GREATBATCH, INC.
Form 10-Q
August 06, 2013
Table of Contents

U.S. SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 or 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended June 28, 2013

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.)

2595 Dallas Parkway

Suite 310

Frisco, TX 75034

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

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

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨	Smaller reporting company	¨

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

The number of shares outstanding of the Company s common stock, $0.001 par value per share, as of August 6, 2013 was: 24,063,744 shares.

Table of Contents

Greatbatch, Inc.

Table of Contents for Form 10-Q

As of and for the Quarterly Period Ended June 28, 2013

Table of Contents

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

GREATBATCH, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS - Unaudited

(in thousands except share and per share data)

	As of June 28, 2013	As of December 28, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$ 10,184	$ 20,284
Accounts receivable, net of allowance for doubtful accounts of $2.2 million in 2013 and $2.4 million in 2012	138,597	120,923
Inventories	122,162	106,612
Deferred income taxes	7,906	7,678
Prepaid expenses and other current assets	9,572	12,636
Total current assets	288,421	268,133
Property, plant and equipment, net	149,214	150,893
Amortizing intangible assets, net	79,973	87,345
Indefinite-lived intangible assets	20,828	20,828
Goodwill	344,909	349,035
Deferred income taxes	2,676	2,534
Other assets	11,261	11,107
Total assets	$ 897,282	$ 889,875
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 42,675	$ 45,274
Income taxes payable	18,915	94
Deferred income taxes	845	874
Accrued expenses	36,250	45,515
Total current liabilities	98,685	91,757
Long-term debt	237,000	225,414
Deferred income taxes	51,990	82,462
Other long-term liabilities	6,500	9,382
Total liabilities	394,175	409,015
Stockholders equity:		
Preferred stock, $0.001 par value, authorized 100,000,000 shares; no shares issued or outstanding in 2013 or 2012		
Common stock, $0.001 par value, authorized 100,000,000 shares; 23,982,662 shares issued and 23,960,657 shares outstanding in 2013 23,731,570 shares issued and 23,711,838 shares outstanding in 2012	24	24

Additional paid-in capital	329,388	320,618
Treasury stock, at cost, 22,005 shares in 2013 and 19,732 shares in 2012	(593)	(452)
Retained earnings	163,138	147,723
Accumulated other comprehensive income	11,150	12,947
Total stockholders equity	503,107	480,860
Total liabilities and stockholders equity	$ 897,282	$ 889,875

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

Table of Contents

GREATBATCH, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

AND COMPREHENSIVE INCOME (LOSS) - Unaudited

(in thousands except per share data)

	Three Months Ended		Six Months Ended	
	June 28, 2013	June 29, 2012	June 28, 2013	June 29, 2012
Sales	$ 171,331	$ 166,548	$ 319,596	$ 325,651
Cost of sales	114,029	114,615	213,545	226,830
Gross profit	57,302	51,933	106,051	98,821
Operating expenses:				
Selling, general and administrative expenses	22,248	20,745	42,340	39,779
Research, development and engineering costs, net	14,097	14,174	25,177	28,085
Other operating expenses, net	3,822	5,923	7,060	8,668
Total operating expenses	40,167	40,842	74,577	76,532
Operating income	17,135	11,091	31,474	22,289
Interest expense	1,445	4,415	8,433	8,774
Other (income) expense, net	679	(194)	964	526
Income before provision for income taxes	15,011	6,870	22,077	12,989
Provision for income taxes	5,259	3,019	6,662	4,671
Net income	$ 9,752	$ 3,851	$ 15,415	$ 8,318
Earnings per share:				
Basic	$ 0.41	$ 0.16	$ 0.65	$ 0.35
Diluted	$ 0.39	$ 0.16	$ 0.62	$ 0.35
Weighted average shares outstanding:				
Basic	23,914	23,611	23,832	23,515
Diluted	24,922	23,876	24,818	23,816
Comprehensive income (loss):				
Net income	$ 9,752	$ 3,851	$ 15,415	$ 8,318
Other comprehensive income (loss)				
Foreign currency translation gain (loss)	631	(5,565)	(2,432)	(1,527)
Net change in cash flow hedges, net of tax	(231)		38	525
Defined benefit plan liability adjustment, net of tax			597	
Other comprehensive income (loss)	400	(5,565)	(1,797)	(1,002)
Comprehensive income (loss)	$ 10,152	$ (1,714)	$ 13,618	$ 7,316

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

Table of Contents

GREATBATCH, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS - Unaudited

(in thousands)

	Six Months Ended June 28, 2013	Six Months Ended June 29, 2012
Cash flows from operating activities:		
Net income	$ 15,415	$ 8,318
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	17,853	22,104
Debt related amortization included in interest expense	5,887	5,959
Stock-based compensation	7,347	5,533
Other non-cash gains	(276)	(59)
Deferred income taxes	(30,910)	45
Changes in operating assets and liabilities, net of acquisitions:		
Accounts receivable	(18,030)	(12,140)
Inventories	(15,966)	(4,570)
Prepaid expenses and other current assets	(161)	538
Accounts payable	(699)	2,749
Accrued expenses	(7,853)	(8,669)
Income taxes payable	18,760	3,732
Net cash provided by (used in) operating activities	(8,633)	23,540
Cash flows from investing activities:		
Proceeds from sale of orthopaedic product lines (Note 9)	3,228	
Acquisition of property, plant and equipment	(11,557)	(24,181)
Purchase of equity method investments	(1,287)	
Acquisitions, net of cash acquired		(17,224)
Other investing activities	30	65
Net cash used in investing activities	(9,586)	(41,340)
Cash flows from financing activities:		
Principal payments of long-term debt	(208,782)	(18,000)
Proceeds from issuance of long-term debt	215,000	10,000
Issuance of common stock	2,579	403
Other financing activities	(688)	(118)
Net cash provided by (used in) financing activities	8,109	(7,715)
Effect of foreign currency exchange rates on cash and cash equivalents	10	140
Net decrease in cash and cash equivalents	(10,100)	(25,375)
Cash and cash equivalents, beginning of period	20,284	36,508
Cash and cash equivalents, end of period	$ 10,184	$ 11,133

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

- 5 -

Table of Contents

GREATBATCH, INC.

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY - Unaudited

(in thousands)

	Common Stock		Additional	Treasury Stock			Accumulated	Total
			Paid-In			Retained	Other Comprehensive	Stockholders
	Shares	Amount	Capital	Shares	Amount	Earnings	Income	Equity
At December 28, 2012	23,732	$ 24	$ 320,618	(20)	$ (452)	$ 147,723	$ 12,947	$ 480,860
Stock-based compensation			4,355					4,355
Net shares issued under stock incentive plans	160		2,020	(2)	(141)			1,879
Income tax liability from stock options, restricted stock and restricted stock units			(82)					(82)
Shares contributed to 401(k) Plan	91		2,477					2,477
Net income						15,415		15,415
Total other comprehensive loss							(1,797)	(1,797)
At June 28, 2013	23,983	$ 24	$ 329,388	(22)	$ (593)	$ 163,138	$ 11,150	$ 503,107

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

Table of Contents

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 in the United States of America for interim financial information (Accounting Standards Codification (ASC) 270, *Interim 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 full presentation of financial position, results of operations, and cash flows in conformity with accounting principles generally accepted in the United States of America (GAAP). 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. and its wholly-owned subsidiary, Greatbatch Ltd. (collectively Greatbatch or the Company), for the periods presented. The preparation of financial statements in conformity with GAAP 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 materially from these estimates. The December 28, 2012 condensed consolidated balance sheet data was derived from audited consolidated financial statements but does not include all disclosures required by GAAP. For further information, refer to the consolidated financial statements and notes included in the Company s Annual Report on Form 10-K for the year ended December 28, 2012. The Company utilizes a fifty-two, fifty-three week fiscal year ending on the Friday nearest December 31st. The second quarter and year-to-date periods of 2013 and 2012 each contained 13 weeks and 26 weeks, respectively, and ended on June 28, and June 29, respectively.

2. ACQUISITIONS

NeuroNexus Technologies, Inc.

On February 16, 2012, the Company purchased all of the outstanding common stock of NeuroNexus Technologies, Inc. (NeuroNexus) headquartered in Ann Arbor, MI. NeuroNexus is an active implantable medical device design firm specializing in developing and commercializing neural interface technology, components and systems for neuroscience and clinical markets. NeuroNexus has an extensive intellectual property portfolio, core technologies and capabilities to support the development and manufacturing of neural interface devices across a wide range of applications including neuromodulation, sensing, optical stimulation and targeted drug delivery. The aggregate purchase price of NeuroNexus was $13.2 million. Total assets acquired from NeuroNexus were $14.6 million, of which $2.9 million were amortizing intangible assets and $8.9 million was allocated to goodwill.

This transaction was accounted for under the acquisition method of accounting. Accordingly, the operating results of NeuroNexus were included in the Company s Implantable Medical segment from the date of acquisition and the purchase price was allocated to the assets acquired and liabilities assumed based on their fair values as of the close of the acquisition, with the amount exceeding the fair value of net assets acquired being recorded as goodwill. The purchase price of NeuroNexus consisted of cash payments of $11.7 million and potential future payments of up to an additional $2 million. These future payments are contingent upon the achievement of certain financial and development-based milestones and had an estimated fair value of $1.5 million as of the acquisition date. The valuation of the assets acquired and liabilities assumed from NeuroNexus was finalized during the first quarter of 2013 and did not result in a material adjustment to the original valuation of net assets acquired, including goodwill.

Table of Contents

GREATBATCH, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Unaudited

Pro Forma Results (Unaudited)

The following unaudited pro forma information presents the consolidated results of operations of the Company and NeuroNexus as if that acquisition occurred as of the beginning of fiscal year 2012 (in thousands, except per share amounts):

	Three Months Ended		Six Months Ended	
	June 28, 2013	June 29, 2012	June 28, 2013	June 29, 2012
Sales	$ 171,331	$ 166,548	$ 319,596	$ 326,091
Net income	9,752	3,851	15,415	8,144
Earnings per share:				
Basic	$ 0.41	$ 0.16	$ 0.65	$ 0.35
Diluted	$ 0.39	$ 0.16	$ 0.62	$ 0.34

The unaudited pro forma information presents the combined operating results of Greatbatch and NeuroNexus, with the results prior to the acquisition date adjusted to include the pro forma impact of the amortization of acquired intangible assets based on the purchase price allocations, the adjustment to interest expense reflecting the amount borrowed in connection with the acquisition at Greatbatch s interest rate, and the impact of income taxes on the pro forma adjustments utilizing the applicable statutory tax rate. The unaudited pro forma consolidated basic and diluted earnings per share calculations are based on the consolidated basic and diluted weighted average shares of Greatbatch.

The unaudited pro forma results are presented for illustrative purposes only and do not reflect the realization of potential cost savings, and any related integration costs. Certain cost savings may result from the acquisition; however, there can be no assurance that these cost savings will be achieved. These pro forma results do not purport to be indicative of the results that would have been obtained, or to be a projection of results that may be obtained in the future.

Table of Contents

GREATBATCH, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Unaudited

3. SUPPLEMENTAL CASH FLOW INFORMATION

(in thousands)	Six Months Ended June 28, 2013	Six Months Ended June 29, 2012
Noncash investing and financing activities:		
Common stock contributed to 401(k) Plan	$ 2,477	$ 4,793
Property, plant and equipment purchases included in accounts payable	825	5,624
Cash paid during the period for:		
Interest	$ 2,926	$ 2,909
Income taxes	18,895	983
Acquisition of noncash assets	$	$ 14,379
Liabilities assumed		1,226

4. INVENTORIES

Inventories are comprised of the following (in thousands):

	As of June 28, 2013	As of December 28, 2012
Raw materials	$ 68,016	$ 58,204
Work-in-process	35,162	30,022
Finished goods	18,984	18,386
Total	$ 122,162	$ 106,612

- 9 -

Table of Contents

GREATBATCH, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Unaudited

5. INTANGIBLE ASSETS

Amortizing intangible assets are comprised of the following (in thousands):

At June 28, 2013	Gross Carrying Amount	Accumulated Amortization	Foreign Currency Translation	Net Carrying Amount
Technology and patents	$ 95,576	$ (65,470)	$ 1,701	$ 31,807
Customer lists	68,257	(21,797)	838	47,298
Other	4,434	(4,370)	804	868
Total amortizing intangible assets	$ 168,267	$ (91,637)	$ 3,343	$ 79,973
At December 28, 2012				
Technology and patents	$ 95,576	$ (61,659)	$ 1,932	$ 35,849
Customer lists	68,257	(18,929)	1,270	50,598
Other	4,434	(4,341)	805	898
Total amortizing intangible assets	$ 168,267	$ (84,929)	$ 4,007	$ 87,345

Aggregate intangible asset amortization expense is comprised of the following (in thousands):

	Three Months Ended		Six Months Ended	
	June 28, 2013	June 29, 2012	June 28, 2013	June 29, 2012
Cost of sales	$ 1,759	$ 1,900	$ 3,539	$ 3,795
Selling, general and administrative expenses	1,445	1,579	2,897	3,140
Research, development and engineering costs, net	136	137	272	273
Total intangible asset amortization expense	$ 3,340	$ 3,616	$ 6,708	$ 7,208

Table of Contents

GREATBATCH, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Unaudited

Estimated future intangible asset amortization expense based on the current carrying value is as follows (in thousands):

	Estimated Amortization Expense
Remainder of 2013	$ 6,435
2014	13,372
2015	12,320
2016	10,026
2017	8,903
Thereafter	28,917
Total estimated amortization expense	$ 79,973

Indefinite-lived intangible assets are comprised of the following (in thousands):

	Trademarks and Tradenames	IPR&D	Total
At June 28, 2013	$ 20,288	$ 540	$ 20,828

The change in goodwill is as follows (in thousands):

	Implantable Medical	Electrochem	Total
At December 28, 2012	$ 307,201	$ 41,834	$ 349,035
Goodwill disposed (Note 9)	(2,771)		(2,771)
Foreign currency translation	(1,355)		(1,355)
At June 28, 2013	$ 303,075	$ 41,834	$ 344,909

Table of Contents

GREATBATCH, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Unaudited

6. DEBT

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

	As of	
	June 28, 2013	**December 28, 2012**
Revolving line of credit	$ 237,000	$ 33,000
2.25% convertible subordinated notes		197,782
Unamortized discount		(5,368)
Total long-term debt	$ 237,000	$ 225,414

Revolving Line of Credit The Company has a revolving credit facility (the Credit Facility), which provides a $400 million secured revolving credit facility, and can be increased by $200 million upon the Company s request and approval by the lenders. The Credit Facility also contains a $15 million letter of credit subfacility and a $15 million swingline subfacility. The Credit Facility has a maturity date of June 24, 2016.

The Credit Facility is secured by the Company s non-realty assets including cash, accounts receivable and inventories. Interest rates under the Credit Facility are, at the Company s option either at: (i) the prime rate plus the applicable margin, which ranges between 0.0% and 1.0%, based on the Company s total leverage ratio or (ii) the applicable LIBOR rate plus the applicable margin, which ranges between 1.5% and 3.0%, based on the Company s total leverage ratio. Loans under the swingline subfacility will bear interest at the prime rate plus the applicable margin, which ranges between 0.0% and 1.0%, based on the Company s total leverage ratio. The Company is also required to pay a commitment fee, which varies between 0.175% and 0.25% depending on the Company s total leverage ratio.

The Credit Facility contains limitations on the incurrence of indebtedness, liens and licensing of intellectual property, investments and certain payments. The Credit Facility permits the Company to engage in the following activities up to an aggregate amount of $250 million: 1) engage in permitted acquisitions in the aggregate not to exceed $250 million; 2) make other investments in the aggregate not to exceed $60 million; 3) make stock repurchases not to exceed $60 million in the aggregate; and 4) retire up to $198 million of CSN (defined below). At any time that the total leverage ratio of the Company for the two most recently ended fiscal quarters is less than 2.75 to 1.0, the Company may make an election to reset each of the amounts specified above. Additionally, these limitations can be waived upon the Company s request and approval of a majority of the lenders. As a result of the repayment of CSN during the first quarter of 2013 (discussed below), as of June 28, 2013, the Company s ability to engage in these activities was reduced to the aggregate limit of $49 million.

The Credit Facility requires the Company to maintain a rolling four quarter ratio of adjusted EBITDA to interest expense of at least 3.0 to 1.0, and a total leverage ratio of not greater than 4.0 to 1.0. The calculation of adjusted EBITDA and total leverage ratio excludes non-cash charges, extraordinary, unusual, or non-recurring expenses or losses, non-cash stock-based compensation, and non-recurring expenses or charges incurred in connection with permitted acquisitions. As of June 28, 2013, the Company was in compliance with all covenants.

Table of Contents

GREATBATCH, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Unaudited

The Credit Facility contains customary events of default. Upon the occurrence and during the continuance of an event of default, a majority of the lenders may declare the outstanding advances and all other obligations under the Credit Facility immediately due and payable.

As of June 28, 2013, the weighted average interest rate on borrowings under the Credit Facility, which does not take into account the impact of the Company s interest rate swap, was 1.97%. As of June 28, 2013, the Company had $163 million of borrowing capacity available under the Credit Facility. This borrowing capacity may vary from period to period based upon the debt levels of the Company and the level of EBITDA, which impacts the covenant calculations described above.

Interest Rate Swap From time to time, the Company enters into interest rate swap agreements in order to hedge against potential changes in cash flows on the outstanding borrowings on the Credit Facility. The variable rate received on the interest rate swaps and the variable rate paid on the debt have the same rate of interest, excluding the credit spread, and resets and pays interest on the same date. During 2012, the Company entered into a three-year $150 million interest rate swap, which amortizes $50 million per year and became effective on February 20, 2013. This swap was entered into in order to hedge against potential changes in cash flows on the outstanding Credit Facility borrowings, which are also indexed to the one-month LIBOR rate. This swap is being accounted for as a cash flow hedge. Information regarding the Company s outstanding interest rate swap as of June 28, 2013 is as follows (dollars in thousands):

Instrument	Type of Hedge	Notional Amount	Start Date	End Date	Pay Fixed Rate	Current Receive Floating Rate	Fair Value June 28, 2013	Balance Sheet Location
Interest rate swap	Cash flow	$ 150,000	Feb-13	Feb-16	0.573%	0.192%	$ (284)	Other Long-Term Liabilities

The estimated fair value of the interest rate swap agreement represents the amount the Company expects to receive (pay) to terminate the contract. No portion of the change in fair value of the Company s interest rate swap during the six months ended June 28, 2013 was considered ineffective. The amount recorded as Interest Expense during the three and six months ended June 28, 2013 related to the Company s interest rate swaps was $0.1 million and $0.2 million, respectively.

Convertible Subordinated Notes In March 2007, the Company completed a private placement of $197.8 million of convertible subordinated notes (CSN) at a 5% discount. CSN accrued interest at 2.25% per annum, payable semi-annually, and were due on June 15, 2013. The effective interest rate of CSN, which took into consideration the amortization of the discount and deferred fees related to the issuance of these notes, was 8.5%. The discount on CSN was being amortized to the redemption date utilizing the effective interest method. On February 20, 2013, the Company redeemed all outstanding CSN using funds borrowed under the Credit Facility.

Table of Contents

GREATBATCH, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Unaudited

The contractual interest and discount amortization for CSN were as follows (in thousands):

	Three Months Ended		Six Months Ended	
	June 28, 2013	June 29, 2012	June 28, 2013	June 29, 2012
Contractual interest	$	$ 1,113	$ 634	$ 2,225
Discount amortization		2,735	5,368	5,424

Deferred Financing Fees - The change in deferred financing fees is as follows (in thousands):

At December 28, 2012	$ 2,056
Amortization during the period	(520)
At June 28, 2013	$ 1,536

7. DEFINED BENEFIT PLANS

The Company is required to provide its employees located in Switzerland, Mexico and France certain statutorily mandated defined benefits. Under these plans, benefits accrue to employees based upon years of service, position, age and compensation. The defined benefit plan provided to employees located in Switzerland is a funded contributory plan while the plans that provide benefits to employees located in Mexico and France are unfunded and noncontributory. The liability and corresponding expense related to these benefit plans is based on actuarial computations of current and future benefits for employees.

During 2012, the Company transferred most major functions performed at its facilities in Switzerland into other existing facilities. As a result, the Company curtailed its defined benefit plan provided to employees at those Swiss facilities during the third quarter of 2012. In accordance with ASC 715, the gain recognized in connection with this curtailment is realized as the related employees are terminated. As nearly all of the Swiss pension liability is expected to be paid in 2013, the Company moved all Swiss pension plan assets into cash accounts during 2012. Swiss plan assets are expected to be sufficient to cover plan liabilities. During 2013, the Company settled approximately $7.7 million of its defined benefit obligation.

The change in net defined benefit plan liability is as follows (in thousands):

At December 28, 2012	$ 3,946
Service cost	151
Interest cost	103
Curtailment	(1,581)
Actuarial gain	(171)
Benefit payments	(109)
Foreign currency translation	(67)
At June 28, 2013	$ 2,272

Table of Contents

GREATBATCH, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Unaudited

Amounts recognized in Accumulated Other Comprehensive Income are as follows (in thousands):

	Six Months Ended June 28, 2013
Net gain occurring during the period	$ (171)
Amortization of losses	(581)
Prior service cost	155
Pre-tax adjustment	(597)
Taxes	
Net gain	$ (597)

Net defined benefit (income) cost is comprised of the following (in thousands):

	Three Months Ended		Six Months Ended	
	June 28, 2013	June 29, 2012	June 28, 2013	June 29, 2012
Service cost	$ 69	$ 278	$ 151	$ 563
Interest cost	40	103	103	207
Curtailment gain (Other Operating Expenses, Net)			(1,150)	
Amortization of net loss		31		62
Expected return on plan assets		(107)		(215)
Net defined benefit (income) cost	$ 109	$ 305	$ (896)	$ 617

Table of Contents

GREATBATCH, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Unaudited

8. STOCK-BASED COMPENSATION

The components and classification of stock-based compensation expense were as follows (in thousands):

	Three Months Ended		Six Months Ended	
	June 28, 2013	June 29, 2012	June 28, 2013	June 29, 2012
Stock options	$ 705	$ 689	$ 1,410	$ 1,367
Restricted stock and units	1,482	1,527	2,945	3,036
401(k) stock contribution	2,729	1,130	2,992	1,130
Total stock-based compensation expense	$ 4,916	$ 3,346	$ 7,347	$ 5,533
Cost of sales	$ 1,707	$ 1,104	$ 2,129	$ 1,367
Selling, general and administrative	2,587	1,909	4,454	3,726
Research, development and engineering	622	333	764	440
Total stock-based compensation expense	$ 4,916	$ 3,346	$ 7,347	$ 5,533

The weighted average fair value and assumptions used to value options granted are as follows:

	Six Months Ended	
	June 28, 2013	June 29, 2012
Weighted average fair value	$ 8.38	$ 8.19
Risk-free interest rate	0.73%	0.83%
Expected volatility	39%	40%
Expected life (in years)	5	5
Expected dividend yield	0%	0%

Table of Contents

GREATBATCH, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Unaudited

The following table summarizes time-vested stock option activity:

	Number of Time-Vested Stock Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (In Years)	Aggregate Intrinsic Value (In Millions)
Outstanding at December 28, 2012	1,775,847	$ 23.17		
Granted	372,676	23.33		
Exercised	(92,549)	22.99		
Forfeited or expired	(41,887)	24.02		
Outstanding at June 28, 2013	2,014,087	$ 23.19	6.3	$ 19.6
Exercisable at June 28, 2013	1,409,348	$ 23.26	5.1	$ 13.7

The following table summarizes performance-vested stock option activity:

	Number of Performance-Vested Stock Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (In Years)	Aggregate Intrinsic Value (In Millions)
Outstanding at December 28, 2012	284,925	$ 23.26		
Granted				
Exercised	(19,489)	23.12		
Forfeited or expired				
Outstanding at June 28, 2013	265,436	$ 23.27	3.8	$ 2.5
Exercisable at June 28, 2013	265,436	$ 23.27	3.8	$ 2.5

The following table summarizes time-vested restricted stock and unit activity:

	Time-Vested Activity	Weighted Average Fair Value
Nonvested at December 28, 2012	80,269	$ 23.48
Granted	61,202	25.56
Vested	(24,562)	22.27
Forfeited	(3,335)	21.11

Nonvested at June 28, 2013	113,574	$ 24.93

Table of Contents

GREATBATCH, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Unaudited

The following table summarizes performance-vested restricted stock and unit activity:

	Performance-Vested Activity	Weighted Average Fair Value
Nonvested at December 28, 2012	782,446	$ 16.02
Granted	318,169	15.86
Vested	(49,139)	14.68
Forfeited	(220,909)	15.22
Nonvested at June 28, 2013	830,567	$ 16.38

9. OTHER OPERATING EXPENSES, NET

Other Operating Expenses, Net is comprised of the following (in thousands):

	Three Months Ended		Six Months Ended	
	June 28, 2013	June 29, 2012	June 28, 2013	June 29, 2012
2013 operating unit realignment	$ 852	$	$ 852	$
Orthopaedic facility optimization	2,667	1,978	5,303	2,322
Medical device facility optimization	125	565	230	894
ERP system upgrade	64	1,912	385	2,807
Acquisition and integration costs	71	112	182	1,055
Asset dispositions, severance and other	43	1,356	108	1,590
	$ 3,822	$ 5,923	$ 7,060	$ 8,668

2013 operating unit realignment. In June 2013, the Company initiated a plan to realign its operating structure in order to optimize its continued focus on profitable growth. As part of this initiative, the sales & marketing and operations groups of its Implantable Medical and Electrochem segments were combined into one sales & marketing and one operations group serving the entire Company. Total restructuring charges expected to be incurred in connection with this realignment is between $4.2 million and $5.0 million, of which $0.9 million has been incurred to date. Expenses related to this initiative will be recorded within the applicable segment and corporate cost centers that the expenditures relate to and include the following:

Severance and retention: $3.0 million - $3.2 million; and

Other: $1.2 million $1.8 million.

Other costs primarily consist of relocation, recruitment and travel expenditures expected to be incurred in connection with the 2013 operating unit realignment.

Table of Contents

GREATBATCH, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Unaudited

The change in accrued liabilities related to the 2013 operating unit realignment is as follows (in thousands):

	Severance and Retention	Other	Total
At December 28, 2012	$	$	$
Restructuring charges	402	450	852
Cash payments	(5)		(5)
At June 28, 2013	$ 397	$ 450	$ 847

Orthopaedic facility optimization. In 2010, the Company began updating its Indianapolis, IN facility to streamline operations, consolidate two buildings, increase capacity, further expand capabilities and reduce dependence on outside suppliers. This initiative was completed in 2011.

In 2011, the Company began construction on an orthopaedic manufacturing facility in Fort Wayne, IN and transferred the manufacturing operations being performed at its Columbia City, IN facility into this new facility. This initiative was completed in 2012.

During 2012, the Company transferred most major functions performed at its facilities in Orvin and Corgemont, Switzerland into existing facilities in Fort Wayne, IN and Tijuana, Mexico. In connection with this consolidation, in 2012, the Company entered into an agreement to sell assets related to certain non-core Swiss orthopaedic product lines to an independent third party including inventory, machinery, equipment, customer lists and technology related to these product lines. As these product lines were considered a business, goodwill was allocated to the transaction. As these product lines did not have cash flows that were clearly distinguishable, both operationally and for financial reporting purposes, from the rest of the Company, they were not considered discontinued operations. This transaction closed in the first quarter of 2013 and no additional loss on sale was recognized. During 2013, the Company received payments totaling $3.2 million in connection with this transaction and the third party assumed $2.4 million of severance liabilities.

The total capital investment expected for these initiatives is between $25 million and $30 million, of which $21.8 million has been expended to date. Total expense expected to be incurred for these initiatives is between $39 million and $40 million, of which $38.4 million has been incurred to date. All expenses will be recorded within the Implantable Medical segment and are expected to include the following:

- Severance and retention: approximately $11 million;
- Accelerated depreciation and asset write-offs: approximately $15 million; and
- Other: $13 million - $14 million.

Other costs include production inefficiencies, moving, revalidation, personnel, training and travel costs associated with these consolidation projects.

Table of Contents

GREATBATCH, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Unaudited

The change in accrued liabilities related to the orthopaedic facility optimization is as follows (in thousands):

	Severance and Retention	Accelerated Depreciation/Asset Write-offs	Other	Total
At December 28, 2012	$ 9,567	$	$	$ 9,567
Restructuring charges	482	48	4,773	5,303
Write-offs		(48)		(48)
Liability assumed by third party	(2,398)			(2,398)
Cash payments	(7,074)		(3,859)	(10,933)
At June 28, 2013	$ 577	$	$ 914	$ 1,491

Medical device facility optimization. Near the end of 2011, the Company initiated plans to upgrade and expand its manufacturing infrastructure in order to support its medical device strategy. This includes the transfer of certain product lines to create additional capacity for the manufacture of medical devices, expansion of two existing facilities, as well as the purchase of equipment to enable the production of medical devices. These initiatives are expected to be completed over the next two years. Total capital investment under these initiatives is expected to be between $15 million and $20 million of which approximately $11.8 million has been expended to date. Total expenses expected to be incurred on these projects is between $2.0 million and $3.0 million, of which $1.8 million has been incurred to date. All expenses will be recorded within the Implantable Medical segment and are expected to include the following:

Production inefficiencies, moving and revalidation: $0.5 million - $1.0 million;

Personnel: $1.0 million - $1.5 million; and

Other: approximately $1.0 million.

The change in accrued liabilities related to the medical device facility optimization is as follows (in thousands):

	Production Inefficiencies, Moving and Revalidation	Personnel	Other	Total
At December 28, 2012	$	$	$	$
Restructuring charges	19	2	209	230
Cash payments	(19)	(2)	(209)	(230)
At June 28, 2013	$	$	$	$

Table of Contents

GREATBATCH, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Unaudited

ERP system upgrade. In 2011, the Company initiated plans to upgrade its existing global ERP system. This initiative is expected to be completed over the next year. Total capital investment under this initiative is expected to be between $4 million to $5 million of which approximately $3.9 million has been expended to date. Total expenses expected to be incurred on this initiative is between $6 million to $7 million, of which $5.4 million has been incurred to date. Expenses related to this initiative will be recorded within the applicable segment and corporate cost centers that the expenditures relate to and include the following:

Training and consulting costs: $4 million - $4.5 million; and

Accelerated depreciation and asset write-offs: $2 million $2.5 million.

The change in accrued liabilities related to the ERP system upgrade is as follows (in thousands):

	Training & Consulting Costs	Accelerated Depreciation/ Asset Write-offs	Total
At December 28, 2012	$ 169	$	$ 169
Charges	385		385
Cash payments	(538)		(538)
At June 28, 2013	$ 16	$	$ 16

Acquisition and integration costs. During 2013 and 2012, the Company incurred costs related to the integration of Micro Power Electronics, Inc. and NeuroNexus, which were acquired in December 2011 and February 2012, respectively. These expenses were primarily for retention bonuses, travel costs in connection with integration efforts, training, severance, and the change in fair value of the contingent consideration recorded in connection with these acquisitions.

Asset dispositions, severance and other. During 2013 and 2012, the Company recorded write-downs in connection with various asset disposals, net of insurance proceeds received, if any. Additionally, during the second quarter of 2012, the Company incurred $1.2 million of costs related to the relocation of its global headquarters to Frisco, Texas.

10. INCOME TAXES

The income tax provision for interim periods is determined using an estimate of the annual effective tax rate, adjusted for discrete items, if any, that are taken into account in the relevant period. Each quarter, the estimate of the annual effective tax rate is updated, and if the estimated effective tax rate changes, a cumulative adjustment is made. There is a potential for volatility of the effective tax rate due to several factors, including changes in the mix of the pre-tax income and the jurisdictions to which it relates, changes in tax laws and foreign tax holidays, business reorganizations, settlements with taxing authorities and foreign currency fluctuations.

As of June 28, 2013, the balance of unrecognized tax benefits is approximately $1.1 million. It is reasonably possible that a reduction of up to $0.2 million of the balance of unrecognized tax benefits may occur within the next twelve months as a result of potential audit settlements. Approximately $0.9 million of the balance of unrecognized tax benefits would favorably impact the effective tax rate, net of federal benefit on state issues, if recognized.

Table of Contents

GREATBATCH, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Unaudited

As a result of the repayment of CSN during the first quarter of 2013, the Company reclassified $30.4 million of Long-Term Deferred Income Taxes to Income Taxes Payable of which approximately $11.5 million was paid in the second quarter of 2013.

11. COMMITMENTS AND CONTINGENCIES

Litigation The Company is a party to various legal actions arising in the normal course of business. While the Company does not believe that the ultimate resolution of any such pending actions will have a material effect on its results of operations, financial position, or cash flows, litigation is subject to inherent uncertainties. If an unfavorable ruling were to occur, there exists the possibility of a material impact in the period in which the ruling occurs.

During 2012, Electrochem and several other unaffiliated parties were named as defendants in a personal injury and wrongful death action filed in the 113th Judicial District Court of Harris County, Texas. The complaint seeks damages alleging marketing defects and failure to warn, negligence and gross negligence relating to a product Electrochem manufactured and sold to a customer, one of the other named defendants, which, in turn, incorporated the Electrochem product into its own product which it sold to its customer, another named defendant. The cost of defense in this matter is the responsibility of Electrochem s customer. Electrochem also has product liability insurance coverage. Electrochem believes that no liability will be incurred on this litigation, that it has meritorious defenses and it intends to vigorously defend the matter. Given the early stages of this action, the amount of loss or range of possible loss cannot be reasonably estimated at this time.

Product Warranties The Company generally warrants that its products will meet customer specifications and will be free from defects in materials and workmanship. The change in aggregate product warranty liability is as follows (in thousands):

At December 28, 2012	$ 2,626
Additions to warranty reserve	860
Warranty claims paid	(52)
At June 28, 2013	$ 3,434

Contractual Obligations Contractual obligations are defined as agreements that are enforceable and legally binding on the Company and that specify all significant terms, including: fixed or minimum obligations; fixed or minimum price provisions; and the approximate timing of the transaction. The Company s contractual obligations are normally fulfilled within short time horizons. The Company also enters into blanket orders with vendors that have preferred pricing and terms, however these orders are normally cancelable by us without penalty. As of June 28, 2013, the total contractual obligations of the Company are approximately $26.9 million and will primarily be funded by existing cash and cash equivalents, cash flow from operations, or the Credit Facility. The Company also enters into contracts for outsourced services; however, the obligations under these contracts were not significant and the contracts generally contain clauses allowing for cancellation without significant penalty.

Table of Contents

GREATBATCH, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Unaudited

Operating Leases The Company is a party to various operating lease agreements for buildings, equipment and software. Estimated future operating lease expense is as follows (in thousands):

Remainder of 2013	$ 2,656
2014	5,067
2015	4,447
2016	3,815
2017	1,425
Thereafter	1,933
Total estimated operating lease expense	$ 19,343

Foreign Currency Contracts - The Company enters into forward contracts to purchase Mexican pesos in order to hedge the risk of peso-denominated payments associated with the operations at its Tijuana, Mexico facility. The impact to the Company s results of operations from these forward contracts was as follows (in thousands):

	Three Months Ended		Six Months Ended	
	June 28, 2013	June 29, 2012	June 28, 2013	June 29, 2012
Reduction in Cost of Sales	$ (390)	$ (97)	$ (562)	$ (19)
Ineffective portion of change in fair value				

Instrument	Type of Hedge	Aggregate Notional Amount	Start Date	End Date	$/Peso	Fair Value	Balance Sheet Location
FX Contract	Cash flow	$ 3,000	Jan-13	Dec-13	0.0727	$ 152	Current Assets
FX Contract	Cash flow	3,000	Jan-13	Dec-13	0.0693	310	Current Assets

Self-Insured Medical Plan The Company self-funds the medical insurance coverage provided to its U.S. based employees. The risk to the Company is being limited through the use of stop loss insurance, which has specific stop loss coverage per associate for claims in the year exceeding $225 thousand per associate with no annual maximum aggregate stop loss coverage. As of June 28, 2013, the Company has $1.7 million accrued related to the self-insurance of its medical plan, which is recorded in Accrued Expenses in the Condensed Consolidated Balance Sheet, and is primarily based upon claim history.

Table of Contents

GREATBATCH, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Unaudited

12. EARNINGS PER SHARE (EPS)

The following table illustrates the calculation of Basic and Diluted EPS (in thousands, except per share amounts):

	Three Months Ended		Six Months Ended	
	June 28, 2013	June 29, 2012	June 28, 2013	June 29, 2012
Numerator for basic and diluted EPS:				
Net income	$ 9,752	$ 3,851	$ 15,415	$ 8,318
Denominator for basic EPS:				
Weighted average shares outstanding	23,914	23,611	23,832	23,515
Effect of dilutive securities:				
Stock options, restricted stock and restricted stock units	1,008	265	986	301
Denominator for diluted EPS	24,922	23,876	24,818	23,816
Basic EPS	$ 0.41	$ 0.16	$ 0.65	$ 0.35
Diluted EPS	$ 0.39	$ 0.16	$ 0.62	$ 0.35

The diluted weighted average share calculations do not include the following securities, which are not dilutive to the EPS calculations or the performance criteria have not been met:

	Three Months Ended		Six Months Ended	
	June 28, 2013	June 29, 2012	June 28, 2013	June 29, 2012
Time-vested stock options, restricted stock and restricted stock units	72,000	1,418,000	395,000	1,280,000
Performance-vested stock options and restricted stock units		718,000		722,000

For the 2013 and 2012 periods, no shares related to CSN were included in the diluted EPS calculations as the average share price of the Company s common stock for those periods did not exceed CSN s conversion price per share.

Table of Contents

GREATBATCH, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS   Unaudited

13. ACCUMULATED OTHER COMPREHENSIVE INCOME

Accumulated Other Comprehensive Income for the quarter and year to date periods are as follows (in thousands):

	Defined Benefit Plan Liability	Cash Flow Hedges	Foreign Currency Translation Adjustment	Total Pre-Tax Amount	Tax	Net-of-Tax Amount
Three Month Period						
At March 29, 2013	$ (365)	$ 533	$ 10,368	$ 10,536	$ 214	$ 10,750
Unrealized loss on cash flow hedges		(107)		(107)	37	(70)
Realized gain on foreign currency hedges		(390)				