Solar Capital Ltd.
Form 10-Q
July 31, 2013
**Table of Contents**

# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# FORM 10-Q

x **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
**For the Quarter Ended June 30, 2013**

¨ **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
**Commission File Number: 814-00754**

# SOLAR CAPITAL LTD.

**(Exact name of registrant as specified in its charter)**

| **Maryland** | **26-1381340** |
|---|---|
| **(State or Incorporation)** | **(I.R.S. Employer Identification No.)** |
| **500 Park Avenue New York, N.Y.** | **10022** |
| **(Address of principal executive offices)** | **(Zip Code)** |

**(212) 993-1670**

**(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 and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

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

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

| | | | |
|---|---|---|---|
| Large accelerated filer | x | Accelerated filer | ¨ |
| Non-accelerated filer | ¨ | Smaller Reporting company | ¨ |

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

The number of shares of the registrant s Common Stock, $.01 par value, outstanding as of July 30, 2013 was 45,040,613.

Table of Contents

**SOLAR CAPITAL LTD.**

**FORM 10-Q FOR THE QUARTER ENDED JUNE 30, 2013**

**TABLE OF CONTENTS**


| | | PAGE |
|---|---|---|
| **PART I. FINANCIAL INFORMATION** | | |
| Item 1. | Financial Statements | |
| | Consolidated Statements of Assets and Liabilities as of June 30, 2013 (unaudited) and December 31, 2012 | 1 |
| | Consolidated Statements of Operations for the three and six months ended June 30, 2013 (unaudited) and the three and six months ended June 30, 2012 (unaudited) | 2 |
| | Consolidated Statements of Changes in Net Assets for the six months ended June 30, 2013 (unaudited) and the year ended December 31, 2012 | 3 |
| | Consolidated Statements of Cash Flows for the six months ended June 30, 2013 (unaudited) and the six months ended June 30, 2012 (unaudited) | 4 |
| | Consolidated Schedule of Investments as of June 30, 2013 (unaudited) | 5 |
| | Consolidated Schedule of Investments as of December 31, 2012 | 9 |
| | Notes to Consolidated Financial Statements (unaudited) | 13 |
| | Report of Independent Registered Public Accounting Firm | 30 |
| Item 2. | Management s Discussion and Analysis of Financial Condition and Results of Operations | 31 |
| Item 3. | Quantitative and Qualitative Disclosures About Market Risk | 45 |
| Item 4. | Controls and Procedures | 45 |
| **PART II. OTHER INFORMATION** | | |
| Item 1. | Legal Proceedings | 46 |
| Item 1A. | Risk Factors | 46 |
| Item 2. | Unregistered Sales of Equity Securities and Use of Proceeds | 46 |
| Item 3. | Defaults upon Senior Securities | 46 |
| Item 4. | Mine Safety Disclosures | 46 |
| Item 5. | Other Information | 46 |
| Item 6. | Exhibits | 47 |
| | Signatures | 49 |

**Table of Contents**

**PART I. FINANCIAL INFORMATION**

In this Quarterly Report, Solar Capital , Company , Fund , we , us , and our refer to Solar Capital Ltd. unless the context states otherwise.

**Item 1. Financial Statements**

**SOLAR CAPITAL LTD.**

**CONSOLIDATED STATEMENTS OF ASSETS AND LIABILITIES**

**(in thousands, except share amounts)**

| | June 30, 2013 (unaudited) | December 31, 2012 |
|---|---|---|
| **Assets** | | |
| Investments at fair value: | | |
| Companies less than 5% owned (cost: $850,659 and $856,134, respectively) | $ 818,068 | $ 831,306 |
| Companies 5% to 25% owned (cost: $174,334 and $167,564, respectively) | 157,829 | 165,406 |
| Companies more than 25% owned (cost: $437,850 and $408,373, respectively) | 440,702 | 398,810 |
| Total investments (cost: $1,462,843 and $1,432,071, respectively) | 1,416,599 | 1,395,522 |
| Cash | 7,503 | 14,133 |
| Foreign currency (cost: $529 and $899, respectively) | 524 | 906 |
| Interest and dividends receivable | 19,747 | 15,147 |
| Deferred financing costs | 4,040 | 4,228 |
| Derivatives | 4 | 17 |
| Receivable for investments sold | 2,862 | |
| Prepaid expenses and other assets | 808 | 450 |
| **Total assets** | $ 1,452,087 | $ 1,430,403 |
| **Liabilities** | | |
| Revolving credit facilities (see note 6 and 8) | $ 143,792 | $ 264,452 |
| Unsecured senior notes (see note 8) | 100,000 | 100,000 |
| Senior secured notes (see note 6 and 8) | 75,000 | 75,000 |
| Term loan (see note 6 and 8) | 50,000 | 50,000 |
| Dividends payable | 27,004 | 23,217 |
| Payable for investments purchased | 31,829 | 21,756 |
| Management fee payable | 7,267 | 6,612 |
| Performance-based incentive fee payable | 4,814 | 6,050 |
| Interest payable | 2,207 | 2,406 |
| Administrative services expense payable | 1,067 | 1,058 |
| Other liabilities and accrued expenses | 804 | 1,579 |
| **Total liabilities** | $ 443,784 | $ 552,130 |
| **Net Assets** | | |
| Common stock, par value $0.01 per share, 200,000,000 and 200,000,000 common shares authorized, respectively, and 45,006,497 and 38,694,060 shares issued and outstanding, respectively | $ 450 | $ 387 |
| Paid-in capital in excess of par | 1,126,441 | 978,279 |
| Distributions in excess of net investment income | (13,875) | (4,662) |

| | | |
|---|---|---|
| Accumulated net realized loss | (56,854) | (55,631) |
| Net unrealized depreciation | (47,859) | (40,100) |
| **Total net assets** | $ 1,008,303 | $ 878,273 |
| **Net Asset Value Per Share** | $ 22.40 | $ 22.70 |

See notes to consolidated financial statements.

1

**SOLAR CAPITAL LTD.**

**CONSOLIDATED STATEMENTS OF OPERATIONS (unaudited)**

**(in thousands, except share amounts)**

| | Three months ended June 30, 2013 | Three months ended June 30, 2012 | Six months ended June 30, 2013 | Six months ended June 30, 2012 |
|---|---|---|---|---|
| **INVESTMENT INCOME:** | | | | |
| Interest and dividends: | | | | |
| Companies more than 25% owned | $ 11,354 | $ 1,362 | $ 21,828 | $ 2,444 |
| Companies 5% to 25% owned | 1,401 | 5,652 | 8,461 | 5,652 |
| Companies less than 5% owned | 26,390 | 27,819 | 54,953 | 63,046 |
| Total investment income | 39,145 | 34,833 | 85,242 | 71,142 |
| **EXPENSES:** | | | | |
| Management fees (see note 3) | $ 7,267 | $ 5,673 | $ 14,401 | $ 10,951 |
| Performance-based incentive fees (see note 3) | 4,814 | 3,591 | 11,194 | 8,866 |
| Interest and other credit facility expenses | 4,819 | 9,051 | 9,642 | 11,746 |
| Administrative services expense | 1,529 | 1,128 | 2,256 | 1,824 |
| Other general and administrative expenses | 1,460 | 995 | 2,974 | 2,004 |
| Total operating expenses | 19,889 | 20,438 | 40,467 | 35,391 |
| Income tax expense | | 26 | | 283 |
| Total expenses | 19,889 | 20,464 | 40,467 | 35,674 |
| Net investment income | $ 19,256 | $ 14,369 | $ 44,775 | $ 35,468 |
| **REALIZED AND UNREALIZED GAIN (LOSS) ON INVESTMENTS, FOREIGN CURRENCIES AND DERIVATIVES:** | | | | |
| Net realized gain (loss) on investments: | | | | |
| Companies more than 25% owned | $ | $ (687) | $ 472 | $ 10,315 |
| Companies 5% to 25% owned | | | | |
| Companies less than 5% owned | (1,619) | (19,635) | (1,391) | (20,360) |
| Net realized loss on investments | (1,619) | (20,322) | (919) | (10,045) |
| Net realized gain (loss) on foreign currencies and derivatives: | (293) | 1,167 | (304) | 841 |
| Total net realized loss before income taxes | (1,912) | (19,155) | (1,223) | (9,204) |
| Income tax expense | | | | 785 |
| Net realized loss | (1,912) | (19,155) | (1,223) | (9,989) |
| Net change in unrealized gain (loss) on investments | (18,263) | 19,286 | (9,695) | 38,120 |
| Net change in unrealized gain (loss) on foreign currencies and derivatives | 906 | 1,562 | 1,936 | (1,379) |
| Net change in unrealized gain (loss) | (17,357) | 20,848 | (7,759) | 36,741 |

| | | | | |
|---|---|---|---|---|
| Net realized and unrealized gain (loss) on investments, foreign currencies and derivatives | (19,269) | 1,693 | (8,982) | 26,752 |
| **NET INCREASE (DECREASE) IN NET ASSETS RESULTING FROM OPERATIONS** | $ (13) | $ 16,062 | $ 35,793 | $ 62,220 |
| **EARNINGS (LOSS) PER SHARE (see note 5)** | $ (0.00) | $ 0.44 | $ 0.80 | $ 1.70 |

See notes to consolidated financial statements.

2

Table of Contents

**SOLAR CAPITAL LTD.**

**CONSOLIDATED STATEMENTS OF CHANGES IN NET ASSETS**

**(in thousands, except shares)**

| | Six months ended June 30, 2013 (unaudited) | Year ended December 31, 2012 |
|---|---|---|
| **Increase in net assets resulting from operations:** | | |
| Net investment income | $ 44,775 | $ 81,927 |
| Net realized loss | (1,223) | (32,537) |
| Net change in unrealized gain (loss) | (7,759) | 66,371 |
| Net increase in net assets resulting from operations | 35,793 | 115,761 |
| **Dividends and distributions to stockholders** | (53,988) | (90,366) |
| **Capital share transactions:** | | |
| Net proceeds from shares sold | 146,857 | 45,020 |
| Less offering costs | (45) | (24) |
| Reinvestment of dividends | 1,413 | 1,941 |
| Net increase in net assets from capital transactions | 148,225 | 46,937 |
| **Total increase in net assets** | 130,030 | 72,332 |
| Net assets at beginning of period | 878,273 | 805,941 |
| Net assets at end of period | $ 1,008,303 | $ 878,273 |
| **Capital share activity:** | | |
| Shares sold | 6,253,226 | 2,000,000 |
| Shares issued from reinvestment of dividends | 59,211 | 86,022 |
| Net increase from capital share activity | 6,312,437 | 2,086,022 |

See notes to consolidated financial statements.

3

Table of Contents

**SOLAR CAPITAL LTD.**

**CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)**

**(in thousands)**

| | Six months ended June 30, 2013 | Six months ended June 30, 2012 |
|---|---|---|
| **Cash Flows from Operating Activities:** | | |
| **Net increase in net assets resulting from operations** | $ 35,793 | $ 62,220 |
| Adjustments to reconcile net increase in net assets resulting from operations: | | |
| Net realized loss on investments | 919 | 10,045 |
| Net realized (gain) loss on foreign currencies and derivatives | 304 | (841) |
| Net change in unrealized (gain) loss on investments | 9,695 | (38,120) |
| Net change in unrealized (gain) loss on foreign currencies and derivatives | (1,936) | 1,379 |
| **(Increase) decrease in operating assets:** | | |
| Purchase of investments | (158,674) | (362,575) |
| Proceeds from disposition of investments | 137,846 | 252,560 |
| Capitalization of payment-in-kind interest | (9,231) | (16,776) |
| Collections of payment-in-kind interest | | 7,141 |
| Fee revenue receivable | | 4,379 |
| Derivatives | 13 | |
| Receivable for investments sold | (2,862) | 2,595 |
| Interest and dividends receivable | (4,600) | (1,654) |
| Prepaid expenses and other assets | (358) | 191 |
| **Increase (decrease) in operating liabilities:** | | |
| Payable for investments purchased | 10,073 | 102,210 |
| Management fee payable | 655 | 396 |
| Performance-based incentive fees payable | (1,236) | (1,612) |
| Deferred fee revenue | | (318) |
| Administrative services expense payable | 9 | (47) |
| Income taxes payable | | 315 |
| Interest payable | (199) | 260 |
| Other liabilities and accrued expenses | (775) | 4,057 |
| **Net Cash Provided by Operating Activities** | 15,436 | 25,805 |
| **Cash Flows from Financing Activities:** | | |
| Cash dividends paid | (48,788) | (21,965) |
| Common stock offering costs | (45) | (190) |
| Deferred financing costs | 188 | 2,463 |
| Proceeds from shares sold | 146,857 | 75,000 |
| Proceeds from borrowings | 415,592 | 292,590 |
| Repayments of borrowings | (536,252) | (373,471) |
| **Net Cash Used in Financing Activities** | (22,448) | (25,573) |
| **NET INCREASE( DECREASE) IN CASH AND CASH EQUIVALENTS** | (7,012) | 232 |
| **CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD** | 15,039 | 11,787 |
| **CASH AND CASH EQUIVALENTS AT END OF PERIOD** | $ 8,027 | $ 12,019 |

| **Supplemental disclosure of cash flow information:** | | | | |
|---|---|---|---|---|
| Cash paid for interest | $ | 9,841 | $ | 4,150 |
| Cash paid for income taxes | $ | 356 | $ | 727 |

Non-cash financing activities consist of the reinvestment of dividends of $1,413 and $711 for the six months ended June 30, 2013 and 2012, respectively.

See notes to consolidated financial statements.

Table of Contents

**SOLAR CAPITAL LTD.**

**CONSOLIDATED SCHEDULE OF INVESTMENTS (unaudited)**

**June 30, 2013**

**(in thousands)**

| Description [1] | Industry | Interest [2] | Maturity | Par Amount* | Cost | Fair Value |
|---|---|---|---|---|---|---|
| **Bank Debt/Senior Secured Loans 53.2%** | | | | | | |
| AREP Embassy Row LLC [5] | Building & Real Estate | 9.50% | 12/6/2013 | $ 37,820 | $ 37,493 | $ 37,442 |
| AREP Fifty Seventh LLC [3][4][5] | Building & Real Estate | 14.33% | 8/1/2013 | 24,710 | 24,710 | 24,709 |
| ARK Real Estate Partners II LP [3][5] | Building & Real Estate | 14.00% | 8/1/2013 | 8,026 | 8,026 | 8,026 |
| AviatorCap SII, LLC I [5] | Aerospace & Defense | 12.00% | 12/31/2014 | 2,669 | 2,652 | 2,669 |
| AviatorCap SII, LLC II [5] | Aerospace & Defense | 11.00% | 12/31/2014 | 3,685 | 3,657 | 3,685 |
| AviatorCap SII, LLC III [5] | Aerospace & Defense | 13.00% | 12/31/2014 | 931 | 921 | 931 |
| Blue Coat Systems, Inc. | Internet Software & Services | 9.5% | 6/28/2020 | 20,500 | 20,295 | 20,295 |
| Direct Buy Inc. [6] | Home, Office Furnishing & Durable Consumer Products | 12.00% PIK | 10/31/2019 | 8,158 | 8,158 | 8,158 |
| DS Waters of America, Inc. [6][7] | Beverage, Foods & Tobacco | 15% (11% Cash & 4% PIK)[8] | 2/28/2018 | 31,630 | 30,753 | 32,896 |
| Easy Financial Services, Inc. [9][10]. | Consumer Finance | 9.97% | 10/4/2017 | C$ 10,000 | 9,737 | 9,511 |
| Global Tel*Link Corporation | Communications Equipment | 9.00% | 11/23/2020 | $ 13,500 | 13,232 | 13,230 |
| Good Sam Enterprise, LLC | Insurance | 11.50% | 12/1/2016 | 7,000 | 6,647 | 7,455 |
| Grakon, LLC [3] | Machinery | 12.00% | 12/31/2015 | 9,524 | 8,060 | 9,524 |
| Interactive Health Solutions, Inc. [12] | Healthcare, Education & Childcare | 11.50% | 10/4/2016 | 18,169 | 17,854 | 18,169 |
| Isotoner Corporation | Personal & Nondurable Consumer Products | 10.75% | 1/8/2018 | 39,000 | 38,118 | 38,805 |
| MYI Acquiror Corporation [10][11][13]. | Insurance | 13% (12% Cash & 1% PIK)[8] | 3/13/2017 | 25,904 | 25,528 | 26,292 |
| Quantum Foods, LLC | Beverage, Foods & Tobacco | 10.78% | 2/6/2018 | 37,500 | 37,500 | 37,500 |
| SMG | Healthcare, Education & Childcare | 10.75% | 12/7/2018 | 25,000 | 24,580 | 25,000 |
| Southern Auto Finance Company [10][14] | Banking | 13.50% | 10/19/2017 | 35,000 | 34,339 | 35,000 |
| SOINT, LLC [5] | Aerospace & Defense | 15.00% | 6/30/2016 | 12,690 | 12,483 | 12,690 |
| Spencer Spirit Holdings, Inc. | Retail Stores | 11.00% | 5/1/2017 | 10,000 | 10,000 | 10,825 |
| The Endurance International Group, Inc. | Internet Software & Services | 10.25% | 5/9/2020 | 25,000 | 24,764 | 25,219 |
| The Robbins Company TLA [11] | Construction & Engineering | 11.78% | 5/31/2017 | 16,939 | 16,324 | 16,262 |
| The Robbins Company TLB [11] | Construction & Engineering | 11.78% | 4/25/2015 | 4,561 | 4,385 | 4,378 |
| TravelClick, Inc. | Hotels, Restaurants & Leisure | 9.75% | 3/26/2018 | 20,000 | 19,811 | 20,000 |
| Trident USA Health Services, LLC [11] | Healthcare, Education & Childcare | 11.75% | 10/30/2017 | 43,000 | 42,277 | 44,290 |
| USAW 767 [5] | Aerospace & Defense | 14.50% | 6/30/2014 | 2,102 | 2,095 | 2,102 |
| ViaWest Inc. [11] | Personal, Food & Misc. Services | 13.5% (12% Cash & 1.5% PIK)[8] | 5/20/2018 | 41,156 | 40,248 | 41,568 |
| **Total Bank Debt/Senior Secured Loans** | | | | | **$ 524,647** | **$ 536,631** |
| **Subordinated Debt/Corporate Notes 39.8%** | | | | | | |
| Adams Outdoor Advertising | Diversified/Conglomerate Service | 17.00% | 12/8/2015 | $ 42,500 | $ 42,080 | $ 45,050 |
| Alegeus Technologies Holdings Corp. | Healthcare Technology | 12.00% | 2/15/2019 | 28,200 | 27,625 | 28,200 |
| Asurion Holdco | Insurance | 11.00% | 3/2/2019 | 12,000 | 11,693 | 12,540 |
| Crosman Corporation | Leisure, Amusement, Entertainment | 13.00% | 10/15/2016 | 15,219 | 14,912 | 14,990 |

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Earthbound Farm [11] | Farming & Agriculture | 14.25% | 6/21/2017 | | 58,947 | 58,048 | 58,947 |
| Grakon Holdings LLC Sr [3] | Machinery | 14.00% PIK | 12/31/2015 | | 1,952 | 1,952 | 1,952 |
| Grakon Holdings LLC Jr [3] | Machinery | 12.00% PIK | 12/31/2015 | | 12,907 | 11,490 | 10,713 |
| Granite Global Solutions Corp. [9][10] | Insurance | 13.50% | 11/30/2016 | C$ | 25,714 | 25,750 | 23,845 |
| Midcap Financial Intermediate Holdings, LLC [10][11] | Banking | 13.00% | 7/9/2015 | $ | 85,000 | 84,072 | 86,500 |
| ProSieben Sat.1 Media AG [9][10][15] | Broadcasting & Entertainment | 7.70%(4.2% Cash & 3.5%PIK)[8] | 3/6/2017 | | 17,214 | 21,433 | 21,979 |
| Richelieu Foods, Inc. [12] | Beverage, Food & Tobacco | 13.75%(12% Cash & 1.75%PIK)[8] | 5/18/2016 | $ | 23,172 | 22,796 | 22,941 |
| Rug Doctor Inc. [16]*** | Personal, Food & Misc. Services | 17.58%[8] | 10/31/2014 | | 55,614 | 52,200 | 25,026 |
| WireCo. Worldgroup Inc. | Building Products | 11.75% | 5/15/2017 | | 48,000 | 47,596 | 48,480 |
| **Total Subordinated Debt/Corporate Notes** | | | | | | **$ 421,647** | **$ 401,163** |

See notes to consolidated financial statements.

**SOLAR CAPITAL LTD.**

**CONSOLIDATED SCHEDULE OF INVESTMENTS (unaudited) (continued)**

**June 30, 2013**

**(in thousands, except shares/units)**

| Description [1] | Industry | Interest [2] | Maturity | Shares/ Units | Cost | Fair Value |
|---|---|---|---|---|---|---|
| **Preferred Equity 14.2%** | | | | | | |
| Senior Preferred 15% Units of DSW Group Holdings LLC [6]*** | Beverage, Food & Tobacco | 15.00% PIK | | 161,604 | $ 135,422 | $ 116,775 |
| SOCAY Limited [5][10][17] | Aerospace & Defense | 8.56%[8] | 6/30/2018 | 14,218 | 14,218 | 14,490 |
| SODO Corp. [5][17] | Aerospace & Defense | 8.40%[8] | 6/30/2018 | 2,196 | 2,196 | 2,371 |
| SOINT, LLC [5][10][17] | Aerospace & Defense | 15.00% | 6/30/2018 | 86,667 | 8,667 | 9,533 |
| Wyle Laboratories** | Aerospace & Defense | 8.00% | 7/17/2015 | 387 | 39 | 53 |
| **Total Preferred Equity** | | | | | **$ 160,542** | **$ 143,222** |
| **Common Equity / Partnership Interests / Warrants 33.3%** | | | | | | |
| Ark Real Estate Partners LP [3][5]** | Buildings & Real Estate | | | 45,905,653 | $ 45,235 | $ 26,565 |
| Ark Real Estate Partners II LP [3][5]** | Buildings & Real Estate | | | 1,070,679 | 498 | 620 |
| Crystal Capital Financial Holdings LLC [5][10] | Diversified Financial Services | | | 275,000 | 275,000 | 294,869 |
| Direct Buy Inc. [6]** | Home, Office Furnishing & Durable Consumer Products | | | 76,999 | | |
| Participating Preferred Units of DSW Group Holdings LLC [6]** | Beverage, Food & Tobacco | | | 1,292,964 | | |
| Grakon, LLC [3]** | Machinery | | | 1,714,286 | 1,714 | |
| Grakon, LLC Warrants [3]** | Machinery | | | 3,518,001 | | |
| Great American Group Inc. [10]** | Personal, Food & Misc. Services | | | 572,800 | 2,681 | 212 |
| Great American Group Inc. [10][18]** | Personal, Food & Misc. Services | | | 187,500 | 3 | 69 |
| Nuveen Investments, Inc.** | Finance | | | 3,486,444 | 30,876 | 13,248 |
| **Total Common Equity/Partnerships Interests / Warrants** | | | | | **$ 356,007** | **$ 335,583** |
| **Total Investments 140.5%** | | | | | **$ 1,462,843** | **$ 1,416,599** |
| Liabilities in Excess of Other Assets (40.5%) | | | | | | (408,296) |
| **Net Assets 100.0%** | | | | | | **$ 1,008,303** |

(1) We generally acquire our investments in private transactions exempt from registration under the Securities Act of 1933, as amended (the Securities Act ). Our investments are therefore generally subject to certain limitations on resale, and may be deemed to be restricted securities under the Securities Act.

(2) A majority of the variable rate debt investments bear interest at a rate that may be determined by reference to the London Interbank Offered Rate ( LIBOR ) or the Euro Interbank Offered Rate ( EURIBOR ), and which reset daily, quarterly or semi-annually. For each debt investment we have provided the current interest rate in effect as of June 30, 2013.

(3) Investments are held in taxable subsidiaries. Ark Real Estate Partners LP is held through SLRC ADI Corp and our equity investment in Grakon LLC is held through Grakon TL Holding, Inc.

(4) Includes an unfunded commitment of $1,759.

(5) Denotes investments in which we are deemed to exercise a controlling influence over the management or policies of a company, as defined in the Investment Company Act of 1940 ( 1940 Act ), due to beneficially owning, either directly or through one or more controlled companies, more than 25% of the outstanding voting securities of the investment. Transactions during the six months ended June 30, 2013 in these controlled investments are as follows:

| Name of Issuer | Fair Value at December 31, 2012 | Gross Additions | Gross Reductions | Interest/Dividend Income | Fair Value at June 30, 2013 |
|---|---|---|---|---|---|
| AREP Embassy Row LLC | $ | $ 37,442 | $ | $ 300 | $ 37,442 |
| AREP Fifty-Seventh LLC | 24,215 | | | 1,571 | 24,709 |
| ARK Real Estate Partners II LP | 7,866 | | | 562 | 8,026 |
| ARK Real Estate Partners LP | 35,095 | | | | 26,565 |
| ARK Real Estate Partners II LP | 824 | | | | 620 |
| AviatorCap SII, LLC I | 3,044 | | 374 | 178 | 2,669 |
| AviatorCap SII, LLC II | 4,390 | | 706 | 236 | 3,685 |
| AviatorCap SII, LLC III | 4,006 | | 3,075 | 250 | 931 |
| Crystal Capital Financial Holdings LLC | 275,000 | | | 15,950 | 294,869 |
| SOCAY Limited | 14,490 | 302 | | 595 | 14,490 |
| SODO Corp. | 2,371 | 45 | | 90 | 2,371 |
| SOINT, LLC | 15,766 | | 3,398 | 1,261 | 12,690 |
| SOINT, LLC (preferred equity) | 8,667 | | | 641 | 9,533 |
| USAW 767 | 3,076 | | 974 | 194 | 2,102 |
| | $ 398,810 | $ 37,789 | $ 8,527 | $ 21,828 | $ 440,702 |

See notes to consolidated financial statements.

Table of Contents

**SOLAR CAPITAL LTD.**

**CONSOLIDATED SCHEDULE OF INVESTMENTS (unaudited) (continued)**

**June 30, 2013**

**(in thousands)**

(6) Denotes investments in which we are an Affiliated Person , as defined in the 1940 Act, due to beneficially owning, either directly or through one or more controlled companies, more than 5% of the outstanding voting securities of the investment. Transactions during the six months ended June 30, 2013 in these affiliated investments are as follows:

| Name of Issuer | Fair Value at December 31, 2012 | Gross Additions | Gross Reductions | Interest/Dividend/ Other Income | Fair Value at June 30, 2013 |
|---|---|---|---|---|---|
| Direct Buy Inc. (common equity) | $ | $ | $ | $ | $ |
| Direct Buy Inc. | 7,700 | 458 | | 478 | 8,158 |
| DS Waters of America, Inc. | 32,095 | 621 | | 2,418 | 32,896 |
| Participating Preferred Units of DSW Group Holdings LLC | | | | | |
| Senior Preferred 15% Units of DSW Group Holdings LLC | 125,611 | 5,628 | | 5,565 | 116,775 |
| | $ 165,406 | $ 6,707 | $ | $ 8,461 | |

43,000 2,223,000 59,000 1,237,000

| | | | | |
|---|---|---|---|---|
| Performance-vested stock options and restricted stock units | 27,000 | 781,000 | 26,000 | 692,000 |

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):

| Three Month Period | Defined Benefit Plan Liability | Cash Flow Hedges | Foreign Currency Translation Adjustment | Total Pre-Tax Amount | Tax | Net-of-Tax Amount |
|---|---|---|---|---|---|---|
| At June 28, 2013 | $ (365) | $ 178 | $ 10,999 | $ 10,812 | $ 338 | $ 11,150 |
| Unrealized loss on cash flow hedges | | (419) | | (419) | 147 | (272) |
| Realized gain on foreign currency hedges | | (346) | | (346) | 121 | (225) |
| Realized loss on interest rate swap hedges | | 145 | | 145 | (51) | 94 |
| Foreign currency translation gain | | | 3,579 | 3,579 | | 3,579 |
| At September 27, 2013 | $ (365) | $ (442) | $ 14,578 | $ 13,771 | $ 555 | $ 14,326 |

| Nine Month Period | Defined Benefit Plan Liability | Cash Flow Hedges | Foreign Currency Translation Adjustment | Total Pre-Tax Amount | Tax | Net-of-Tax Amount |
|---|---|---|---|---|---|---|
| At December 28, 2012 | $ (962) | $ 120 | $ 13,431 | $ 12,589 | $ 358 | $ 12,947 |
| Unrealized gain on cash flow hedges | | 2 | | 2 | (1) | 1 |
| Realized gain on foreign currency hedges | | (908) | | (908) | 318 | (590) |
| Realized loss on interest rate swap hedges | | 344 | | 344 | (120) | 224 |
| Net defined benefit plan gain (Note 7) | 597 | | | 597 | | 597 |
| Foreign currency translation gain | | | 1,147 | 1,147 | | 1,147 |
| At September 27, 2013 | $ (365) | $ (442) | $ 14,578 | $ 13,771 | $ 555 | $ 14,326 |

The realized (gain) loss relating to the Company s foreign currency and interest rate swap hedges was reclassified from Accumulated Other Comprehensive Income and included in Cost of Sales and Interest Expense, respectively, in the Condensed Consolidated Statements of Operations.

## 14. FAIR VALUE MEASUREMENTS

***Assets and Liabilities Measured at Fair Value on a Recurring Basis***

Fair value measurement standards apply to certain financial assets and liabilities that are measured at fair value on a recurring basis (each reporting period). For the Company, these financial assets and liabilities include its derivative instruments and accrued contingent consideration. The Company does not have any nonfinancial assets or liabilities that are measured at fair value on a recurring basis.

Foreign currency contracts   The fair value of foreign currency contracts are determined through the use of cash flow models that utilize observable market data inputs to estimate fair value. These observable market data inputs include foreign exchange rate and credit spread curves. In addition to the above, the Company receives fair value estimates from the foreign currency contract counterparty to verify the reasonableness of the Company s estimates. The Company s foreign currency contracts are categorized in Level 2 of the fair value hierarchy. The fair value of the Company s foreign currency contracts will be realized as Cost of Sales as the inventory, which the contracts are hedging the cash flows to produce, is sold, of which approximately $0.04 million is expected to be realized within the next twelve months.

Table of Contents

**GREATBATCH, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Unaudited**

Interest rate swap The fair value of the Company s interest rate swap outstanding at September 27, 2013 was determined through the use of a cash flow model that utilizes observable market data inputs. These observable market data inputs include LIBOR, swap rates, and credit spread curves. In addition to the above, the Company received a fair value estimate from the interest rate swap counterparty to verify the reasonableness of the Company s estimate. This fair value calculation was categorized in Level 2 of the fair value hierarchy. The fair value of the Company s interest rate swap will be realized as Interest Expense as interest on the Company s Credit Facility is accrued.

Accrued contingent consideration In circumstances where an acquisition involves a contingent consideration arrangement, the Company recognizes a liability equal to the fair value of the contingent payments it expects to make as of the acquisition date. The Company re-measures this liability each reporting period and records changes in the fair value through Other Operating Expenses, Net. Increases or decreases in the fair value of the contingent consideration liability can result from changes in discount periods and rates, as well as changes in the timing, amount of, or the likelihood of achieving the applicable milestones.

The fair value of accrued contingent consideration recorded by the Company represents the estimated fair value of the contingent consideration the Company expects to pay to the former shareholders of NeuroNexus based upon the achievement of certain financial and development-based milestones. The fair value of the contingent consideration liability was estimated by discounting to present value, the probability weighted contingent payments expected to be made. The maximum amount of future contingent consideration (undiscounted) that the Company could be required to pay is $2.0 million. The Company s accrued contingent consideration is categorized in Level 3 of the fair value hierarchy. Changes in accrued contingent consideration were as follows (in thousands):

| | |
|---|---|
| At December 28, 2012 | $ 1,530 |
| Fair value adjustments | (430) |
| At September 27, 2013 | $ 1,100 |

Table of Contents

**GREATBATCH, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Unaudited**

The recurring Level 3 fair value measurements of the Company s contingent consideration liability include the following significant unobservable inputs (dollars in thousands):

| Contingent Consideration Liability | Fair Value at September 27, 2013 | Valuation Technique | Unobservable Inputs | |
|---|---|---|---|---|
| Financial milestones | $ 470 | Discounted cash flow | Discount rate | 12% |
| | | | Projected year of payment | 2014 |
| | | | Probability weighted payment amount | $ 500 |
| Development milestones | 630 | Discounted cash flow | Discount rate | 20% |
| | | | Projected year of payment | 2016 |
| | | | Probability weighted payment amount | $ 1,000 |

The following table provides information regarding assets and liabilities recorded at fair value on a recurring basis in the Condensed Consolidated Balance Sheet (in thousands):

| | | Fair Value Measurements Using | | |
|---|---|---|---|---|
| Description | At September 27, 2013 | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| **Assets** | | | | |
| Foreign currency contracts (Note 11) | $ 37 | $ | $ 37 | $ |
| **Liabilities** | | | | |
| Interest rate swap (Note 6) | $ 400 | $ | $ 400 | $ |
| Foreign currency contracts (Note 11) | 79 | | 79 | |
| Accrued contingent consideration | 1,100 | | | 1,100 |

**GREATBATCH, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Unaudited**

***Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis***

Fair value standards also apply to certain nonfinancial assets and liabilities that are measured at fair value on a nonrecurring basis. As of September 27, 2013, the fair value of the Company s variable rate Long-Term Debt approximates its carrying value. A summary of the valuation methodologies for the Company s assets and liabilities measured on a nonrecurring basis is as follows:

Long-lived assets The Company reviews the carrying amount of its long-lived assets to be held and used, other than goodwill and indefinite-lived intangible assets, for potential impairment whenever certain indicators are present such as: a significant decrease in the market price of the asset or asset group; a significant change in the extent or manner in which the long-lived asset or asset group is being used or in its physical condition; a significant change in legal factors or in the business climate that could affect the value of the long-lived asset or asset group, including an action or assessment by a regulator; an accumulation of costs significantly in excess of the amount originally expected for the acquisition or construction of the asset; a current-period operating or cash flow loss combined with a history of operating or cash flow losses or a projection or forecast that demonstrates continuing losses associated with the use of the long-lived asset or asset group; or a current expectation that it is more likely than not the long-lived asset or asset group will be sold or otherwise disposed of significantly before the end of its previously estimated useful life. The term more likely than not refers to a level of likelihood that is more than 50 percent.

If an indicator is present, potential recoverability is measured by comparing the carrying amount of the long-lived asset or asset group to its related total future undiscounted cash flows. If the carrying value is not recoverable, the asset or asset group is considered to be impaired. Impairment is measured by comparing the asset or asset group s carrying amount to its fair value, which is determined by using independent appraisals or discounted cash flow models. The discounted cash flow model requires inputs such as a risk-adjusted discount rate, terminal values, operating budgets, long-term strategic plans and remaining useful lives of the asset or asset group. If the carrying value of the long-lived asset or asset group exceeds the fair value, the carrying value is written down to the fair value in the period identified. The Company did not record any impairment charge related to its long-lived assets, other than goodwill and indefinite-lived intangible assets, during the first nine months of 2013. During the first nine months of 2012, the Company recorded an impairment charge to Other Operating Expenses, Net of $0.3 million relating to the write-off of a definite-lived intangible asset.

Goodwill and indefinite-lived intangible assets The Company assess the impairment of goodwill and other indefinite-lived intangible assets on the last day of each fiscal year, or more frequently if certain indicators are present as described above under long-lived assets. The Company assesses goodwill for impairment by comparing the fair value of its reporting units to their carrying amounts. If the fair value of a reporting unit is less than its carrying value, an impairment loss is recorded to the extent that the implied fair value of the goodwill within the reporting unit is less than its carrying value. Fair values for reporting units are determined based on discounted cash flow models and market multiples. The discounted cash flow model requires inputs such as a risk-adjusted discount rate, terminal values, operating budgets, and long-term strategic plans. The fair value from the discounted cash flow model is then combined, based on certain weightings, with market multiples in order to determine the fair value of the reporting unit. These market multiples include revenue multiples and multiples of earnings before interest, taxes, depreciation and amortization.

GREATBATCH, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Unaudited

Indefinite-lived intangible assets are assessed for impairment by comparing the fair value of the intangible asset to its carrying value. If the carrying value of the indefinite-lived intangible asset exceeds the fair value, the carrying value is written down to the fair value in the period identified. The fair value of indefinite-lived intangible assets is determined by using a discounted cash flow model. The discounted cash flow model requires inputs such as a risk-adjusted discount rate, royalty rates, operating budgets, and long-term strategic plans.

The Company recorded impairment charges in Other Operating Expenses, Net related to its indefinite-lived intangible assets, excluding goodwill, of $0.4 million and $0 during the first nine months of 2013 and 2012, respectively. No impairment loss was recorded for goodwill during the first nine months of 2013 or 2012. Note 5 Intangible Assets contains additional information on the Company s intangible assets.

Cost and equity method investments The Company holds investments in equity and other securities that are accounted for as either cost or equity method investments and are classified as Other Assets. The total carrying value of these investments is reviewed quarterly for changes in circumstance or the occurrence of events that suggest the Company s investment may not be recoverable. The fair value of cost or equity method investments is not adjusted if there are no identified events or changes in circumstances that may have a material effect on the fair value of the investments. Gains and losses realized on cost and equity method investments are recorded in Other (Income) Expense, Net, unless separately stated. The aggregate recorded amount of cost and equity method investments at September 27, 2013 and December 28, 2012 was $10.6 million and $9.1 million, respectively. The Company recorded losses related to its cost and equity method investments of $0.6 million and $0 during the first nine months of 2013 and 2012, respectively.

## 15. BUSINESS SEGMENT, GEOGRAPHIC AND CONCENTRATION RISK INFORMATION

The Company currently operates its business in two reportable segments Implantable Medical and Electrochem. The Implantable Medical segment is comprised of Greatbatch Medical and QiG Group and designs and manufactures medical devices and components for the cardiac, neuromodulation, vascular and orthopaedic markets. The Implantable Medical segment offers complete medical devices including design, development, manufacturing, regulatory submission and supporting worldwide distribution, which is facilitated through the QiG Group and leverages the component technology of Greatbatch Medical. The devices designed and developed by the QiG Group are manufactured by Greatbatch Medical. The Implantable Medical segment also offers individual components for implantable medical devices as well as value-added assembly and design engineering services for its component products. Examples of these components include batteries, capacitors, filtered and un-filtered feedthroughs, machined components, enclosures, leads, introducers, catheters, as well as orthopaedic implants, instruments and cases and trays.

Electrochem is an industry leader in designing and manufacturing total power solutions for critical applications with market-leading OEMs, largely in the portable medical and energy space. Electrochem offers its customers components, consultation, design, development and testing for medical device applications, in high-value markets, including those that support the transition of delivery of health care from clinical to outpatient and home settings, as well as those that enhance the quality of life for an aging population. Examples of these devices include powered surgical tools, automated external defibrillators, portable ultrasound devices, portable oxygen concentrators, and

ventilators, among others. Electrochem provides cell and battery pack configurations for rechargeable and non-rechargeable battery power systems, charging and docking stations, and power supplies, for devices where failure is not an option.

**GREATBATCH, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Unaudited**

As discussed further in Note 9 Other Operating Expenses, Net, 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 and marketing and operations groups of its Implantable Medical and Electrochem segments were combined into one sales and marketing and one operations group serving the entire Company. As a result of this realignment initiative, which includes changing the management and reporting structure, the Company is re-evaluating its operating and reportable segments.

The Company defines segment income from operations as sales less cost of sales including amortization and expenses attributable to segment-specific selling, general, administrative, research, development, engineering and other operating activities. Segment income also includes a portion of non-segment specific selling, general, and administrative expenses based on allocations appropriate to the expense categories. The remaining unallocated operating and other expenses are primarily administrative corporate headquarters expenses and capital costs that are not allocated to reportable segments. Transactions between the two segments are not significant.

An analysis and reconciliation of the Company s business segment, product line and geographic information to the respective information in the Condensed Consolidated Financial Statements follows. Sales by geographic area are presented by allocating sales from external customers based on the location to which products are shipped (in thousands):

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 27, 2013 | September 28, 2012 | September 27, 2013 | September 28, 2012 |
| Sales: | | | | |
| Implantable Medical | | | | |
| Cardiac/Neuromodulation | $ 86,980 | $ 80,246 | $ 242,161 | $ 235,406 |
| Orthopaedic | 30,079 | 27,173 | 92,043 | 91,079 |
| Vascular | 12,279 | 13,674 | 35,152 | 37,791 |
| Total Implantable Medical | 129,338 | 121,093 | 369,356 | 364,276 |
| Electrochem | | | | |
| Portable Medical | 19,320 | 20,219 | 60,376 | 59,346 |
| Energy | 13,625 | 13,054 | 39,025 | 41,024 |
| Other | 5,447 | 6,974 | 18,569 | 22,345 |
| Total Electrochem | 38,392 | 40,247 | 117,970 | 122,715 |
| Total sales | $ 167,730 | $ 161,340 | $ 487,326 | $ 486,991 |

**GREATBATCH, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Unaudited**

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 27, 2013 | September 28, 2012 | September 27, 2013 | September 28, 2012 |
| Segment income from operations: | | | | |
| Implantable Medical | $ 19,074 | $ 2,744 | $ 50,057 | $ 24,252 |
| Electrochem | 2,216 | 5,350 | 12,860 | 16,020 |
| Total segment income from operations | 21,290 | 8,094 | 62,917 | 40,272 |
| Unallocated operating expenses | (4,288) | (5,967) | (14,441) | (15,856) |
| Operating income as reported | 17,002 | 2,127 | 48,476 | 24,416 |
| Unallocated other expense | (1,458) | (4,299) | (10,855) | (13,599) |
| Income (loss) before provision for income taxes | $ 15,544 | $ (2,172) | $ 37,621 | $ 10,817 |

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 27, 2013 | September 28, 2012 | September 27, 2013 | September 28, 2012 |
| Sales by geographic area: | | | | |
| United States | $ 81,736 | $ 82,522 | $ 242,304 | $ 249,306 |
| Non-Domestic locations: | | | | |
| Puerto Rico | 31,936 | 31,320 | 87,592 | 81,541 |
| Belgium | 14,947 | 11,346 | 49,895 | 41,737 |
| Rest of world | 39,111 | 36,152 | 107,535 | 114,407 |
| Total sales | $ 167,730 | $ 161,340 | $ 487,326 | $ 486,991 |

Three customers accounted for a significant portion of the Company s sales as follows:

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 27, 2013 | September 28, 2012 | September 27, 2013 | September 28, 2012 |
| Customer A | 21% | 19% | 20% | 19% |
| Customer B | 16% | 18% | 16% | 15% |
| Customer C | 11% | 10% | 13% | 10% |

| | | | | |
|---|---|---|---|---|
| Total | 48% | 47% | 49% | 44% |

Long-lived tangible assets by geographic area are as follows (in thousands):

| | As of | |
|---|---|---|
| | **September 27, 2013** | **December 28, 2012** |
| United States | $ 117,393 | $ 123,104 |
| Rest of world | 30,038 | 27,789 |
| Total | $ 147,431 | $ 150,893 |

**GREATBATCH, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS Unaudited**

**16. IMPACT OF RECENTLY ISSUED ACCOUNTING STANDARDS**

In the normal course of business, management evaluates all new accounting pronouncements issued by the Financial Accounting Standards Board ( FASB ), Securities and Exchange Commission, Emerging Issues Task Force, American Institute of Certified Public Accountants or other authoritative accounting bodies to determine the potential impact they may have on the Company s Condensed Consolidated Financial Statements. Based upon this review except as noted below, management does not expect any of the recently issued accounting pronouncements, which have not already been adopted, to have a material impact on the Company s Condensed Consolidated Financial Statements.

On February 5, 2013, the FASB issued Accounting Standards Update ( ASU ) 2013-02, Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. This ASU added new disclosure requirements regarding the effect of significant amounts reclassified from each component of accumulated other comprehensive income ( AOCI ) based on its source and the income statement line items affected by the reclassification. This ASU gave companies the flexibility to present the information either in the notes or parenthetically on the face of the financial statements provided that all of the required information is presented in a single location. This ASU was effective prospectively for annual and interim reporting periods beginning after December 15, 2012. This ASU was adopted during the first quarter of 2013 and did not have a material impact on the Company s Condensed Consolidated Financial Statements as it only changed the disclosures surrounding AOCI.

In July 2012, the FASB issued ASU No. 2012-02, Intangibles Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment. This ASU simplified the guidance for testing the decline in the realizable value (impairment) of indefinite-lived intangible assets other than goodwill. The amendment allowed an organization the option to first assess qualitative factors to determine whether it is necessary to perform the quantitative impairment test. An organization electing to perform a qualitative assessment is no longer required to calculate the fair value of an indefinite-lived intangible asset unless the organization determines, based on a qualitative assessment, that it is more likely than not that the asset is impaired. The amendments in this ASU were effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. This ASU did not have a material impact on the Company s Condensed Consolidated Financial Statements as it only impacted the timing of when the Company was required to perform the two-step impairment test of its indefinite-lived intangible assets other than goodwill.

In December 2011, the FASB issued ASU No. 2011-11 Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities. This ASU requires companies to provide expanded disclosures about trading in financial instruments and related derivatives, and creates new disclosure requirements about the nature of an entity s rights of offset and related arrangements associated with its financial instruments and derivative instruments. The disclosure requirements are effective for annual reporting periods beginning on or after January 1, 2013, and interim periods therein, with retrospective application required. This ASU did not have a material impact on the Company s Condensed Consolidated Financial Statements as it only changes the disclosures surrounding the Company s offsetting assets and liabilities.

Table of Contents

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

**Our Business**

We currently operate our business in two reportable segments  Implantable Medical and Electrochem Solutions ( Electrochem ). The Implantable Medical segment is comprised of our Greatbatch Medical and QiG Group and designs and manufactures medical devices and components for the cardiac, neuromodulation, vascular and orthopaedic markets. The Implantable Medical segment offers complete medical devices including design, development, manufacturing, regulatory submission and supporting worldwide distribution, which is facilitated through the QiG Group and leverages the component technology of Greatbatch Medical. The devices designed and developed by the QiG Group are manufactured by Greatbatch Medical. The Implantable Medical segment also offers individual components for implantable medical devices as well as value-added assembly and design engineering services for its component products. Examples of these components include batteries, capacitors, filtered and unfiltered feedthroughs, machined components, enclosures, leads, introducers, catheters, as well as orthopaedic implants, instruments and cases and trays.

Electrochem is an industry leader in designing and manufacturing total power solutions for critical applications with market-leading OEMs, largely in the portable medical and energy space. Electrochem offers its customers components, consultation, design, development and testing for medical device applications in high-value markets, including those that support the transition of delivery of health care from clinical to outpatient and home settings, as well as those that enhance the quality of life for an aging population. Examples of these devices include powered surgical tools, automated external defibrillators, portable ultrasound devices, portable oxygen concentrators, and ventilators, among others. Electrochem provides cell and battery pack configurations for rechargeable and non-rechargeable battery power systems, charging and docking stations, and power supplies, for devices where failure is not an option.

As discussed in Note 9  Other Operating Expenses, Net  of the Notes to Condensed Consolidated Financial Statements in Item 1 of this report, in June 2013, we initiated a plan to realign our operating structure in order to optimize our continued focus on profitable growth. Under this initiative, the sales and marketing and operations groups of our Implantable Medical and Electrochem segments were combined into one sales and marketing and one operations group serving the entire Company. As a result of this realignment initiative, which includes changing the management and reporting structure, we are re-evaluating our operating and reportable segments.

**Our Customers**

Implantable Medical customers include leading original equipment manufacturers ( OEMs ), in alphabetical order here and throughout this report, such as Biotronik, Boston Scientific, Johnson & Johnson, Medtronic, Smith & Nephew, Sorin Group, St. Jude Medical, Stryker and Zimmer. The nature and extent of our selling relationships with each OEM varies in terms of breadth of products purchased, purchased product volumes, length of contractual commitment, ordering patterns, inventory management and selling prices. During the nine months ended September 27, 2013, Johnson & Johnson, Medtronic and St. Jude Medical collectively accounted for 49% of our total Company sales.

Electrochem s customers are primarily companies involved in demanding markets with sophisticated total power solutions needs, such as in the portable medical and energy markets. Some of Electrochem s larger OEM customers are, in alphabetical order here and throughout this report, Carefusion, Covidien, Ethicon Endo-Surgery, Halliburton, Phillips Healthcare, Physio-Control, and Weatherford International.

Table of Contents

## Financial Overview

Third quarter 2013 sales increased $6.4 million over the prior year period to $167.7 million. After adjusting sales by $3.2 million for the divestiture of certain non-core orthopaedic product lines during the first quarter of 2013 and approximately $1 million for the positive impact of foreign currency exchange rate fluctuations in comparison to the prior year, sales increased $8.6 million or 5% organically. This growth was primarily due to increased sales and marketing investment in our cardiac/neuromodulation product line, as well as orthopaedic market share gains, which helped drive 8% and 22% organic constant currency growth, respectively. This growth was partially offset by a $1.4 million and $1.9 million decline in vascular and Electrochem sales, respectively, due to the previously disclosed voluntary recall of two vascular medical devices and continued pricing discipline in our Electrochem product lines resulting in the rationalization of some lower-margin business. For the first nine months of 2013, sales of $487.3 million were consistent with the prior year period. On an organic constant currency basis, sales for the first nine months of 2013 increased 2% in comparison to 2012 as strong cardiac/neuromodulation and orthopaedics sales in the second and third quarter of 2013 were partially offset by slower demand in the first quarter of 2013 due to customer inventory adjustments and the impact of our Swiss consolidation. For the remainder of 2013, we expect Implantable Medical revenue to remain strong as new product introductions are commercialized, as we further partner across business lines with our large OEM customers, and as we further leverage our sales and marketing resources to drive core business growth.

We prepare our condensed consolidated financial statements in accordance with generally accepted accounting principles in the United States of America ( GAAP ). Additionally, we consistently report and discuss in our quarterly earnings releases and investor presentations adjusted operating income and margin, adjusted net income and adjusted earnings per diluted share. These adjusted amounts consist of GAAP amounts excluding the following adjustments to the extent they occur during the period: (i) acquisition-related charges, (ii) facility consolidation, optimization, manufacturing transfer and system integration charges, (iii) asset write-down and disposition charges, (iv) severance charges in connection with corporate realignments or a reduction in force, (v) litigation charges and gains, (vi) the impact of certain non-cash charges to interest expense, (vii) unusual or infrequently occurring items, (viii) certain R&D expenditures (such as medical device design verification ( DVT ) expenses in connection with developing our neuromodulation platform), (ix) gain/loss on the sale of investments, (x) the income tax (benefit) related to these adjustments and (xi) certain tax charges related to the consolidation of our Swiss Orthopaedic facility. We believe that reporting these amounts provides important supplemental information to our investors and creditors seeking to understand the financial and business trends relating to our financial condition and results of operations. Additionally, certain performance-based compensation incentives provided to our executives are determined utilizing these adjusted amounts.

Table of Contents

A reconciliation of GAAP operating income (loss) to adjusted amounts is as follows (dollars in thousands):

| | Three Months Ended | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Implantable Medical | | Electrochem | | Unallocated | | Total | |
| | Sept. 27, 2013 | Sept. 28, 2012 | Sept. 27, 2013 | Sept. 28, 2012 | Sept. 27, 2013 | Sept. 28, 2012 | Sept. 27, 2013 | Sept. 28, 2012 |
| Sales | $ 129,338 | $ 121,093 | $ 38,392 | $ 40,247 | $ | $ | $ 167,730 | $ 161,340 |
| Operating income (loss) as reported | $ 19,074 | $ 2,744 | $ 2,216 | $ 5,350 | $ (4,288) | $ (5,967) | $ 17,002 | $ 2,127 |
| Adjustments: | | | | | | | | |
| Medical device DVT expenses (RD&E) | 1,510 | 1,224 | | | | | 1,510 | 1,224 |
| Consolidation and optimization costs | 2,131 | 12,944 | 1,235 | | 199 | 1,834 | 3,565 | 14,778 |
| Acquisition and integration expenses (income) | (541) | 101 | 19 | 127 | | 4 | (522) | 232 |
| Asset dispositions, severance and other | 419 | (129) | 38 | 432 | | | 457 | 303 |
| Adjusted operating income (loss) | 22,593 | 16,884 | 3,508 | 5,909 | (4,089) | (4,129) | 22,012 | 18,664 |
| Adjusted operating margin | 17.5% | 13.9% | 9.1% | 14.7% | N/A | N/A | 13.1% | 11.6% |
| Medical device related adjusted expenses (excluding DVT) | 6,302 | 7,496 | | | | | 6,302 | 7,496 |
| Adjusted operating income (loss) excluding medical device related adjusted expenses | $ 28,895 | $ 24,380 | $ 3,508 | $ 5,909 | $ (4,089) | $ (4,129) | $ 28,314 | $ 26,160 |
| | 22.3% | 20.1% | 9.1% | 14.7% | N/A | N/A | 16.9% | 16.2% |

Adjusted operating margin excluding medical device related adjusted expenses

| | Nine Months Ended | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Implantable Medical | | Electrochem | | Unallocated | | Total | |
| | Sept. 27, 2013 | Sept. 28, 2012 | Sept. 27, 2013 | Sept. 28, 2012 | Sept. 27, 2013 | Sept. 28, 2012 | Sept. 27, 2013 | Sept. 28, 2012 |
| Sales | $ 369,356 | $ 364,276 | $ 117,970 | $ 122,715 | $ | $ | $ 487,326 | $ 486,991 |
| Operating income (loss) as reported | $ 50,057 | $ 24,252 | $ 12,860 | $ 16,020 | $ (14,441) | $ (15,856) | $ 48,476 | $ 24,416 |
| Adjustments: | | | | | | | | |
| Inventory step-up amortization (COS) | | | | 532 | | | | 532 |
| Medical device DVT expenses (RD&E) | 4,479 | 3,839 | | | | | 4,479 | 3,839 |
| Consolidation and optimization costs | 7,956 | 16,407 | 1,361 | | 1,018 | 4,394 | 10,335 | 20,801 |
| Acquisition and integration expenses (income) | (430) | 245 | 89 | 1,037 | 1 | 5 | (340) | 1,287 |
| Asset dispositions, severance and other | 472 | 378 | 93 | 843 | | 672 | 565 | 1,893 |
| Adjusted operating income (loss) | 62,534 | 45,121 | 14,403 | 18,432 | (13,422) | (10,785) | 63,515 | 52,768 |
| Adjusted operating margin | 16.9% | 12.4% | 12.2% | 15.0% | N/A | N/A | 13.0% | 10.8% |
| Medical device related adjusted | 18,792 | 22,140 | | | | | 18,792 | 22,140 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| expenses (excluding DVT) | | | | | | | | |
| Adjusted operating income (loss) excluding medical device related adjusted expenses | $ 81,326 | $ 67,261 | $ 14,403 | $ 18,432 | $ (13,422) | $ (10,785) | $ 82,307 | $ 74,908 |
| Adjusted operating margin excluding medical device related adjusted expenses | 22.0% | 18.5% | 12.2% | 15.0% | N/A | N/A | 16.9% | 15.4% |

GAAP operating income for the third quarter and year-to-date periods of 2013 was $17.0 million and $48.5 million, respectively, compared to $2.1 million and $24.4 million, respectively, for the comparable 2012 periods. Adjusted operating income, which excludes consolidation, optimization and DVT costs, increased 18% and 20% for the third quarter and year-to-date periods of 2013, respectively, to $22.0 million and $63.5 million, respectively. These GAAP and adjusted operating income variances are primarily due to the following:

The increase in gross profit for the quarter and year-to-date periods, driven primarily by our higher sales volumes as well as cost savings and production efficiencies, including savings realized from the consolidation of our Swiss orthopaedic facilities and product line rationalizations. This increased operational leverage resulted in a 170 basis point and 240 basis point improvement on our gross margin when comparing the 2013 and 2012 quarter and year-to-date periods, respectively;

- 36 -

Table of Contents

The increase in selling, general, and administrative ( SG&A ) expenses for the third quarter and year-to-date periods was primarily due to the additional cost from our investment in sales and marketing resources to drive future core business growth, as well as increased performance based compensation. These increases were partially offset by synergies realized from our acquisitions and benefits from the Swiss orthopaedic facility consolidation;

The decrease in our net research, development and engineering ( RD&E ) for the year-to-date period is primarily a result of our efforts, beginning in 2012, to focus on medical RD&E investment and discontinue certain non-core RD&E projects as well as increased customer cost reimbursements in the first quarter of 2013; and

The increase in GAAP operating income for the quarter and year-to-date periods of 2013 in comparison to 2012 also included lower consolidation and optimization costs due to the timing of when these initiatives were completed.

A reconciliation of GAAP net income and diluted EPS to adjusted amounts is as follows (in thousands, except per share amounts):

| | Three Months Ended | | | | Nine Months Ended | | | |
|---|---|---|---|---|---|---|---|---|
| | September 27, 2013 | | September 28, 2012 | | September 27, 2013 | | September 28, 2012 | |
| | Net Income | Impact Per Diluted Share | Net Income (Loss) | Impact Per Diluted Share | Net Income | Impact Per Diluted Share | Net Income | Impact Per Diluted Share |
| Net income (loss) as reported | $ 11,071 | $ 0.44 | $ (7,561) | $ (0.32) | $ 26,486 | $ 1.06 | $ 757 | $ 0.03 |
| Adjustments: | | | | | | | | |
| Inventory step-up amortization (COS) | | | | | | | 346 | 0.01 |
| Medical device DVT expenses (RD&E) | 981 | 0.04 | 796 | 0.03 | 2,911 | 0.12 | 2,495 | 0.10 |
| Consolidation and optimization costs[a] | 2,453 | 0.10 | 11,119 | 0.46 | 7,749 | 0.31 | 15,034 | 0.63 |
| Acquisition and integration expenses (income)[a] | (339) | (0.01) | 151 | 0.01 | (221) | (0.01) | 837 | 0.03 |
| Asset dispositions, severance and other[a] | 298 | 0.01 | 197 | 0.01 | 389 | 0.02 | 1,230 | 0.05 |
| Loss (gain) on cost and equity method investments, net[a][b] | 10 | | (228) | (0.01) | 408 | 0.02 | (228) | (0.01) |
| CSN conversion option discount and deferred fee accelerated amortization[a][c] | 101 | | 1,498 | 0.06 | 3,007 | 0.12 | 4,413 | 0.18 |
| 2012 R&D Tax Credit[d] | (100) | | | | (1,600) | (0.06) | | |
| Swiss tax impact | | | 5,008 | 0.21 | | | 5,008 | 0.21 |
| | $ 14,475 | $ 0.57 | $ 10,980 | $ 0.46 | $ 39,129 | $ 1.56 | $ 29,892 | $ 1.25 |

| | | | | |
|---|---|---|---|---|
| Adjusted net income and diluted EPS[e] | | | | |
| Adjusted diluted weighted average shares[f] | 25,188 | 24,011 | 25,017 | 23,924 |

(a) Net of tax amounts computed using a 35% U.S. statutory tax rate for the 2013 and 2012 periods and a 0% and 22.5% Switzerland tax rate for the 2013 and 2012 periods, respectively.
(b) Pre-tax amounts are $16 thousand and $628 thousand for the 2013 quarter and year-to-date periods, respectively, and $350 thousand for the 2012 quarter and year-to-date periods.
(c) Pre-tax amounts are $156 thousand and $4.6 million for the 2013 quarter and year-to-date periods and $2.3 million and $6.8 million for the 2012 quarter and year-to-date periods, respectively.
(d) Relates to the 2012 portion of the R&D tax credit which was reinstated in the first quarter of 2013 retroactive back to the beginning of 2012. As required, the impact of the R&D tax credit relating to 2012 was recognized in 2013.
(e) The per share data in this table has been rounded to the nearest $0.01 and therefore may not sum to the total.
(f) Weighted average diluted shares for the third quarter of 2012 includes 365 thousand shares of dilution related to outstanding stock incentive awards that were not dilutive for GAAP EPS purposes.

Table of Contents

GAAP and adjusted diluted EPS for the third quarter of 2013 were $0.44 and $0.57, respectively, compared to a loss of $0.32 and income of $0.46, respectively, for the third quarter 2012. For the first nine months of 2013, GAAP and adjusted diluted EPS were $1.06 and $1.56 per share, respectively, compared to $0.03 and $1.25 per share, respectively, for the 2012 periods. These variances were primarily due to the same factors impacting GAAP and adjusted operating income as well as the following:

Lower interest expense as a result of lower interest rates paid on our long-term debt due to the repayment of our convertible subordinated debt with availability under our revolving line of credit in 2013;

A lower effective tax rate for 2013 in comparison to the 2012 primarily due to a $5.0 million tax charge recorded during the third quarter of 2012 in connection with our Swiss Orthopaedic consolidation. Additionally, the reinstatement of the R&D tax credit in 2013, as well as higher income in lower tax rate jurisdictions contributed to a more favorable tax rate in 2013; and

These increases were partially offset by a 5% increase in weighted average diluted shares outstanding for the quarter and year-to-date periods primarily as a result of the increase in our weighted average stock price during those respective periods. This increase impacted the quarter and year-to-date adjusted diluted EPS by approximately $0.03 and $0.08 per share, respectively.

**Financial Guidance**

Based upon our results for the first three quarters, as well as our expectations for the remainder of the year, we believe that our adjusted diluted EPS for 2013 will be near the middle to high end of our raised guidance range provided last quarter of $2.05 to $2.15. We continue to believe that our revenue for 2013 will be closer to the lower end of our revenue guidance of $660 to $680 million provided at the beginning of the year and we expect operating margin to approximate 13%. Finally, we expect our full year GAAP effective tax rate will be approximately 31% and that diluted shares will be around 25 million as a result of our higher stock price.

**Our CEO s View**

We are very pleased with our performance in the third quarter as adjusted diluted EPS increased 24% to $0.57 per share. The key highlights for the quarter are as follows:

5% organic constant currency sales growth;

Gross margin improved to 33.3%, an increase of 170 basis points and the fourth consecutive quarter our gross margins have improved in comparison to the prior year;

Planned investment in sales and marketing were funded by lower medical device spending and reduction in our other operating expense; and

Cash flow from operating activities was $24.7 million, up 54% over the prior year.

Our 2013 initiatives are all progressing as planned. Our approach to commercializing Algostim has not changed, and is proceeding as planned with FDA and CE Mark submissions. Our core business is well positioned because our OEM customers leverage our portfolio of intellectual property, and we are building a healthy pipeline of diverse medical technology opportunities. Our new organization structure allows dedicated resources to focus on growth. Combined with stronger discipline to ensure we have adequate returns for all investments, our bottom line performance and our return on invested capital continues to improve. In this new structure we have retained and enhanced the leadership team and the capabilities that have driven our operational excellence. This foundation we stand on when working with our OEM partners will continue to drive our growth strategy. We expect these initiatives to continue to pay dividends for the remainder of 2013 and will position the Company to meet its long-term objective of maintaining at least 5% organic constant currency revenue expansion and at least double that growth rate for adjusted diluted EPS over time.

## Product Development

*Implantable Medical*

Medical Devices We provide our Implantable Medical customers with complete medical devices. This medical device strategy is being facilitated through the QiG Group and includes strategic equity investments and medical devices developed independently as well as in conjunction with our OEM partners. While we do not intend to discuss each of these projects individually each quarter, we will discuss significant milestones as they occur.

Algostim, our spinal cord stimulator for the treatment of chronic pain in the trunk and limbs, continues to progress on schedule. FDA submission is planned for the fourth quarter 2013 and Europe CE Mark submission is planned for early 2014. Collaboration continues with our investment bankers who are assisting us in identifying commercial partners.

Medical Device Components Our core business is well positioned because our OEM customers leverage our portfolio of intellectual property, and we are building a healthy pipeline of diverse medical technology opportunities. We continue to deepen our relationships with our OEM customers and continue to see an increased pace of product development opportunities, and in particular, from our cardiac/neuromodulation customers. New cardiac/neuromodulation product introductions are scheduled for the fourth quarter of 2013, which, when combined with our increased sales and marketing resources, we expect will allow us to continue to grow this product line faster than the underlying market.

*Electrochem*

Our Electrochem product development activities are centered around the portable medical market. Gaining better access to this attractive market is one of our strategic priorities as it provides us with a significant opportunity for growth given its $1 billion market size. Additionally, this market is benefiting from favorable market trends as patient care shifts from clinical settings to the home and as an aging population drives the need for lightweight and portable devices for patients and caregivers. These favorable trends are expected to allow this market to grow faster than our legacy markets over the next several years. Finally, this market is also attractive to us given that it has long product life cycles that should provide stability and diversification to our revenue base.

## Cost Savings and Consolidation Efforts

In 2013 and 2012, we recorded charges in Other Operating Expenses, Net related to various cost savings and consolidation initiatives. These initiatives were undertaken to improve our operational efficiencies and profitability. Additional information regarding the timing, cash flow impact and amount of future expenditures is set forth in Note 9 Other Operating Expenses, Net of the Notes to the Condensed Consolidated Financial Statements contained in Item 1 of this report.

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 and marketing and operations groups of our Implantable Medical and Electrochem segments were combined into one sales and marketing and one operations group serving the entire Company. Total restructuring charges expected to be incurred in connection with this realignment is between $6.2 million to $7.0 million, of which $3.1 million has been incurred to date. Expenses related to this initiative will be recorded within the applicable segment and corporate cost centers to which the expenditures relate. When fully implemented, this plan is expected to result in annual savings of approximately $7.0 to $7.7 million.

In addition, in 2010, we initiated a multi-faceted plan to further enhance, optimize and leverage our orthopaedics operations. This plan includes the construction of an orthopaedic manufacturing facility in Fort Wayne, IN, updating our Indianapolis, IN facility to streamline operations, increase capacity, and further expand capabilities, and transferring manufacturing and development operations performed at our facilities in Orvin and Corgemont, Switzerland into our Fort Wayne, IN and Tijuana, Mexico facilities. The total capital investment expected for these initiatives is between $25 million and $30 million, of which $22.0 million has been expended to date. Total expense expected to be incurred for these initiatives is between $40 million and $41 million, of which $39.9 million has been incurred to date.

Near the end of 2011, we initiated plans to optimize and expand our manufacturing infrastructure in order to support our medical device strategy. This included the transfer of certain product lines to lower cost facilities, expansion of two of our existing facilities, as well as the purchase of equipment to create additional capacity for the manufacture of medical devices and to create additional cost savings. Total capital investment under these initiatives is expected to be between $15 million and $20 million, of which approximately $12.4 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.

These orthopaedic and medical device initiatives are nearly complete and were expected to generate approximately $10 million to $15 million of annual cost savings, a significant portion of which are already reflected in our 2013 results. Additionally, these initiatives increased our capacity in order to support anticipated future growth and the manufacturing of complete medical devices.

In 2011, we initiated plans to upgrade our existing global ERP system. This initiative is expected to be completed over the next six months. Total capital investment under this initiative is expected to be approximately $4.5 million to $5 million, of which approximately $4.3 million has been expended to date. Total expenses expected to be incurred on this initiative is between $6 million to $7 million, of which $5.3 million has been incurred to date.

Table of Contents

## Our Financial Results

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. The third quarter and year-to-date periods of 2013 and 2012 ended on September 27, and September 28, respectively, and each contained 13 weeks and 39 weeks, respectively. The fourth quarter of 2013 will contain 14 weeks compared to the fourth quarter of 2012 which had 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 Annual Report on Form 10-K for the fiscal year ended December 28, 2012. The following table presents certain selected financial information derived from our Condensed Consolidated Financial Statements for the periods presented (dollars in thousands, except per share data):

| | **Three Months Ended** | | **Change** | | **Nine Months Ended** | | **Change** | |
|---|---|---|---|---|---|---|---|---|
| | **Sept. 27, 2013** | **Sept. 28, 2012** | **$** | **%** | **Sept. 27, 2013** | **Sept. 28, 2012** | **$** | **%** |
| Sales: | | | | | | | | |
| Implantable Medical | | | | | | | | |
| CRM/Neuromodulation | $ 86,980 | $ 80,246 | $ 6,734 | 8% | $ 242,161 | $ 235,406 | $ 6,755 | 3% |
| Orthopaedic | 30,079 | 27,173 | 2,906 | 11% | 92,043 | 91,079 | 964 | 1% |
| Vascular | 12,279 | 13,674 | (1,395) | -10% | 35,152 | 37,791 | (2,639) | -7% |
| Total Implantable Medical | 129,338 | 121,093 | 8,245 | 7% | 369,356 | 364,276 | 5,080 | 1% |
| Electrochem | | | | | | | | |
| Portable Medical | 19,320 | 20,219 | (899) | -4% | 60,376 | 59,346 | 1,030 | 2% |
| Energy | 13,625 | 13,054 | 571 | 4% | 39,025 | 41,024 | (1,999) | -5% |
| Other | 5,447 | 6,974 | (1,527) | -22% | 18,569 | 22,345 | (3,776) | -17% |
| Total Electrochem | 38,392 | 40,247 | (1,855) | -5% | 117,970 | 122,715 | (4,745) | -4% |
| Total sales | 167,730 | 161,340 | 6,390 | 4% | 487,326 | 486,991 | 335 | 0% |
| Cost of sales | 111,853 | 110,386 | 1,467 | 1% | 325,398 | 337,216 | (11,818) | -4% |
| Gross profit | 55,877 | 50,954 | 4,923 | 10% | 161,928 | 149,775 | 12,153 | 8% |
| Gross profit as a % of sales | 33.3% | 31.6% | | | 33.2% | 30.8% | | |
| Selling, general and administrative expenses (SG&A) | 21,569 | 20,274 | 1,295 | 6% | 63,909 | 60,053 | 3,856 | 6% |
| SG&A as a % of sales | 12.9% | 12.6% | | | 13.1% | 12.3% | | |
| Research, development and engineering costs, net (RD&E) | 13,806 | 13,240 | 566 | 4% | 38,983 | 41,325 | (2,342) | -6% |
| RD&E as a % of sales | 8.2% | 8.2% | | | 8.0% | 8.5% | | |
| Other operating expenses, net | 3,500 | 15,313 | (11,813) | -77% | 10,560 | 23,981 | (13,421) | -56% |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Operating income | 17,002 | 2,127 | 14,875 | NA | 48,476 | 24,416 | 24,060 | 99% |
| Operating margin | 10.1% | 1.3% | | | 9.9% | 5.0% | | |
| Interest expense | 1,515 | 4,401 | (2,886) | -66% | 9,948 | 13,175 | (3,227) | -24% |
| Other (income) expense, net | (57) | (102) | 45 | -44% | 907 | 424 | 483 | 114% |
| Provision for income taxes | 4,473 | 5,389 | (916) | -17% | 11,135 | 10,060 | 1,075 | 11% |
| Effective tax rate | 28.8% | NA | | | 29.6% | 93.0% | | |
| Net income (loss) | $ 11,071 | $ (7,561) | $ 18,632 | NA | $ 26,486 | $ 757 | $ 25,729 | NA |
| Net margin | 6.6% | -4.7% | | | 5.4% | 0.2% | | |
| Diluted earnings (loss) per share | $ 0.44 | $ (0.32) | $ 0.76 | NA | $ 1.06 | $ 0.03 | $ 1.03 | NA |

*Sales*

***Implantable Medical*** Cardiac/neuromodulation sales for the third quarter of 2013 increased 8% compared to the prior year to $87.0 million. This increase was driven by stronger market performance and continued deepening relations with OEM partners as a result of a better managed and an expanded sales force, our manufacturing excellence, and our strong intellectual property portfolio. More specifically, during the quarter we experienced double digit growth in medical batteries, capacitors, leads and feedthroughs. Cardiac/neuromodulation revenues for the first nine months of 2013 were 3% above the comparable 2012 period. We continue to see an increased pace of product development opportunities from our cardiac customers. We believe that these opportunities, combined with our increased sales and marketing resources, will allow the Company to continue to grow this product line faster than the underlying market.

Orthopaedic sales of $30.1 million and $92.0 million for the third quarter and year-to-date periods of 2013 increased 11% and 1%, respectively, versus the comparable 2012 periods. During the first quarter of 2013, the Company divested certain non-core orthopaedic product lines which reduced quarter and year-to-date 2013 orthopaedic revenue by approximately $3.2 million and $11.9 million, respectively, in comparison to the prior year periods. Foreign currency exchange rate fluctuations did not have a material impact on the first two quarters of 2013 results but benefited third quarter 2013 sales by approximately $1 million. On a constant currency organic basis, orthopaedic product line sales increased 22% and 15% in comparison to the prior year periods, respectively, which was primarily due to implant, and cases and tray market share gains, which benefitted from our increased sales and marketing efforts. Backlog, which resulted from our consolidation activities, began to be relieved in the third quarter and is expected to benefit the fourth quarter of 2013.

Vascular sales decreased 10% and 7%, respectively, to $12.3 million and $35.2 million, respectively, for the third quarter and year-to-date periods of 2013. These decreases were primarily due to the previously communicated voluntary recall of two vascular medical devices near the end of 2012. Our Vascular sales force, in targeting underpenetrated markets, has seen success with existing products. We expect to re-introduce one of our voluntarily recalled products in the fourth quarter although this re-launch will not materially impact 2013 revenue.

***Electrochem*** Third quarter and year-to-date 2013 Electrochem sales decreased 5% and 4%, respectively, in comparison to the 2012 periods. We are experiencing lower revenue from our portable medical, environmental and military customers as a result of our increased pricing discipline, as well as reduced government funding on certain military and environmental projects. Our increased pricing discipline resulted in the rationalization of two lower margin portable medical programs, which totaled approximately $9 million of annualized revenues in 2013. We expect these factors to continue to impact our business for the foreseeable future.

During the third quarter of 2013, we saw a rebound in our energy product line, with sales growing 4% in comparison to the prior year as customer ordering patterns normalized. We expect nominal growth in the fourth quarter of 2013 from this product line. We expect that this growth, combined with the slow start in the first half of the year will cause this product line to be flat to slightly positive versus 2012.

We are not satisfied with our Electrochem revenue growth performance and have re-focused resources to drive improvements.

Table of Contents

### *Gross Profit*

Changes to gross profit as a percentage of sales from the prior year were due to the following:

| | Change From Prior Year | |
|---|---|---|
| | Three Months | Nine Months |
| Impact of Swiss consolidation[a] | 0.0% | 0.6% |
| Performance-based compensation[b] | -0.7% | -0.6% |
| Cost savings and production efficiencies[c] | 2.7% | 2.2% |
| Other | -0.3% | 0.2% |
| Total percentage point change to gross profit as a percentage of sales | 1.7% | 2.4% |

(a) Our third quarter and year-to-date gross profit percentage benefitted approximately $0.2 million and $2.7 million, respectively, from the consolidation of our Swiss orthopaedic facilities into other existing Greatbatch facilities in the first quarter of 2013. The 2012 gross profit percentage includes the negative impact of production inefficiencies at those facilities.

(b) Amounts represent the change in performance-based compensation versus the prior year period and is recorded based upon the results achieved.

(c) Our gross profit percentage benefitted from production efficiencies gained at our manufacturing facilities as a result of our various lean and supply chain initiatives as well as higher production volumes due to increased sales and inventory levels.

Over the short-term, we expect our gross margin to remain strong as a result of the various productivity improvement initiatives that were implemented (See Cost Savings and Consolidation Efforts section of this Item).

Table of Contents

***SG&A Expenses***

Changes to SG&A expenses from the prior year were due to the following (in thousands):

| | Change From Prior Year | |
|---|---|---|
| | Three Months | Nine Months |
| Selling and marketing[(a)] | $ 772 | $ 2,193 |
| Performance-based compensation[(b)] | 1,202 | 3,402 |
| Swiss consolidation[(c)] | (359) | (1,314) |
| Other | (320) | (425) |
| Net increase in SG&A | $ 1,295 | $ 3,856 |

(a) Amounts represent the incremental SG&A expenses related to our decision in 2012 to increase selling and marketing resources to drive core business growth and sustain a pipeline in order to achieve our 5% or better organic revenue growth performance goal.
(b) Amounts represent the change in performance-based compensation versus the prior year period and is recorded based upon the results achieved.
(c) Amounts represent the estimated impact to SG&A costs as a result of the consolidation of our Swiss orthopaedic facilities into other existing Greatbatch facilities in the first quarter of 2013.

***RD&E Expenses, Net***

Net RD&E costs are comprised of the following (in thousands):

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 27, 2013 | September 28, 2012 | September 27, 2013 | September 28, 2012 |
| Research and development costs | $ 5,046 | $ 6,324 | $ 13,409 | $ 18,864 |
| Engineering costs | 10,771 | 9,787 | 32,754 | 28,956 |
| Less cost reimbursements | (2,011) | (2,871) | (7,180) | (6,495) |
| Engineering costs, net | 8,760 | 6,916 | 25,574 | 22,461 |
| Total RD&E, net | $ 13,806 | $ 13,240 | $ 38,983 | $ 41,325 |

Net RD&E for the 2013 third quarter increased $0.6 million and for the year-to-date period decreased $2.3 million, versus the comparable 2012 periods. The increase for the third quarter was primarily attributable to a decrease in customer cost reimbursements compared to the prior year of $0.9 million, due to the timing of achievement of milestones on various projects. The year-to-date decrease compared to the prior year is a result of the Company s

efforts, beginning in 2012, to refocus medical device RD&E investment and discontinue certain non-core RD&E projects, as well as higher customer cost reimbursements in the first quarter of 2013. DVT expenses totaled $1.5 million ($4.5 million year-to-date) for the third quarter of 2013 compared to $1.2 million ($3.8 million year-to-date) for the comparable 2012 period. In total, medical device related expenses declined $0.9 million ($2.7 million year-to-date) from the third quarter of 2012 to the third quarter of 2013. The Company s medical device technology investment is focused on successfully commercializing Algostim and being selective in opportunities that leverage our strengths in the core business units and drive exceptional and sustainable growth.

***Other Operating Expenses, Net***

Other operating expenses, net is comprised of the following (in thousands):

| | Three Months Ended | | Nine Months Ended | |
|---|---|---|---|---|
| | September 27, 2013 | September 28, 2012 | September 27, 2013 | September 28, 2012 |
| 2013 operating unit realignment[(a)] | $ 2,214 | $ | $ 3,066 | $ |
| Orthopaedic facility optimization[(a)] | 1,420 | 12,452 | 6,723 | 14,774 |
| Medical device facility optimization[(a)] | 52 | 388 | 282 | 1,282 |
| ERP system upgrade[(a)] | (121) | 1,938 | 264 | 4,745 |
| Acquisition and integration (income) costs[(b)] | (522) | 232 | (340) | 1,287 |
| Asset dispositions, severance and other[(c)] | 457 | 303 | 565 | 1,893 |
| Total other operating expenses, net | $ 3,500 | $ 15,313 | $ 10,560 | $ 23,981 |

(a) Refer to Cost Savings and Consolidation Efforts section of this Item and Note 9 Other Operating Expenses, Net of the Notes to the Condensed Consolidated Financial Statements contained in Item 1 of this report for disclosures related to the timing and level of remaining expenditures for these initiatives.

(b) During 2013 and 2012, we incurred costs (income) related to the integration of Micro Power Electronics, Inc. and NeuroNexus. 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.

(c) During 2013 and 2012, we recorded (gains) losses in connection with various asset disposals and/or write-downs. 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.

***Interest Expense***

Interest expense for the third quarter and year to date periods of 2013 decreased $2.9 million and $3.2 million, respectively, in comparison to the prior year periods. These decreases were primarily due to lower discount amortization as a result of the repayment of our convertible subordinated notes during the first quarter of 2013. Additionally, interest expense was lower for the third quarter and year-to-date periods due to lower outstanding debt balances, and lower interest rates paid on outstanding debt. During the third quarter and for the first nine months of 2013 we made net repayments of $27 million and $21 million on long-term debt, respectively. For the fourth quarter of 2013, interest expense is expected to decline in comparison to 2012, due to lower discount amortization expense and as excess cash flow from operations is used to pay down outstanding debt.

***Other (Income) Expense, Net***

Other (income) expense, net increased $0.05 million and $0.5 million, respectively, for the 2013 third quarter and year-to-date periods in comparison to 2012. The increase in expense for the year-to-date period is primarily due to $0.6 million of losses incurred on our cost and equity method investments during the second quarter of 2013. Other (income) expense, net also includes the impact of foreign currency exchange rate fluctuations on transactions

denominated in foreign currencies. We generally do not expect foreign currency exchange rate fluctuations to have a material impact on our financial results.

Table of Contents

### *Provision for Income Taxes*

The effective tax rate (including discrete items) for the first nine months of 2013 was 29.6% compared to 93.0% for 2012. This decrease was primarily attributable to the reinstatement of the research and development tax credit in the first quarter of 2013 and higher income in lower tax rate jurisdictions. Additionally, the 2012 effective tax rate was impacted by tax charges recorded in connection with the Company s Swiss orthopaedic consolidation of $5.0 million. During 2013, the Company recognized a $1.6 million discrete tax benefit related to the 2012 portion of the research and development tax credit. The benefit of the 2013 portion of the research and development tax credit is being recognized through the 2013 effective tax rate.

On September 13, 2013, the IRS and U.S. Treasury Department released final regulations on the deduction and capitalization of expenditures related to tangible property (the Repair Regulations ). The final Repair Regulations apply to tax years beginning on or after January 1, 2014. The Company is planning to adopt the regulations in a timely manner, and is in the process of assessing the impact, if any, to the consolidated financial statements.

We currently expect our 2013 annual GAAP effective tax rate to be approximately 31%. We expect continued volatility of this effective tax rate due to several factors, including changes in the mix of 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.

## Government Regulation

The Patient Protection and Affordable Care Act and the Health Care and Education Affordability Reconciliation Act (collectively Health Care Reform ) legislated broad-based changes to the U.S. health care system that could significantly impact our business operations and financial results, including higher or lower revenue, as well as higher employee medical costs and taxes. Health Care Reform imposes significant new taxes on medical device OEMs, which will result in a significant increase in the tax burden on our industry and which could have a material negative impact on our financial condition, results of operations and our cash flows. Other elements of Health Care Reform such as comparative effectiveness research, an independent payment advisory board, payment system reforms including shared savings pilots and other provisions could meaningfully change the way healthcare is developed and delivered, and may materially impact numerous aspects of our business, results of operations and financial condition. Many significant parts of Health Care Reform will be phased in over the next several years and require further guidance and clarification in the form of regulations. Management has evaluated the impact that the new medical device tax, which began in 2013, will have on our results from operations, and has estimated that it will reduce gross profit annually by approximately $0.6 million to $1.0 million.

On August 22, 2012, the U.S. Securities and Exchange Commission ( SEC ) issued a rule under Section 1502 of the Dodd-Frank Wall Street Reform and Consumer Protection Act requiring companies to publicly disclose their use of conflict minerals that originated in the Democratic Republic of the Congo ( DRC ) or an adjoining country. Under the rule, issuers are required to conduct a reasonable due diligence process to ascertain the source of conflict minerals, defined as tantalum, tin, gold or tungsten, that are necessary to the functionality or production of their manufactured or contracted to be manufactured products. Companies are required to provide this disclosure on a new form to be filed with the SEC called Form SD. Companies are required to file Form SD on May 31, 2014 for the 2013 calendar period and annually on May 31 every year thereafter. We anticipate additional, new compliance costs to be incurred since we utilize all of the minerals specified in the rule. We are unable to quantify the cost of implementing this new regulation at this time.

Table of Contents

## Liquidity and Capital Resources

| (Dollars in thousands) | As of September 27, 2013 | December 28, 2012 |
|---|---|---|
| Cash and cash equivalents | $ 4,973 | $ 20,284 |
| Working capital | $ 183,690 | $ 176,376 |
| Current ratio | 3.00 | 2.92 |

The decrease in cash and cash equivalents from the end of 2012 was primarily due to an increase in working capital levels in anticipation of our higher sales, maintenance level property plant and equipment purchases, as well as repayments made on our long-term debt. Our current ratio for the first nine months of 2013 remained consistent with the prior year. Of the $5.0 million of cash on hand as of September 27, 2013, $2.2 million is being held at our foreign subsidiaries.

***Credit Facility*** We have a secured credit facility (the Credit Facility ), which provides a $300 million revolving credit facility (the Revolving Credit Facility ), a $200 million term loan (the Term Loan ), a $15 million letter of credit subfacility, and a $15 million swingline subfacility. The Credit Facility can be increased by $200 million upon our request and approval by the lenders. The Revolving Credit Facility has a maturity date of September 20, 2018, which may be extended to September 20, 2019 upon notice by us and subject to certain conditions. The principal of the Term Loan is payable in quarterly installments as specified in the Credit Facility until its maturity date of September 20, 2019 when the unpaid balance is due in full.

The Credit Facility is supported by a consortium of fifteen banks with no bank controlling more than 18% of the facility. As of September 27, 2013, 98% of the Credit Facility is supported by banks that have an S&P credit rating of at least BBB+ or better, which is considered investment grade.

The Credit Facility requires us to maintain a rolling four quarter ratio of adjusted EBITDA to interest expense of at least 3.0 to 1.0. For the twelve month period ended September 27, 2013, our ratio of adjusted EBITDA to interest expense, calculated in accordance with our credit agreement, was 21.6 to 1.0, well above the required limit. The Credit Facility also requires us to maintain a total leverage ratio of not greater than 4.5 to 1.0 and not greater than 4.25 to 1.00 after January 2, 2016. As of September 27, 2013, our total leverage ratio, calculated in accordance with our credit agreement, was 1.9 to 1.0, well below the required limit.

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. See Note 6 Debt of the Notes to Condensed Consolidated Financial Statements in this report for a more detailed description of the Credit Facility.

As of September 27, 2013, we had $290 million of borrowing capacity available under the Credit Facility. This amount may vary from period to period based upon our debt and EBITDA levels, which impacts the covenant calculations discussed above. We believe that our cash flow from operations and the Credit Facility provide adequate liquidity to meet our short- and long- term funding needs.

***Operating activities*** Cash provided by operations for the first nine months of 2013 was $16.1 million versus $39.5 million for the comparable 2012 period. This decrease was primarily due to an increase in accounts receivable and inventory balances during the period, due to higher actual and expected sales levels, as well as $19.6 million of estimated tax payments made in connection with the retirement of our convertible subordinated notes during the first nine months of 2013. Excluding these estimated tax payments, cash flow from operations was $35.7 million for the first nine months of 2013, which is consistent with the prior year. We are not seeing any issues with the collectability of our receivables and are taking measures to reduce our receivable and inventory balances in the near term in order to improve our cash flows from operations. During the third quarter of 2013, we reduced our receivable balances by $7.6 million and continue to remain highly focused on cash flow generation. As of September 27, 2013 we had $3.9 million accrued for product warranties. Approximately $2 million of this amount is expected to be paid in the fourth quarter of 2013.

***Investing activities*** Net cash used in investing activities for the first nine months of 2013 was $13.8 million. This included $3.2 million of proceeds received from the sale of our Swiss orthopaedic product lines which closed during the first quarter of 2013. The proceeds received were offset by $15.0 million used for the purchase of property, plant and equipment to support normal operations as well as our cost savings and consolidation initiatives, and purchases of equity method investment of $1.9 million during the period. Our current expectation is that capital spending for the full year of 2013 will be in the range of $20 million to $25 million, of which approximately half is discretionary in nature. We anticipate that cash on hand, cash flow from operations and availability under our Credit Facility will be sufficient to fund these capital expenditures. As part of our growth strategy, we have and will continue to consider targeted and opportunistic acquisitions.

***Financing activities*** Net cash used in financing activities for the first nine months of 2013 was $17.6 million compared to cash used of $13.0 million in the comparable 2012 period. This cash outflow was primarily the result of net repayments on our long-term debt of $20.8 million. Going forward, we expect excess cash flow from operations to be used to fund our remaining consolidation initiatives and to pay down outstanding debt.

***Capital Structure*** As of September 27, 2013, our capital structure consisted of $210 million of debt under our Credit Facility and 24.1 million shares of common stock outstanding. Additionally, we had $5.0 million in cash and cash equivalents. If necessary, we currently have access to $290 million under our Credit Facility and are authorized to issue 100 million shares of common stock and 100 million shares of preferred stock. We believe that if needed we can access public markets to raise additional capital. We believe that our capital structure provides adequate funding to meet our growth objectives. We continuously evaluate our capital structure, including our Credit Facility, as it relates to our anticipated long-term funding needs. Changes to our capital structure may occur as a result of this analysis, or changes in market conditions.

## Off-Balance Sheet Arrangements

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

Table of Contents

**Impact of Recently Issued Accounting Standards**

In the normal course of business, we evaluate all new accounting pronouncements issued by the Financial Accounting Standards Board ( FASB ), SEC, Emerging Issues Task Force ( EITF ), American Institute of Certified Public Accountants ( AICPA ) or other authoritative accounting body to determine the potential impact they may have on our Condensed Consolidated Financial Statements. Based upon this review, we do not expect any of the recently issued accounting pronouncements, which have not already been adopted, to have a material impact on our Condensed Consolidated Financial Statements. See Note 16 Impact of Recently Issued Accounting Standards of the Notes to the Condensed Consolidated Financial Statements in Item 1 of this report for additional information.

**Contractual Obligations**

The following table summarizes our significant contractual obligations at September 27, 2013 (in thousands):

| | Payments due by period | | | | |
|---|---|---|---|---|---|
| CONTRACTUAL OBLIGATIONS | Total | Remainder of 2013 | 2014 - 2015 | 2016 - 2017 | After 2017 |
| Debt obligations[(a)] | $ 247,673 | $ 13,206 | $ 32,152 | $ 46,133 | $ 156,182 |
| Operating lease obligations[(b)] | 18,228 | 1,400 | 9,645 | 5,250 | 1,933 |
| Purchase obligations[(b)] | 24,093 | 8,075 | 12,718 | 3,180 | 120 |
| Foreign currency contracts[(b)] | 10,700 | 3,000 | 7,700 | | |
| Pension obligations[(c)] | 4,271 | 105 | 822 | 928 | 2,416 |
| Total contractual obligations | $ 304,965 | $ 25,786 | $ 63,037 | $ 55,491 | $ 160,651 |

(a) Includes expected interest expense on the $210 million outstanding on our Credit Facility based upon the period end weighted average interest rate of 2.09%, which includes the impact of our interest rate swap agreement. Also includes $15.7 million of current and deferred federal and state taxes payable on the Company s convertible subordinated notes. See Note 6 Debt of the Notes to Condensed Consolidated Financial Statements in Item 1 of this report for additional information.

(b) See Note 11 Commitments and Contingencies of the Notes to Condensed Consolidated Financial Statements in Item 1 of this report for additional information about our operating leases, purchase obligations and foreign currency contracts.

(c) See Note 7 Defined Benefit Plans of the Notes to Condensed Consolidated Financial Statements in Item 1 of this report for additional information about our defined benefit plan obligations. During 2012, we transferred most major functions performed at our facilities in Switzerland into other existing facilities. As a result of this decision, we curtailed our defined benefit plan provided to employees at those facilities in the third quarter of 2012. As nearly all of the Swiss pension liability is expected to be paid off 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.

This table does not reflect $1.4 million of unrecognized tax benefits as we are uncertain as to if or when such amounts may be settled. Refer to Note 10 Income Taxes of the Notes to Condensed Consolidated Financial Statements in Item 1 of this report for additional information about these unrecognized tax benefits.

We self-fund the medical insurance coverage provided to our U.S. based employees. The Company s risk 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 September 27, 2013, we have $1.9 million accrued related to our self-insured medical plan, which is recorded in Accrued Expenses in the Condensed Consolidated Balance Sheet, and is primarily based upon claim history. This table does not reflect any potential future payments for self-insured medical claims.

## Forward-Looking Statements

Some of the statements contained in this report 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:

- future sales, expenses and profitability;
- the future development and expected growth of our business and industry;
- our ability to successfully execute our business model and our business strategy;
- our ability to identify trends within our markets and to offer products and services that meet the changing needs of those markets; and
- projected capital expenditures.

You can identify forward-looking statements by terminology such as may, will, should, could, expects, intends anticipates, believes, estimates, predicts, potential, or continue, or variations or the negative of these terms or 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: our dependence upon a limited number of customers; customer ordering patterns; product obsolescence; our inability to market current or future products; pricing pressure from customers; our ability to timely and successfully implement cost reduction and plant consolidation initiatives; our reliance on third party suppliers for raw materials, products and subcomponents; fluctuating operating results; our inability to maintain high quality standards for our products; challenges to our intellectual property rights; product liability claims; our inability to successfully consummate and integrate acquisitions and to realize synergies and to operate these acquired

businesses in accordance with expectations; our unsuccessful expansion into new markets; our failure to develop new products including system and device products; our inability to obtain licenses to key technology; regulatory changes or consolidation in the healthcare industry; global economic factors including currency exchange rates and interest rates; the resolution of various legal actions brought against the Company; 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 SEC.

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

***Foreign Currency*** We have foreign operations in France, Mexico and Switzerland, which expose the Company to foreign currency exchange rate fluctuations due to transactions denominated in Euros, Mexican pesos and Swiss francs, respectively. We continuously evaluate our foreign currency risk and will take action from time to time in order to best mitigate these risks, which includes the use of various derivative instruments such as forward currency exchange rate contracts. A hypothetical 10% change in the value of the U.S. dollar in relation to our most significant foreign currency exposures would have had an impact of approximately $8 million on our annual sales. This amount is not indicative of the hypothetical net earnings impact due to partially offsetting impacts on cost of sales and operating expenses in those currencies. We estimate that foreign currency exchange rate fluctuations during the nine months ended September 27, 2013 increased sales in comparison to the 2012 period by approximately $1 million.

In May 2012, we entered into two forward contracts to purchase 6.9 million and 7.2 million Mexican pesos per month beginning in January 2013 through December 2013 at an exchange rate of $0.0727 and $0.0693 per peso, respectively. These contracts were entered into in order to hedge the risk of peso-denominated payments associated with a portion of the operations at our Tijuana, Mexico facility for 2013 and are being accounted for as cash flow hedges.

In September 2013, we entered into a forward contract to purchase 8.4 million Mexican pesos per month beginning in January 2014 through December 2014 at an exchange rate of $0.0767 per peso, respectively. These contracts were entered into in order to hedge the risk of peso-denominated payments associated with a portion of the operations at our Tijuana, Mexico facility for 2014 and are being accounted for as cash flow hedges.

As of September 27, 2013, these contracts had a negative fair value of $0.04 million. The amount recorded as a reduction of Cost of Sales during the nine months ended September 27, 2013 and nine months ended September 28, 2012 related to our forward contracts was $0.9 million and $0.008 million, respectively. No portion of the change in fair value of our foreign currency exchange rate contracts during the nine months ended September 27, 2013 or September 28, 2012 was considered ineffective.

We translate all assets and liabilities of our foreign operations, where the U.S. dollar is not the functional currency, at the period-end exchange rate and translate sales and expenses at the average exchange rates in effect during the period. The net effect of these translation adjustments is recorded in the Condensed Consolidated Financial Statements as Comprehensive Income. The translation adjustment for the first nine months of 2013 was a gain of $1.1 million and for the first nine months of 2012 a loss of $0.5 million. Translation adjustments are not adjusted for income taxes as they relate to permanent investments in our foreign subsidiaries. Net foreign currency transaction gains and losses included in Other (Income) Expense, Net amounted to a gain of $0.02 million and a loss of $0.2 million for the first nine months of 2013 and 2012, respectively. A hypothetical 10% change in the value of the U.S. dollar in relation to our most significant foreign currency net assets would have had an impact of approximately $8 million on our foreign net assets as of September 27, 2013.

***Interest Rates*** Interest rates on our Credit Facility reset, at our option, based upon the prime rate or LIBOR rate, thus subjecting us to interest rate risk. To help offset this risk, from time to time, we enter into receive floating-pay fixed interest rate swaps indexed to the same applicable index rate as the debt it is hedging. In October 2012 we entered into a three-year $150 million interest rate swap, which amortizes $50 million per year, which became effective during the first quarter of 2013. Under terms of the contract, we receive a floating interest rate indexed to the one-month LIBOR rate and pay a fixed interest rate of 0.573%. This swap was entered into in order to hedge against potential changes in cash flows on the outstanding debt on the Credit Facility, which is also indexed to the one-month LIBOR rate. The receive variable leg of the interest rate swap and the variable rate paid on the debt is expected to have the same rate of interest, excluding the credit spread, and reset and pay interest on the same dates. This swap is accounted for as a cash flow hedge.

Table of Contents

As of September 27, 2013, we had $210 million outstanding on our Credit Facility, of which $150 million is currently being hedged. See Note 6 Debt of the Notes to Condensed Consolidated Financial Statements in Item 1 of this report for additional information about our outstanding debt. A hypothetical one percentage point (100 basis points) change in the prime rate on the $60 million of unhedged floating rate debt outstanding at September 27, 2013 would have an impact of approximately $0.6 million on our interest expense.

## ITEM 4. CONTROLS AND PROCEDURES

a. Evaluation of Disclosure Controls and Procedures.

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 as of September 27, 2013. These disclosure controls and procedures have been designed to provide reasonable assurance 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. Based on their evaluation, as of September 27, 2013, our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures are effective.

b. Changes in Internal Control Over Financial Reporting.

We completed the acquisition of NeuroNexus Technologies, Inc. ( NeuroNexus ) on February 16, 2012. We believe that the internal controls and procedures of NeuroNexus are reasonably likely to materially affect our internal control over financial reporting. We are currently in the process of incorporating the internal controls and procedures of NeuroNexus into our internal controls over financial reporting.

The Company continues to extend its Section 404 compliance program under the Sarbanes-Oxley Act of 2002 (the Act ) and the applicable rules and regulations under such Act to include NeuroNexus. However, the Company has excluded NeuroNexus from management s assessment of the effectiveness of internal control over financial reporting as of December 28, 2012, as permitted by the guidance issued by the Office of the Chief Accountant of the SEC. The Company will report on its assessment of the internal controls of its combined operations within the time period provided by the Act and the applicable SEC rules and regulations concerning business combinations.

There have been no changes in our internal control over financial reporting that occurred during our last fiscal quarter to which this Quarterly Report on Form 10-Q relates that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

## PART II OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

There have been no material changes to the Company s legal proceedings as previously disclosed in the Company s Annual Report on Form 10-K for the year ended December 28, 2012.

### ITEM 1A. RISK FACTORS

There have been no material changes from the Company s risk factors as previously disclosed in the Company s Annual Report on Form 10-K for the year ended December 28, 2012.

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

None.

### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

### ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

### ITEM 5. OTHER INFORMATION

None.

### ITEM 6. EXHIBITS

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

Table of Contents

**SIGNATURES**

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

| Dated: November 5, 2013 | GREATBATCH, INC. |
| --- | --- |
| | By /s/ Thomas J. Hook<br>Thomas J. Hook<br>President and Chief Executive Officer<br><br>(Principal Executive Officer) |
| | By /s/ Michael Dinkins<br>Michael Dinkins<br>Executive Vice President and Chief Financial Officer<br>(Principal Financial Officer) |
| | By /s/ Thomas J. Mazza<br>Thomas J. Mazza<br>Vice President and Corporate Controller<br>(Principal Accounting Officer) |

Table of Contents

**EXHIBIT INDEX**

| Exhibit No. | Description |
|---|---|
| 3.1 | Amended and Restated Certificate of Incorporation, as amended (incorporated by reference to Exhibit 3.1 to our quarterly report on Form 10-Q for the period ended June 27, 2008). |
| 3.2 | Amended and Restated Bylaws (incorporated by reference to Exhibit 3.2 to our annual report on Form 10-K for the period ended January 1, 2010). |
| 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. |
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Extension Schema Document |
| 101.CAL | XBRL Extension Calculation Linkbase Document |
| 101.LAB | XBRL Extension Label Linkbase Document |
| 101.PRE | XBRL Extension Presentation Linkbase Document |
| 101.DEF | XBRL Extension Definition Linkbase Document |