated balance sheet and consolidated statement of cash flows as of December 31, 2004 as described in Amendment 1 to Form 10-K for the year ended December 31, 2004, the Company's management, including the principal executive officer and principal financial officer, have concluded that there was a material weakness in internal control over financial reporting. Specifically, the

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Company's review of the financial statements utilizing a financial statement presentation and disclosure checklist to ensure that the financial statements were fairly presented in accordance with generally accepted accounting principles did not operate effectively as it relates to the misstatements identified above. Solely as a result of this material weakness, our Management has revised its earlier assessment and has now concluded that our internal control over financial reporting was not effective as of June 30, 2005.

b. Changes in Internal Control Over Financial Reporting.

Since March 31, 2005, except as disclosed below, there have been no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

As of the date of this filing, we have remediated the material weakness in our internal controls over financial reporting. The remedial actions included:

1. Enhancing the financial reporting process to include the formal review of all auction rate securities for proper classification, as well as the appropriate cash flow presentation of liabilities related to the acquisition of property, plant and equipment.
2. Establishing formal quarterly disclosure meetings which will include our third party tax advisors to review significant transactions during the period as well as to review and discuss new accounting presentation and disclosure guidelines. Our outside accountants, although not part of our control structure, will participate in these meetings.

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3. Enhancing our financial reporting practices to include the use of multiple third-party financial reporting technical alerts that we utilize to evaluate our accounting policies and financial statement disclosures.

While we have not completed all of our Sarbanes-Oxley testing for 2005, we believe that after putting into effect the remedial actions described above, our Company's system of internal controls over financial reporting is effective, which should enable us to arrive at the 2005 assessment that our system of internal controls over financial reporting are adequate and operating effectively.

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PART II - OTHER INFORMATION

ITEM 6. Exhibits.

See the Exhibit Index for a list of those exhibits filed herewith.

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SIGNATURES

Pursuant to the requirements of Sections 13 or 15(d) 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.

Dated: December 16, 2005 GREATBATCH, INC.

By /s/ Edward F. Voboril

Edward F. Voboril
Chairman of the Board and Chief Executive Officer
(Principal Executive Officer)

By /s/ Thomas J. Mazza

Thomas J. Mazza
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)

By /s/ Marco F. Benedetti

Marco F. Benedetti
Corporate Controller
(Principal Accounting Officer)

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EXHIBIT INDEX

| Exhibit No. | Description |
|-------------|---|
| ----- | ----- |
| 31.1 | Certification of Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act. |
| 31.2 | Certification of Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities Exchange Act. |
| 32.1 | Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

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