Integer Holdings Corp
Form 10-Q
October 30, 2017
Table of Contents

UNITED STATES
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 September 29, 2017
Commission File Number 1-16137

---

INTEGER HOLDINGS CORPORATION
(Exact name of Registrant as specified in its charter)

---

| | |
|---|---|
| Delaware | 16-1531026 |
| (State of Incorporation) | (I.R.S. Employer Identification No.) |

2595 Dallas Parkway
Suite 310
Frisco, Texas 75034
(Address of principal executive offices)
(214) 618-5243
(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 ý 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 ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

| | | | |
|---|---|---|---|
| Large accelerated filer | ý | Accelerated filer | ¨ |
| Non-accelerated filer | ¨ | Smaller reporting company | ¨ |

Emerging growth company ¨
If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý

The number of shares outstanding of the Company’s common stock, $0.001 par value per share, as of October 26, 2017 was: 31,669,830 shares.

Table of Contents

INTEGER HOLDINGS CORPORATION
Form 10-Q
For the Quarterly Period Ended September 29, 2017
TABLE OF CONTENTS

Table of Contents

PART I—FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
INTEGER HOLDINGS CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)

| (in thousands except share and per share data) | September 29, 2017 | December 30, 2016 |
|---|---|---|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | $ 43,637 | $ 52,116 |
| Accounts receivable, net of allowance for doubtful accounts of $1.0 million and $0.7 million, respectively | 221,520 | 204,626 |
| Inventories | 246,972 | 225,151 |
| Refundable income taxes | 4 | 13,388 |
| Prepaid expenses and other current assets | 16,167 | 22,026 |
| Total current assets | 528,300 | 517,307 |
| Property, plant and equipment, net | 374,436 | 372,042 |
| Goodwill | 987,316 | 967,326 |
| Other intangible assets, net | 930,644 | 940,060 |
| Deferred income taxes | 4,308 | 3,970 |
| Other assets | 28,468 | 31,838 |
| Total assets | $ 2,853,472 | $ 2,832,543 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Current portion of long-term debt | $ 28,125 | $ 31,344 |
| Accounts payable | 94,404 | 77,896 |
| Income taxes payable | 5,419 | 3,699 |
| Accrued expenses | 77,125 | 72,281 |
| Total current liabilities | 205,073 | 185,220 |
| Long-term debt | 1,601,829 | 1,698,819 |
| Deferred income taxes | 207,005 | 208,579 |
| Other long-term liabilities | 16,136 | 14,686 |
| Total liabilities | 2,030,043 | 2,107,304 |
| Stockholders' equity: | | |
| Common stock, $0.001 par value; 100,000,000 shares authorized; 31,776,356 and 31,059,038 shares issued, respectively; 31,669,830 and 30,925,496 shares outstanding, respectively | 32 | 31 |
| Additional paid-in capital | 662,729 | 637,955 |
| Treasury stock, at cost, 106,526 and 133,542 shares, respectively | (4,654) | (5,834) |
| Retained earnings | 121,730 | 109,087 |
| Accumulated other comprehensive income (loss) | 43,592 | (16,000) |
| Total stockholders' equity | 823,429 | 725,239 |
| Total liabilities and stockholders' equity | $ 2,853,472 | $ 2,832,543 |

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

Table of Contents

INTEGER HOLDINGS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
AND COMPREHENSIVE INCOME (Unaudited)

| (in thousands except per share data) | Three Months Ended September 29, 2017 | Three Months Ended September 30, 2016 | Nine Months Ended September 29, 2017 | Nine Months Ended September 30, 2016 |
|---|---|---|---|---|
| Sales | $363,308 | $ 346,567 | $1,071,440 | $ 1,027,187 |
| Cost of sales | 265,073 | 248,658 | 782,707 | 741,779 |
| Gross profit | 98,235 | 97,909 | 288,733 | 285,408 |
| Operating expenses: | | | | |
| Selling, general and administrative expenses | 39,733 | 36,265 | 118,956 | 115,781 |
| Research, development and engineering costs, net | 13,607 | 11,412 | 39,907 | 42,358 |
| Other operating expenses, net | 6,264 | 13,370 | 24,955 | 50,004 |
| Total operating expenses | 59,604 | 61,047 | 183,818 | 208,143 |
| Operating income | 38,631 | 36,862 | 104,915 | 77,265 |
| Interest expense, net | 26,485 | 27,870 | 81,025 | 83,395 |
| Other (income) loss, net | 156 | 275 | 11,979 | (2,772) |
| Income (loss) before income taxes | 11,990 | 8,717 | 11,911 | (3,358) |
| Benefit for income taxes | (1,700) | (2,741) | (430) | (1,386) |
| Net income (loss) | $13,690 | $ 11,458 | $12,341 | $ (1,972) |
| Earnings (loss) per share: | | | | |
| Basic | $0.43 | $ 0.37 | $0.39 | $ (0.06) |
| Diluted | $0.43 | $ 0.37 | $0.39 | $ (0.06) |
| Weighted average shares outstanding: | | | | |
| Basic | 31,594 | 30,782 | 31,304 | 30,756 |
| Diluted | 32,173 | 31,153 | 31,724 | 30,756 |
| | | | | |
| Comprehensive Income | | | | |
| Net income (loss) | $13,690 | $ 11,458 | $12,341 | $ (1,972) |
| Other comprehensive income: | | | | |
| Foreign currency translation gain | 16,728 | 3,191 | 57,863 | 12,250 |
| Net change in cash flow hedges, net of tax | (339) | 571 | 1,729 | (309) |
| Other comprehensive income | 16,389 | 3,762 | 59,592 | 11,941 |
| Comprehensive income | $30,079 | $ 15,220 | $71,933 | $ 9,969 |

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

Table of Contents

INTEGER HOLDINGS CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

| (in thousands) | Nine Months Ended September 29, 2017 | September 30, 2016 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net income (loss) | $12,341 | $ (1,972) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Depreciation and amortization | 74,584 | 67,414 |
| Debt related amortization included in interest expense | 8,850 | 5,387 |
| Stock-based compensation | 9,895 | 7,179 |
| Other non-cash losses | 10,666 | 1,938 |
| Deferred income taxes | (6,821) | (12,519) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (13,958) | 12,510 |
| Inventories | (20,259) | (10,010) |
| Prepaid expenses and other current assets | 8,460 | (4,663) |
| Accounts payable | 12,905 | 4,885 |
| Accrued expenses | 4,191 | (5,650) |
| Income taxes | 14,716 | 7,300 |
| Net cash provided by operating activities | 115,570 | 71,799 |
| Cash flows from investing activities: | | |
| Acquisition of property, plant and equipment | (34,059) | (46,968) |
| Purchase of cost and equity method investments | (1,316) | (2,917) |
| Other investing activities | 673 | (1,000) |
| Net cash used in investing activities | (34,702) | (50,885) |
| Cash flows from financing activities: | | |
| Principal payments of long-term debt | (156,526) | (28,750) |
| Proceeds from issuance of long-term debt | 50,000 | 57,000 |
| Proceeds from the exercise of stock options | 17,074 | 723 |
| Payment of debt issuance costs | (1,789) | (781) |
| Distribution of cash and cash equivalents to Nuvectra Corporation | — | (76,256) |
| Purchase of non-controlling interests | — | (6,818) |
| Other financing activities | (76) | (3,983) |
| Net cash used in financing activities | (91,317) | (58,865) |
| Effect of foreign currency exchange rates on cash and cash equivalents | 1,970 | 468 |
| Net decrease in cash and cash equivalents | (8,479) | (37,483) |
| Cash and cash equivalents, beginning of period | 52,116 | 82,478 |
| Cash and cash equivalents, end of period | $43,637 | $ 44,995 |

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

Table of Contents

INTEGER HOLDINGS CORPORATION
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY (Unaudited)

| (in thousands) | Common Stock Shares | Common Stock Amount | Additional Paid-In Capital | Treasury Stock Shares | Treasury Stock Amount | Retained Earnings | Accumulated Other Comprehensive Income (Loss) | Total Stockholders' Equity |
|---|---|---|---|---|---|---|---|---|
| December 30, 2016 | 31,059 | $ 31 | $637,955 | (134) | $(5,834) | $109,087 | $ (16,000) | $ 725,239 |
| Cumulative effect adjustment of the adoption of ASU 2016-09 (Note 16) | — | — | (812) | — | — | 302 | — | (510) |
| December 30, 2016, adjusted | 31,059 | 31 | 637,143 | (134) | (5,834) | 109,389 | (16,000) | 724,729 |
| Comprehensive income: | | | | | | | | |
| Net income | — | — | — | — | — | 12,341 | — | 12,341 |
| Other comprehensive income, net | — | — | — | — | — | — | 59,592 | 59,592 |
| Share-based compensation plans: | | | | | | | | |
| Stock-based compensation | — | — | 9,895 | — | — | — | — | 9,895 |
| Net shares issued | 717 | 1 | 15,691 | 27 | 1,180 | — | — | 16,872 |
| September 29, 2017 | 31,776 | $ 32 | $662,729 | (107) | $(4,654) | $121,730 | $ 43,592 | $ 823,429 |

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

Table of Contents

INTEGER HOLDINGS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
(1.) BASIS OF PRESENTATION

Integer Holdings Corporation (together with its consolidated subsidiaries, "Integer" or the "Company") is a publicly traded corporation listed on the New York Stock Exchange under the symbol "ITGR." Integer is one of the largest medical device outsource manufacturers in the world serving the cardiac, neuromodulation, orthopedics, vascular, advanced surgical and portable medical markets. The Company provides innovative, high-quality medical technologies that enhance the lives of patients worldwide. In addition, it develops batteries for high-end niche applications in the energy, military, and environmental markets. The Company's reportable segments are: (1) Medical and (2) Non-Medical. The Company's customers include large multi-national original equipment manufacturers ("OEMs") and their affiliated subsidiaries.

On March 14, 2016, Integer completed the spin-off of a portion of its former QiG segment through a tax-free distribution of all of the shares of its QiG Group, LLC ("QiG") subsidiary to the stockholders of Integer on a pro rata basis (the "Spin-off"). See Note 2 "Divestiture" for further description of this transaction. The Company's results include the financial and operating results of QiG until the Spin-off on March 14, 2016.

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, these financial statements 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"). 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 the Company for the periods presented. Intercompany transactions and balances have been fully eliminated in consolidation.

Certain reclassifications have been made to prior year financial statements to conform to classifications used in the current year. Refer to Note 15 "Segment Information," for a description of the changes made to reflect the current year product line sales reporting and changes made to the Company's reportable segment structure during the fourth quarter of 2016.

Operating results for interim periods are not necessarily indicative of results that may be expected for the fiscal year as a whole. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, certain components of equity, 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. 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 30, 2016.

The Company utilizes a fifty-two, fifty-three week fiscal year ending on the Friday nearest December 31. The third quarter and first nine months of 2017 and 2016 each contained 13 weeks and 39 weeks, respectively, and ended on September 29, and September 30, respectively. The Company's 2017 and 2016 fiscal years will end or ended on December 29, 2017 and December 30, 2016, respectively.

Table of Contents
INTEGER HOLDINGS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

(2.) DIVESTITURE
Spin-off of Nuvectra Corporation
On March 14, 2016, Integer completed the spin-off of a portion of its former QiG segment through a tax-free distribution of all of the shares of its QiG Group, LLC subsidiary to the stockholders of Integer on a pro rata basis. Immediately prior to completion of the Spin-off, QiG Group, LLC was converted into a corporation organized under the laws of Delaware and changed its name to Nuvectra Corporation ("Nuvectra"). On March 14, 2016, each of the Company's stockholders of record as of the close of business on March 7, 2016 received one share of Nuvectra common stock for every three shares of Integer common stock held as of that date. Upon completion of the Spin-off, Nuvectra became an independent publicly traded company whose common stock is listed on the NASDAQ stock exchange under the symbol "NVTR."
The portion of the QiG segment spun-off consisted of QiG Group, LLC and its subsidiaries: (i) Algostim, LLC ("Algostim"), (ii) PelviStim LLC ("PelviStim"), and (iii) the Company's NeuroNexus Technologies ("NeuroNexus") subsidiary. The operations of Centro de Construcción de Cardioestimuladores del Uruguay ("CCC") and certain other existing QiG research and development capabilities were retained by the Company and not included as part of the Spin-off. As the Company continues to focus on the design and development of complete medical device systems and components, and more specifically on medical device systems and components in the neuromodulation market, the Spin-off was not considered a strategic shift that had a major effect on the Company's operations and financial results. Accordingly, the Spin-off is not presented as a discontinued operation in the Company's Condensed Consolidated Financial Statements. The results of Nuvectra are included in the Condensed Consolidated Statements of Operations and Comprehensive Income through the date of the Spin-off.
In connection with the Spin-off, during the first quarter of 2016, the Company made a cash capital contribution of $75 million to Nuvectra and divested the following assets and liabilities (in thousands):

| | |
|---|---|
| Assets divested | |
| Cash and cash equivalents | $76,256 |
| Other current assets | 977 |
| Property, plant and equipment, net | 4,407 |
| Amortizing intangible assets, net | 1,931 |
| Goodwill | 40,830 |
| Deferred income taxes | 6,446 |
| Total assets divested | 130,847 |
| Liabilities transferred | |
| Current liabilities | 2,119 |
| Net assets divested | $128,728 |

For the first quarter of 2016, Nuvectra contributed a pre-tax loss of $5.2 million to the Company's results of operations.
In connection with the Spin-off, on March 14, 2016, Integer entered into several agreements with Nuvectra that govern its post Spin-off relationship with Nuvectra, including a Separation and Distribution Agreement, Tax Matters Agreement, Employee Matters Agreement and Transition Services Agreement. The Transition Services Agreement contains customary mutual indemnification provisions. Amounts earned by Integer under the Transition Services Agreement were immaterial for the nine month periods ended September 29, 2017 and September 30, 2016.
(3.) SUPPLEMENTAL CASH FLOW INFORMATION

| (in thousands) | Nine Months Ended September 29, 2017 | September 30, 2016 |
|---|---|---|
| Noncash investing and financing activities: | | |
| Property, plant and equipment purchases included in accounts payable | $6,406 | $ 5,062 |
| Purchase of technology included in accrued expenses | — | 1,000 |

| | | |
|---|---|---|
| Divestiture of noncash assets | — | 54,591 |
| Divestiture of liabilities | — | 2,119 |

Table of Contents
INTEGER HOLDINGS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

(4.) INVENTORIES
Inventories are comprised of the following (in thousands):

| | September 29, 2017 | December 30, 2016 |
|---|---|---|
| Raw materials | $ 102,247 | $ 100,738 |
| Work-in-process | 101,098 | 89,224 |
| Finished goods | 43,627 | 35,189 |
| Total | $ 246,972 | $ 225,151 |

(5.) GOODWILL AND OTHER INTANGIBLE ASSETS, NET
Goodwill
The changes in the carrying amount of goodwill by reportable segment for the nine months ended September 29, 2017 were as follows (in thousands):

| | Medical | Non-Medical | Total |
|---|---|---|---|
| December 30, 2016 | $950,326 | $17,000 | $967,326 |
| Foreign currency translation | 19,990 | — | 19,990 |
| September 29, 2017 | $970,316 | $17,000 | $987,316 |

Intangible Assets
Intangible assets at September 29, 2017 and December 30, 2016 were as follows (in thousands):

| | Gross Carrying Amount | Accumulated Amortization | Foreign Currency Translation | Net Carrying Amount |
|---|---|---|---|---|
| September 29, 2017 | | | | |
| Definite-lived: | | | | |
| Purchased technology and patents | $256,719 | $ (113,460 ) | $ 4,434 | $147,693 |
| Customer lists | 759,987 | (80,720 ) | 13,304 | 692,571 |
| Other | 4,534 | (5,230 ) | 788 | 92 |
| Total | $1,021,240 | $ (199,410 ) | $ 18,526 | $840,356 |
| Indefinite-lived: | | | | |
| Trademarks and tradenames | | | | $90,288 |
| | | | | |
| December 30, 2016 | | | | |
| Definite-lived: | | | | |
| Purchased technology and patents | $256,719 | $ (100,719 ) | $ 333 | $156,333 |
| Customer lists | 759,987 | (60,474 ) | (6,269 ) | 693,244 |
| Other | 4,534 | (5,142 ) | 803 | 195 |
| Total | $1,021,240 | $ (166,335 ) | $ (5,133 ) | $849,772 |
| Indefinite-lived: | | | | |
| Trademarks and tradenames | | | | $90,288 |

Table of Contents
INTEGER HOLDINGS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

(5.) GOODWILL AND OTHER INTANGIBLE ASSETS, NET (Continued)

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

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 29, 2017 | September 30, 2016 | September 29, 2017 | September 30, 2016 |
| Cost of sales | $4,138 | $ 4,228 | $12,333 | $ 12,708 |
| Selling, general and administrative expenses | 6,776 | 5,109 | 20,333 | 15,368 |
| Research, development and engineering costs, net | 137 | 136 | 409 | 375 |
| Total intangible asset amortization expense | $11,051 | $ 9,473 | $33,075 | $ 28,451 |

Estimated future intangible asset amortization expense based on the carrying value as of September 29, 2017 is as follows (in thousands):

| | 2017 | 2018 | 2019 | 2020 | 2021 | After 2021 |
|---|---|---|---|---|---|---|
| Amortization Expense | $11,083 | $45,543 | $45,653 | $46,266 | $45,138 | $646,673 |

(6.) DEBT

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

| | September 29, 2017 | December 30, 2016 |
|---|---|---|
| Senior secured term loan A | $ 342,188 | $ 356,250 |
| Senior secured term loan B | 883,286 | 1,014,750 |
| 9.125% senior notes due 2023 | 360,000 | 360,000 |
| Revolving line of credit | 79,000 | 40,000 |
| Unamortized discount on term loan B and debt issuance costs | (34,520 ) | (40,837 ) |
| Total debt | 1,629,954 | 1,730,163 |
| Less current portion of long-term debt | 28,125 | 31,344 |
| Total long-term debt | $ 1,601,829 | $ 1,698,819 |

Senior Secured Credit Facilities

The Company has senior secured credit facilities (the “Senior Secured Credit Facilities”) consisting of (i) a $200 million revolving credit facility (the “Revolving Credit Facility”), (ii) a $375 million term loan A facility (the “TLA Facility”), and (iii) a $1,025 million term loan B facility (the “TLB Facility”). The TLA Facility and TLB Facility are collectively referred to as the “Term Loan Facilities.” The TLB facility was issued at a 1% discount.

On March 17, 2017, the Company amended the Senior Secured Credit Facilities to lower the interest rate on the TLB Facility. The amendment reduced the applicable interest rate margins of its TLB Facility for both base rate and adjusted LIBOR borrowings by 75 basis points. The amendment also includes a prepayment fee of 1.00% in the event of another repricing event (as defined in the Senior Secured Credit Facilities) on or before the six-month anniversary of this amendment. There was no change to maturities or covenants under the Senior Secured Credit Facilities as a result of this repricing amendment.

Table of Contents
INTEGER HOLDINGS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

(6.) DEBT (Continued)
Revolving Credit Facility
The Revolving Credit Facility matures on October 27, 2020. The Revolving Credit Facility also includes a $15 million sublimit for swingline loans and a $25 million sublimit for standby letters of credit. The Company is required to pay a commitment fee on the unused portion of the Revolving Credit Facility, which will range between 0.175% and 0.25%, depending on the Company's Total Net Leverage Ratio (as defined in the Senior Secured Credit Facilities agreement). Interest rates on the Revolving Credit Facility, as well as the TLA Facility, are at the Company's option, either at: (i) the prime rate plus the applicable margin, which will range between 0.75% and 2.25%, based on the Company's Total Net Leverage Ratio, or (ii) the applicable LIBOR rate plus the applicable margin, which will range between 1.75% and 3.25%, based on the Company's Total Net Leverage Ratio.
As of September 29, 2017, the Company had $79 million of outstanding borrowings on the Revolving Credit Facility and an available borrowing capacity of $111.7 million after giving effect to $9.3 million of outstanding standby letters of credit. As of September 29, 2017, the weighted average interest rate on all outstanding borrowings under the Revolving Credit Facility was 4.49%.
Subject to certain conditions, commitments under the Revolving Credit Facility may be increased through an incremental revolving facility so long as, on a pro forma basis, the Company's first lien net leverage ratio does not exceed 4.25:1.00. The outstanding amount of the Revolving Credit Facility approximated its fair value as of September 29, 2017 based upon the debt being variable rate and short-term in nature.
Term Loan Facilities
The TLA Facility and TLB Facility mature on October 27, 2021 and October 27, 2022, respectively. Interest rates on the TLB Facility are, at the Company's option, either at: (i) the prime rate plus 2.50% or (ii) the applicable LIBOR rate plus 3.50%, with LIBOR subject to a 1.00% floor. As of September 29, 2017, the interest rates on the TLA Facility and TLB Facility were 4.49% and 4.74%, respectively. Subject to certain conditions, one or more incremental term loan facilities may be added to the Term Loan Facilities so long as, on a pro forma basis, the Company's first lien net leverage ratio does not exceed 4.25:1.00.
As of September 29, 2017, the estimated fair value of the TLB Facility was approximately $890 million, based on quoted market prices for the debt, recent sales prices for the debt and consideration of comparable debt instruments with similar interest rates and trading frequency, among other factors, and is classified as Level 2 measurements within the fair value hierarchy. The par amount of the TLA Facility approximated its fair value as of September 29, 2017 based upon the debt being variable rate in nature.
Covenants
The Revolving Credit Facility and TLA Facility contain covenants requiring (A) a maximum Total Net Leverage Ratio of 6.25:1.00, subject to step downs beginning in the first quarter of 2018 and (B) a minimum interest coverage ratio of adjusted EBITDA (as defined in the Senior Secured Credit Facilities) to interest expense of not less than 2.50:1.00 subject to step ups beginning in the first quarter of 2018. The TLB Facility does not contain any financial maintenance covenants. As of September 29, 2017, the Company was in compliance with these financial covenants.
The Senior Secured Credit Facilities also contain negative covenants that restrict the Company's ability to (i) incur additional indebtedness; (ii) create certain liens; (iii) consolidate or merge; (iv) sell assets, including capital stock of the Company's subsidiaries; (v) engage in transactions with the Company's affiliates; (vi) create restrictions on the payment of dividends or other amounts from the Company's restricted subsidiaries; (vii) pay dividends on capital stock or redeem, repurchase or retire capital stock; (viii) pay, prepay, repurchase or retire certain subordinated indebtedness; (ix) make investments, loans, advances and acquisitions; (x) make certain amendments or modifications to the organizational documents of the Company or its subsidiaries or the documentation governing other senior indebtedness of the Company; and (xi) change the Company's type of business. These negative covenants are subject to a number of limitations and exceptions that are described in the Senior Secured Credit Facilities agreement. As of September 29, 2017, the Company was in compliance with all negative covenants under the Senior Secured Credit Facilities.

The Senior Secured Credit Facilities provide for customary events of default. Upon the occurrence and during the continuance of an event of default, the outstanding advances and all other obligations under the Senior Secured Credit Facilities become immediately due and payable.

(6.) DEBT (Continued)

9.125% Senior Notes due 2023

On October 27, 2015, the Company completed a private offering of $360 million aggregate principal amount of 9.125% senior notes due on November 1, 2023 (the “Senior Notes”). Interest on the Senior Notes is payable on May 1 and November 1 of each year.

As of September 29, 2017, the estimated fair value of the Senior Notes was approximately $392 million, based on quoted market prices of these Senior Notes, recent sales prices for the Senior Notes and consideration of comparable debt instruments with similar interest rates and trading frequency, among other factors, and is classified as Level 2 measurements within the fair value hierarchy.

The indenture for the Senior Notes contain certain restrictive covenants and provides for customary events of default, subject in certain cases to customary cure periods, in which the Senior Notes and any unpaid interest would become due and payable. As of September 29, 2017, the Company was in compliance with all restrictive covenants under the indenture governing the Senior Notes.

Contractual maturities under the Senior Secured Credit Facilities and Senior Notes for the remainder of 2017 and the five years and thereafter, excluding any discounts or premiums, as of September 29, 2017 are as follows (in thousands):

| | 2017 | 2018 | 2019 | 2020 | 2021 | After 2021 |
|---|---|---|---|---|---|---|
| Future minimum principal payments | $7,031 | $30,469 | $37,500 | $116,500 | $229,688 | $1,243,286 |

Debt Issuance Costs and Discounts

The change in deferred debt issuance costs related to the Revolving Credit Facility is as follows (in thousands):

| | |
|---|---|
| December 30, 2016 | $3,800 |
| Amortization during the period | (744) |
| September 29, 2017 | $3,056 |

The change in unamortized discount and debt issuance costs related to the Term Loan Facilities and Senior Notes is as follows (in thousands):

| | Debt Issuance Costs | Unamortized Discount on TLB Facility | Total |
|---|---|---|---|
| December 30, 2016 | $32,096 | $ 8,741 | $40,837 |
| Financing costs incurred | 1,789 | — | 1,789 |
| Write-off of debt issuance costs and unamortized discount[1] | (2,244) | (1,028) | (3,272) |
| Amortization during the period | (3,878) | (956) | (4,834) |
| September 29, 2017 | $27,763 | $ 6,757 | $34,520 |

(1) The Company prepaid portions of its TLB Facility during 2017. The Company recognized losses from extinguishment of debt during the three and nine months ended September 29, 2017 of $0.8 million and $3.3 million, respectively, which is included in Interest Expense, Net in the accompanying Condensed Consolidated Statements of Operations and Comprehensive Income. The loss from extinguishment of debt represents the portion of the unamortized discount and debt issuance costs related to the portion of the TLB Facility that was prepaid.

Interest Rate Swaps

From time to time, the Company enters into interest rate swap agreements in order to hedge against potential changes in cash flows on its outstanding variable rate debt. During 2016, the Company entered into a one-year $250 million interest rate swap, which expired during the second quarter of 2017, and a three-year $200 million interest rate swap to hedge against potential changes in cash flows on the outstanding variable rate debt, which is indexed to the one-month LIBOR rate. The variable rate received on the interest rate swap and the variable rate paid on the outstanding debt will have the same rate of interest, excluding the credit spread, and will reset and pay interest on the same date. The swaps are being accounted for as cash flow hedges.

Table of Contents
INTEGER HOLDINGS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

(6.) DEBT (Continued)
Information regarding the Company’s outstanding interest rate swap designated as a cash flow hedge as of September 29, 2017 is as follows (dollars in thousands):

| Notional Amount | Start Date | End Date | Pay Fixed Rate | Receive Current Floating Rate | Fair Value | Balance Sheet Location |
|---|---|---|---|---|---|---|
| $200,000 | Jun-17 | Jun-20 | 1.1325% | 1.2367% | $3,054 | Other Long-Term Assets |

The estimated fair value of the interest rate swap agreement represents the amount the Company would receive (pay) to terminate the contract. No portion of the change in fair value of the Company’s interest rate swap during the nine months ended September 29, 2017 and September 30, 2016 was considered ineffective. The amount recorded to Interest Expense, Net during the nine months ended September 29, 2017 and September 30, 2016 related to the Company’s interest rate swaps was a reduction of $0.4 million and an increase of $0.05 million, respectively. The estimated Accumulated Other Comprehensive Income related to the Company’s interest rate swaps that is expected to be reclassified into earnings within the next twelve months is a $0.6 million gain.

(7.) BENEFIT PLANS
The Company is required to provide its employees located in Switzerland, Mexico, France, and Germany certain statutorily mandated defined benefits. Under these plans, benefits accrue to employees based upon years of service, position, age and compensation. The defined benefit pension plan provided to the Company’s employees located in Switzerland is a funded contributory plan, while the plans that provide benefits to the Company’s employees located in Mexico, France, and Germany 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.

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

| | |
|---|---|
| December 30, 2016 | $7,556 |
| Net defined benefit cost | 505 |
| Benefit payments | (70) |
| Foreign currency translation | 927 |
| September 29, 2017 | $8,918 |

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

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 29, 2017 | September 30, 2016 | September 29, 2017 | September 30, 2016 |
| Service cost | $120 | $ 108 | $345 | $ 326 |
| Interest cost | 42 | 44 | 120 | 132 |
| Amortization of net loss | 19 | 47 | 55 | 140 |
| Expected return on plan assets | (5) | (5) | (15) | (14) |
| Net defined benefit cost | $176 | $ 194 | $505 | $ 584 |

Table of Contents

INTEGER HOLDINGS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

## (8.) STOCK-BASED COMPENSATION

The Company maintains certain stock-based compensation plans that were approved by the Company's stockholders and are administered by the Board of Directors, or the Compensation and Organization Committee of the Board. The stock-based compensation plans provide for the granting of stock options, shares of restricted stock, restricted stock units ("RSUs"), stock appreciation rights and stock bonuses to employees, non-employee directors, consultants, and service providers.

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

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 29, 2017 | September 30, 2016 | September 29, 2017 | September 30, 2016 |
| Stock options | $372 | $ 663 | $1,365 | $ 1,857 |
| Restricted stock and restricted stock units | 1,573 | 1,554 | 8,530 | 5,322 |
| Total stock-based compensation expense | $1,945 | $ 2,217 | $9,895 | $ 7,179 |
| | | | | |
| Cost of sales | $131 | $ 158 | $612 | $ 505 |
| Selling, general and administrative expenses | 1,874 | 1,677 | 6,766 | 4,860 |
| Research, development and engineering costs, net | 144 | 115 | 428 | 408 |
| Other operating expenses, net | (204 ) | 267 | 2,089 | 1,406 |
| Total stock-based compensation expense | $1,945 | $ 2,217 | $9,895 | $ 7,179 |

During the first quarter of 2017, the Company recorded $2.2 million of accelerated stock-based compensation expense in connection with the transition of its former Chief Executive Officer per the terms of his contract, which was classified as Other Operating Expenses, Net. In connection with the Spin-off, certain awards granted to employees who transferred to Nuvectra were canceled. As required, the Company accelerated the remaining expense related to these canceled awards of $0.5 million during the first quarter of 2016, which was classified as Other Operating Expenses, Net.

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

| | Nine Months Ended | |
|---|---|---|
| | September 29, 2017 | September 30, 2016 |
| Weighted average fair value | $12.86 | $ 9.25 |
| Risk-free interest rate | 1.77 % | 1.56 % |
| Expected volatility | 37 % | 26 % |
| Expected life (in years) | 4.5 | 5.0 |
| Expected dividend yield | — % | — % |

(8.) STOCK-BASED COMPENSATION (Continued)

The following table summarizes the Company's stock option activity:

| | Number of Stock Options | Weighted Average Exercise Price | Weighted Average Remaining Contractual Life (In Years) | Aggregate Intrinsic Value (In Millions) |
|---|---|---|---|---|
| Outstanding at December 30, 2016 | 1,739,972 | $ 28.26 | | |
| Granted | 125,020 | 38.78 | | |
| Exercised | (680,065 ) | 25.11 | | |
| Forfeited or expired | (118,167 ) | 45.87 | | |
| Outstanding at September 29, 2017 | 1,066,760 | $ 29.55 | 5.9 | $ 23.0 |
| Exercisable at September 29, 2017 | 818,663 | $ 27.24 | 5.0 | $ 19.6 |

During the nine months ended September 29, 2017, the Company awarded grants of 0.7 million RSUs to certain members of management, of which 0.4 million are performance-based RSUs ("PSUs") and the remainder are time-based RSUs that vest over three years. Of the PSUs, 0.3 million of the shares subject to each grant will be earned based upon achievement of specific Company performance metrics for the Company's fiscal year ending December 29, 2017, and 0.1 million of the shares subject to each grant will be earned based on the Company's achievement of a relative total shareholder return ("TSR") performance requirement, on a percentile basis, compared to a defined group of peer companies over a two-year performance period ending December 28, 2018. The number of PSUs earned based on the achievement of the Company performance metrics and TSR performance requirements, if any, will vest based on the recipient's continuous service to the Company over a period of generally one to three years from the grant date. The time-based RSUs generally vest ratably over a three-year period. The RSUs do not have rights to dividends or dividend equivalents.

The grant-date fair value of the TSR portion of the PSUs granted during the nine months ended September 29, 2017 was determined using the Monte Carlo simulation model on the date of grant, assuming the following (i) expected term of 1.84 years, (ii) risk free interest rate of 1.14%, (iii) expected dividend yield of 0.0% and (iv) expected stock price volatility over the expected term of the TSR award of 48%. The grant-date fair value of all other restricted stock awards is equal to the closing market price of Integer common stock on the date of grant.

The following table summarizes restricted stock and RSU activity:

| | Time-Vested Activity | Weighted Average Fair Value |
|---|---|---|
| Nonvested at December 30, 2016 | 39,394 | $ 45.51 |
| Granted | 304,857 | 33.98 |
| Vested | (62,543 ) | 32.45 |
| Forfeited | (34,525 ) | 37.83 |
| Nonvested at September 29, 2017 | 247,183 | $ 35.67 |

The following table summarizes PSU activity:

| | Performance-Vested Activity | Weighted Average Fair Value |
|---|---|---|
| Nonvested at December 30, 2016 | 356,586 | $ 31.87 |
| Granted | 419,112 | 31.62 |
| Forfeited | (301,003 ) | 30.76 |
| Nonvested at September 29, 2017 | 474,695 | $ 32.35 |

Table of Contents
INTEGER HOLDINGS CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

## (9.) OTHER OPERATING EXPENSES, NET

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

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 29, 2017 | September 30, 2016 | September 29, 2017 | September 30, 2016 |
| Investments in capacity and capabilities | $1,542 | $ 4,542 | $4,407 | $ 13,821 |
| Lake Region Medical consolidations | 1,456 | 2,908 | 3,623 | 7,355 |
| Acquisition and integration costs | 2,267 | 5,319 | 10,057 | 23,143 |
| Asset dispositions, severance and other | 854 | 272 | 6,528 | 5,057 |
| Other consolidation and optimization initiatives | 145 | 329 | 340 | 628 |
| Total other operating expenses, net | $6,264 | $ 13,370 | $24,955 | $ 50,004 |

Investments in Capacity and Capabilities

One of the Company's strategic objectives is to invest in its capacity and capabilities in order to better align its resources to meet its customers' needs and drive organic growth and profitability. Currently this initiative includes the following:

- Functions performed at the Company's facility in Plymouth, MN to manufacture catheters and introducers will transfer into the Company's existing facility in Tijuana, Mexico. This initiative is expected to be substantially completed by the end of 2017 and is dependent upon our customers' validation and qualification of the transferred products as well as regulatory approvals worldwide.
- Functions performed at the Company's facilities in Beaverton, OR and Raynham, MA to manufacture products for the portable medical market were transferred to a new facility in Tijuana, Mexico. Products manufactured at the Beaverton facility, which do not serve the portable medical market, were transferred to the Company's Raynham facility. This initiative was substantially completed during the first half of 2016. The final closure of the Beaverton, OR site occurred in the fourth quarter of 2016.
- The design engineering responsibilities previously performed at the Company's Cleveland, OH facility were transferred to the Company's facilities in Minnesota in 2015.
- The realignment of the Company's commercial sales operations was completed in 2015.

The total capital investment expected for these initiatives is between $24.0 million and $25.0 million, of which $23.4 million has been expended through September 29, 2017. Total restructuring charges expected to be incurred in connection with these initiatives are between $54.0 million and $56.0 million, of which $53.5 million has been incurred through September 29, 2017. Expenses related to this initiative are primarily recorded within the Medical segment and include the following:

- Severance and retention: $6.0 million - $7.0 million;
- Accelerated depreciation and asset write-offs: $3.0 million; and
- Other: $45.0 million - $46.0 million

Other expenses primarily consist of costs to relocate certain equipment and personnel, duplicate personnel costs, excess overhead, disposal, and travel expenditures. All expenses are cash expenditures except accelerated depreciation and asset write-offs. The change in accrued liabilities related to the Company's investments in capacity and capabilities is as follows (in thousands):

| | Severance and Retention | Accelerated Depreciation/ Asset Write-offs | Other | Total |
|---|---|---|---|---|
| December 30, 2016 | $ 66 | $ — | $ — | $ 66 |
| Restructuring charges | 264 | — | 4,143 | 4,407 |
| Cash payments | (259) | — | (4,140) | (4,399) |
| September 29, 2017 | $ 71 | $ — | $ 3 | $ 74 |

- 16 -

(9.) OTHER OPERATING EXPENSES, NET (Continued)

Lake Region Medical Consolidations

In 2014, Lake Region Medical initiated plans to close its Arvada, CO site, consolidate its two Galway, Ireland sites into one facility, and other restructuring actions that will result in a reduction in staff across manufacturing and administrative functions at certain locations. This initiative was substantially completed by the end of 2016.

During the third quarter of 2016, the Company announced the planned closure of its Clarence, NY facility. The machined component product lines manufactured in this facility will be transferred to other Integer locations in the U.S. The project is expected to be completed by the first quarter of 2018.

The total capital investment expected to be incurred for these initiatives is between \$5.0 million and \$6.0 million, of which \$3.2 million has been expended through September 29, 2017. Total expense expected to be incurred for these initiatives are between \$20.0 million and \$25.0 million, of which \$14.2 million has been incurred through September 29, 2017. Expenses related to these initiatives have been and will be recorded within the Medical segment and are expected to include the following:

- Severance and retention: \$5.0 million - \$7.0 million;
- Accelerated depreciation and asset write-offs: approximately \$1.0 million - \$2.0 million; and
- Other: \$14.0 million - \$16.0 million.

Other expenses primarily consist of production inefficiencies, moving, revalidation, personnel, training, consulting, and travel costs associated with these consolidation projects. All expenses are cash expenditures except accelerated depreciation and asset write-offs. The change in accrued liabilities related to the Lake Region Medical consolidation initiatives is as follows (in thousands):

Severance
and
Retention